

## Public enterprises in Spain: historical cycles and privatizations

This paper presents an historical account of the public enterprise in Spain, focusing on the recovery of public enterprise in the 20th century, its consolidation following the Second World War and the large-scale privatizations in the last decade of the century. It shows that Spanish public business sector was among the smallest in Europe. At the same time, the public sector in Spain was very much manufacturing-inclined due to the frailty of its public financial enterprises. For that reason, the scale of privatization was smaller in Spain than in the rest of Europe. However, Spain's privatizations were carried out more efficiently and more rapidly than in other European Union countries. Finally, the paper shows that in Spain the privatized companies preserved their command of the market.

**Keywords:** public enterprise; nationalization; industrial policy; privatization.

### **Empresas públicas em Espanha: ciclos históricos e privatizações**

Este artigo apresenta a evolução histórica da empresa pública em Espanha, focando sobretudo o ressurgimento da empresa pública no século xx, a sua consolidação após a Segunda Guerra Mundial e o processo de privatização em larga escala na última década do século. Demonstra-se que no contexto europeu o sector público espanhol tinha um reduzido peso na economia. Em simultâneo, o sector público tinha uma forte orientação para a presença de empresas da indústria transformadora, devido à fragilidade das empresas financeiras estatais. Por isso, a escala da privatização em Espanha foi menor do que no resto da Europa. Contudo, as privatizações foram executadas com maior eficácia e rapidez do que nos outros países da União Europeia. Por último, o artigo demonstra que estas empresas, depois de privatizadas, mantiveram o seu domínio do mercado espanhol.

**Palavras-chave:** empresa pública; nacionalização; política industrial; privatização.

### INTRODUCTION

Between 1940 and 1980, there were few enemies of public enterprise among European politicians and economists. In the 1980s, in contrast, criticism of public enterprise was the predominant theme. Governments began to privatize these enterprises — although as a policy it did not become

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\* Facultad de Ciencias Económicas y Empresariales, Universidad de Alcalá, Pza. de la Victoria 3, 28802 Alcalá de Henares, Madrid, Spain. e-mail: francisco.comin@uah.es.

generalized until the 1990s — and economists highlighted their problems. The recent about-face in the appreciation of public enterprise is by no means the first of its kind. It is yet another manifestation of the historical cycles that mark the practice of governments and the ideas of economists in the field of public enterprise. Indeed, from a long-term viewpoint, the current enthusiasm for privatizing is but a pale reflection of the reaction that shook Europe, with the 19th-century revolutions, against the excessive expansion of royal manufactories and state interventionism during the preceding mercantilist period. The present movement in opposition to public enterprise has roots similar to that earlier one. Following the Second World War, European governments overused this instrument of economic policy, extending the bounds of its activity beyond what was technically advisable. Between 1945 and 1980 governments and corporate executives failed to look to the efficiency and profitability of public enterprises. To the contrary, they tied up their organization with administrative red tape and subordinated their management to political decisions. Consequently, the budgetary costs of public enterprises burdened by heavy losses became unacceptable for economies that were being forced to tighten their belts in order to meet European Union convergence requirements, and were facing fierce international competition fuelled by globalization. As in the 19th century, the loss of confidence in public enterprise, and the ensuing policy of privatizations, is now a consequence of two factors: on the one hand the losses sustained by public enterprises, which were becoming increasingly difficult to finance from national budgets, and on the other hand the spread of liberal thought hostile to state intervention in the economy. As in the earlier cycle, neither the European nationalizations of the post-War years nor those of the 1980s followed a common pattern. Nor did they follow any theoretical guidelines: on the contrary, such political processes involving public enterprises were the product of financial and budgetary decisions and the pragmatism of politicians, while ideological factors took a back seat.

This article presents an historical account of the behavior of public enterprises in Spain over the very long term. The goal is to portray the two cycles in the history of public enterprise: the first marked by the apogee of the royal factories in the 18th century and their decline in the 19th century; the second marked by the recovery of public enterprise in the 20th century and its consolidation following the Second World War, followed by large-scale privatizations in the last decade of the century. After describing the two cycles, the article focuses on the 20th century, particularly on the growth of the public sector after the Civil War, and on privatizations. The article is structured in the following way. The first section describes the historical phases of public enterprise, in order to place its behavior into an

historical context. The second examines the performance of the public enterprises comprising the *Instituto Nacional de Industria* (National Institute of Industry — INI), which were the most representative during the Franco regime. The third section analyzes public enterprise in the democratic period, which is divided into phases demarcated by the transition, the Spanish Socialist Workers' Party (PSOE) governments and the Popular Party (PP) governments. The article ends with a discussion that places the Spanish privatizations within the context of the European experiment.

#### PUBLIC ENTERPRISE IN CONTEMPORARY SPAIN

In this section we first examine the historical cycles of public enterprise in Spain, and then the forms of organization that characterized it in the various different periods.

#### HISTORICAL PHASES

In the history of public enterprise in Spain, we distinguish five separate phases paralleling those that took place in Europe<sup>1</sup>. The first phase came in the 18th century. This was an age of mercantilism, and the royal factories were used for a variety of purposes: to enhance the government's political prestige (tapestry and glass works); to administer the assets of the royal treasury (fiscal monopolies such as tobacco and salt, and the state mines); to secure strategic objectives (arms factories and arsenals); and to promote industrialization of the country (metal-working and textile factories). The royal factories were state-owned, sometimes with some participation by private capital. They were run by politicians having no economic training or knowledge of business. Their costs were high and the quality of their products poor. Products were sold to sheltered markets in the metropolitan country and in the colonies, to the court and to the army and navy. Losses were the general rule in the royal factories, and they survived only through royal subsidies. The enlightened governments of the late 18th century privatized some of these factories, meaning that their management was farmed out to private entrepreneurs.

The second phase came in the 19th century and was characterized by the waning importance of public enterprise. This was the result first of a shortage of treasury resources and of the wars that ravaged Spain from the late 18th century onwards, and secondly of the comprehensive privatizations of the royal manufactories, government monopolies (*estancos*) and national

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<sup>1</sup> See Comín and Díaz Fuentes (2004).

assets during the first half of the 19th century. In fact, liberal ideology and the needs of the Treasury prompted liberal governments to sell off public lands and forest, by way of the de-amortization of national assets such as the royal factories, and the deregulation of certain products until then subjected to monopoly by the Spanish state treasury. Those public manufactories that could not be sold were closed down. Nonetheless, the liberal policies pursued from the time of the first Carlist War — in the 1830s — included maintenance of some public enterprises and even the creation of other new ones for the purpose of administering some state properties and monopolies that remained in the public sector. The reasons for maintaining some public enterprises were: strategic, concerning defense (arsenals, arms and munitions factories); fiscal, aimed at increasing the state revenues (profitable public mines or fiscal monopolies such as tobacco); and budgetary, in order to provide some public services (public forest, mail and telegraph services)<sup>2</sup>.

The third phase runs from the end of the 19th century to the start of the Civil War (1936), when there was some timid resurgence of public enterprise in Spain as an instrument of nationalist and interventionist economic policy. However, it was still not fully accepted, as politicians and businessmen alike viewed entrepreneurial activity by the state with suspicion. These agents argued that public enterprises competed unfairly with private enterprise and that the state was a “bad businessman”. From 1874 to 1935, these antagonistic views restricted the expansion of public enterprise. They also led to farming out of the management of state properties and monopolies to private companies, whereby governments sought to promote private initiative. One example of this was the awarding of the state contract for ship construction for the Maritime Ministry to the *Sociedad Española de Construcción Naval*, under the Navy Reconstruction Act of 1908<sup>3</sup>.

