

CHAPTER 11

PRIVATISATION AND PRODUCTIVITY PERFORMANCE IN IRELAND

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ABSTRACT

This chapter presents an analysis of privatisation in Ireland. It discusses the sale of state owned enterprises, the contracting out of refuse collection services and Public Private Partnership (PPPs). The analysis of the sale of state owned enterprises demonstrates a clear pattern of improved performance prior to change of ownership. The post-privatisation productivity performance is not as clear cut, with the specific case studies highlighting the importance of product market competition as a driver of sustained productivity growth. This lesson also emerges from an examination of the experience of the contracting out of services - strong competition for contracts is an important determinant of whether efficiency gains accrue.

11.1 Introduction

Although the term ‘privatisation’ was originally used to describe economic policies of the National Socialist Party in Germany during the 1930s (Bel, 2006) it only gained popular international currency in the late 1970s and early 1980s when newly elected governments in countries such as Great Britain, France and New Zealand commenced programmes of divestiture of state owned enterprises (SOEs). The scale of such programmes worldwide has been enormous and it is estimated that at the turn of the new millennium the volume of privatisation had exceeded €1 trillion. However, global privatisation activity has not been confined to the sale of SOEs, as the term has been applied to a range of other public sector reforms including liberalisation, de-regulation and contracting out. This wide application of the term ‘privatisation’ highlights a need for clarity about its precise meaning and scope.

Starr (1988) provides a useful working definition of privatisation as any shift in the production of goods and services from public to private. According to Starr this more focused definition of privatisation includes the following sub-categories:

1. The cessation of public programmes and disengagement of government from specific kinds of responsibilities. At a less drastic level, the restriction of publicly produced services in volume, availability, or quality which may lead to a shift by consumers toward privately produced and purchased substitutes (called ‘privatisation by attrition’ when a government lets public services run down);
2. Transfer of public assets to private ownership, through the sale or lease of public land, infrastructure, and enterprises; and
3. The withdrawal of government from production but not the financing of services, for example, through contracting-out or vouchers.

This paper presents an analysis of privatisation in Ireland, covering variants of the reform covered by Starr’s (1988) typology, namely the privatisation of SOEs, the contracting out of refuse collection services and PPPs. The extent of privatisation activity varies across these three categories but in all cases these reforms have been adopted for the purpose of raising efficiency, defined usually in terms of achieving higher productivity and lower-cost production. The following sections examine the impact of the three forms of privatisation on these aspects of performance.

11.2 Privatisation of State Owned Enterprises

The rationale behind the adoption of privatisation programmes worldwide varies from country to country.¹ Of the numerous factors put forward for industrialised countries, the most common are: (1) public enterprises are inefficient and privatisation will lead to increased efficiency; (2) technological developments in markets such as telecommunications no longer justifies monopoly provision of services and the consequent requirement for liberalisation of utility markets in EU countries; (3) the sale of SOEs can raise useful sums of money for the Exchequer and remove the burden of loss-making public enterprises; and (4) the privatisation of public enterprises through flotation on the stock market can help the development of domestic capital markets and widen domestic equity ownership.

When privatisation policies initially came into vogue, economic arguments in favour of the reform were based on theories of government failure such as agency, public choice and property rights theory. These focused on aspects of structure, control and incentives in SOEs compared to private enterprise and argued that performance is superior in the case of the latter. Empirical evidence has however failed to conclusively support predictions from these theories.² This points to the limitations of theories that focus entirely on ownership (rather than including, for example, product market competition) as a determinant of performance. The broad conclusion to be drawn from this literature is that the case for private ownership is confined to sectors where markets are competitive and does not apply in the case of natural monopolies or heavily regulated industries (Boardman and Vining, 1989; Martin and Parker, 1997).

Numerous empirical studies on the effects of privatisation on the financial and operating performance of divested firms have been carried out in recent years and on the whole the evidence can be considered mixed. In general, the empirical literature can be divided into two main groups; broad based international studies which by and large find that privatisation leads to improved performance; and more comprehensive country-specific studies that find more ambiguous results and suggest that privatisation does not necessarily lead to an improvement in company performance, with other factors such as competition and regulation proving to be significant determinants of performance.³

The first Irish privatisations took place in 1991 and since then the privatisation programme has developed gradually. To date, ten SOEs have been privatised and these sales have had a significant impact on the Irish economy. Table 11.1 provides details on the companies sold and the amounts raised thus far.

