PRODUCTIVITY ANALYSIS

ECONOMICS RESEARCH CENTRE

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UNIVERSITY OF CYPRUS

PUBLIC OR PRIVATE:
ELECTRICITY AND TELECOMMUNICATIONS IN CYPRUS AND THE EU

SUMMARY AND POLICY CONCLUSIONS

This bulletin summarises results obtained by research carried out at the Economics Research Centre of the University of Cyprus using European data and argues that privatisation can improve competitiveness and, at the same time, correct existing inequities.

Privatisation of public utilities emerges as an attractive option for Cyprus, not only as a way to reform its underperforming economy but also as means to reduce excessive debt and satisfy the demands of its international lenders. In fact, legislation to privatise the three major public utilities (Electricity Authority of Cyprus, Cyprus Ports Authority and Cyprus Telecommunications Authority) has already been approved by Parliament, albeit amidst severe opposition from the left and centre-left parties and trade unions. The government is now expected to produce a privatisation plan that entertains apprehension about selling off government assets (and losing revenue from 'profits') and responds to concerns about the negative impact on the welfare of those working in public utilities.

It is clear from the results reported in this bulletin that fully private ownership is the regime demonstrating the best performance in terms of both productivity and competitiveness. It will, therefore, be a mistake for the government to succumb to political and trade union pressure and proceed to privatisations that retain for it a share in the new companies. Even worse is for the government to keep for itself a share in ownership that is large enough so as to maintain control of these companies. In general, the empirical evidence in Europe suggests that all scenarios with the government having a share in the ownership of utilities appear to encourage non-competitiveness. This may be related to the fact that governments have no incentive (and political pressure) to regulate sectors of the economy where they are major stakeholders.

Continuing from the last argument in the previous paragraph, regulation is the key issue the Cyprus government needs to address in the design of the impending privatisations. Properly designed and effectively implemented regulation will make certain that the benefits of higher productivity from privatisation will be passed on to consumers in the form of lower prices. This is particularly important in small countries like Cyprus, where privatisation can often result in excessive control of the market. The government can ensure that this will not happen by introducing, along with privatisation, an adequate regulation regime to promote competition (free entry, lower price etc) so that the new private companies do not use monopoly practices to maximise their profits at the expense of consumers. The experience of market regulation in Cyprus is disappointing and past mistakes must not be repeated in the case of the impending privatisations.

As regards wages and employment in the privatised utilities, inevitably, the impact will be negative – at least in the short run. After all, productivity gains and increased competitiveness are realised through reduction in the wage bill and improved management. In simple words, successful privatisation entails transfer of benefits from those currently employed in public utilities to the society at large. However, the long run benefits to the society from improved competitiveness will be much larger than the losses of those now employed in public utilities. Indeed, the fact that the employees of public utilities – and the broader public sector – have been benefiting for many years at the expense of employees in the private sector is a reason for, not against, privatisation. Those negatively affected from privatisation, as in every reform promoting the welfare of society at large, have the right to safeguard their legitimate interests; but do not have the right (and objectivity) to decide whether the reform should happen or not.

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Issue 14/1

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1. Introduction

In this bulletin we investigate the relationship between competitiveness and the ownership (public vs private) status of enterprises in the telecommunications and electricity sector in Cyprus and the Europe. The empirical analysis is based on data drawn from Eurostat and cover the period from 1996 to 2011.

The objective of the analysis is to enlighten the debate regarding the impending privatisations of the two state-owned companies, Electricity Authority of Cyprus (EAC) and Cyprus Telecommunications Authority (CYTA), as agreed in the MoU between Cyprus and Troika. The conclusions reached are used to make policy recommendations.

2. Competitiveness in Cyprus and Europe

Looking at the prices charged for their products by the electricity and telecommunications industries in Cyprus and the EU-25 countries (Figure 1) we observe a contrasting picture.

