DIRECTORATE FOR FINANCIAL, FISCAL AND ENTERPRISE AFFAIRS

OECD Privatisation Network

SUMMARY RECORD OF THE SIXTH SESSION OF THE OECD PRIVATISATION NETWORK

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Budapest (Hungary)

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Summary Record
Sixth session of the OECD Privatisation Network
Budapest, 18 September 2000

The 6th annual session of the OECD Privatisation Network was held in Budapest on 18 September 2000. The meeting brought together 35 participants from Denmark, Finland, France, Greece, Hungary, Ireland, Italy, Korea, the Netherlands, Norway, Switzerland, Turkey, the UK and TUAC. Professor Vittorio Grilli, Director at the Italian Treasury and chairman of the Privatisation Network, chaired the meeting.

The meeting focused on four main issues:

(i) Discussion of global privatisation trends,
(ii) Review of Hungarian privatisation,
(iii) Discussion of privatisation transactions carried out in 1999 and
(iv) Proposals for future work of the network.

I. The Secretariat review of privatisation trends was based on information gathered in the framework of the ongoing privatisation database and the recent paper published in Issue No 76 (July 2000) of the OECD Publication Financial Market Trends (FMT). Recent data underlines the continuing strong global privatisation drive. The OECD countries accounted for over two thirds of the privatisation activity last year. During 1999, the privatisation prospects of non-OECD countries remained unchanged, but there was a shift in focus of activity to Asia as economic recovery gained hold in Asia and in other economies previously affected by financial crisis. Planned privatisations for 2000 suggest that privatisation proceeds among OECD countries will likely remain strong. However, whether global privatisation activity will grow critically depends on the performance of emerging market economies.

Several emerging trends will most likely shape privatisation developments in the future. They include:

- growing share of secondary offerings and disposal of residual shares, as the stock of wholly owned state-owned enterprises declines,
- possible problems for partially privatised enterprises in forging strategic alliances with foreign companies, because of remaining residual state ownership or golden shares,
- public-private partnerships as an important vehicle for design, financing, construction and management of infrastructure projects or services, while actual property rights remain with the state,
- likely opening of European Union postal services to competition, restructuring and privatisation,
- Growing importance of the privatisation activity at the level of local or regional governments.

II. Mr. Tamas Eder, managing director of the Hungarian Privatisation and State Holding company made a presentation on the Hungarian privatisation policies. The main points raised in his speech and during the discussion can be summarised as follows:

- Privatisation in Hungary was carried out as a part of the process of systemic transition from a planned to market economy. It resulted in a massive reduction of state ownership from nearly 90 per cent ten years ago to 15-20 per cent currently with trade sales being the main privatisation method. The volume of state assets is now comparable to the level of some OECD economies and is distributed in a similar way across sectors, including mainly infrastructure and utilities companies.
Market-based privatisation was consistently implemented, and in contrast to other transition economies, Hungary did not institute a mass privatisation scheme, based on a free distribution of shares to the population at large. A strong characteristic of Hungary was the emphasis on foreign participation in privatisation, partly due to the large external debt of the country at the beginning of the transition process. Privatisation policy acknowledged the primary importance of access to fresh capital and new technology, and foreign participation in privatisation reached record levels among transition and OECD economies alike.

The Hungarian Privatisation and State Holding Company (APV Rt.) manages state assets worth HUF 768 billion, including stakes in the 93 companies that are to remain under long-term state ownership, and residual assets that are to be privatised over the next two-three years. The latter include shares in broadcasting and telecommunications, the national airline, pharmaceuticals and real estate. In Hungary, during the early days privatisation was more about speed and raising revenue, whereas today the emphasis has shifted and is focused on improving the companies.

With the completion of the bulk of privatisation, the emphasis is shifting to the methods and procedures to enable the APV Rt. to carry out its asset management tasks efficiently and according to market practices. The scope for long-term state ownership, an efficient institutional structure, legal framework and tools for management of commercial assets under state ownership are to be redefined and the debate is currently focusing on different alternatives.