Table 11.1: Privatisation of Irish State-Owned Enterprises 1991-2006

Company	Year	Sector	Exchequer Proceeds (€m)	Method of Sale
Greencore	IPO in April 1991	Sugar/Food	210.65	IPO and Placements
Irish Life	IPO in July 1991	Insurance	601.93	IPO and Placements
B&I	1992	Shipping	10.80	Trade Sale
Irish Steel	1994	Steel	0	Trade sale
Eircom	IPO in July 1999	Telecoms	6,399.91	Trade sale and IPO
ICC Bank	Jan 2001	Banking	322.27	Trade Sale
TSB Bank	April 2001	Banking	408.35	Trade Sale
INPC	May 2001	Energy	20.00	Trade Sale
ACC Bank	December 2001	Banking	154.60	Trade Sale
Aer Lingus	September 2006	Air Transport	200.00	IPO
Total			€8,328.51	

Note: IPO = initial public offering; (2) At time of writing, Aer Lingus had just been floated. The proceeds for Aer Lingus given above are a conservative estimate based on the IPO price of €2.20.

Of the various reasons put forward in support of privatisation, the goal of improving the performance of SOEs has been most prominent.⁴ The measurement of performance is however complex and the choice of performance indicator can be problematic. Ideally, economists seek to measure firm performance in terms of both allocative and productive efficiency. Productive

efficiency is achieved when a firm produces its output at minimum cost while allocative efficiency is concerned with achieving the level of output valued most highly by society. In practice, allocative efficiency is not easy to measure and most of the empirical work carried out to date on the impact of privatisation on firm performance concentrates on the measurement of productive efficiency. The two most common indicators of firm-level efficiency in the literature are productivity and profitability and the following section analyses the pre- and post-privatisation performance of SOEs privatised in Ireland between 1991 and 2006.

Profitability measures are unsuitable where enterprises operate in imperfectly competitive markets, which is the case for most SOEs.⁵ Consequently, productivity measures are preferred but these are also subject to limitations. Labour productivity measures can be biased for reasons such as the use of output rather than value-added as a numerator and the prevalence of contracting out labour intensive services (Parker, 2003). In addition, labour productivity measures based on output to employment ratios do not take account of the impact of other inputs such as capital on output and care needs to be taken when interpreting these partial productivity results.

As well as the complications inherent in performance measurement our study of the performance of privatised companies in Ireland is further hindered by the following:

1. Six of the ten privatised companies were sold by trade sale and absorbed into the operations of the acquiring company, thus rendering an analysis of post-privatisation performance impossible; and
2. Aer Lingus was sold very recently and therefore no post-privatisation data is available;

With these factors in mind the following section analyses the pre and post-privatisation (where possible) performance of the ten SOEs divested to date.

11.2.1 Pre-Privatisation Performance

Since the ten privatised companies operate in different sectors and differ in terms of size and historical performance, an aggregate analysis of their performance requires the use of basic indicators that can be applied across all companies. For the purpose of this study we restrict our analysis to two basic profitability indicators: Profit Before Interest, Tax and exceptional items (PBIT) and Return On Capital Employed (ROCE); and one productivity indicator, namely Labour Productivity. The results presented below analyse the five years prior to privatisation for all companies and are presented as five-year average annual rates of growth.⁶

Table 11.2: Pre-privatisation Performance of SOEs: Average Annual Rates of Growth

Company	Labour Productivity	PBIT	ROCE
Irish Life	-1.40	-	-
Greencore	14.36	20.09	2.46
B&I	8.92	-63.92	-124.15
Irish Steel	1.67	-135.15	-183.32
Eircom	8.18	0.41	2.61
ACC	2.31	8.25	-6.89
ICC	5.78	22.45	1.38
TSB	-	11.25	-0.46
Aer Lingus	6.36	5.18	-0.37

Notes: (1) ROCE figures for ACC, ICC and TSB are ROA figures ($ROA = PBIT \div \text{Total Assets}$); (2) Output indices used to calculate labour productivity in the case of Irish Life, ICC and ACC were based on total income figures instead of turnover; (3) B&I figures are four-year averages as data for 1991 unavailable; (4) Employment figures are unavailable for TSB, hence no labour productivity analysis could be carried out.

