PRIVATIZATION, DEREGULATION AND COMPETITION: EVIDENCE FROM SPAIN

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Recibido: febrero 2002
Aprobado: mayo 2003

RESUMEN

No se puede garantizar el éxito de una privatización si no se desregulan los mercados y se intensifica la competencia. Este trabajo pretende ser una reflexión sobre los resultados efectivos de las privatizaciones realizadas en España desde 1985 y de las principales políticas de desregulación acometidas en diversos sectores con el objetivo de incrementar la competencia.

Palabras clave: privatización, desregulación, competencia, eficiencia, déficit público
Clasificación JEL: H42, H62, H63

ABSTRACT

The success of a privatization cannot be guaranteed if markets are not deregulated and competition intensified. This paper aims to provide a reflection on the effective results of privatizing in Spain from 1985 onwards and on the main deregulation policies implemented in different sectors in order to increase competition.

Key words: privatization, deregulation, competition, efficiency, public deficit
Clasificación JEL: H42, H62, H63

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I. INTRODUCTION

Although privatization is currently in fashion and is quite extended, at the beginning of the 1980´s the term did not even appear in American dictionaries[1] . Privatization, in the widest sense of the word, can be taken to be both the promotion of the private provision of public goods and services and the private management of public companies and bodies, as well as the transfer of ownership and/or control of state-owned enterprises (SOEs) to the private sector. The essential idea is that of improving the firm's results by increasing the role played by market forces. Above all, privatization is considered as a way of improving a firm's economic efficiency. On the other hand, deregulation refers either to the simplification of economic rules or to the opening up of regulated sectors – occupied by public or private monopolistic entities – to free competition. The main objective of deregulation policies is, therefore, to break down the barriers and obstacles that protect certain economic activities, whether they are carried out under public initiative or not. In this way, the aim is to bring competition to the economic sphere.

The phenomena of privatization and deregulation are, in principle, distinct and independent, and may or may not, coincide in time. The State might possibly decide to implement a privatization program, simultaneously maintaining regulated sectors and public monopolies. A Government may even decide to privatize a public monopoly without simultaneously submitting the sectors competition; a public monopoly would simply be replaced by a private one. The confusion between the two terms lies in that, generally, when privatizations are presented on a political level, one of the positive elements highlighted is the stimulus for the forces of competition. In fact, privatizations are frequently accompanied by liberalizing measures. Privatization itself is not enough to encourage competition; there also has to be a mechanism in place to defend it. That is the objective of deregulation.

In recent decades, views on the role of SOEs in the Western world have changed radically. We are currently seeing a wave of State privatizations in many different sectors. The underlying factors that have contributed towards accelerating this flow of privatization include the need for a more liberalized economic environment, in line with the goals of international competitiveness, the growing financial needs of economies creaking under the weight of budgetary imbalances and, also, the idea that private management is more efficient than public control and, therefore, the public sector´s economic importance should be reduced. Privatization is, then, an initial response to public enterprise inefficiency.

If we agree to the fact that the improved competitiveness of firms goes towards increasing society's welfare, privatization cannot be considered solely as the transfer

[1] The Washington Post, on Jan. 13, 1986, credits Steve Hanke (lecturer in Applied Economics at the John Hopkin University) with the acceptance of the term *privatize* in the 1983 edition of Webster´s Ninth New Collegiate Dictionary.

of public-sector ownership to the private sector. Rather, it implies the redefining of the role of the State and civil society, since we are also required to agree with the idea that improving economic welfare requires privatizations in order to transfer resources from inefficient firms to other ends. However, privatization's main objective cannot be the need to reduce the relative size of the public deficit, but, rather, to increase business efficiency and competitiveness. Privatization cannot be guaranteed if markets are not deregulated and competition intensified.

This paper aims to reflect upon the effective results of privatization policy in Spain. To achieve this aim, the study has been divided into four parts. Following this introduction, the second section briefly analyzes the reasons put forward to justify the generalization of privatizing policies in most developed countries, as well as the conditions for their success. In the third section, we analyze the different stages privatizations in Spain have undergone since 1985, when a relatively modest privatizing process was carried out. We take stock of the firms that have been placed under private management and analyze the pursued objectives. Likewise, we look at the main deregulation policies implemented in various sectors to improve competitiveness. Finally, the article closes with a presentation of our main conclusions.

II. JUSTIFICATION AND OBJECTIVES OF PRIVATIZING

1. Arguments in favor of privatization

Privatization policies aim to accomplish a series of objectives or arguments that governments themselves brandish as a justification or defense of their privatization programs:

a) *Economic reasons*: These present privatizing as a way to increase system efficiency and to achieve improvements in social welfare. Their defenders maintain that the shifting of SOEs to the private sector will expose these firms to the market discipline and, thus, will increase their efficiency.

b) *Financial reasons*: These are based on reducing the financial needs of the public sector; in other words, the public deficit. They are not reasons in themselves but, rather, are the consequence of the foreseeable efficiency improvements in SOEs following their privatization. Through privatizing, on the one hand, a firm should cease to receive direct public sector financial aid and be submitted to the discipline of the private capital market. On the other hand, privatizing provides an initial resource inflow and reduces future reliance on public financing.

c) *Political reasons*: These are aimed at reducing State involvement in business decision-making and limiting the size of the public business sector, as well as increasing the number of stockholders by encouraging the so-called "popular (people´s) capitalism", thus halting the power of public sector trade unions, among others.

On the contrary, critics of conventional economic analysis state that privatization policies open new spaces for private accumulation and profit, at the cost of a greater destruction of productive forces and social regression. Each privatizing process tends to lead to job losses, both through closing down of productive (?) activities and a search for higher workforce productivity. The process, in turn, forces wage levels downwards. Privatizations, on the one hand, favor the consolidation of all-powerful conglomerates that can influence politics, communication (media?) and culture.On the other hand, they also favor the formation of a social mentality that looks benignly upon the market and views the State as representing greater costs, bureaucracy and corruption.

