

Privatization in Energy and Airlines

Lecture 8

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Privatization in Energy and Airlines: Overview

- Along with telecoms and banking, the two major industries that have accounted for the largest number and highest value of privatizations over the past quarter-century are oil and gas companies and electric utilities.
- These four industries collectively account for almost \$900 billion of the total \$1.25 trillion that governments have raised through asset sales and public share offerings since 1977.
- This chapter also examines national airlines, which—although less important in financial terms—are the most internationally visible of all privatizations.
- The chapter presents estimates showing that governments still retain large stakes in partially privatized firms and that fully state-owned oil companies could generate between \$1.45 and \$3.21 trillion if sold.

Privatizing Oil and Gas Companies

- After telecommunications, oil and gas companies have been the most valuable state-owned enterprises to be privatized during the past 25 years.
- British Petroleum, Total and Elf (France), Repsol (Spain), Statoil (Norway), and ENI (Italy) are now among the 100 most valuable companies in the world.
- However, the largest and most important oil companies remain wholly state-owned—especially those of OPEC countries and major non-OPEC producers in Mexico, Oman, and Malaysia.

The Logic Behind State Ownership in Oil and Gas

- It may seem counterintuitive that many countries opted for national ownership of oil and gas companies, given petroleum's global nature and lack of monopoly characteristics.
- Unlike electricity or telecoms, oil and gas are traded globally, produced on every continent, and consumed even in the poorest countries.
- The refining and trading of petroleum products have no natural monopoly characteristics, and the competitive global market largely eliminates the need for regulatory oversight.
- In contrast, natural gas distribution does exhibit some monopoly features, and thus privatization requires a regulatory framework—though it is easier to regulate due to pricing transparency and competitive upstream markets.

The case of British Petroleum

- British Petroleum was one of the earliest and most important examples of oil privatization, starting in 1979 and proceeding through multiple tranches in the 1980s and 1990s.
- The UK government raised over \$14 billion from selling BP shares, which helped reduce public debt and broaden public share ownership.
- This privatization also contributed to the development of capital markets in the UK and created momentum for further state divestitures.

The case of ENI

- ENI in Italy is one of the largest oil and gas companies in Europe and underwent a staged privatization process between 1995 and 2001.
- The government sold over 70% of the company, raising more than \$24 billion, while retaining a “golden share” to protect national interests.
- The privatization of ENI led to significant operational improvements and global expansion, especially in North Africa and Central Asia.

Electricity Sector Privatization

- Electricity utilities are typically divided into three segments: generation, transmission, and distribution.
- Generation is potentially competitive, while transmission and distribution are usually considered natural monopolies that require regulatory oversight.
- The privatization of electricity utilities has proceeded more slowly than in oil and gas due to the complex regulatory and infrastructure requirements.
- Nevertheless, many countries have undertaken successful restructurings, including the UK, which unbundled and privatized its electricity system with the aid of an independent regulator.

Electricity Privatization: The UK Model

- The UK fully restructured its electricity sector beginning in 1990, separating generation from transmission and introducing competition in retail supply.
- Independent regulatory institution (OFGEM) were created to monitor pricing and ensure fair competition in the post-privatization period.
- This model is considered one of the most comprehensive electricity privatization globally, and has inspired similar efforts in Australia, Chile, and parts of the EU.

Privatization Outcomes in Energy

- According to the empirical studies, 161 privatizations in oil and gas raised \$137 billion between 1977 and 2003, while governments still retain stakes worth approximately \$174 billion.
- Privatizations in electricity sector have raised \$129 billion across 136 transactions from 1986 to 2003.
- Estimates suggest that a full-scale privatization of national oil companies could raise between \$1.45 trillion and \$3.21 trillion globally.

Airline Industry Privatization

- While less financially significant, airline privatizations are highly visible and politically sensitive due to their national importance.
- Airlines were often considered strategic national assets and were kept under state ownership for sovereignty and public services.
- British Airways led the wave of airline privatizations in the 1980s, followed by major carriers such as Lufthansa and Air France.
- The airline industry has seen mixed results, with successful turnarounds in some cases and persistent challenges in others due to regulation, competition, and labor issues.

Challenges in Airline Privatization

- Airlines are often burdened by legacy costs, labor agreements, and obligations to maintain unprofitable routes as public services.
- In addition, bilateral air service agreements and international slot allocations limit flexibility and competition.
- Some privatizations have struggled, especially where carriers failed to adapt to market liberalization or faced strong competition from low-cost airlines.

Emerging Market Experiences

- In Latin America, such as Argentina and Brazil, undertook large-scale energy and airline privatizations during the 1990s under IMF-backed reforms.
- While initial investment and efficiency gains were recorded, weak regulation and lack of competition often led to consumer dissatisfaction.
- In Asia, Petronas of Malaysia remains fully state-owned, whereas India has partially privatized its power generation and distribution in phases.

Lessons Learned

- 1 The privatization of energy and airline industries has been shaped by unique sectoral dynamics, political considerations, and institutional capacity.
- 2 While privatization can improve efficiency and attract capital, its success depends heavily on the quality of regulation, market structure, and transparency of the process.
- 3 Transparent privatization with strong institutional support tends to yield better outcomes than abrupt or politically motivated sales.
- 4 Regulatory reform must precede or accompany privatization to avoid monopolistic behavior and ensure consumer and producer benefits.
- 5 Privatization should be aligned with national development goals, ensuring investment in infrastructure while balancing efficiency with equity.