Greencore (formerly Irish Sugar) improved their performance dramatically prior to its flotation in 1991. The company implemented a significant rationalisation programme during the 1980s, halving the number of employees and closing two loss-making plants. The impact of these decisions is reflected in the impressive labour productivity and PBIT growth figures provided in Table 11.2.

An analysis of PBIT and ROCE was not possible in the case of Irish Life due to various changes in the company's accounting policies over the pre and post-privatisation periods examined. The measurement of performance in the insurance industry is highly problematic, requiring sector-specific indicators commonly based on actuarial valuations. The method of valuation adopted by the company prior to privatisation was the *surplus arising* measure.⁷ Between 1984 and 1989 this figure grew by an annual average of 3.3 per cent. In addition, Sweeney (1990) notes that the company increased the funds under its management tenfold in the decade prior to divestiture. Although, the labour productivity result for Irish Life in Table 11.2 is negative, it must be recognised that it is based on annual total income figures, which do not reflect the future value of many of the company's investments.

Turning to both B&I Line and Irish Steel, despite implementing significant rationalisation programmes prior to privatisation, which is reflected in the positive growth rates for labour productivity; both companies continued to perform poorly in terms of profitability. The decision to sell both companies was taken on the basis that the only other alternative would have been liquidation and their sale would ensure the companies continued as going concerns.

Eircom (formerly Telecom Éireann), the national telecommunications company, was privatised through flotation on the stock market in 1999. In 1996, the company entered into a strategic alliance with the Comsource consortium, which acquired a 20 per cent stake in Eircom.⁸ Given that this effectively started the privatisation process, 1996 is thus taken to be the year of privatisation for the purpose of our analysis and the results provided for Eircom refer to the five years prior to this date. Prior to 1996, the company implemented a programme of rationalisation, which included a significant reduction in employees, the impact of which is evident in the strong labour productivity growth of 8.1 per cent. The poor growth in PBIT is explained by a large increase in depreciation charges and other operating costs over the period examined.

Table 11.2 shows that prior to their divestiture in 2001, the three state banks experienced significant growth in profits. However, the more informative Return On Assets (ROA) ratio indicates that underlying performance was less impressive for both the TSB and ACC. ICC Bank showed considerable improvement across every indicator prior to privatisation. Although the pre-privatisation period for all three state banks was characterised by an improvement in efficiency and profitability, it must be borne in mind that all three banks were small players in the Irish banking sector, lacking the scale necessary for sustained improvements in performance. In addition, the ACC and ICC banks had benefited from decades of government subsidisation which may exaggerate their true underlying performance (Sweeney, 1990).

The Initial Public Offering (IPO) of government shares in Aer Lingus in September 2006 is the most recent privatisation to take place. The government originally decided to sell the airline in December 1999; however the plan was put on hold after a number of strikes by employees and the negative impact on company performance of the September 11th attacks in the US in 2001. The decision to finally float the airline on the stock market was taken in early 2006, with the government opting to retain a stake of 28 per cent in the company.

Significantly improved performance was recorded by Aer Lingus after 2001, with the company implementing a rationalisation programme involving a reduction in the workforce of over 1,500 staff in 2002, and employees securing a 14.9 per cent shareholding in the company.⁹ Marked improvements in performance have been sustained with Aer Lingus cutting costs further in order to compete with low-cost competitors such as Ryanair. Overall, the workforce has been reduced by approximately 3,000 since 2001 as a result of restructuring and redundancy plans and this is reflected in the strong growth in labour productivity shown in Table 11.2. While the growth figures for PBIT are positive, the growth in ROCE was negative on average over the period analysed.