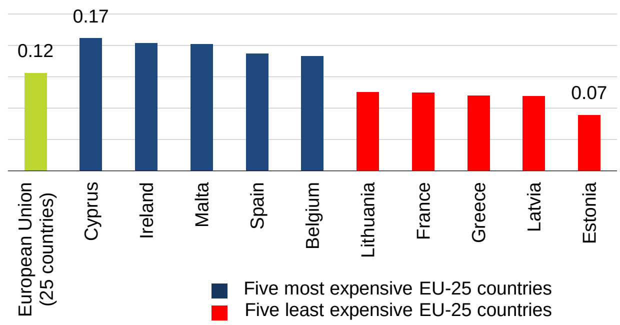
- As shown by Figure 1(a), the price charged for kilowatt per hour by the electricity authourity in Cyprus in 2010 was the highest in the EU-25 countries.
- In contrast, the price of telecommunication services in Cyprus in the same year is the lowest among the EU-25 countries, except Denmark (Figure1b).

The question arising from the observations above is how far these price differences between the two sectors in Cyprus, and the contrasting picture vis-à-vis their European counterparts, reflect differences in productivity. We seek an answer to this question by constructing some sectoral indicators of performance, namely (i) the real unit labour cost that measures competitiveness and its components; (ii) labour productivity, and (iii) real wages. We then compare these indicators in Cyprus with their counterparts in Europe.

Figure 2 below reports the path of labour productivity, real wages and real unit labour cost for the electricity and telecommunications sectors in Cyprus over the period 1996 to 2011.[1]

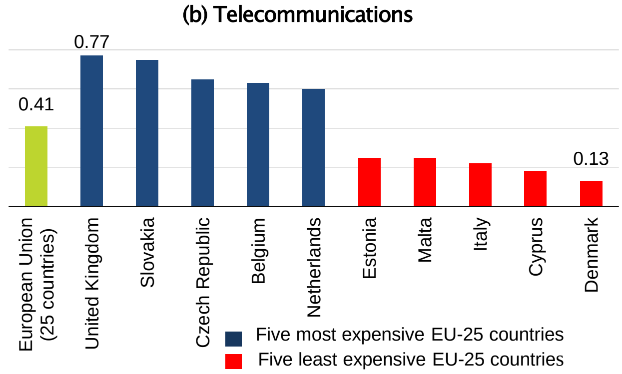
Figure 1: Prices charged by Utilities in EU25

(a) Electricity



Note: Price of kWh in €
Source: Eurostat

(b) Telecommunications



Note: Price of 10-minute local call in €
Source: Eurostat

Labour productivity is the value of goods and services produced per unit of labour (hours worked). The real unit labour cost measures the cost of labour required to produce one unit of output. An increase in the real unit labour cost is interpreted as loss of competitiveness and can happen if wages grow faster than labour productivity; or labour productivity grows at a slower pace than wages.

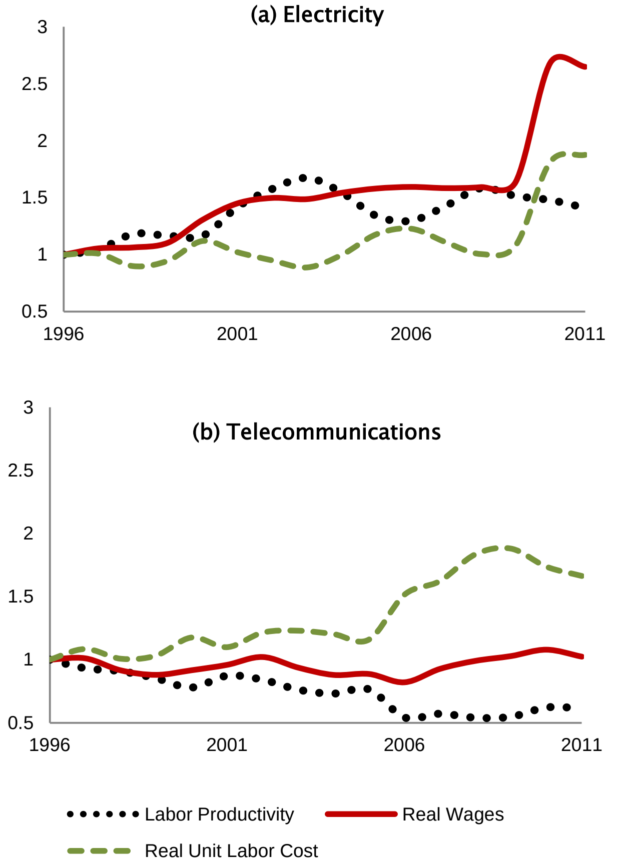
As shown in Figure 2 the competitiveness of the electricity and the telecommunications sectors in Cyprus, as depicted by the real unit labour cost, follows a similar pattern over the period 1996-2011.