Generally speaking, competition and deregulation have a greater influence on economic results than the public-private dichotomy. If privatizing SOEs is to improve the efficiency of the business system, increased competition is a necessary condition. Many international studies back this up, including Sanchís (1996), Argimón, Artola and González- Páramo (1997), Cuervo and Villalonga (1999), Anderson, De Palma and Thisse (1997), Martin and Parker (1997) and the large study carried out by Megginson and Netter (2001) in which they give an overview of the main international empirical studies made over the last twenty years, both in market and transitional (Central and Eastern European) economies.

The nature of companies subject to regulation has meant that, in most cases, these have been, or are, SOEs. These are companies with clear economies of scale in the main phase of their production process, or at least in part of it; capital intensive companies, where technological changes strongly affect the production processes; or companies that return part of their fixed assets to the State, with no compensation after a period of time. In many cases, these companies operate in situations of natural monopoly and so the production or service is generally provided by a single enterprise. To this we should also add the nature of the demand the producer is dealing with, which is usually unaffected by price, or even by income. Then there is the fact that, in certain services, there is a physical connection between customer and supplier so that, should the supplier change, the customer will be forced to carry out a series of investments.

The elimination of access barriers and the subsequent opening of markets to competition often require establishing a new set of rules regulating competition, which may even increase regulation[2] with regard to the previously existing situation. As Yarrow (1986, p. 353) points out, eliminating regulatory access barriers can give rise to their substitution for strategic barriers lifted by the company itself, or it resorting to predatory practices. The mere transforming of a public monopoly into a private concern, even if it is accompanied by formal sector deregulation , initially places the private monopoly in a dominant position. The need to establish new regulations (de- or

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2 Regulatory practices try to complement and improve the functioning of markets as a mechanism for the efficient assigning of resources, the final objective being to improve welfare. For more information on the cases in which regulatory practices are justified, as well as the problems regulation proposes, see Segura (1993). This same study includes an extensive bibliography on the Theory of Regulation.

re-regulation) crops up again in order to prevent possible abuse derived from monopolistic power, to guarantee competition and to ensure that certain social objectives protected under the old regulations are maintained.

In short, deregulation and increased competition are needed for privatized SOEs to improve the efficiency of the business system as a whole.

2. The need to define an institutional and legal framework

Every privatization should be designed very carefully. The procedure for privatizing should be ordered and transparent. An institutional and legal framework is needed to avoid ambiguity and political discretionality since they may lead stockholder rights to be devalued (a lower value of the company to be privatized) and incentives may be given to risky investor behavior or to political manipulation. For this reason, the greatest possible amount of information should be given on the process, on how prices were set, should they be regulated, and on the demands to be fulfilled and sanctions to be imposed should the strategic or industrial plan not be adhered to, since the latter element is the determining factor in many privatization concessions.

To encourage transparency in the process, some countries have set up Committees or Councils of an advisory and/or binding nature, such as the *Consejo Consultivo de Privatizaciones* in Spain, the *Commission pour les Privatisation*s (binding) in France, the *Comitato Permanente di Consuleza Globale e Garanzia* (advisory) in Italy or the *Comissao de Acompanhamento das Reprivatizaçoes* (advisory) in Portugal. The ex-post control is left to the controlling body of the Administraciones Públicas IGAE (Spain), the National Audit Office (UK), or directly to Parliament (Italy, Mexico or Portugal).

Likewise, the privatization process should be presented in such a way as to avoid stakeholders opposing measures aimed at improving common welfare in the name of specific interests. All privatizations require a certain political stability and a minimum of popular support. Guarantees are needed that the advantages obtained from the process will be equally divided among the agents involved, These advantages may include obtaining positive results for stockholders, improvements in efficiency and in the provision of goods and services for consumers, and a reduction in the general taxpayer burden , brought about by a lower public deficit.

In short, if the privatization is to be a success, it must be taken on clearly and decisively by the political authorities and receive a much greater backing from public opinion than other alternative policies. There should also be an institutional and legal framework in place to avoid political ambiguity and discretionality. As Vickers (1993, p.87) points out, public ownership is extremely vulnerable to political manipulation and to the search for and appropriation of returns, since it is an activity that is in the hands of very powerful politicians and public postholders.

III. SPAIN'S PRIVATIZATIONS PROGRAM

1. Privatizations between 1985 and 1996

Privatizations in Spain began to take on some importance from 1985 and included two types of measure: the deregulation of certain sectors to comply with EEC legislation and the sale of SOEs. The Socialist government of the time avoided using the term "privatization", preferring that of a State "disinvestment process" in public companies, which numerous authors have referred to as "silent privatization". It must be said, though, that it was more a restructuring process of SOEs than an isolated privatization program.

These disinvestment decisions did not respond so much to political or ideological imperatives as to criteria of industrial and financial rationality. Prior to 1985, a public enterprise management policy had been implemented according to market principles, along with a search for efficiency and rationalization of the public business sector [Ortega (2002, pp.207-210)]. The main objective was to reduce the losses of the National Institute for Industry (INI)[3], a proprietary company holding several industrial enterprises. . Three types of action were taken: 1) the conversion and gradual reduction of firms considered non-viable and with chronic losses, such as those involved in coal-mining, ship-building and defense; 2) the sale or privatizing of firms considered non-viable within the framework of the INI group, but which would be viable outside it (the carmaker SEAT, for example); and, 3) the creation of business projects that would then be placed on the market, as in the case of ENDESA, INESPAL, IBERIA, etc.