In general, with the exception of the two loss-making firms, B&I Line and Irish Steel, the pre-privatisation period for the companies examined was one of improved performance in terms of labour productivity and profitability. The key underlying reason for improved performance in the non-financial public enterprises has been the implementation of significant rationalisation programmes as the companies restructured their businesses along more commercial lines. The observed trend of improved performance prior to privatisation is consistent with the findings from similar studies carried out in other industrialised countries.¹⁰

11.2.2 Post-privatisation Performance

Our analysis of post-privatisation performance is restricted to Irish Life, Greencore and Eircom as post-privatisation data is unavailable for the other seven SOEs that were sold. The results presented below cover the five-year period after the divestiture of each company and are expressed as five-year average annual rates of growth.

Over the five-year period after privatisation, Greencore recorded lower average rates of growth across all indicators compared to the pre-privatisation period. Whilst growth in labour productivity and PBIT improved, the gains were not as impressive as before privatisation and the important ROCE indicator decreased on average over the period analysed. It is noteworthy that since 1997 the company's share price has consistently under-performed the overall ISEQ index and this can be attributed to problems with a major acquisition in the US sugar industry and perceived uncertainty about plans to diversify away from its core sugar business.

Table 11.3: Post-privatisation Performance of Privatised SOEs: Average Annual Rates of Growth

Companies	Labour Productivity	PBIT	ROCE
Irish Life	1.23	-	-
Greencore	7.67	9.42	-0.66
Eircom	5.67	2.10	-5.82

Note: The output index used to calculate labour productivity in the case of Irish Life is based on total income data rather than turnover.

In the case of Irish Life, pre-privatisation improvements were sustained following its divestiture in 1991. The *embedded value* method of actuarial valuation was adopted by Irish Life from 1990 onwards and in the five years after divestiture this measure grew by 7.3 per cent on average.¹¹ In addition, the company’s share price performed well, never falling below its IPO price level after 1993 and increasing significantly in the period prior to the company’s merger with Irish Permanent in 1999. Funds under management increased by close to 60 per cent, from approximately €6.1 billion in 1992 to €9.7 billion in 1996, reflecting strong business growth.

Post-privatisation gains in Eircom’s labour productivity were not as impressive as those recorded pre-1996, mainly due to increases in employment in the rapidly expanding mobile division, Eircell. Although the rate of growth in PBIT improved from 0.4 to 2.1 per cent, the more important ROCE measure decreased significantly after 1996. It must be noted that the 5-year averages above do not provide an accurate overview of the post-1996 period in Eircom. The post-flotation years, 1999-2001, account for much of the deterioration in performance shown in Table 11.3. Significant improvements across all indicators were in fact recorded in the years 1996-99 prior to divestiture.

There are a number of reasons for improved performance prior to full privatisation in 1999. Chief among these was the establishment of an independent communications regulator in January 1997 and the full liberalisation of the telecommunications market in December 1998.¹² Indeed impending liberalisation had been one of the main reasons why Eircom entered into a strategic alliance in 1996. Eircom held an effective monopoly position in its core product markets throughout the 1990s, however during the mid-1990s the company improved its performance significantly in an effort to prepare for the threat of competition. The company also benefited from the transfer of advanced technology and other expertise from its strategic alliance partners as well as major growth in mobile telephony during the late 1990s.

The privatisation of Eircom led to a marked turnaround in the performance of the company. The collapse of the company’s share price after the dot-com bubble burst in effect led to the merger of the company just two and a half years after its flotation. Eircell, the most profitable division in the firm, was sold to Vodafone in May 2001 and this was shortly followed by the sale of the remaining fixed-line business to the Valentia telecommunications consortium. Since 2001, Vodafone Ireland has continued to grow its business and has emerged as the most profitable division of the international Vodafone group.¹³ Over the same period, Eircom has changed ownership twice with the company refloating on the stock market in 2004 and then taken over in 2006 by the Australian company Babcock and Brown. Although Eircom has improved its performance in terms of profitability since 2001, it must be noted that this is mainly due to massive cuts in capital expenditure and a large amount of labour shedding. Whether reductions in capital expenditure result in a trade-off between short term improvements and deteriorating performance in the long-run is a question that will require further analysis in the future.