- During the first part of this period the unit labour cost (green segmented line) is relatively constant, meaning that the two rectors do not face a change in competitiveness over this period.
- Towards the end of the period investigated the unit labour cost in both sectors increases sharply, first in the electricity sector (from 2008) and subsequently

[1] All three measures have been turned into indices taking the value of 1 in the beginning of the sample.

(from 2011) in the telecommunications sector, indicating severe deterioration of competitiveness.

Figure 2: Measures of performance in Cyprus Utilities



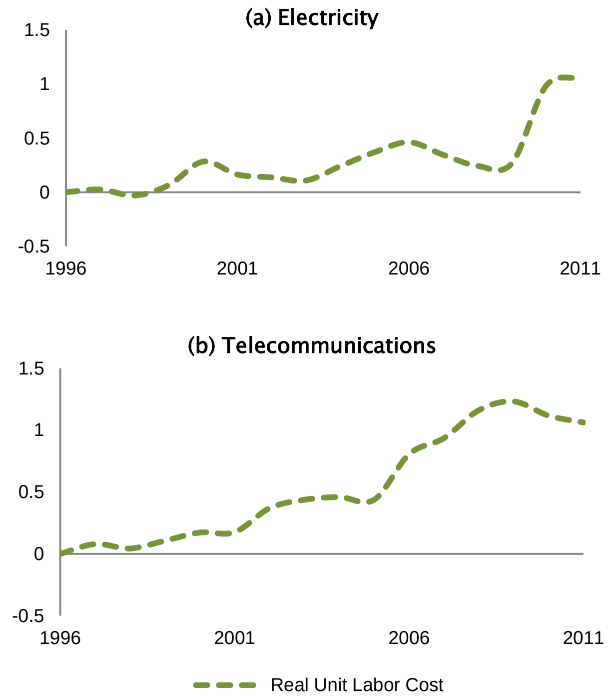
To study the causes of the abrupt loss of competitiveness in the electricity and telecommunications sectors in Cyprus, we examine the change in the two components of unit labour cost: real wages and labour productivity – shown by the red continuous and black dotted lines, respectively, in Figure 2.

- In the electricity sector labour productivity and real wages were increasing by about the same rate over the period 1996-2008; albeit, labour productivity follows a more cyclical pattern than real wages. However, in 2009 wages increased steeply, pushing down the sector's competitiveness.
- A different picture emerges in the telecommunications sector, where the decline in competitiveness that started in 2005 was the result of falling labour productivity. Real wages in this sector remained relatively stable throughout the period under investigation.

Next, we examine whether the trends shown in Figure 2 are idiosyncratic to Cyprus or, also, reflect a Europe-wide phenomenon. We do this by examining how the unit labour cost in the electricity and telecommunications sectors in Cyprus deviate from the corresponding Eurozone average. This deviation in reported in Figure 3, where a positive number (i.e. when the line is above zero) occurs when the unit labour cost increases faster in Cyprus that in Eurozone, indicating a decline in competitiveness.

- The results suggest that in both the electricity and telecommunications sectors the unit labour cost increases faster in Cyprus compared to the average in Eurozone, indicating that Cyprus is persistently becoming less competitive in Eurozone.