The fourth phase takes in the Franco years (1939-1975) and the beginnings of democracy (1976-1982). This in turn breaks down into three sub-phases. The first was the post-war period, characterized by a policy of autarchy (1940-1949). The drive for industrialization and military consolidation of the early Franco years combined with the interventionist spirit of the post-war years to produce numerous public enterprises in the basic, military and public service industrial sectors. The symbol of the new concept of public enterprise was the *Instituto Nacional de Industria* (INI), which played a major role under the chairmanship of Suanzes (1941-1963). Another important development was the nationalization of some public services that had

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<sup>2</sup> See Comín (1991).

<sup>3</sup> For the CAT contract, see Comín and Martín Aceña (1999); for the SECN contract, see Lozano (1994).

been operated by private companies on a concession basis — for instance, the railway companies from which *Renfe* was created (1941) and the *Compañía Telefónica Nacional de España* (nationalized in 1945). During the post-war years, public enterprise — essentially the INI — was used openly as a fundamental instrument of the current autarchic and interventionist industrial policy. The justification offered by Suanzes for the interventionism of the INI companies was the inefficiency of private enterprise (industrial and financial) and its incapacity to fuel the industrialization of Spain, which was seen as essential for the achievement of greater military clout<sup>4</sup>. The second phase in the history of public enterprise under Franco (1964-1970) began with the First Development Plan and the removal of Suanzes from the INI in 1963. Thereafter, Franco's governments granted the leading role in industrialization to private enterprise, relegating public enterprise to a subsidiary role in which it could undertake only activities abandoned by private companies. The World Bank recommended that the INI be closed down, but Franco's governments merely relegated it, obliging it to renounce its original ambitious plans. Once the keystone of Spanish industrialization, the INI now became a "hospital for lame ducks", whose chief function was to take over bankrupt private companies. This company rescue function explains why the INI's loss of industrial leadership was accompanied by growth in its size from 1964 on. The third phase coincided with the end of Francoism starting in 1970 and the transition to democracy following Franco's death in 1975. From 1970 on, the INI's administrators strove to recover a greater say in industrial policy and to introduce business criteria in the management of its companies. This increase in activity was apparent not only in the INI but also in other public enterprises such as *Renfe* and *Telefónica*. Moreover, during the 1970s public enterprises were used — within a context of pacts for the transition to democracy and for the establishment of a welfare state — as a key instrument of industrial policy. There were fundamentally two objectives assigned to public enterprises: restructuring of industry and anti-cyclic activity to maintain employment. The public enterprises, and specifically those of the INI Group, acted in the opposite way to private companies. They had to invest large amounts of capital and increase their payroll costs, while private companies were letting workers go and freeing up capital in order to weather the crisis. The INI's strategy downgraded the quality of its portfolio as it continued to rescue private companies and invest in crisis-bound industrial sectors. It also aggravated its financial situation. To finance these ruinous investments it had to increase its borrowing,

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<sup>4</sup> For the INI, see Martín Aceña and Comín (1991), San Román (1999), Gómez Mendoza (2002) and Comín (2000 and 2001). For nationalizations of foreign companies during the period of autarchy, see Comín and Gálvez Muñoz (2003), and Gálvez Muñoz and Comín (2004).

as the only shareholder — the state — would not grant it a capital increase. The cost of this added borrowing exceeded the financial returns of the public enterprises, thus generating negative leverage. Hence, to the problems of inefficiency inherited from the Franco years were added these imbalances from the transition period, placing the public enterprises into an alarming position<sup>5</sup>.

Finally, the fifth phase in the historical evolution of public enterprise in Spain began with the accession to power of the Socialists in 1983, at which time they embarked on a process of industrial restructuring and rehabilitation of public enterprise. In order to halt the deterioration and improve results, the public business sector was reorganized. The aim was to retain public enterprises only in those sectors where their activity made sense and there was some prospect of future survival. At the same time, solutions were sought to the problem of excessive financial costs. With these ends in view, privatization of public enterprises got under way in the mid-1980s, for reasons of industrial policy (*Seat, Enasa*), and, in the financial sphere, to secure resources by placing minority share packages of profitable public enterprises (*Endesa, Repsol, Argentaria*) on the stock market. The importance attached to rehabilitation of the public sector was partly an imposition deriving from accession to the European Community, and it forced the government to reorient the administration of public enterprise. Under the policy of industrial restructuring, rehabilitation of the INI Group began in 1983, and its enterprises were restructured, meaning privatization and the closure of companies that either were not strategic for the group or lacked future viability<sup>6</sup>. Beginning in 1996, the Popular Party took this privatization policy further, as we shall see below.

#### FORMS OF ORGANIZATION: FROM MINISTERIAL BODIES TO JOINT-STOCK COMPANIES

These historical cycles also saw transformations in the organization and management of public enterprises, most importantly the following. Initially, these enterprises and organizations were affiliated with ministries. They had no independent legal personality, their activities were subject to the laws governing public organization and accounting, and they were legally and financially dependent on the State Treasury. Their activity was therefore governed by the strict bureaucratic and accounting rules of the Public Administration. In the 19th century this was the situation of bodies like the Post and Telegraph Office, the Directorate-General of Public Forests, the Directorate-

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<sup>5</sup> See Martín Aceña and Comín (1991), Comín and Martín Aceña (1999) and Comín, Martín Aceña, Muñoz and Vidal (1998).

<sup>6</sup> For the history of the INI, see Martín Aceña and Comín (1991); for *Renfe*, see Muñoz Rubio (1995) and Comín, Martín Aceña, Muñoz and Vidal (1998); for *Telefónica*, see Isidro (1994).

General of Public Works and the Directorate of Mines and Monopoly Revenues, which administered the state's properties and monopolies. The Directorate-General of State Assets was the body that administered public and other service enterprises, in practice constituting a large holding company with the form of a ministerial department. The 20th century saw the emergence of autonomous bodies. These were wholly owned by the state and possessed their own legal personality, but their activities were excluded from the state budget. These features afforded them greater independence and flexibility of management without excluding the possibility of finance from state resources. These included the Autonomous Boards (*Cajas Especiales*), Port Works Boards (*Juntas de Obras de Puertos*), and Canal and Reservoir Boards (*Juntas de Canales y Pantanos*). Such autonomous bodies proliferated under the Franco regime, and one of the most important was the *Instituto Nacional de Industria*. Finally, with the creation of the INI and the nationalizations of the early Franco years, State companies were set up. There were two types: On the one hand were the joint-stock companies controlled by the government, as majority shareholder, either because the public administrations held a majority of the capital or because they were controlled through state contracts for the provision of public services. On the other hand there were public entities whose operations, although they were not joint-stock companies but public-law entities, were governed by mercantile law<sup>7</sup>.

For a very remote precursor of state companies we may look to the royal factories, which were a general feature of 18th century Spain. However, public enterprises in the modern sense (that is, in the form of joint-stock companies) did not develop until after the Civil War, following the creation of the INI in 1941. The INI was a holding company having the form of an autonomous body but whose component enterprises were joint-stock companies. Later, in 1980, with democracy well established, another large holding company was split off from the INI. This was the *Instituto Nacional de Hidrocarburos* (INH), which was given the legal form of a public entity, while its component enterprises were state companies, including the subholding company *Repsol*. Later on, *Teneo* was detached from the INI with the profitable enterprises, leaving the INI with only the loss-makers. In 1995 the *Sociedad Estatal de Participaciones Industriales* (SEPI) was created as a holding company for the stocks of *Teneo* and *Repsol*, both in turn holding companies controlling profitable enterprises; meanwhile, the INI's unprofitable enterprises were handed over to the *Agencia Industrial del Estado* (AIE), a body dependent on the Ministry of Industry. Finally, in 1996 the AIE was absorbed by the *Sociedad Estatal de Participaciones Industriales* (SEPI), so that all the public industrial enterprises belonged once again to a single body, as was the case of the INI up to 1980. Lumped in together with

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<sup>7</sup> See Comín (1996).



the public industrial enterprises were those that had traditionally been controlled by the Finance Ministry's Department of Assets. In the 1990s these companies, including *Tabacalera*, *Telefónica* and *Argentaria*, were brought together under the umbrella of the *Sociedad Estatal de Participaciones Accionariales* (SEPA). The SEPI soon became affiliated with the Ministry of Finance, under whose control the principal State enterprises were once again brought together.