The Irish privatisation experience to date provides no evidence of a simple relationship between ownership and performance. With the exception of the two loss-making firms, pre-privatisation improvements in performance were recorded in all cases suggesting that commercialisation measures carried out in public enterprises have had more of an impact than privatisation *per se* in the case of Ireland. Where post-privatisation evidence on performance is available it is largely disappointing, especially in the case of Eircom.¹⁴ Both Eircom and Greencore were dominant in their markets at the time of sale. Eircom enjoyed an approximate 80 per cent share of the fixed-line market while holding the larger share of the mobile market duopoly. Greencore held control of the Irish EU sugar quota after divestiture. The post-privatisation record of both companies suggests that product market competition is a hugely important determinant of enterprise performance.

The case of Eircom in particular highlights problems that arise when a regional economy privatises telecommunications infrastructure. From a strategic perspective the post-privatisation experience in the case of Eircom has been characterised by significant reductions in capital expenditure and failure to grant access to its network. The latter issue has impeded the rollout of broadband services, which are vital in the context of a regional economy. The government's recent decision to re-enter the telecommunications market by investing in broadband capital raises obvious questions about the rationale behind earlier decisions to privatise.

11.3 Contracting Out and Public Private Partnership

Privatisation activity in Ireland has not been confined to the divestiture of shares in high profile SOEs such as Aer Lingus and Eircom. For a number of years, there have been examples of privatisation in the form of government withdrawal from the production but not necessarily the financing of private services. The cases considered in this paper are:

1. The contracting out of local authority services, focusing on the case of refuse collection; and
2. The adoption of public private partnerships for purpose of providing physical infrastructure and related public services.

11.3.1 Contracting Out

Despite the traditional role of the state as both a funder and provider of public services most governments have a tradition of buying in certain goods and services from the private sector (e.g. road-building, house building). What emerged in the late 1970s and early 1980s however, was a widespread rapid growth in market-based reforms, which altered the traditional role of the state. Deakin and Walsh (1996) described the emergence of the 'contract-state' at the centre of a process of reinvention of the state's functions "separating out a 'core' of policy making and direction and retaining only a minimal 'periphery' of residual delivery functions that are defined as essential but cannot for whatever reason be discharged elsewhere" (Deakin and Walsh, 1996: 33).

In many countries the role of the state was largely altered to an enabling one, with the state responsible for service delivery but not necessarily producing them itself. Conferring monopoly rights of service provision on a private producer need not necessarily reduce economic welfare. The theory of contestable markets developed by Baumol et al. (1982) suggests that efficient production and delivery of goods and services depends on the contestability of the market rather than competition within it. According to these writers, a market is contestable if there is freedom of entry and exit because sunk costs are low. Under such conditions, a firm that must purchase assets (e.g. plant and equipment) in order to enter the industry can sell the assets if it consequently decides to leave the industry without incurring a loss on the transaction. These conditions create a threat of entry that drives down prices and guarantees efficiency. If there is perfect contestability the price set in the market will equal the average cost of production even in the limit case of one monopoly firm in the market. The implication of this theory for public services is that if supply is perfectly contestable the government should procure the good through contracting (Vining and Weimer, 1990).

Supported by the predictions of such theories, governments around the world turned to privatisation in the form of contracting out services. The undoubted pioneer of such policies was the UK where The Local Government Act 1988 compelled local authorities to put certain 'blue collar' services up for tender. Similar policies were adopted in countries such as Holland, Sweden, New Zealand and Australia where contracting out was mostly encouraged rather than compulsory.

In the case of Ireland, local authorities have traditionally made extensive use of external sources for service provision (for example, major capital projects such as roads and water/sewerage). Such arrangements can be distinguished from privatisation, as they are not characterised by a transfer from traditionally public to private provision. A prominent case of privatisation has been refuse collection services where it has been noted that due to financial pressures on local authorities the "domestic refuse collection service has been contracted out, franchised or privatised in many areas, in the latter case the local authority withdrawing from the service and allowing private contractors take over and charge for the service" (Coughlan and de Buitleir, 1996: 103).