Figure 3: Non-competitiveness in Cyprus vis-à-vis Eurozone



As previously, we investigate the causes of the falling competitiveness of the two sectors in Cyprus by comparing the change in its two components, real wages and labour productivity, with the corresponding variables in Eurozone. The results are summarised in Figure 4.

- The worsening of competitiveness of the electricity sector in Cyprus compared to the Eurozone average over 1996-2011 was due to the wages in Cyprus increasing faster than those in Eurozone.

PRODUCTIVITY ANALYSIS

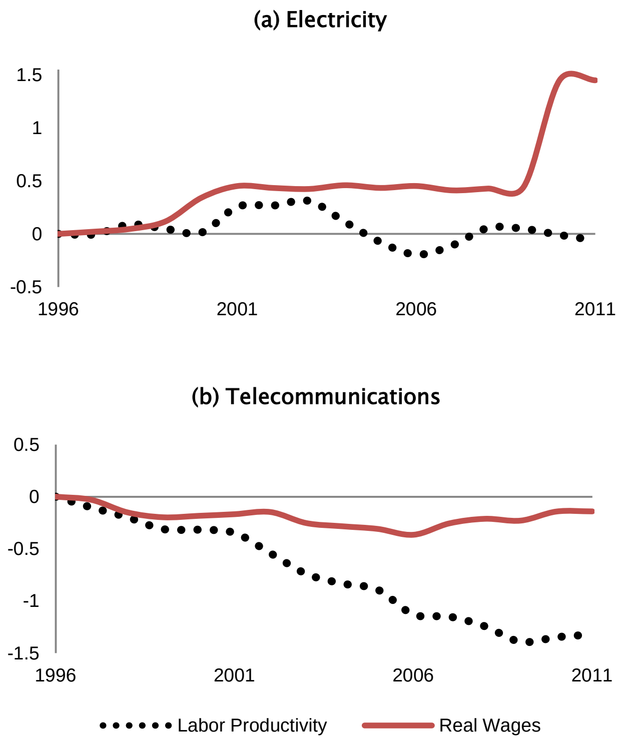
ECONOMICS RESEARCH CENTRE

Issue 14/1

March 2014

- The competitiveness of the telecommunications sector in Cyprus has been worsening relative to the Eurozone average over the same period due to the labour productivity in Cyprus falling faster than that in Eurozone.

Figure 4: Deviations of productivity and wages in Cyprus from the Eurozone average



3. Public vs. Private Ownership

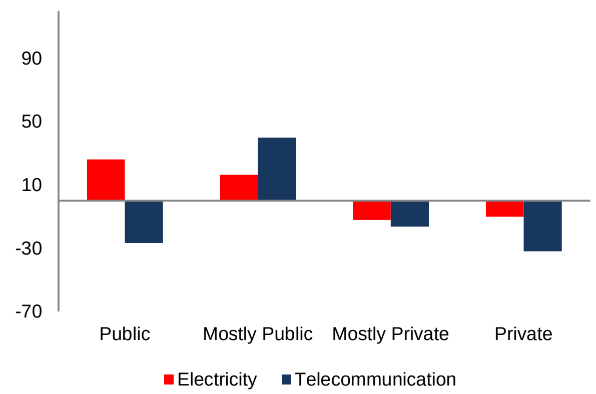
The results above show that both the electricity and telecommunications sectors in Cyprus are becoming less competitive relative to the rest of the Eurozone countries. In this section we investigate the extent to which this deterioration of competitiveness can be explained by the large government share in the ownership of the two sectors is Cyprus. We do this by using data on the ownership structure of the electricity and telecommunications industries for a number of European countries[2] to estimate how productivity and real unit labour cost relate to the ownership (public or private) regime in each of the two sectors.