#### THE HISTORICAL SURVIVAL OF THE *INSTITUTO NACIONAL DE INDUSTRIA*

The *Instituto Nacional de Industria* was a key part of the plans laid down after the Civil War for industrialization in a context of authoritarianism and autarchy<sup>8</sup>. Nonetheless, the INI survived the end of autarchy following the Stabilization Plan of 1959. Once a symbol of the Franco regime, the INI also survived after Franco's death in 1975. Indeed, the INI became an essential instrument of industrial policy under democracy, during the governments of the Union of the Democratic Center and the Socialist Party. It was only with the coming to power of the Popular Party in 1996 that the dismantling of the Public Business Sector in Spain began. In other words, the INI was able to adapt to changing political circumstances. It was a versatile instrument, used by mutually incompatible political regimes for highly disparate, and in some cases contradictory, purposes. Moreover, the INI was also subject to pressures from the various political, business and union groups, as well as from regional and local interests. But despite all of that, the INI Group retained the sectoral specialization that it had built up since its creation in 1941. The reason for this was that the first enterprises created by the INI were those that attracted most investment and determined its business and industrial strategy right up until its disappearance<sup>9</sup>. The experience of the INI enterprises is representative of the public enterprises controlled by the Ministry of Finance's Directorate-General of Assets.

#### THE OBJECTIVES OF THE PUBLIC ENTERPRISES

Before founding the INI, Franco's government attempted to support private initiative by means of industrial laws promulgated in 1939, which followed the strategy laid down in the laws of 1917 and 1924 for the promotion of national industry. It was not until the end of 1941 that the Franco authorities resolved to create the INI as a "public enterprise" to

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<sup>8</sup> The study of other public enterprises bears out the conclusions of the study of the INI Group (see Comín, Martín Aceña, Muñoz and Vidal, 1998, and Comín and Martín Aceña, 1999).

<sup>9</sup> See Martín Aceña and Comín (1991).



substitute for and supplement private initiative. The model it was copied from was the Italian *Istituto per la Ricostruzione Industriale* (IRI) of 1937. The actions of the INI are explained by the fact that it was the fundamental instrument of the autarchic and interventionist industrialization strategy of the Franco regime. In the circumstances of the time, public enterprises were essential, as private enterprise was not prepared to invest in the basic sectors, essentially because of the political uncertainty prevailing until the United States came out in support of Franco following the outbreak of the Cold War. However, it was also a reaction to the arbitrary decisions of politicians, enforced by means of intense interventionism and price control. Economic nationalism and protection from the exterior during the 1940s prevented the importation of inputs and capital. The scarcity of certain intermediate inputs, energy resources and capital goods placed a stranglehold on industrialization, which was the key goal of the Franco regime, seeking to increase its military strength. During the autarchy, the INI was given priority to secure sufficient supplies of these inputs and of the currencies and licenses necessary for their importation<sup>10</sup>. The abandonment of the policy of autarchy in 1959 had a profound effect on the INI. Financing from the Treasury came to an end, and its enterprises were relegated as the spotlight moved on to private enterprises. From that point on, economic policy was characterized by openness to the exterior. After the First Development Plan of 1964, indicative planning became the watchword, with multifarious subsidies, tax exemptions and privileged financing for private companies. The application of the principle of subsidiarity to public enterprise deprived the INI of its leading role in industry. It became a mere financial intermediary whose function was to secure funding for its enterprises, while these gained autonomy of management due to the loss of power of the INI's chairman. For the technocratic governments of the period 1960-1975, the INI was clearly an instrument at the service of private initiative. In its reports of 1962 and 1972 the World Bank recommended the gradual closure of the INI, criticizing its excessive interventionism, the privileges enjoyed by its enterprises and the unnecessary public intrusion in industrial sectors. However, these recommendations went unheeded by Franco's governments, which held on to the INI.

The INI recovered some of its prominence toward the end of the dictatorship, starting in the early 1970s, with the last of the Franco governments, at which time it adapted to the new political and economic circumstances. Subsidiarity was superseded by more aggressive goals for public enterprises, such as the provision of public services and production in activities of national interest not catered to by private enterprise (basic industries, strategic sectors, national defense industry, development of technol-

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<sup>10</sup> For the INI's initial actions, see Martín Aceña and Comín (1991), San Román (1999), Gómez Mendoza (2000) and Comín (2001).

ogy, fostering of regional development, promotion of exports). The INI was also assigned the function of eliminating sectoral bottlenecks and assuring competition where markets were imperfect, supplementing and competing with private companies. It was also given the task of acting as an anti-cyclic agent to drive the productive restructuring of sectors in crisis. Later, during the transition to democracy, the UCD governments used the INI to maintain employment and redistribute income as part of the Moncloa Pacts<sup>11</sup>. In addition, in the 1980s the public enterprises were a decisive factor in the policy of industrial restructuring undertaken by the PSOE governments. The transfer of the oil and gas companies to the *Instituto Nacional de Hidrocarburos* (INH) in 1980, the string of privatizations initiated in 1984, and the creation of *Teneo* in 1992, all undermined the soundness of the INI as a holding company, so that it shrank in size and lost ground in the basic sectors. The INI formally disappeared in 1995.

The most outstanding sectors and enterprises in the industrial intervention of the INI were the following. In electricity production, the INI helped to reduce the shortage of electrical power by expanding generation. Its activities met with resistance from the private electric companies, organized in an oligopoly, which complained of the advantages enjoyed by the INI companies. The latter were eventually merged to form the *Endesa* Group, which was among the most profitable and productive groups in the country both before and after privatization. A major development in the hydrocarbon (oil and gas) sector was the creation of *Repsol* by the INI. *Repsol* also increased petrochemical production. *Repesa* and *Encaso* (which possessed two refineries) were merged to create *Enpetrol*, which later became the *Instituto Nacional de Hidrocarburos* and was finally named *Repsol* before being privatized. As a public holding company, *Repsol* was every bit as profitable and efficient as the private companies in the sector. In the steel and metal sector, the INI created the company *Ensidesa*, which increased steel production. It also created *Endasa* (later called *Inespal*), an enterprise that was instrumental in developing the aluminum industry, which until then had been practically non-existent in Spain. In vehicle building, the INI created SEAT (cars) and *Enasa* (trucks), both of which were leaders of their respective sectors for many years. In the road transport vehicles sector, the INI promoted market expansion, and in the 1950s began to compete with other private producers operating in Spain. The process of globalization and the opening up of the Spanish economy to the outside world forced the sale of both enterprises (SEAT and *Enasa*) to multinational companies, as they lacked either the technology of their own or the commercial networks with which to compete internationally. The same occurred in other key industries, such as paper

pulp (*Ence*), fertilizers (*Enfersa*) and the food industry (*Endiasa*). Finally, the INI was also a basic mover in transport services, as seen in the cases of Iberia (air transport) and *Elcano* (maritime transport)<sup>12</sup>.