Reeves and Barrow (2000) conducted the only detailed analysis of the impact of privatisation on the efficiency of refuse collection services in Ireland. Their study was based on data gathered in a survey of Irish local authorities that had either retained the provision of refuse collection services in-house or contracted out the service over the years 1993-1995. Using data on service costs, quantity (e.g. number of households) and service characteristics (e.g. frequency of collection), multivariate statistical analysis was conducted. This approach, which enabled control of relevant service characteristics, revealed significant savings for contracting authorities in the region of 45 per cent on average. Although the analysis found that the best non-contracting authorities performed as well as the best contracting ones, the incidence of efficiency was much greater amongst authorities that contracted out the service. The study also examined the source of these efficiency gains and concluded that lower costs incurred by private contractors were partly attributable to more flexible work practices (e.g. smaller crew sizes). While these represent real productivity gains, some cases reported the existence of poorer working conditions in the private sector (e.g. lower health and safety standards and the employment of underage labour). The latter sources of cost savings have obvious redistributive consequences and reduce the extent to which measured cost savings improve overall economic welfare.

The finding that sizeable cost savings are accrued following the contracting out of refuse collection services is consistent with findings from a host of similar studies from different countries (see Domberger and Jensen, (1997) for a review). Although such savings can be reduced by transaction costs (e.g. the costs of organising procurement and monitoring contracts), such costs tend to be manageable in the case of refuse collection services because asset specificity is low and quality is relatively easy to measure. It is however noteworthy that there is evidence from other countries of initial cost savings disappearing over time. Dijkgraaf and Gradus (2006) suggest that the problem of reduced savings is in part attributable to the increased concentration of suppliers in this market. This is relevant in the case of Ireland where the Competition Authority (2005) has noted increased market power in some local refuse collection markets in Ireland. However, this phenomenon is occurring in markets where local authorities no longer contract out but have withdrawn entirely from service provision. The evidence from studies on the effects of contracting out indicate that if efficiency gains are to be sustained this requires periodic competition for contracts that are well specified and enforced.

11.3.2 Public Private Partnerships (PPPs)

In recent years the Irish Government has adopted PPPs as an important element of efforts to address Ireland's acute deficit of economic infrastructure. Although there is no commonly accepted definition of PPP, the model adopted in the Irish case has mainly involved contractual agreements between the public and private sectors whereby the private sector takes responsibility for designing, planning, financing, constructing and/or operating infrastructure projects normally provided through traditional procurement mechanisms by the State. Compared to the contracting out of public services, this form of PPP constitutes a more extensive form of privatisation as it involves the withdrawal of government from its traditional role of providing and financing investment in infrastructure and the provision of related public services.

To date, different variants of the PPP model have been adopted across a range of sectors. In the case of roads for example, the National Roads Authority (NRA) is at various stages of implementing ten PPP concessions. In these cases the private contractor is contracted to design, build and operate the routes (usually for a 25 to 30 year period). Most of the projects are financed by a mix of public and private finance and the private sector recoups its investment from tolls levied on road-users on the basis of a revenue sharing agreement with the NRA.¹⁵ In the case of schools, the Design, Build, Operate and Finance (DBOF) model is being used to procure school buildings and services (excluding education services). Typically the private contractor designs, builds and operates the school over a 25 year period. The contractor takes responsibility for financing the project and recoups its investment via a structure of payments from the exchequer over the duration of the contract. In the water and wastewater sector the preferred model of procurement has been Design, Build and Operate (DBO). Other PPP models being adopted or under consideration include: Design, Build, Finance and Maintain (DBFM), in prisons and Design, Build and Finance (DBF) in the housing sector.

Proponents of PPP, in Ireland and elsewhere, assert that the model offers a better alternative to traditional procurement methods, which are often beset by cost and time overruns.¹⁶

For example, the Department of Finance (2001: 3) asserts that the goals and benefits of PPP include the following:

1. Speedy, efficient and cost-effective delivery of projects;
2. Value for money for the taxpayer, *inter alia*, through optimal risk transfer and risk management; and
3. Efficiencies from integrating design and construction of public infrastructure with financing, operation and maintenance/upgrading.