The large number of investment, employment and other guarantees included in privatisation contracts has placed significant costs on the state management authorities. There are currently 600 lawsuits pending, and their costs are not likely to be balanced by the benefits. This underlines the importance of the selective rather than a standard use of commitments in privatisation contracts.

Privatisation of public utilities in an early stage mainly for revenue reasons has created significant problems. A hastily developed regulatory framework has created problems especially in light of Hungary’s current EU accession negotiations and commitments to liberalise some of these industries. The state has found itself locked in costly contracts for long periods of time, due to miscalculation of future demand.

Mr. Harry Bush, Deputy Director at the UK Treasury underlined the large scope of the Hungarian privatisation programme compared to programmes implemented in other OECD countries and its systemic character, requiring a major effort in carrying out a complex reform menu in parallel to a large scale disinvestment.

Ms. Aldona Kamela-Sowinska, Secretary of State of the Polish Ministry of the Treasury looked at the Hungarian privatisation through the prism of the Polish privatisation policy. The Polish approach to privatisation is similar to the Hungarian one, as it too aimed at removing the state from ownership and decision making in a large number of enterprises as a complement to liberalisation and stabilisation programmes related to transition. As in Hungary, Poland focused primarily on direct sales to strategic investors, however it also relied on the implementation of a mass privatisation programme. The government's commitment is to complete privatisation by 2001. To achieve this objective, privatisation of financial institutions, together with restructuring and privatisation of defence and heavy industry is a priority.

It was noted that after the initial declines in employment, both Poland and Hungary have witnessed employment growth in their privatised sectors.
III. In Session two, the Members of the Privatisation Network discussed specific transactions that took place over the last year and during the first half of 2000. Mr. Lars Johan Cederlund, Deputy Director at the Swedish Ministry of Industry and Trade presented the IPO of the telecoms utility Telia:

- Six months after the attempted merger with the Norwegian telecoms operator Telenor, the Swedish government carried out the largest initial public offering in Europe in 2000 and the largest privatisation ever in the Nordic region. Following a Parliament approval to reduce state ownership by up to 49 per cent, the government placed approximately 25 per cent of its holding and issued new shares equal to 5 per cent of the enlarged company.

- The main objective was to increase the value of the company and to provide Telia the possibility to develop under the same conditions as its competitors with access to capital markets, i.e., the possibility to issue shares and make strategic acquisitions. Also the government wanted to increase retail participation without offering special incentives.

- A special nomination committee was formed to nominate board members according to their competence and in a transparent manner.

- Thanks to strong demand 23 per cent of the shares were sold to retail investors (about 11 per cent of the population), approximately 47 per cent to Nordic institutional investors, and 30 per cent to international institutional investors at prices close to the higher end of the indicative range. The share price was in line with that of the sector until the beginning of September, when it started declining as a result of price cuts and the launch of new ventures. However, the longer-term prospects of Telia are optimistic because of its high penetration in fast-growing businesses.

Ms. Olimpia Cuomo, expert of the Council of the Italian Treasury presented the cases of the electricity company Enel, the aerospace and defence group Finmeccanica and Autostrade.

- Italy’s privatisation programme, which dates back to 1992 accelerated in the years prior to the launch of Euro and has raised close to USD 118 billion since 1993, mainly through public offerings. In 1999, the USD 16.5 billion IPO of 34.5 per cent of Enel, Italy’s electricity company became Europe’s largest ever initial public offering. Enel’s IPO was characterised by a flexible pricing and sizing strategy. At the time of sale, the shares were priced at the top end of the indicative range (3.4 to 4.3 Euro), and the percentage of shares offered went from 15% to 30% in response to strong demand from investors.

