The political creation of European utility multinationals[1]

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1. Introduction

Since 1990 a small group of companies[2] has grown to dominate some key utility sectors in Europe: water, electricity, and waste management. These sectors were previously characterized by national operators, normally owned by the state and/or municipalities.

This article gives a brief account of the major multinational companies in each sector, and the development of their dominance in Europe. It then considers the companies' own strategies, and the contribution of state initiatives both by nation states and supranational entities such as the EU. It concludes that the markets themselves, and the dominance of these companies, have been created politically, not through processes of competition or innovation.

Table 1. Major European multinationals in utility sectors

		Water	Electricity	Gas	Waste management
Electricite de France (EDF)	France	*	X	**	
E.on	Germany	*	X	X	
RWE	Germany	X	X	X	X
Suez	France	X	X	X	X
Veolia	France	X	*		X

Notes: *major presence in sector for some years, but no longer.
**Gaz de France, separate but state-owned, also operates internationally.

2. The growth of European utility oligopolies

2.1. Electricity

Until 1990, electricity in European countries was normally supplied through vertically integrated state-owned companies, or, as in Germany a set of municipal and partly private companies. Five major changes took place in the next decade – (i) the privatisation by sale of electricity companies in the UK, Spain and to a lesser extent other countries; (ii) the dismantling of the state electricity companies of the former communist countries of central and eastern Europe; (iii) the creation of a single market between the Nordic countries; (iv) the compulsory liberalisation introduced under the EU electricity directive of 1998; and (v) the active encouragement by the World Bank and the IMF of privatisation and liberalisation of electricity in developing countries.

All of these factors combined to create opportunities and incentives for the international expansion of electricity (and gas) companies in Europe. By the early 2000s, three companies – Electricite de France (EdF) (France), E.ON (Germany) and RWE (Germany) – had emerged as dominant international companies in European electricity markets. A second layer of companies, such as Vattenfall (Sweden), ENEL (Italy), Endesa (Spain), Electrabel/Tractebel/Suez (France/Belgium) and Ivo/Fortum (Finland) have smaller international activities in Europe (although Tractebel and Endesa are major electricity multinationals outside Europe).

Neither the UK nor the USA electricity companies figure in this list. The UK electricity companies, privatised in 1990, never established themselves seriously elsewhere in Europe: they made little attempt to establish themselves in the Scandinavian market – which was liberalised in the early 1990s – or in the auction of Hungary's electricity companies in 1995, and most of the privatised power companies in the UK have now been taken over by EdF, RWE and E.ON. Europe, and indeed the rest of the world, experienced an initial wave of investment by USA companies during the 1990s, followed by almost total retreat: in 2003 the US company AES even abandoned the 4000MW Drax plant – the largest power station in the UK – to its creditors without even attempting a sale.

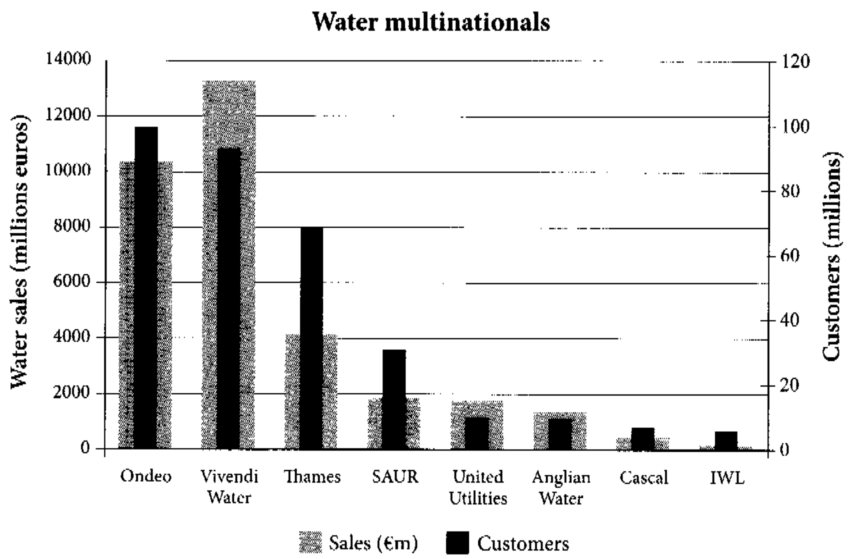
The Russian energy companies EES (electricity) and Gazprom (gas) are also beginning to develop significant presence – especially Gazprom, which owns about 25% of the world's natural gas resources. The process has taken place overwhelmingly by a series of takeovers and mergers rather than competitive entry to new markets, and has sometimes involved joint ventures between the major companies. The privatisation of Slovakia's energy in 2003 is typical: three electricity distribution companies were sold, one each to RWE, E.ON and EDF; and the national gas company was sold to a consortium of Ruhrgas – now part of E.ON – Gaz de France (the French state-owned gas company, sister of EdF) and Gazprom.