The international evidence in support of these claims is however scarce. As PPP contracts are typically based on durations of 25-30 years, *ex-post* evaluations are not possible. Hence, studies on the cost efficiency (value for money) of PPP are confined to pre-implementation appraisals. Among the studies that provide supporting evidence in terms of value for money are Anderson and LSE Enterprise (2000), National Audit Office (NAO) (1998: 1999) and Fitzgerald (2004). However, there is a significant and growing literature, which questions the thrust of the findings in these studies. For example, Shaoul (2005) provides an extensive review of empirical studies covering the health, transport and education sectors that query whether the projects covered demonstrated value for money. Other writers have raised issues of concern in relation to estimates of value for money. These include: (1) difficulties in quantifying risk transfer which is a key determinant of estimated value for money (Ball et al, 2001; Hodge, 2004); (2) the complexities of the financial modelling required to appraise Value for Money (VFM) (Quiggin; 2004, Shaoul, 2003); and (3) the problem of bias towards PPP options (Spackman, 2002; Heald, 2003).

In Ireland, the only PPP project that has been subjected to in-depth analysis is the contract for five secondary schools. In this case, the private sector consortium (Jarvis Project Limited) was contracted to design, build, operate and finance the schools over a 25-year period. The schools opened in 2003 and in June 2004 the Comptroller and Auditor General (C&AG) published its Value for Money Report on the project. The C&AG have estimated that the public sector obligations under the contract amount to €283 million (€150 million in net present value terms). It reported that the initial value for money exercise conducted by the DOES estimated that PPP would yield cost savings of six per cent compared to traditional procurement. On the basis of their examination however, the C&AG highlighted a number of significant errors in the original value for money exercise. Having corrected for these errors the C&AG estimated that the PPP would be between 13 per cent and 19 per cent more expensive than under traditional procurement. The C&AG also accounted for elements of the deal that changed after the value for exercise (namely, changes in interest rates and treatment of VAT). Including these elements ultimately led the C&AG to conclude that the final PPP deal was in the range eight per cent to 13 per cent more expensive than under traditional procurement.

The C&AG described a number of important failings in the procurement process that potentially led to sub-optimal decisions at important junctures. While space does not permit a detailed discussion of these issues it is worth noting that they exemplify one of the principal shortcomings of the PPP that is the potentially high transaction costs involved in PPP.¹⁷ Transaction costs are the costs of using the market. In the context of PPPs these can be thought of as the costs of organising the tendering process, designing and executing contracts, monitoring contract performance and enforcing contract terms where failures occur. The latter are likely to be significant in the case of a complex procurement process such as PPP, yet they are rarely, if ever, included in estimates of value for money.

Overall the efficiency effects of the PPP model of procurement are unclear. While features such as risk transfer give PPP the potential to deliver efficiency gains the evidence in support of the model is scarce. Moreover the transaction costs incurred under PPP tend to be ignored and require greater consideration if the PPP model is to be applied appropriately.

11.4 Conclusions

The last fifteen years or so have witnessed an appreciable degree of privatisation activity in Ireland as Irish governments follow the global trend of reducing direct government provision of goods and services across a range of sectors. Although the reasons for such change differ from case to case, the general objective of privatisation has been to improve the efficiency of service delivery.

The sale of SOEs tends to be the most high-profile measure of privatisation with governments often choosing to sell shares to the public. The extent of privatisation in the Irish SOE sector has been significant with the public sector withdrawing entirely from sectors including banking, steel, sugar, shipping and telecommunications. The analysis conducted in this paper demonstrates a clear pattern of improved performance prior to changes in ownership. In most cases firms prepared for privatisation by implementing cost-cutting measures including significant labour shedding. The post-privatisation impact is not as clear-cut. The cases of Greencore and especially Eircom highlight the importance of product market competition as a driver of efficiency gains. In this respect the distinction between static and dynamic efficiency gains merits attention. The incidence of improved performance in the years before and after privatisation is indicative of static efficiency gains, which are inherently once-off. Dynamic efficiency gains depend on factors such as ongoing investment in research and development and improved processes and management. While the relationship between privatisation and dynamic efficiency will take time to establish, the post-privatisation experience at Eircom provides grounds for concern about the case for privatisation in this respect as the company has implemented significant cuts in capital expenditure with Ireland consequently ranking close to the bottom of European rankings of broadband penetration.