The results obtained are reported in Figures 5 and 6 below, where the extent to which the competitiveness and productivity vary with ownership is measured, using the case of equal state and private share as benchmark. We consider four ownership regimes: public, mostly public, mixed, mostly private and private. It should be noted here that Figure 5 shows unit labour cost so that positive (negative) values indicate worsening (improvement) of competitiveness. The opposite holds true in Figure 6, where estimates of productivity for the various ownership regimes are reported.

Figure 5 shows the estimated effect of ownership on real unit labour cost. The results reported in this figure can be summarised as follows.

- In both the telecommunications and electricity sectors fully private is the most competitive ownership regime as it corresponds to the lowest unit labour cost. This is more for telecommunications than electricity.
- The worst regime in terms of competitiveness is the fully public one in electricity and the mostly public one in telecommunications. It is worth noting here that in telecommunications the fully public regime is the second best in terms of competitiveness, bettering the mixed ownership regimes.

Figure 5: Effect of ownership on unit labour cost



[2] In terms of data availability, for the telecommunication industry we have the share owned by the Government in 13 countries from 1996 to 2007. Countries included in our analysis are Austria, Belgium, Cyprus, Czech Republic, Denmark, Finland, Germany, Greece, Hungary, Italy, Netherlands, Slovakia and UK. Regarding the electricity industry we have data on 17 countries covering the same period: Austria, Belgium, Cyprus, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Italy, Netherlands, Portugal, Slovakia, Slovenia, Spain and UK.

PRODUCTIVITY ANALYSIS

ECONOMICS RESEARCH CENTRE

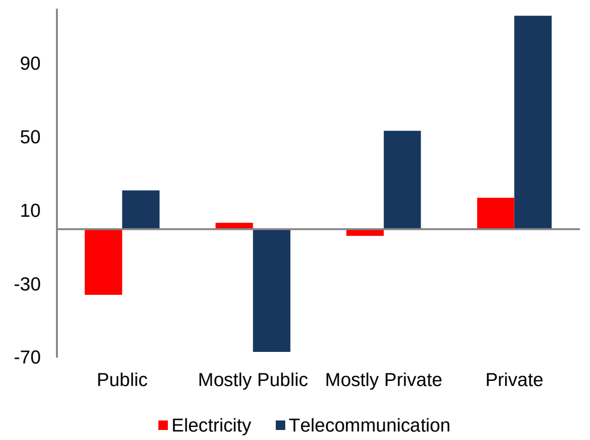
Issue 14/1

March 2014

Figure 6 reports the estimated effect of ownership on productivity, suggesting the following.

- Vast increases in productivity growth are seen in both the telecommunications and electricity sectors when moving from fully public to fully private ownership.
- As in competitiveness, the mostly public ownership regime in telecommunications is the worst in terms of productivity, outperformed even by the fully public regime.

Figure 6: Effect of ownership on productivity



4. Conclusion and Policy Implications

Privatisation of public utilities emerges as an attractive option for Cyprus, not only as a way to reform its underperforming economy but also as means to reduce excessive debt and satisfy the demands of its international lenders. In fact, legislation to privatise the three major public utilities (Electricity Authority of Cyprus, Cyprus Ports Authority and Cyprus Telecommunications Authority) has already been approved by Parliament, albeit amidst severe opposition from the left and centre-left parties by trade unions. The government is now expected to produce a privatisation plan that entertains apprehension about selling off government assets (and losing revenue from 'profits') and responds to concerns about the negative impact on the welfare of those working in public utilities.

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Issue 14/1

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Corporate and Productivity Analysis sector at CypERC

Director:	Prof. Panos Pashardes
Supervisor:	Prof. Theofanis Mamuneas
Research Officer:	Charalampos Karagiannakis
Research Associate:	Dr. Elena Ketteni

Economics Research Centre, University of Cyprus, P.O. box 20537, 1678 Nicosia, CYPRUS
Telephone: 22893660, Fax: 22895027, Website: www.erc.ucy.ac.cy, Email: erc@ucy.ac.cy