Actions taken in the sphere of privatizations from 1985 up until the beginning of the 1990s were two-fold: a) the direct sale of SOEs to private concerns; and, b) the placing of minority share packages on the stock market, whereby the public sector maintained management control (see Chart 1). The aim of the latter was to diversify financing sources and to discipline management by exposing it to capital market control.

Direct or majority capital sale was the most widely used system, both for companies with little strategic importance due to their small size or their activity (Viajes Marsans, SKF, Textil Tarazona, etc.) and for the larger firms. In the latter, privatizing made more sense when due to technological and commercial reasons, and by taking advantage of economies of scale and synergies derived from greater industrial co-operation among different firms, the new shareholder could generate greater value for the business than the public sector. This, was the case, for example, of car (SEAT) and truck (ENASA) manufacturing, along with several public investment goods companies. In the case of

3 Up until 1995, Public-Sector firms were organized into three holding companies: Instituto Nacional de Industria (INI), Instituto Nacional de Hidrocarburos (INH) and Dirección General de Patrimonio del Estado. In 1995, the INI and INH holding companies were dismantled, giving rise to the Agencia Industrial del Estado and the Sociedad Estatal de Participaciones Industriales.

Chart 1.
Public companies privatized in Spain in the 1985-1996 period (1)

YEAR	COMPANY	SECTOR (and PARENT COMPANY)	% SOLD	BUYER
		Instituto Nacional de Industria		
1985	Textil Tarazona	Textile	69.6	Entrecanales/Cima
	Ingenasa	Inmun./genetics (Enisa)	67.6 (51 in 1985 14.2 in 1986 2.4 in 1989)	ERT
	Igfisa	Food (Endiasa)	100	Pleamar
	Cesquisa	Chemicals (Enisa)	45.4	Cepsa
	Secoinsa	Electronics	69.1	Fujitsu*/CTNE
	SKF Española	Bearings	98.8	Aktiebogalet SKF*
	Marsans	Tourism	100	Trapsatur
1986	Entursa	Tourism	100	Ciga/Hoteles lujo españ.
	Frigsa	Food (Endiasa)	100	Saprogal*
	Gypisa	Food (Endiasa)	100	Fri.g. Santana
	La Luz	Food (Carcesa)	100	Prevert
	Insisa	Capital goods (BWE)	60	Acctas. Privados Insisa
	Remetal	Aluminum (Inespal)	66.6 (66.1 in 1986 0.5 in 1990)	Socios Fundadores Remetal
	Issa	Aluminum (Inespal)	100	
	Aluflet	Aluminum (Alúmina Esp.)	40	Aluperfil
	Motores MBD	Naval construction (Motores Barreras/Sodiga)	60 (38.4 in 1986 21.6 in 1989)	Acctas.privados Aluflet Klockner Humboldt Deutz AG*
	Pamesa	Paper (Ence)	100	
	Fovisa	Iron and steel (Made)	100	Torras Hostench
	Indugasa	Automotive (Seat)	50	Gekanor (GKN*/Acenor)
	Seat	Automotive	100 (75 in 1986 25 in 1990)	GKN* Wolkswagen AG*
	Telesincro	Electronics (Inisel)	100 (40 in 1986 33.9 in 1988 26.1 in 1994)	Bull*
	Gesa	Gas/Electricity (Endesa)	39	(PIS)
1987	Dessa	Naval c. (Bazan/Astano)	80	Forestal del Atlántico
	Evatsa	Aluminum (Inespal/Sodiga)	100	Cebal
	Litofan	Aluminum (Inespal)	100	Baumgartner Ibérica*
	Alumalsa	Aluminum (Inespal)	44	Montupet*
	Purolator	Autom.(INI/CASA)	97.4	Knecht Filterwerke*
	Victorio	Automotive	33.3	Eisenwert Bruhl*
	Luzuriaga	Food (Endiasa)	50	Saudisa (Promodes*)/BBV
	Diasa	Food (Endiasa)	51	Sugemesa (Agrolimen)
	Miel Española Miraflores	Food (Lc. Castellana)		Queserías Miraflores

Public companies privatized in Spain in the 1985-1996 period (1) (cont.)

YEAR	COMPANY	SECTOR (and PARENT COMPANY)	% SOLD	BUYER
1988	Endesa	Electricity	29.2 (20.4 in 1988 8.7 in 1994)	(PIS)
	Ence	Paper (INI; Teneo/ Cofivacasa)	53.8 (39.3 in 1988 14.5 in 1995 (5)	(PIS)
1989	Astican	Naval construction	90.72	Italmar
	MTM	Capital goods	100 (85 in 1989 15 in 1992)	GEC Alsthom*
	Ateinsa	Capital goods	100 (85 in 1989 15 in 1992)	GEC Alsthom*
	Enfersa	Fertilizers	100 (80 in 1989 20 in 1991)	Ercros
	Oesa	Food (Endiasa)	100	Ferruzzi*
	Pesa	Electronics (Inisel)	97.4	Amper
	Ancoal	Aluminum (Enisa)	75.2	Omnium Industrie*
1990	Adaro Indonesia	Engineering (Enadimsa)	80	Indonesia Coal*/Asmincco Bara, Utama/Tirtamas Majutamas*
1991	Enasa	Automotive	100 (60 in 1991 40 in 1993)	Iveco/Fiat*
	Gr.Empr.Alvárz	Industrial craftmanship	100 (90 in 1991 10 in 1992)	Pickman (Estudesa)
	TSD	Electronics (Enosa)	100	Telepublicaciones
1992	Icuatro	Iniexport	90	Grupo Alegre
1993	Automoción 2000 Fábrica S.Carlos Palco	Automotive (Teneo) Capital goods (Teneo) Aluminum (Inespal)	100 100 100 (50 in 1993 50 in 1994)	Inversores Reo Grupo Navacel/Total Technical, Trade/Luis Tellería Usabiaga Alcan Detsschland
1994	C. Trasatlántica	Maritime transp. (Teneo)	100	Naviera
	Artespaña	Craftmanship (Teneo)	100	Odiel/Marít.Valenc
	ASDL	Aeronautics (Ceselsa)	87.7	Medino S.L.
	Sodiga	Indust. Develop. Society	51.2	Quadrant Group* Xunta de Galicia

Public companies privatized in Spain in the 1985-1996 period (1) (cont.)