Competition is an important determinant of whether efficiency gains are accrued as a result of privatisation, not just in the case of SOEs but also in the case of other public services. This is exemplified in the case of contracting out local authority services where the evidence in the case of refuse collection demonstrates the scope for productivity improvements where there is strong competition for contracts and where transaction costs are low.

The question of transaction costs is critical in the case of more complicated public procurement like PPP. The early evidence from Ireland illustrates the difficulties associated with implementing a significant programme of PPP. These include problems with sustaining competitive tensions in the context of long term contracts as well as difficulties in forging agreements based on optimal risk allocation.

Looking ahead it appears that privatisation will continue to be an important tool of public policy in Ireland over the coming years. The Irish experience to date however shows that privatisation *per se* is not necessarily a panacea for any public sector inefficiencies. The findings reported in this chapter suggest that policymakers ought to bear in mind that the effectiveness of future privatisation policies will depend on factors including the underlying economic characteristics of each activity, the technological characteristics of its production and the supporting institutional frameworks.

Notes

- 1 See for example, Miller (1995); OECD (2003).
- 2 For comprehensive reviews of comparative studies of public versus private sector performance see Vickers and Yarrow (1988) and Martin and Parker (1997).
- 3 See Megginson and Netter (2001) for a detailed review of empirical evidence.
- 4 Space does not permit a review of the rationale behind the development of the Irish privatisation programme, however this is discussed in detail in Reeves and Palcic (2004).
- 5 In the case of Ireland however, with the exception of Eircom, most privatised companies operate under mainly competitive conditions.
- 6 The INPC is not included in our analysis. The instability of the international oil market within which the company operated caused wide fluctuations in company profits in the years preceding privatisation. Consequently rates of growth measures are not instructive.
- 7 Under the 'surplus arising' method, all the expenses associated with new business are written off in year one and a conservative view is taken on future liabilities. No allowance is made for future profits on new business.
- 8 The Comsource consortium consisted of KPN (Netherlands) and Telia (Sweden).
- 9 Employees were given an additional 9.9 per cent stake; workers had already been granted a five per cent shareholding in 1994 as part of a previous restructuring programme.
- 10 For example Megginson et al. (1994) and Martin and Parker (1997).
- 11 The embedded value method attempts to calculate the profits which will arise on new business written during the period by projecting the profits that will be earned over the life of the policy and discounting it back to give a present value for these profits.
- 12 At the same time a CPI-X price cap (similar to the one used for British Telecom in the UK) on a basket of Eircom services was introduced with responsibility for the implementation of the price cap given to the newly created regulator.
- 13 Vodafone Ireland's Average Revenue per User (ARPU) in March 2006 was the highest of the 18 countries in which the Vodafone group operates.
- 14 In addition, the Irish Steel Company was closed in 2001, just five years after being taken over by Indian firm, ISPAT. The company claimed mounting losses and a failure to control costs as the principal reason for its closure.
- 15 For example, in the case of the N4 Kilcock-Kinnegad PPP, the NRA website (www.nra.ie) states that for infrastructure with an estimated value of €550 million, excluding land and preparatory costs, the state will pay €152 million, excluding land and preparatory costs.
- 16 Problems with traditional procurement have highlighted in two influential studies. One Danish study by Flyvberg et al. (2002) examined 258 large transport infrastructure projects covering 20 countries. The vast majority of these projects were procured by conventional means and costs were underestimated in 90 per cent of cases. Another major study, published by Matt MacDonald (2002) examined the outcome of 50 large infrastructure projects in the UK. They reported that time overruns exceeded the estimated duration by 17 per cent and capital costs exceeded estimates by 17 per cent on average.
- 17 See Reeves and Ryan (2007) for a discussion of these aspects of the C&AG's findings.

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