If only as a reminder, we should note that in addition to these industrial enterprises controlled by the INI, there were public enterprises controlled by the Ministry of Finance, such as official and public banks, which were eventually merged to form *Argentaria*; the fiscal monopolies, especially *Tabacalera*, the Lotteries, *Telefónica* and *Transmediterránea*, and enterprises controlled by the Ministry of Public Works and Transport, such as *Renfe* and the Post Office. Despite the considerable size of the public business sector in Spain in absolute terms, its relative size in terms of macroeconomic variables was far below that of the European average, as Table 1 shows. In general, the public business sectors (PBS) of the democracies were larger than those of the European dictatorships (Spain, Greece and Portugal). If we look only at the final columns, in the summary quotient (mean of the three indicators: non-agrarian employment, GFCF and GAV), we find that before privatizations commenced in the United Kingdom, Spain was the country with the smallest PBS (only 7.7 % in 1963 and 9.2 % in 1975), behind even Belgium (a country traditionally characterized by a small PBS) and far behind France, Italy and the United Kingdom. It cannot therefore be said that Spanish democracy inherited a large PBS from the Franco regime, and yet the problems that it faced in the 1970s were similar to, if not as great as, those suffered by public enterprises in other European countries, as we shall see below.

**Size of public enterprises**  
(assessment of the INI's performance: successes and errors)

[TABLE 1]

	1963			1975			1998			1963	1975	1991	1998
	NAE	GFCF	GAV	NAE	GFCF	GAV	NAE	GFCF	GAV	Mean of the three indicators*			
Germany ..	8.1	18.1	–	10.6	15.2	10.1	9.0	14.0	9.9	13.1	12.0	11.1	10.9
Belgium ..	7.6	10.5	–	7.0	32.3	14.0	10.4	10.9	11.3	9.1	17.8	11.0	10.9
France . . .	13.1	26.4	–	11.5	27.8	12.8	10.3	13.5	11.5	19.8	17.4	17.6	11.8
Italy . . . .	11.6	28.0	–	23.7	47.4	24.3	7.7	11.0	10.0	19.8	31.8	18.9	9.6
UK . . . . .	–	–	–	8.1	25.7	11.3	2.5	2.5	1.9	–	15.0	4.4	2.3
Spain . . . .	4.4	14.5	4.3	5.4	16.3	5.9	5.0	5.0	3.3	7.7	9.2	9.0	4.1

\* NAE = non-agrarian employment; GFCF = gross fixed capital formation; GAV = gross added value.

Source: Tafunell (2005), p. 726.

<sup>12</sup> See Martín Aceña and Comín (1991); for the INI's action in mining and steel, see Sudrià (1992) and Fraile (1992).

Despite the positive role played by some of the INI's initiatives, the history of this institution is marked by a number of blunders. Some were the outcome of decisions taken by the holding company's executives, and others of political and social pressures on the government, which in the event forced some seriously poor decisions on the INI. The policy of autarchy implemented by the Franco governments from 1941 to 1959 forced through a number of industrial projects that were not economically viable. However, the amount that the INI invested in the most mis-directed of such projects — which did not outlive autarchy — was small. These were attempts to achieve technological self-sufficiency and produce in isolation from international competition. The most noteworthy of these were: extraction of oil from slate and bituminous rock (*Encaso*); manufacture of scrap steel with iron nodules, utilizing minerals with low metal content; production of synthetic fibers using cereal straw (*Fefasa*); production of paper pulp from sugar-making *by-products*.

After 1963, following the INI's abandonment of autarchic objectives through the removal of Suanzes from the chairmanship, ruinous projects tended to be the result of political mandates, to which the public enterprises were bound. In this vein, the INI was forced to rescue bankrupt private companies, taking over losses and liabilities for which their private owners and managers were responsible. The INI was forced to tie up large amounts of resources in such business rescue operations, and the firms thus taken over placed a heavy burden on the INI Group's business strategy, requiring ever more subsidies to cover their burgeoning losses. The most outstanding examples of this were coal mining (*Hunosa* and *Encasur*), shipbuilding (*Aesa* and *Astano*), steel (AHM and AHV), aluminum (*Alumina* and *Alugasa*) and machinery and capital goods (*Ateinsa*, MTM, FSC). There were also operations of this kind in such disparate sectors as food, textiles and chemicals. The INI managed to re-float most of the companies cast off by private enterprise, and once rehabilitated, these companies were reprivatized. The costs to the Treasury of these rescues, rehabilitations and privatization operations were huge.

Some of the shortcomings in the performance of the INI Group were the result of the industrialization strategies pursued by Spanish governments, ignoring the market and international competition. To the extent that the INI was a prime instrument of these economic policies, it must shoulder responsibility for the inefficiencies that were generated. By operating in reserved and controlled markets, it was complicit in the loss of general welfare that that policy produced. The success of the INI's larger enterprises in boosting national production and consolidating existing industrial sectors during the Franco regime was due to the protection of the state in the form of import

quotas and tariffs, subsidies and tax exemptions. Indeed, these public enterprises controlled by the INI grew during the Franco years thanks to protection from outside competition. This limited their efficiency and their ability to compete, but the same was true of private companies and Spanish or multinational capital, since these also operated in a market shielded from the exterior. In addition, the public administration was generous with subsidies and aids of all kinds, to both public and private enterprises. Some INI companies ran into difficulties in the years starting in 1973 as the sectors concerned went into recession, but the private companies in the same sectors encountered exactly the same difficulties. As we have just seen, some of the private companies in coal mining, steel making and shipbuilding, for instance, were nationalized by the state, which handed them over to the INI to prevent them from failing.

Following the advent of democracy with the elections of 1977, protectionism was abandoned and a new economic policy was inaugurated, consisting of opening up to the exterior, reduction of state intervention and exposure of enterprises to the market. This policy forced the INI's enterprises to adapt to the new circumstances. Thereafter, the INI enterprises helped reduce the inefficiencies in the Spanish economy by striving for efficiency and profitability and cooperating in industrial restructuring. However, there were some INI enterprises that hung on to their privileges, thus hindering the modernization of the country's productive apparatus and constituting a burden on the Treasury.

There have been a variety of approaches to evaluating the INI. One is to ask whether it was inevitable. Obviously, contrary to what the Franco authorities claimed, the INI was not inevitable, inasmuch as its ends could have been achieved via other instruments of economic policy. However, once the Franco regime had opted for a policy of autarchy, the INI served a number of purposes, consisting essentially of increasing the output of certain products and services in which there was a severe shortage. This goal was reached without paying the slightest heed to production costs and the opportunity costs of the resources used by the INI enterprises<sup>13</sup>. It is by no means the case that without a dictatorship those resources controlled by the INI would have been handed over to private enterprise<sup>14</sup>. The opposite could well have occurred, for governments elsewhere in democratic Europe in fact nationalized more private companies and more sectors than was the case in Spain. Hence, the most visible difference lay in the fact that public enterprises grew larger in democratic Europe than in the Iberian dictatorships. In fact the two countries with the smallest public sectors were

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<sup>13</sup> See Comín and Martín Aceña (1991).

<sup>14</sup> As Gómez Mendoza (2000) suggests.

Spain and Portugal, because their approach to economic policy was initially modeled on that of the fascist governments of the 1930s. In a democratic situation, then, a Spanish government would not have handed over control of public enterprises to private companies; on the contrary, it would have nationalized more sectors, created more public enterprises and endowed them with more resources. Starting in the 1930s, and especially following the Second World War, public enterprise was the fashion in Europe. Theorists and politicians were in favor of nationalizing certain sectors and creating public companies to achieve a variety of objectives, among them the rescue of private companies in difficulties. These aspects are not generally taken into consideration when evaluating the performance of the INI and of Suanzes. On the contrary, economists see through the filter of the dominant ideological viewpoint of the 21st century, in which the winds of the currently predominant school of political thought in the world blow in favor of privatizing public enterprises. In the 1940s, 1950s and 1970s, however, the situation in the European democracies was very different. Public enterprise was preferred to private enterprise in some sectors, for economic, political and social reasons. The hypothetical alternative to the dictatorship and the INI would not have been “dictatorship and private enterprise” but democracy and more public enterprise. In such conditions the Spanish economy would assuredly have grown more.