YEAR	COMPANY	SECTOR (and PARENT COMPANY)	% SOLD	BUYER
		Instituto Nacional de Hidrocarburos		
1989	Repsol	Petrol/Gas	79 (26.4 in 1989 4.2 in 1989 2.9 in 1990 2.1 in 1992 9.8 in 1992 14.1 in 1993 19.5 in 1995 11 in 1996)	 (PIS) BBV Pemex* Pemex* (Bonds exchange) Institutional PIS (PIS) (PIS)
1994	Enagás Caivsa	Gas Gas (INH/c. Madrileña alum. y calef. por Gas)	91 100	Gas Natural Gas Natural
		D.G. Patrimonio del Estado		
1985	Gossypium Intelhorce	Textile (DGPE/intelhorce) Textile	100 100	Textil Guadiana Orefici*
1990	Hytasa Imepiel Dirsa Seb de la Fuente Salinas Torrevieja Coifer	Textile Footwear Distrib. Tabacalera Distrib. Dirsa Salt Food (Tabacalera)	100 100 75.06 100 38.5 50	Textil Guadiana DFG Grupo Cusi Diasa Cofidisa (BBV) Solvay* Alim. Natural. BBV
1991	Fridarago Coisa	Food (Tabacalera) Food (Tabacalera)	100 100	Rústicas Rústicas
1993	Argentaria	Banking	49.99 24.99 in V-1993 25 in IX-1993 25 in 1996	 (PIS) (PIS) (PIS)
1994	RJR Alimentación	Food (Tabacalera)	50	RJR Nabisco*
1995	Telefónica Lesa	Telecommunications Food (Tabacalera)	10.7 100	(PIS) Leyma/Iparlat

(1) Classified according to their functional dependence and date of their (first) privatization. Not included selling of shares which did not involve a State loss of control (except PISs), nor asset sellings. Foreign buyers are marked with an asterisk.
Source: Villalonga Morenés, B. *Expansión*, 24 July, 1996.

the larger firms, many were sold off to foreign conglomerates, as is the case of SEAT, which was sold to VOLKSWAGEN, ENASA to FIAT, TELESINCRO to BULL, MTM and ATEINSA to ALSTHOM, SECOINSA to FUJITSU, INTELHORCE to OREFICI, etc. The smaller companies were mainly sold off to national investors (Viajes Marsans, GOSSYPIUM, HYTASA, MACOSA, IMPIEL, ALUMASA, etc.). Most of them were ailing companies taken under the wing of the State after private initiative pulled out during the 1970-1982 period. A systematic plan was not followed in these privatizations, but, rather, the State acted casuistically, responding to specific problems. It was just one of many measures taken to rationalize and restructure the public business sector and was not an objective in itself.

Until well into the 1990s there was no general policy for privatizations, in spite of the operations brought to fruition in the 1980s and in the beginning of the following decade. Segments of the large public industrial groups were placed in private hands for reasons of reorganization or viability. However, these actions were born out of isolated decisions and were not due to a defined and coherent privatization strategy. This process of expansion in certain areas and privatizing in others meant that, in 1992, the public business sector had a similar economic role to the one it possessed in 1985. However, between 1992 and 1996, a serious budget crisis and the Convergence Programme forced the Ministry for the Economy and the Treasury to adopt a global decision regarding privatizations.

In 1994 privatizations began to be seen as an instrument of industrial policy and the *Plan for the Rationalization and Modernization of the Public Business Sector* was drawn up. This plan established a series of mechanisms to allow public sector access to domestic and international financial and industrial conglomerates. Thus, Spain signed up to the liberal privatizing wave that was spreading throughout the world, satisfying the principles of the search for efficiency and improved competition. Market globalization and liberalization, trade and financial exchanges, deregulation of economic sectors and the need for constant technological progress all justified the implementation of a privatizations program. To this, we should also add the particularly delicate moment public finances were going through, with a public deficit in 1995 of over 6% of GDP and a level of public debt that was approaching 65% of GDP. These circumstances made turning to privatization more attractive as a way of generating income or limiting expenditure in the public sector. Income from privatizations in Spain between 1985 and March 1994 [Comín, (1996, pp.356)] was in the order of one trillion pesetas (6 billion euros). However, from 1984 to 1993, the accumulated cost of loss-making SOEs, dependent on the State, reached 22.9 trillion pesetas (138 billion euros), which cost the State the equivalent of 4.5% of GDP annually. 1993 and 1995 saw the greatest flurry of privatizations , with income from privatizing activities totaling 0.7% and 0.6% of GDP, respectively. Vergés (1998, pp.226-228) estimates that income from the sale of stock in SOEs modestly reduced the State budget deficit: 4.6% in 1993 and 11.7% in 1995.

