The political economy of mixed ownership of utilities

Lewis Evans
Professor of Economics

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The referendum on state electricity asset sales is behind us. Whatever one thinks of the outcome, the mix of state and private ownership of utility firms will continue to be a live issue in New Zealand, as it is in many countries. Studies of other countries shed some light on political and economic forces that together affect performance of these firms.

Political uses of firms occur for reasons that include governments imposing their particular view of the future on industry. Also, because the electoral cycle is relatively short, actions may be taken to influence election prospects rather than long-term outcomes.

Government actions can entail such things as the selection of directors, extent of information disclosure and directives on investment and pricing. These may be put in place directly through ownership and less directly through regulation.

Private ownership typically benefits the performance of firms, and promotes wider community understanding of industries. This is particularly the case where the firm's equity is tradable as on a stock exchange. However, the relationship between ownership and performance is complex because it is affected by the state's conflicting roles as owner and regulator.

The conflict is particularly acute for utility companies because they supply goods and services – e.g. gas, electricity, and telecommunications – that are so widely consumed by households and companies that they are politically, as well as economically, important. Relatedly, some of these firms may have natural monopoly characteristics for which direct regulation is the remedy.

For utilities, there is a balance for society between the ability of a government to use these companies for political purposes, and scope for the firm and market to evolve independently; through the interaction of buyers, sellers, technology and investors.

The balance is suggested by research on utilities that finds privatization lifts economic and financial performance, but that fully-privatised utility firms may be less valuable than mixed-ownership firms. This difference is attributed to fully privatised firms carrying a premium for risk of political action. Governments have no direct interest in these firms' performances, and find them relatively difficult to manipulate. For such firms, government control by regulation can substitute for state ownership, and firms react accordingly.

There is some evidence that one such reaction is for fully private regulated utilities to take on more debt at the expense of equity, to limit the discretion of regulators. The higher indebtedness makes the required return for financial viability of the firm more obvious, and it limits the scope of regulators to set excessively low prices. Put another way, (partially) state-owned utilities need not hedge regulatory risk in their business decisions, but regulatory risk is important under private ownership.

Research finds regulatory risk to be higher in industries with regulatory agencies whose decisions are not at arms length of the government of the day. Such independence is affected by a country's political and electoral arrangements, and the existence of checks on regulatory agency decisions. Checks such as the ability to appeal decisions to the courts are a discipline on the quality of agency decisions as well as on direct government involvement in industry.

Where do data for state-ownership research come from? It is made possible by the wide variation in state ownership and control across countries. This variation allows different mixes of ownership and regulation to be compared. The European Union is one important source of data for it has, or is developing, a common legal framework in many respects.

In 2010, mixed ownership was widespread in EU utility businesses (see the accompanying table). In 25 out of the 36 firms reported the state's ownership stake is less than 50 per cent.

State Ownership in per cent (%)	**Electricity**	**Gas**	**Telecommunications**
Austria	51 %	31 %	25 %
Belgium	49 %	31 %	> 50 %
Denmark	-	-	0 %
Finland	54 %	-	>50 %
France	85 %	37.5 %	32 %
Germany	2.5 %	2.5 %	28 %
Greece	51 %	-	10 %
Ireland	-	-	0 %
Italy	33 %	20 %	100 %
Luxemburg	100 %	100 %	100 %
Netherlands	-	-	0 %
Portugal	26 %	-	6 %
Spain	0 %	0 %	0 %
Sweden	0 %	0 %	>50 %
UK	0 %	0 %	0 %

The additional 12 new EU states are similar: only one (Cyprus) has all utilities 100% owned by the state, only two others have any electricity, gas or telecommunications utilities 100% state owned. Of the utilities of the remaining 9 new EU states, 51% are purely privately held and the remainder held under mixed ownership, with approximately 36% of these with state majority shareholding. In some cases, state control is strengthened by a government-held share, which confers control over certain decisions.

The New Zealand referendum question was too vague for the result to reveal a consensus about state ownership. The ownership of utilities is a question with various dimensions that are amenable to research and experience.