To give an overall assessment of the performance of the INI enterprises is no easy task. However, in the context of the duration of the policy of autarchy until 1959 and of the Franco regime until 1975, it is fair to say that the INI contributed to Spanish industrialization. This was mainly because the output of its enterprises was essential in basic industries such as energy, steel, metal, construction of transport materials and chemicals, and in services such as air and maritime transport. The INI enterprises supplied the private companies operating in Spain at subsidized prices, which entailed losses for the INI enterprises since they did not cover production costs. Thus, the public enterprises eased some of the sectoral bottlenecks strangling growth in the 1950s. It was then that the INI’s principal industrial projects matured, and their contribution to the national investment in fixed assets was appreciable. The INI was a major player in the policy of import substitution pursued by Franco’s governments in the 1950s. In the 1960s and 1970s, although no longer a leading element in industrial policy, the INI did maintain an active presence in strategic sectors and even diversified its activities. The INI Group continued to register a high rate of investment and fostered some of the more prominent developments in the concentration and restructuring of enterprises and sectors, helping to increase the size of Spanish companies and their activity abroad. If one examines the large Spanish-owned companies currently operating in the industrial and services sectors, one finds that most are former

public enterprises — spun off from the INI or Directorate-General of State Assets — which were later privatized. We might posit the following counterfactual hypothesis: what would have happened had there been no such State entrepreneurial action? The answer is that there would probably not now be any large companies with private Spanish capital, such as *Telefónica*, *Repsol*, *Endesa*, *Iberia*, *Aceralia* and many others<sup>15</sup>.

#### THE PROBLEMS OF PUBLIC ENTERPRISES IN SPAIN

A study of the INI's enterprises throws light on the shortcomings of public enterprises in Spain. There were five distinct problems.

The first problem stems from political interference, of which there were two types. The first type arose when the minister of Industry was changed, and this in turn entailed the replacement of the chairman of the INI. With the INI's presidentialist style, this also meant new appointments to executive positions at the INI and in the enterprises. Such political interference produced an excessive turnover of executives, thus hindering the professionalization of management. However, there were exceptions to the precariousness of tenure of the chairmen of public enterprises. Suanzes and Planell both held positions of responsibility in the Ministry of Industry and in the INI for two decades. The chairmanship of Boada marked a change of direction in the management of the INI between 1970 and 1973. There was also a notable continuity of executive personnel and criteria during the governments of the PSOE (1983-1996) and the Popular Party (1996-2004). The second type of political interference was when the government laid down objectives for the INI's enterprises. In this way they were forced to perform social and political functions foreign to the mercantile nature of public enterprises. The INI was created with a wide-ranging mandate and a capacity to cover many angles, and with the passage of time it was allocated new briefs to add to those it already had. The broad spectrum of its goals was a consequence of the variety of groups that used the INI to further their own interests: unions, employers, regions, political parties, its own executives, and, of course, the government and the administration. The goals assigned by various governments to the INI were excessive and changed over time: (1) to achieve autarchic industrialization of the country; (2) to contribute to the saving of foreign currencies; (3) to correct market defects; (4) to stand in for private initiative; (5) to stave off foreign economic colonization; (6) to reduce regional economic differences; (7) to supply strategic raw materials and inputs; (8) to contribute to the national defense by creating and maintaining defense industries and industries of national interest; (9) to foster scientific research and technological development;

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<sup>15</sup> See Comín (2001).



(10) to contribute to the redistribution of income and wealth; (11) to maintain employment levels; (12) to defend and stimulate competition; (13) to operate in new sectors; (14) to act as a company hospital, rescuing private companies in difficulties; and (15) to assist in the restructuring and reindustrialization of the country<sup>16</sup>. To accomplish all these goals at once was not only impossible but their pursuit was also counter-productive in that it detracted from the efficiency of INI's operations, complicated its administration and confused its senior managers. In 1985, for the first time those in charge of the INI insisted that its sole objective should be to achieve profitability.

The second problem arose from the kind of management difficulties that affect all large corporations, public and private. The shortcomings of the management of the INI Group were not remedied in time. Relations between the INI and its enterprises were not coordinated because there was no organizational structure suited to the needs of a corporation of its size. Until the 1980s, the INI lacked an integrated corporate planning and management control system embracing all the group's companies, which would serve to convey industrial policy objectives and check that they were being fulfilled by the enterprises. Initially, the enterprises lacked sufficient autonomy to be able to react to market conditions. In the Suanzes period (1941-1963), inflexibility in the management of public enterprises — which confined themselves to carrying out the decisions dictated by the INI — placed them at a clear disadvantage *vis-à-vis* private companies. After the departure of Suanzes, the ensuing reaction went to the opposite extreme. The INI's enterprises were mature by then and their executives acted independently of the INI. At the beginning of the 1970s the actions of the big public enterprises depended more on direct decisions of the government than on the INI. The enterprises' autonomy turned the holding company into a passive observer of actions that were determined by direct negotiations between the enterprises and the Ministry of Industry.

The INI's third problem was financial and arose immediately because its majority shareholder — the state — never contributed enough capital. Scarce financial resources were a permanent constraint on the operations of INI enterprises. When the government restricted its capital contributions, the group was forced to cut back its operations. It also had to resort to outside financing, thus depleting its asset position as the outside resources were far greater than its own capital. Then again, when the state made abundant budget allocations to the INI for new investments (largely in the 1950s) or to cover losses (in the transition to democracy, from 1976-1983) — it created inflationary tensions.

The fourth problem was the INI's structural imbalances, which reduced the return on its investments and eventually generated losses in most of the group's enterprises. There were a variety of factors influencing these losses: (1) frequent operations to rescue bankrupt private companies, which continued to generate losses after nationalization; (2) goals of distributive policy and maintenance of employment imposed by the government; (3) operations in strategic sectors, precisely because their low profitability and the high capital input required was a deterrent to the entry of private enterprise; and (4) the need to secure outside resources to finance barely-profitable investments, which produced the effect of negative leverage. In such circumstances, it would have been astonishing had the INI turned a profit. Then there were a number of important questions that remained un-addressed for a long time: (a) whether public enterprises were the best instrument to perform certain functions; and (b) whether the losses of the public enterprises ought to be absorbed by the group or by the state, which in the final analysis imposed its own industrial policy<sup>17</sup>. But, as we have already noted, the losses and low returns of the INI's enterprises were also the product of poor management and ill-conceived investment.

Indeed, the fifth problem was precisely that the business administration of the INI had very serious shortcomings. Until the 1970s, the management of public enterprises was concerned solely with increasing production and dealing with technical matters, giving no thought to the opportunity cost of the resources these actions utilized. Many of the INI's industrial adventures were launched with absolutely no consideration for the return on investment; moreover, the absence of a competitive environment and the certainty — these being public companies — that their losses would not lead to bankruptcy or to the replacement of their senior executives prompted a number of investments whose rationality was open to doubt. As we have seen, the INI undertook investments in sectors that were at a clear comparative disadvantage, so that as soon as the protection shielding the Spanish economy from the exterior relaxed, companies began to mark up losses. The INI group even ventured into industries where public intervention was very hard to justify<sup>18</sup>.

#### PUBLIC ENTERPRISE UNDER DEMOCRACY

When the dictator Franco died, there were numerous public enterprises in Spain, and these absorbed abundant subsidies from the State Treasury. This

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<sup>17</sup> In fact in 1982-1983 the state took over debts totalling 423,600 million *pesetas* from the public enterprises.