In principle, when a firm ceases to come under the Public umbrella, this leads to a dramatic breaking-off of links with the State. One of the main concerns expressed

Chart 2

Returns obtained from privatizations by Public Holding Companies in the 1985-1996 period before March 1996 General Elections (in billions of pesetas)

Year	Public Seller	By sale of stocks	By direct sale of public enterprises	Total returns obtained
1985	INI	-	N/A	N/A
1987	INI	-	N/A	N/A
1988	INI	93.2	-	93.2
1989	INH	156.23	3.77*	160
1990	INH	15.6		15.6
1991	-	-	0	
1992	INH	86.32	40*	130
1993	Grupo Patrimonio	292		
	INH	110		
	INI		3*	405
1994	INI-Teneo	145		
	INH		51	196
1995	SEPI-Teneo	216.5		
	Grupo Patrimonio	158		
	AIE/ICO		15*	389.5
1996	SEPI-Teneo	171.806	5.567	
	Grupo Patrimonio	160		337.373

(*) Estimate
Source: Vergés (1999, p. 126) and authors calculation.

in the debate on privatizations was the adequate safeguarding of Public interest when privatizing firms where some form of State participation was required. This, for example, would be deemed necessary in cases where national security had to be upheld (basic goods and services sectors), or to avoid market failures(‘) and natural monopolies. These cases would justify Public regulation and ownership in order to ensure that the service was avaiable to all customers, or to maintain key industries for the country’s development and, therefore, avoid the eroding of employment and income levels in certain population sectors or geographical areas. As in other countries, the Government has held on to a certain level of temporary control by establishing such formulae as the *golden share* or creating hard cores, in the form of a Prior Administrative Authorization and the regulations included in Law 5/1995 of March 23, concerning the *Legal Regime for Disposal of Public Participations in Specific Firms*. This formula was applied by the Socialist Government in the case of the partial privatization of REPSOL (10 year duration) and, more recently, in the privatization processes of ARGENTARIA (3 year duration), INDRA (7 years), TABACALERA (8 years), TELEFONICA (10 years), ENDESA (10 years) and IBERIA (5 years plus an extension option for 2 further years). It gives the Government the power to veto attempts to gain control (specifically, owning over 10% of shares) by shareholders in the firm, along with other faculties, such as that of preventing the firm from being split up or from changing its business objectives.

Chart 3

Partial privatizations, by sale of stocks or by tender before March 1996 General Elections

Year	Firm	Holding Company with control	Sector/activity	% sold	Returns obtained (in '000,000s of pesetas)	% remaining under public control
1986	ACESA	FGD	Highways	57.6	N/A	0
	GESA	Endesa/INI	Electricity	38.0	N/A	55.3
1988	ENDESA	INI	Electricity	20.4	80	75.6
	ENCE	INI	Paper	34.8	13.2	66.2
1989	REPSOL	INH	Oil	30.6	156.229	69.4
1990	REPSOL	INH	Oil	2.9	31.919	66.5
1992	REPSOL	INH	Oil	2.1	N/A	64.4
	REPSOL	INH	Oil	10.0	70	54.4
1993	ARGENTARIA	G. Patrimonio	Banking	24.1	119	
	ARGENTARIA	G. Patrimonio	Banking	24.3	173	51.66
	REPSOL	INH	Oil	13.9	110	40.5
1994	ENDESA	INI-Teneo	Electricity	8.7	145	66.9
1995	REPSOL	SEPI-Teneo	Oil	19.5	200.5	21.0
	ENCE	SEPI-Teneo	Paper	14.9	13	51.3
	TELEFÓNICA	G. Patrimonio	Telecos	10.7	158	21.16
	INDRA	SEPI-Teneo	Electronics	24.9	3	63.0
1996	AUXINI	SEPI-Teneo	Construction	40.0	3.03	60.0
	REPSOL	SEPI-Teneo	Oil	11.0	132.71	10.0
	ARGENTARIA	G. Patrimonio	Banking	25.4	160	26.2

Source: Vergés (1999, p. 124) and authors calculation.

2. The privatization program from 1996 onwards

In March 1996 the center-right People's Party (*Partido Popular*) came to power. The priorities in their new industrial policy consisted of promoting competition in all markets and adopting privatization as the main basis for public enterprise management. In a series of measures passed by the Council of Ministers on June 28, 1996 (*Modernization Program for the State Public Business Sector*), the new government adopted as part of its political program actions to be taken in the area of privatizations, committing itself to global privatizing (in the sense that it would cover all saleable companies and would affect all State interest, however small or large). Until June 1996 there was no real privatization program that explicitly defined the principles that would govern the policy itself, nor was there a specific declaration of the objectives this policy was to pursue.

The privatization process picked up steam from 1997 onwrads and the role of the public business sector within the economy was considerably reduced. The process affected the largest SOEs with high profitability, a strong market position and substantial international projection (TELEFONICA, REPSOL, TABACALERA or ENDESA among others). During the first two years of the new government sales of public companies reached over 4 trillion pesetas, doubling the income of the previous ten years of Socialist privatizations. The most intense privatizing activity was carried out in 1997 and 1998, when obtained income reached 2.7% and 2.8% of GDP, respectively. In 1997 alone, privatizations produced 2.05 trillion pesetas in income, a sum equal to 77% of the public deficit in the previous year [Vergés (1999, p. 134)]. That same year, Spain was sixth in the ranking of the 29 OECD countries, in terms of income from privatizations. Two thirds of privatization this income within the OECD corresponded to EU countries[4]. This is a reflection of the haste with which some countries had to act before the introduction of the Economic and Monetary Union (EMU).