- The privatisation of Enel was one of the largest and most successful offerings ever, ranking number one, also as the largest Italian company and electric utility worldwide by market capitalisation. It generated the largest retail and institutional response in an Italian offering, where 6% of the population applied for shares. It must sell three electricity generators to satisfy market liberalisation legislation at the EU level. It was noted that in the case of Enel the government had opted for selling the company as a whole with the prospect of reducing Enel’s dominant market position later.

- Shortly before it was wound up in June this year, IRI -- the Treasury controlled holding -- sold 45 per cent of the giant defence and engineering group Finmeccanica. Finmeccanica is Italy’s leading technology company and the second largest manufacturing company involved in defence and information technology. The company was restructured in 1997, and a new business plan was put in place. Finmeccanica’s Euro 5.7 billion public offering was the largest secondary offering of 2000 (at the time), and the largest ever equity offering by an aerospace defence company. There was also a concurrent convertible offering of Euro 0.8 billion launched by Finmeccanica. Strong international demand for Finmeccanica played a key role in ensuring the success of the offering, with 76 per cent of the shares going to Italian retail investors and the remaining 24 going to Italian and international
institutions. The global offering was considered a success, especially in light of the weakness of financial markets at the time, the recent turnaround for the company, which suffered considerable losses four years ago, and the liquidation date of IRI which left no flexibility with respect to the sizing of the offer. The case of Finmeccanica involves no "noyau dur", but given the company’s presence in the defence sector the Italian government has retained a core 30% equity in the company.

- The privatisation of Autostrade is considered as one of the most complex Italian transactions, because of the legal and regulatory issues, which needed to be addressed beforehand. It included sale to a stable core of shareholders (noyau dur) and a global offering of shares and resulted in a high retail (79 per cent) versus institutional participation in the global offering (21 per cent), of which 51% of the shares remained with local institutions. Particular attention was paid to the preservation of the potential for a change of control, keeping the noyau dur to 30 per cent of the shares and by ensuring transparency in its composition and competitive tension among the bidders.

- It was pointed out that privatisation of banks is very important for the development of capital markets, and that perhaps the predominance of trade sales over public offerings in non-OECD privatisations is a reflection of the degree of state presence in the financial sector. In Italy share of state-owned banking assets in the public sector has dropped from 73% to 9%.

- The participants also commented on the recent EU actions against several member countries (such as Italy, and UK among others) for their use of golden shares, on the grounds that the use of these shares infringes upon the free movement of capital as envisaged by the EU Treaty. Many participants pointed out that the existence of golden shares had in fact been conducive to progress with privatisation in their countries. They noted that appropriately limited golden shares might prove to be a more efficient way of protecting the government concerns rather than keeping large stakes in the partially privatised companies. Such a strategy is more efficient in preserving state interest while achieving the main goals of privatisation.

IV. Under the last item of the agenda the group decided:

1. To compile a comprehensive report on member country policy experiences with privatisation and a menu of policy options and best practices based on these experiences. The report will be completed and submitted to Ministers in 2002.

2. To further develop the privatisation database and asked the Secretariat to intensify its work in this regard. It is deemed to be a most useful instrument for detecting emerging trends. Work on the database is also considered key for the preparation of the above report on privatisation experiences and policy options.

3. To broaden the mandate of its work to one that encompasses all value creating mechanisms for the management of state commercial assets, in addition to privatisation. A name change for the relevant activities might also be useful. A broader mandate will address highly topical issues and problems that Treasuries and other equivalent institutions will continue to face. The Italian Treasury is currently supporting the continuation of the analytical and policy dialogue work. Additional support may be needed starting in 2001.

The Network has asked the Secretariat to formulate a plan to broaden the scope of its mandate and to further the policy dialogue and analytical work.
To hold the *seventh meeting of the Network and the fifteenth plenary session of the AGP in Turkey in 2001* hosted by the Turkish Treasury and Privatisation Agency, possibly in Istanbul. The AGP will discuss issues related to *Privatisation and Employment*. 