<sup>18</sup> See Martín Aceña and Comín (1991) and Comín (1996).

was true of the enterprises controlled by both the INI and the Directorate-General of Assets. Both were beset by similar problems. The enterprises controlled by the INI, an organization dependent on the Ministry of Industry, were basically industrial, whereas those of the DG of Assets were enterprises that provided public services or administered state properties and monopolies<sup>19</sup>.

During the transition to democracy in Spain, between 1976 and 1983, the situation of the public enterprises inherited from the Franco years deteriorated still further. The losses of public enterprises swelled. The governments of the Union of the Democratic Center could do nothing to solve the problems of public enterprise. With the accession of the Socialist Party to power in 1983, a start was made on rehabilitation, restructuring, improvement of results and privatization of public enterprise. Beginning in 1985 we can distinguish two separate phases, coinciding with the governments first of the Socialist Party and then of the Popular Party. The first, from 1985 to 1995, was characterized by rehabilitation and partial privatizations by socialist governments, euphemistically referred to as “disinvestments”. The second stage of privatization began with the accession of the Popular Party to power, and this stage saw a series of total privatizations of public enterprises. Let us look briefly at these two stages, bearing in mind that these total privatizations by the Popular Party government would have been unviable without the prior rehabilitation and privatizations carried out by the Socialist governments.

#### REORGANIZATION AND STATE “DISINVESTMENTS” (1983-1995)

The accession of the Socialists to power in 1983 marked the start of a new public enterprise policy in Spain, which was consolidated following Spain’s accession to the EEC in January 1986. The first Socialist governments improved the management of the INI and DG Assets enterprises like *Telefónica*, *Tabacalera* and *Renfe*. Moreover, with entry in the European Union, the Spanish public enterprises were forced to adapt to Community rules on deregulation, de-monopolization and defense of competition. This meant that some public enterprises had to deal with traditional problems: on the one hand the public monopolies (such as *Campsa*, *Tabacalera*, *Telefónica*, *Iberia*, *Renfe*, and the Post Office) had to liberalize; and on the other hand sectors that had been receiving substantial operating subsidies (for example *Hunosa* and the entire steel industry) ceased to receive them.

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<sup>19</sup> For *Tabacalera* and *Renfe*, see Comín and Martín Aceña (1999) and Comín, Martín Aceña, Muñoz and Vidal (1998).

In 1985 the Socialist governments began to sell off enterprises, or part of their capital, to solve industrial and financial difficulties. The Socialists were not against public enterprise, but entry in the EEC meant that public companies could no longer receive government subsidies. Only profitable enterprises would be able to carry on. Privatization was thus perceived as the only way of saving those enterprises that were in trouble. The privatizations followed no systematic plan, but proceeded on a case-by-case basis, responding to specific problems in each productive sector. Also, the privatizations were not directed by the government, but by the public holding companies or the enterprises themselves. This lack of coordination gave rise to contradictory operations<sup>20</sup>.

The primary purposes of the Socialist privatizations were, then, restructuring of industry and rehabilitation of the public enterprises. The aims were: (1) to make the public business sector profitable by selling off (privatizing) or closing down those enterprises that were not "going concerns" (*Hytasa*, *Intelhorce*, Potasas de Navarra); (2) to dispose of companies that were of no strategic interest for public enterprise policy (Textil Tarazona, *Marsans*, *Entursa*); (3) to assure the viability of public enterprises that otherwise had no future (because they were too small or lacked technology or commercial networks) by selling them off in their entirety to multinational companies (*Secoinsa*, SKF, SEAT, *Enasa*); and (4) to contribute to the reindustrialization policy by promoting business concentration (*Enfersa*, *Inisel*). Generally speaking, these were total privatizations in which the entire capital of the enterprise was sold to the private sector. As they were loss-makers, they had to be disposed of at a negative price: that is, either rehabilitating them beforehand with large government cash inputs or granting government subsidies to the company after privatization. In the period 1985-1994, the INI earned 305 billion *pesetas* from the sale of public enterprises, but it had to lay out 381 billion on their prior rehabilitation. In a word, the income from these privatizations was negative. In the INI's total privatizations, companies from the IT, motor and rolling-stock building sectors were sold off. In 1985 *Secoinsa* was sold to CTNE, then to Fujitsu; in 1986 SEAT was sold to Volkswagen; in 1989 MTM and *Ateinsa* were sold to GEC-Alsthom, *Enfersa* to *Ercros*, *Oesa* to Grupo Ferruzzi and *Enasa* to Fiat. In 1989, *Intelhorce*, *Hytasa* and *Imepiel*, belonging to DG Assets, were also sold, for a symbolic price and with large subsidies. In total privatizations of large public companies, the purchasers were almost always foreign concerns.

The second objective of the Socialist privatizations was financial, with the aim of: (1) reducing the burden that subsidies to loss-making enterprises

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<sup>20</sup> See Comín, Martín Aceña and Jiménez (1992), Jiménez (1994), De la Dehesa (1992) and Montoro (1991).

placed on the Treasury; (2) securing finance for public enterprises (for new investment and to offset the losses of other public enterprises; and (3) financing of the budget deficit. This sale of shares was also intended to introduce stricter external discipline and control, through floating on the stock market and the enlistment of private stockholders. Nonetheless, until 1996 the public holding companies retained control of the capital of their profitable enterprises. These privatizations were therefore partial, in that only a minority of the share capital was sold. Prominent instances were the sale on the stock market of share packages in INI Group companies (*Gesa*, *Endesa*, *Ence*) and in *Repsol* and *Argentaria*. The first such operation went ahead in 1986, with the sale of 38 percent of the capital of *Gesa*. There was a drawback to these so-called “disinvestments” in that the state retained business control, thus deterring potential buyers who were reluctant to become sleeping partners of a public organization.

At the close of the Socialist period, starting in 1994, a “plan for the rationalization and modernization of the public business sector”, proposed by the Ministry of Industry, was approved. The strategy adopted was the French one of “hard cores of shareholders”. Facilities were provided for domestic partners to acquire stakes in public enterprises and thus prevent them from falling into the hands of multinationals. Additionally, in the budget the Ministry of Economy and Finance proposed a privatization plan to reduce the deficit and meet the conditions for convergence with Europe, in which the paramount goal was to generate revenue. By means of this privatization the Ministry of Economy planned to make a billion *pesetas* in the years 1995 and 1996. Following the privatization of part of the capital of *Argentaria* in 1994, in April 1995 15 percent of *Repsol* was sold in the first of a new wave of privatizations. In March 1995 an Act was passed regulating “the legal situation in the event of disposal of public stakes in certain enterprises” (in which the State retained a holding in excess of 25 percent), in order to protect “the public interest” in those enterprises. In this “privatization act”, the retention of a golden share to assure public control was regulated for the first time.

In order to facilitate the privatization of profitable enterprises, in June 1995 the minister of Industry created the *Sociedad Estatal de Participaciones Industriales* (SEPI), a holding company to control the shares of *Teneo* and *Repsol* (i.e., the profitable enterprises), which would take over the debt of the INI, calculated at 700 billion *pesetas*. Also, a state industrial agency was set up to handle the INI’s loss-making enterprises (i.e., ship-building, the CSI, mining companies — basically *Hunosa* — and the defense industry — Santa Bárbara) and supervise their relations with the Treasury, but without powers of management. Thus, the INI and the INH both disappeared on 20 June 1995, when the Official State Gazette published a Royal Decree-Law approving that proposal.

The upshot of the privatizations carried out by the Spanish Socialist Workers' Party (PSOE) was that the public business sector was downsized, it was rehabilitated to a considerable extent, and revenue from privatizations increased. With all these privatizations, between 1985 and 1993 the overall weight of public enterprise was reduced from 12 to 7 percent of the aggregate value of the economy<sup>21</sup>. Between 1985 and 1994 the number of sectors in which the INI-*Teneo* group (which accounted for 90 percent of the industrial public sector) was a basic element fell from 12 to 5; the number of enterprises in the group fell from 65 to 42, and the workforce was reduced from 262,000 to 130,000. The revenue from privatizations between 1985 and March 1994 totaled a billion *pesetas*. To determine the net revenue, one has to deduct everything that the state spent on rehabilitating the public enterprises before selling them<sup>22</sup>.