In the race towards EMU, European governments faced moree incentives to accelerate their privatization programs. Although income from privatizations could not be used in deficit calculations, they were allowed to take this income to reduce the debt [5]. To this we should also add that privatizations avoid having to earmark expenditure for financing both the exploitation losses of certain SOEs and the investment programs for the public business sector as a whole. In the short term, such privatizations go a long way towards helping to accomplish two of the macroeconomic indicators required by the Maastricht Treaty: public deficit and public debt. According to Vergés (1998, p. 223), part of the income from the privatizing holdings does not formally have the concept of "the sale of shares", but, rather, of "capital gain" obtained from the sale of those shares (the difference between the value achieved in the sale and the value the corresponding stock was given in the privatized holding's accounts). As a capital gain, it is included in the holding's annual results and, in turn, part of it will be computed in the State's public budget as a tax on the holding's profits. The remainder can legally be considered as dividends paid to the Treasury by the holding. In other words, in both cases they will appear as current income, thus reducing the current budgetary deficit for the year in which the income is produced. Vergés (1998, pp. 226- 228) has estimated that the public deficit was brought down by almost half (45%) thanks to privatizations, using the aforementioned financial/fiscal mechanism, and that, in 1998, the reduction was proportionally even greater, given that the income obtained by the privatizations carried out in that year (ENDESA, TABACALERA and ARGENTARIA) reached an annual record. In accordance with this, the acceleration in the privatizing process of 1997 and 1998 has been decisive in reducing Spain's budget deficit to the formally established level of 3% of GDP, thus fulfilling what was required in the Maastricht convergence criteria [Vergés (1998, p. 230)].

1999 and 2000 saw a slowing-down of the privatization process, due to ministerial changes following the general elections (March 2000). In 2001 things picked up again

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4 According to the preliminary data from an OECD report on privatizations, during 1997 the group of OECD States earned income from privatizations of 157 million US dollars, 70% more than the year before. Two thirds of this amount was attributable to the EU countries. Spain received close on 6 billion US dollars, 123% more than in 1996. El País. Negocios, May 17, 1998, p. 3.

5 The interest of that operation lies in the possibility of using the funds obtained from the disposal of a financial asset to reduce a financial liability, especially the amortization of public debt to bring down the outstanding debit balance. At the same time, if the income from privatizations is used to amortize outstanding debt, the interest on the amortized debt will be reduced, which will bring the public deficit down.

with the privatization of six SOEs and seven landed properties that belonged to the public concern EXPASA (a company that, in May 2001, was transferred from State Heritage to the Public Industrial Participations Company). Income from privatizations in that year amounted to 139 billion pesetas (835 million euros) [Pampillón (2002, p.127)], representing 0.1% of GDP.

The overall balance for the 1996-2001 period has been the privatization of 43 SOEs and income nearing five trillion pesetas (30 billion euros). The basic formulae of SOE asset disposal implemented during these years take on two forms:

a) The negotiated sale of assets, where ownership is transferred within the framework of private negotiations, after pre-selecting potential buyers, who were normally producers from the same sector, either through competition or through complementarity. The final buyer would be the interested party that, according to public officials, offered the best conditions or guarantees. This formula was used, for example, in the sale of AUXINI, ACERALIA, INESPAL, Aluminum Conversion or the State-held E.N. Santa Bárbara.

b) The public offering of securities, in which the typical overall offer is usually split into a national section and various international sections, corresponding to different geographic regions. This was the method chosen for the largest and most profitable public companies: TELEFONICA, REPSOL, ARGENTARIA, ENDESA, TABACALERA, ENCE and IBERIA.

The system used for the sale of the seven EXPASA landed properties was a universal auction, open to any personal or legal entity that met a a series of pre-requisites.

There are two sectors where privatization is particularly difficult, for both political and socio-economic reasons: mining and shipyards. For this reason, the shift from public to private ownership will probably be undertaken last in this overall privatization process. Interinvest (Aerolíneas Argentinas and Austral), the E.N. Santa Bárbara or Aluminum Conversion are examples of privatized companies with extremely large accumulated losses.

The privatizing of Spain's major State-owned organizations would not have been as successful as it was, if it had not been backed by the financing provided by Society's saving habits, which were encouraged by the extraordinary period the capital market was going through and by the sharp drop in interest rates during the final years of that period. The low interest rate environment has made holding shares more appealing and turned the domestic market into a key source of demand, increasing the number of company shareholders and boosting the so-called "people´s capitalism". The share packages put up for sale to the general public have been well received and over two million small savers have purchased stocks in firms privatized since 1997 (see Chart 5). The privatizations mechanism not only reinforces the capital market, allowing acces to new investors, but also, by making it easier for large sections of the population to own company shares, makes taxpayers more aware of the implications of stability and

Chart 4

Public Enterprises privatized in the period 1996-2001

Firm	Owner	Price (in millions of pesetas)	Purchaser	Date (*)
Telefónica	SEPPA (1)	630,000	Public Offer	20/12/1996
Minas Almagrera	SEPI (2)	443	N.Resources	17/1/1997
Sodiga (5%)	SEPI	-	Xunta Galicia	30/1/1997
Iongraf	SEPI	165	Management	7/3/1997
Repsol (10%)	SEPI	168,692	Public Offer	7/3/1997
Surgiclinic (50%)	SEPI	-	Hambros	7/3/1997
Sodical (51%)	SEPI	717	Dip. y Cajas	14/31997
Auxini (60%)	SEPI	5,950	OCP Const.	7/6/1997
Aldeasa (20%)	SEPPA	15,000	Tabacalera	15/6/1997
Retevisión (70%)	Fomento	181,003	Endesa-Stet	12/7/1997
Endesa (25,57%)	SEPI	695,462	Public Offer	24/7/1997
Inespal	SEPI	61,500	Alcoa	29/7/1997
CSI(Aceralia) (35%)	AIE (3)	129,200	Arbed	1/8/1997
Aldeasa (80%)	SEPPA	48,545	Public Offer	1/8/1997
Infoleasing	SEPI	3,100	La Caixa	12/9/1997
Elcano	SEPI	5,770	National	24/10/1997
Aceralia (52,8%)	SEPI	212,367	shipyards	7/11/1997
Aceralia (10,8%)	SEPI	40,000	Public Offer	7/11/1997
Aceralia (0,6%)	SEPI	1,500	Aristrain	7/11/1997
Aceralia (1%)	SEPI	3,692	J.M.Aristrain	7/11/1997
Ferroperfil	SEPI	21	Gestamp	14/11/1997
Sodicaman (51%)	SEPI	658	Management	26/11/1997
Barreras	SEPI	750	Dip. y Cajas	26/12/1997
Argentaria	SEPPA	325,000	G. Barreras	16/1/1998
Tabacalera	SEPPA	310,000	Public Offer	**13/4/1998
Iberia (40%)	SEPI	N/A	Public Offer 10% ind. partners 30% inst. partners Public Offer	2000
Iberia (52%)	SEPI	87,210	Grupo Alucoil	5/2001
Conversión Aluminio	SEPI	120	General	2001
E.N. Santa Bárbara	SEPI	832	Dynamics	2001
Ence(51%)	SEPI	38,248	Public Offer	2001
Interinvest	SEPI	N/A	Air Comet	2001
Fincas Rústicas (total 7)	EXPASA	5,257	Public Offer	5/11/2001