#### THE TOTAL PRIVATIZATION CARRIED OUT BY THE POPULAR PARTY

With the accession of the PP to power in 1996, the drive to privatize intensified and would become total and general. For the first time in the entire 20th century, a government spoke openly in Spain of getting rid of all public enterprises. Thus, the historical inertia that had made the INI's survival possible was broken<sup>23</sup>. For the purposes of coordinating the process, all the public industrial enterprises, including those controlled by the AIE, were merged into the *Sociedad Estatal de Participaciones Industriales* or State Industrial Holding Company. Other changes included the following: (1) privatization policy was coordinated and approved by the cabinet, that is, the full government; (2) privatizations were administered by the public holding companies; (3) privatizations were governed by principles of transparency, publicity and competition, to ensure which a Privatization Advisory Board (*Consejo Consultivo de Privatizaciones*) was created; and (4) a deadline was set for total privatization by 2001. Exceptions to these total sales were coal mining and some public service enterprises, such as the railways, television and post. After 1996 the main object of privatizations was not financial, but rather the achievement of overall efficiency in the economy, the survival of privatized enterprises and maintenance of the workforce.

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<sup>21</sup> Taking the average of its share of employment, added value and gross fixed capital formation.

<sup>22</sup> It should be remembered that between 1984 and 1993 the cumulative cost of the loss-making public enterprises dependent on the state came to 22.9 billion *pesetas*, distributed as follows: 7.34 billion in subsidies; 6.45 billion in capital transfers; 4.84 billion in losses and 4.33 billion in public grants to stimulate industrial production. The annual cost to the State was equivalent to 4.5 percent of the GDP.

<sup>23</sup> See Martín Aceña and Comín (1991).

As for the results, between 1996 (second half) and the first half of 1999, 30 enterprises were privatized. In general, the principal goal was accomplished, in that the SEPI and the SEPA were able to assure the viability of the privatized enterprises, their industrial plans and the maintenance of the workforce. On the financial side, the revenue from the sale of public enterprises from July 1996 until July 1999 totaled 4.4 billion *pesetas*; that is, more than twice the figure of 2 billion inflation-adjusted *pesetas* earned from privatizations between 1988 and June 1996. During the period 1992-1996 the revenue from privatizations averaged 0.4 points of the GDP; in 1997 and 1998 the annual average was 2.65 percent of the GDP. As to forms of sale, the Public Offering of Shares was the principal method of privatization. It accounted for only a third of all such operations, but it brought in more than three-quarters of the total revenue. Public Offerings of Shares were not the same after 1996 as they had been before. First, after 1996 the state disposed of all its holdings in privatized enterprises, and second, the average volume of such operations grew from 133 to 321 billion *pesetas*. Third, there was a greater incidence of minority shareholdings, with a decline in the relative weight of institutional packages. Up until June 1996 minority holdings accounted on average for 48 percent of the total operation; thereafter, the figure rose to 67 percent. And fourth, competitive procedures were followed in the choice of financial advisers, overall coordinators, assessors and so on, which meant that the commissions charged by these financial advisers could be cut down. After June 1996, different procedures were also followed in Public Offerings of Shares. Specifically, around 20 operations were conducted on the basis of auctioning, restricted invitations to tender, open invitations to tender, direct award, and also Public Offerings of Shares, which brought in about 800 billion *pesetas* — that is, rather less than a quarter of the revenue from privatizations for this period<sup>24</sup>.

There were a number of institutional changes in this period. In September 1997, as noted above, the assets and liabilities of the loss-making public enterprises, grouped together in the AIE, were transferred to the SEPI. In addition, it was decided that beginning in 1998, neither the SEPI nor its enterprises would receive assistance from the Treasury, except for those operating in the coal-mining sector. The losses and all the passive and implicit liabilities of the loss-making public enterprises would be financed by the SEPI with the revenue from privatizations, with their profits, or with credits. Thereafter, direct financial support from the Treasury was confined to *Renfe*, which received almost half of the transfers from the State, *Hunosa*, Figaredo, RTVE and the Post Office<sup>25</sup>.

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<sup>24</sup> According to the Privatization Advisory Board, *Consejo Consultivo de Privatizaciones* (1999).

<sup>25</sup> See OECD (1998).



The rehabilitation processes prior to privatization reduced the number of jobs in the Public Business Sector, which fell by almost half between 1985 and 1995. The causes of this were workforce reductions in loss-making public enterprises (in coal mining, shipbuilding, railways and air transport) and some total privatizations carried out by the PSOE. In 1996 the PBS employed about 3.5 percent of all salaried workers in Spain; note that in France the figure was 10 percent, whereas in the United Kingdom it was 1.5 percent. Starting in that year, the size of the PBS shrank still further with the departure of such major enterprises as *Telefónica*, *Argentaria*, *Repsol*, *Gas Natural*, *Aceralia*, *Inespal*, *Endesa*, *Indra* and *Retevisión*, to name only the most important of them. With the total privatizations carried out by the Popular Party, the public business sector practically ceased to operate in areas where it had traditionally been a leading player, such as telecommunications, electricity, oil, natural gas and steel.

The problem was that despite the intentions of the Ministry of Industry, the privatizations of monopolies preceded their liberalization. The result was that public monopolies were replaced by private monopolies — in the case of gas — or by oligopolies with companies in dominant positions, which pursued abusive practices and prevented effective competition, as occurred in the oil and gas, electricity, air transport, telecommunication and tobacco sectors. Such practices were condemned in rulings by the Competition Defense Tribunal; *Telefónica*, for instance, was heavily fined for the use of exclusive contracts and abuse of a dominant position, and *Tabacalera* for exclusive contracts. The challenge that the government faced was precisely to introduce effective competition in these sectors through legislation and through the action of bodies to regulate and defend competition<sup>26</sup>.

The privatization process turned the structure of business power in Spain upside down. At first, the initial equity structure of the privatized public enterprises reflected — as was natural — the government's interest in encouraging the incorporation of small shareholders, the objective being to promote popular capitalism. In the recent privatizations, almost half of the offerings of shares were reserved for small domestic shareholders, at prices below those negotiated in the institutional brackets. Then, the equity structure of the privatized enterprises was also affected by the substantial share packages acquired by international institutional investors. Finally, however, the big Spanish banks and savings banks not only acquired large holdings in these privatized enterprises, but they gained control of them, placing their people in permanent core positions and on boards of directors. Moreover, the big banks and savings banks also established crossover holdings with international or domestic firms, which enabled them to control sectors that

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<sup>26</sup> See Lasheras (1999).

had until then been managed by the public sector. The privatizations have consolidated an equity structure that revolves around two pairs of banks: on the one hand *Banco de Bilbao Vizcaya* (which merged with *Argentaria* in October 1999) and *La Caixa*, and on the other *Banco Central Hispano* and *Banco de Santander* (which merged in March 1999). Each of these groupings of financial institutions had large holdings in operators in the oil, gas, electricity and telecommunications sectors. The privatizations helped to reinforce the already stable links between banking and industry. On the one hand this facilitated executive decision-making in the medium and long terms and enhanced the possibilities of profiting from economies of scale in these sectors. But on the other hand, the banks were able to influence the activity of these enterprises, from their dual position as creditors and major shareholders.

Moreover, the weight of the permanent bank holdings in the privatized enterprises was liable to discourage competition among enterprises with common interests in the same or related markets. Also, the crossover holdings of banks and savings banks would tend to generate problems such as reduced liquidity in the stock market, and they would certainly reduce the attraction for overseas investors. Another problem for these privatized public enterprises was the state's right of intervention or veto, exercised through the golden share, which enabled it to control strategic decisions such as the disposal of large share packages. This tended to hold back the incorporation of new investors, to orient company mergers, and above all to diminish any threat of loss of control by the company management. In fact, the government retained the right of intervention and veto in *Telefónica*, *Repsol* and *Argentaria*; this was to last 10 years in the case of *Telefónica* and *Repsol*, and a maximum of 4 years in the case of *Argentaria*. The situation of *Tabacalera* after privatization was similar.

#### THE RISE AND FALL OF PUBLIC ENTERPRISES IN 20TH-CENTURY SPAIN

The 20th century witnessed a complete cycle in the evolution of public enterprise. Following a period of slow growth from 1887, the size of the public sector grew considerably during the Franco regime. On the one hand, many private concessionaires were nationalized (*Renfe*, the official banks, *Telefónica*) and the portfolio of enterprises controlled by the DG State Assets grew; on the other hand the INI was created during the period of autarchy for purposes of industrialization and defense. The public sector continued to grow even after the INI fell from its key position in industrialization policy starting in 1963. Thereafter, the public sector grew because the INI acted as a clinic for sick enterprises, rescuing bankrupt private compa-

nies. Not only did the INI survive the Franco regime, it actually continued to grow during the early years of democracy. Its enterprises were used as an instrument of anti-cyclic policy. What prompted the growth of the public sector was that its enterprises provided politicians with a highly flexible tool. Once created, public enterprises were used to pursue a multitude of goals, from combating oligopolies to redistributing income, the latter being the more common. Energy enterprises (electricity or gas and oil, like *Endesa* or *Repsol*) or communications enterprises (the Post Office or *Telefónica*) were created to realize the strategic goals of the national economy, and in some cases also to combat private oligopolies or avert the emergence of a private monopoly. Politicians also used them to achieve other ends, however, such as redistribution of income, by setting telephone or electricity rates, or by subsidizing the losses of public enterprises and taking over bankrupt private companies. The INI survived the disappearance of the Franco regime, but it did not long survive Spain's accession to the EEC. Accession brought the opening of the markets to the exterior and the application of a number of Community directives that did away with the public sector. It then ceased to make any sense to maintain public enterprises that were incapable of surviving through lack of technology and lack of commercial networks in the world's markets.

Within the European context, Spain stood out in terms of the ineffectual part that the public sector played in its economy. In terms of total non-agrarian employment, in 1988 the Spanish public business sector was among the smallest in Europe, three points below the Community average. At the same time, the public sector in Spain was very much manufacturing-inclined due to the feebleness of its public financial enterprises. For that reason, the scale of privatization was smaller in Spain than in the rest of Europe. Moreover, Spain's privatizations were carried out more efficiently and more rapidly than in other European Union countries<sup>27</sup>. Table 2 shows the effect of privatizations on the size of the public business sector (PBS) in Spain. In Europe there has been a process of downward convergence in the size of the PBS. However, this downsizing of public sectors has followed three distinct patterns. A first group of countries (total privatizes) opted for the virtual disappearance of the public sector; these were the United Kingdom, the Netherlands, Spain, Denmark and Luxembourg. A second group (reluctant privatizes), such as Germany, Belgium and Sweden, carried out less comprehensive privatizations despite the fact that their public sectors were not very large, and these remained larger than the European average after the privatizations. These were countries organized along federal lines or with an autonomous business organization. The third group (rapid privatizes) had large public sectors whose size they reduced drastically through privatizations

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<sup>27</sup> See Clifton, Comín and Díaz Fuentes (2003) and Comín and Díaz Fuentes (2004).

in the 1990s. Such cases include Italy, France, Portugal, Austria, Finland, Ireland and Greece, who privatized in response to European monetary integration, underway at the time. Overall, the average percentage of employment accounted for by the public sectors in all of the EU fell from 13.3 to 9 between 1988 and 1999. Moreover, the differences between countries shrank, as demonstrated by the reduction in the standard deviation between 1991 and 1999. As one of the countries that have privatized most wholeheartedly, Spain saw its public business sector shrink by more than the average, from 12 percent in 1982 to 10 percent in 1988 and to 4.1 percent in 1999<sup>28</sup>.

**The public business sector in the EU 1982/1999**

(simple average of percentages of employment, GAV and GFCF of the PBS in total)

[TABLE 2]

	1982	1985	1988	1991	1995	1999
Luxembourg . . . . .	6.5	–	7.2	6.4	6.4	5.7
Netherlands . . . . .	9.0	9.0	9.6	7.5	6.8	4.6
Spain . . . . .	12.0	12.0	10.0	9.0	8.0	4.1
Denmark . . . . .	12.0	11.4	11.9	11.5	9.7	7.9
Belgium . . . . .	12.1	11.1	12.0	11.0	11.6	10.9
Germany . . . . .	14.0	12.4	11.6	11.1	10.7	10.9
United Kingdom . . . . .	16.2	12.7	7.4	4.4	2.7	2.3
European Union . . . . .	16.4	15.3	13.3	11.8	10.4	9.0
Ireland . . . . .	15.1	15.3	14.4	12.3	11.8	10.1
Italy . . . . .	20.0	20.3	19.0	18.9	14.2	9.6
Greece . . . . .	22.3	23.2	20.8	20.2	15.4	14.2
France . . . . .	22.8	24.0	18.3	17.6	14.7	11.8
Portugal . . . . .	23.9	22.7	24.0	20.7	12.3	8.5
Austria . . . . .	17.9	–	27.0	16.9	13.3	12.0
Sweden . . . . .	8.4	–	–	–	12.9	13.1
Finland . . . . .	16.9	–	–	–	17.6	10.9
St. Dev. EEC12 . . . . .	0.049	0.053	0.051	0.052	0.036	0.035
St. Dev. EU15 . . . . .	–	–	–	0.051	0.037	0.034

Source: Clifton, Comín and Díaz Fuentes (2003).

There are not yet any studies available on the performance of privatized public enterprises in Spain, but it does not seem to differ very much from that of the United Kingdom. Studies in the United Kingdom show that privatization did not in principle bring any substantial improvement in economic efficiency unless it was accompanied by liberalization of the sectors involved and by State regulation to guarantee effective competition after privatization. Studies of privatizations show that gains in efficiency depend

more on the sector's being liberalized than on privatization as such. Privatized enterprises in Great Britain increased their output and profits more than did those that remained in public hands. However, this was due more to the nature of the industries that were sold off than to the change in ownership of the companies, because these privatized companies were already growing before they were sold, whereas it was precisely their poor market prospects that prevented the disposal of public enterprises in the areas of coal, trains and, initially at least, steel<sup>29</sup>. In fact, the un-privatized enterprises gained more in efficiency than some of those sold off, thanks to "privatization of management" (shifting the emphasis in technical aspects of management to upgrade marketing and finance), which was applied to public enterprises before their disposal, particularly in the cases of loss-makers. The reason why greater gains were not made in efficiency was undoubtedly that the privatized companies preserved their command of the market; the introduction of competition would have improved their efficiency. Some of these problems — including the famous issue of stock options and the gross increases in the pay of executives in privatized companies — were reproduced in the Spanish case, despite the fact that the British experience was known and hence could have helped in avoiding them<sup>30</sup>. In the Spanish case, the big privatized companies are still operating in imperfect markets where there is no effective competition, which suggests that greater gains in efficiency could have been achieved.

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<sup>29</sup> See Bishop and Kay (1992).

<sup>30</sup> See Díaz Fuentes and Clifton (1999).

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