(1)Sociedad Estatal de Participaciones Patrimoniales (Ministerio de Economía).(2) Sociedad Estatal de Participaciones Industriales. (3) Agencia Industrial del Estado.
(*) Corresponds to authorization for sale by Council of Ministers.
(**) Date in which put up for sale by Public Offer.
Source: authors calculation.

economic growth. These taxpayers will adopt a more positive attitude toward the Public Sector and the market in general. It should also be remembered that the sale of State-owned firms is an abundant source of commissions and profits for the banks and institutions that mediate in the operations. In theory, creating a large shareholder base that is directly interested in the process provides a powerful tool for discouraging future nationalizing tendencies.

Chart 5
Popular Capitalism

Enterprise	% of overall Public Offer for sale to minority shareholders	Volume of minority shareholder sale (in '000,000s of euros)	Volume of Public Offer (in '000,000s of euros)
Telefónica (1997)	58.99	2,056.38	3,485.99
Repsol (1997)	51.00	521.09	1,021.75
Endesa (1997)	67.50	2,755.00	4,081.50
CSI-Aceralia (1997)	73.39	544.75	742.27
Argentaria (1998)	54.50	1,122.26	2,059.20
Tabacalera (1998)	74.13	1,120.00	1,664.30
Endesa (1998)	78.52	4,860.39	6,190.00
Indra (1999)	44.03	192.40	436.97
Red Eléctrica Española (1999)	49.30	168.05	340.88
Iberia 2000	-	-	1,092.28
Average	**61.26**	**1,428.26**	**2,111.51**

Source: Expansión, 24 March 1999

IV. EVALUATION

Spain's privatization process has gone through two very different stages: a first stage, from 1985 to 1994, in which no systematic plan was followed, but, rather, a casuistic approach was taken responding to specific problems. During this phase, privatizations were just one of a series of measures taken to rationalize and restructure the public business sector, which was an objective in itself. A liberalizing process was undertaken to adapt Spain's public business sector to EEC norms, doing away with the monopolies of oil distribution and refining and tobacco. During this first Socialist-government stage, privatizations responded to the government's will to reduce public-sector presence in sectors considered to be non-strategic according to market criteria. The most important privatizations were done partially through the public offering of securities. In the second Socialist phase, from 1994 onwards, budgetary motives began to gain importance, due to the delicate situation of the public finances, though they were never primordial objectives. 1994 was the year when privatizing began to be seen as an industrial policy instrument, backed by the *Plan for the Rationalization and Modernization of the Public Business Sector*.

The privatization model changed following the 1996 elections. Via the State's *Program for Modernizing the Public Business Sector*, privatization was intensified and the public business sector's importance in the economy fell considerably, affecting the largest and most profitable SOEs. It is interesting to note the high concentration of privatizations in 1997, a decisive year for entry into the Monetary Union. Income from privatizations in the period 1996-1998 was around 4 trillion pesetas (doubling the income gained from the prior ten years of Socialist-government privatizing). As we have already mentioned, privatizations have been instrumental in enabling Spain's public deficit to be reduced below the 3% of GDP limit established in the Maastricht convergence criteria. They had an influence on the debt and, indirectly, helped tip the balance for Spain's entry into the Monetary Union.

The main objective of privatization should be the increase in economic efficiency, not only as the key to improve public business sector actions, but also as the source for other improvements that are frequently associated with privatization, above all its favorable budgetary effects. It is difficult to evaluate how much a short-term solution to a purely budgetary problem avoids the need for future State borrowing to compensate for the loss of income previously generated by a profitable public enterprise. In a recent study, Vergés (1999) estimates that the annual benefits of Spain's major profitable privatized SOEs were 5.3 times the total losses estimated for the loss-making privatized public concerns. In the short term, such privatizations provide important aid to the State Budget, but in the mid and long term the overall repercussions of privatizations on the State Budget will be negative. In this sense, we should bear in mind that, if the reduction in interest costs, due to the amortization of the debt generated through income from privatization, does not offset the underestimation of expected income from profitable public enterprise, the State could be forced to raise income through taxation or opt for a reduction in socially-popular expenditure. If, on the contrary, privatizations affect loss-making concerns, it will undoubtedly be necessary to back up these measures with an increase in inter-territorial compensation funds, as well as taking care of the social costs such privatizations produce.

Until very recently, various sectors that are decisive in the functioning of the economy (E.g. oil, electricity and telephony) were under the control of State-owned firms with a position of dominance. The dominant organization in the oil sector was REPSOL; ENDESA was the largest electricity provider and, together with the privately-run IBERDROLA, has an 80% share of the production and distribution of electricity. TELEFONICA, in turn, was a telephone communications monopoly up until a few years ago. Privatizing in itself does not liberate the markets; they still show substantial signs of rigidity. But thanks, to EU directives and national legislation, these markets have been given an initial liberalizing boost, explicit, from a legislative point of view, in the 1998 Hydrocarbon Law, the 1997 Electricity Law or the 1998 General Telecommunications Law.

Generally, competition and regulation are more decisive determinants affecting economic results than whether ownership is public or private. Whenever there are deficiencies in these areas, government action should be principally aimed at stimulating competition and improving regulation. Privatization is neither necessary nor suffices in order to create a competitive market. In the case of privatizations carried out in Spain over recent years, some of the main SOEs were sold off before the markets were liberalized. The privatization of ENDESA (electricity), Red Eléctrica Española -REE- (an electricity carrier), REPSOL (oil) or TABACALERA (tobacco/food) were basically a transfer from public to private hands of companies maintaining a monopolistic control over the areas in which they operate. Theory and international experience recommend privatizing and liberalizing simultaneously (or liberalization before privatization). This places a question mark above the increase in economic efficiency and the obtaining of benefits that, for the consumer, arise from opening the market to competition. Evidence shows that consolidating monopolistic or oligopolistic concerns in the private sphere is a danger to competition, since these groups immediately begin to resist liberalization or competition. If privatization occurs without modifying the sector's productive structure, as, for example, has happened in Spain's electricity industry[6], the sector will continue to exert its influence on the market and an active competition defense policy will be needed to avoid this influence. For this reason, in non-competitive environments, privatization should be carried out alongside an adequate restructuring of the sector. The Spanish electricity providers warned the Government in 2002 that they were not prepared to carry out the necessary investments if they were not allowed to set the prices they wished. The result has been a rise in energy prices, when the Government, in recent years, had promised that costs would fall.

The permanent risks of competition being restricted due to the behavior of firms and groups with a strong presence in the different markets and sectors, the effects of which can be extremely detrimental to economic growth, forced the Government to pass a new series of measures (Law 9/2001 of June 4). This package aimed to establish a defense framework adapted to the needs stemming from the economic liberation process. It included coercive fines as a means to force the execution of agreements authorizing operations of business concentration (the fines imposed on each of the firms involved can be as much as 10% of their respective turnovers in Spain for the year in which the operation took place).

However, in practice, we find that privatization and deregulation in themselves are not enough to ensure market competition. In the case of Spain, there have been some privatizations of firms that operate under conditions of natural monopoly [ENAGAS (gas distribution), REE (an electricity carrier) o RETEVISIÓN (a TV signal broadcaster), among others] . That monopolistic situation has been totally or partially maintained (economic rationality recommends so in these cases). Regulation by the Administration of these activities has been simultaneously put in place along with new public bodies set up to apply these regulations (the Telecommunications Market Commission or the National Electricity System Commission). Thus, in these cases, the real change following privatization, is that some monopolies have passed from State to private hands and their operations have been subjected to new regulatory measures by the State. The aim of regulatory bodies should be none other than promoting competition, eliminating benefits derived from monopolistic or informational advantage and setting efficient prices that achieve an optimum assignation of resources.

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6 The Electricity Sector Law, in force sine January 1, 1998, established the basic principles for the sector's new regulation: a) freedom of establishment, b) freedom of raw materials supply, c) free market principle in generation, in order to encourage the reduction of prices by exposing electricity generation to competition, and d) freedom of concentration and freedom of consumers to choose their electricity provider.

Just two or three decades ago, Spain was among the top spots in the list of OECD countries in terms of economic interventionism. In the last twenty years, the country has had an economy with a substantial degree of liberalization. A wide-ranging liberalization program has been implemented that takes in both factor markets (movement of capital, banking and the job market) and the goods and services markets (opening of foreign trade, elimination of price and quantity controls, splitting up of many monopolies or the introduction of competition in public service-related activities). The restructuring and privatization process undergone by Spanish public enterprise over the last decade, together with incipient liberalization of traditionally regulated sectors has begun to bear its fruits. These appear in terms of greater flexibility in the productive system and progress in consumer welfare through lower prices of products and services subjected to stronger competition. The telecommunications market is a clear example of this. Liberalization measures have brought important benefits, including a drop in prices, services innovation, wider use of services, setting-up of new networks (particularly broadband), and the availability of Internet services for families and firms. According to data from the Ministry for Science and Technology, the reduction, both accumulated and in real terms, in fixed telephony prices from the introduction of liberalization up until November 2001 was 16.4% for local calls, 52.24% for provincial calls, 75.97% for inter-provincial calls, 70.13% for international calls and 58.84% for calls from mobile phones to fixed sets. However, the figures show that TELEFONICA still controls around 90% of the fixed telephony market (the last remnant of the monopoly up until January 1, 2001). This market share is the highest of all the traditional telecos in the EU markets[7].

Nonetheless, there are still activities that have not been liberalized (land, professional activities or commercial distribution), markets that are still substantially rigid or certain sectors where liberalization is more a formality and where the conditions needed to guarantee effective competition have yet to be established. In many cases, privatization and deregulation have not been enough to bring competition to the markets. According to OECD data, once the process of deregulation and competition promotion is concluded, prices should be 20% lower in the electricity sector, just below 7% lower in the oil and gas sector, and around 22% lower in telecommunications. The Competition Defence Tribunal and the Public Regulatory Bodies have an essential role to play in this process. Inefficient regulations can hinder competitiveness. Therefore, the State should be vigilant to ensure the effective accomplishment of conditions required for competition. This does not free it, in certain cases, from re-regulating or establishing a new framework of regulations to promote competition and to make sure that certain social objectives are met.

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[7] In the case of mobile telephony, the result is quite different: Telefónica Móviles has a 56% market share, compared with Vodafone's 27% and Amena's 17%. Nonetheless, the traditional teleco still has a market share that is substantially higher than its competitors'.

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