2.2. Water

The growth in the private water market has happened for similar reasons: the privatisation of the UK's water companies in 1989, the restructuring of water services in former communist countries, and the global encouragement of privatisation by the World Bank and the IMF. There has not been a formal requirement for liberalisation through an EU directive, but the EC has encouraged the use of the private sector in other ways, especially in former communist countries. Outside France, the UK, Spain, Czech republic and Hungary water remains overwhelmingly in the hands of municipal operators: company attempts at expansion have frequently met with public and political resistance.

In France, Europe and the world over 2/3 of the privatised water sector is in the hands of the two large French companies- Suez and Veolia, with a third French company – SAUR – in fourth place globally: in third place is Thames Water, now part of RWE – the other water companies from the UK or elsewhere have failed to establish significant international positions. This pattern reflects the historical accident that, before 1989, France was the only country in the world with private water companies of any great size. The biggest of the private Spanish water companies, Aguas de Barcelona, is effectively controlled by Suez; and another, Aguas de Valencia, was and is controlled by SAUR.

Chart 1: Water companies' international operations, 2002



Source: Company reports, PSIRU estimates

2.3. Other sectors

The same group of companies also dominate other sectors: gas, waste, management, and district heating. Gas and electricity companies are now beginning to operate in both sectors. The main new development was E.ON's takeover of Ruhrgas, but in other cases this gas-electricity combination already existed, for example in Suez' energy division Tractebel, owner in Belgium of both Electrabel and Distrigas, in the ›twinned‹ partnership between Electricité de France (EDF) and GDF in France, and for a while in Fortum (Finland), formed from a merger of IVO and Neste in 1996.

Suez – through its subsidiary Sita, and Veolia, through its subsidiary Onyx, are the two largest waste management companies in Europe and the world (outside the USA), and are the dominant contractors in a number of individual countries. One factor in their growth was the creation of a national market in the UK, when the Thatcher government introduced compulsory competitive tendering for selected municipal services including refuse collection. A number of European countries had made some use of private contractors for refuse collection before this, and outsourcing became more common during the 1990s. These two companies also grew by acquisition both of locally owned contractors and of the European subsidiaries of the US waste multinationals which exited from Europe in the late 1990s. RWE's waste management division is the largest in Germany, and the third largest in Europe. The same three companies, and E.on, are dominant providers of district heating, and EdF has a 49% stake in Veolia's heating subsidiary Dalkia.

2.4. Multinationals' strategies

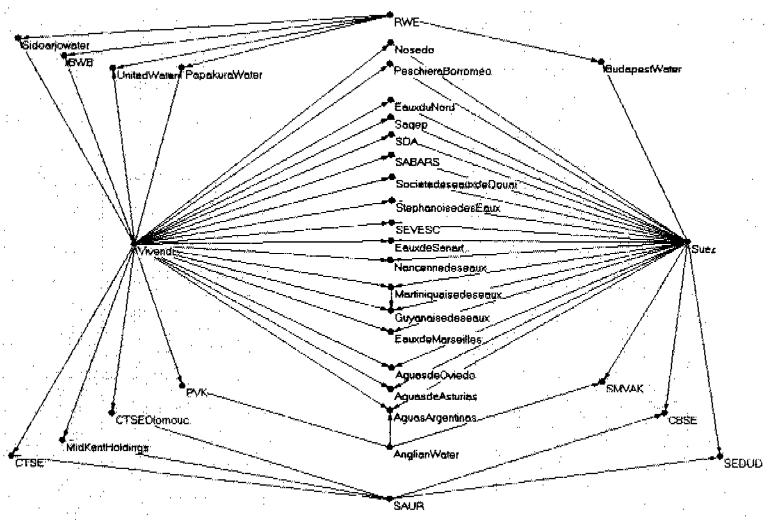
The main strategy pursued has been growth in new and established markets, principally by acquisition. This search for growth has involved some major failures of judgment, of which the most spectacular was the expansion of Vivendi into media, and its subsequent collapse. International expansion in water and electricity in developing countries is another example of failure, notably with major losses being incurred by Suez and EdF from the economic crisis in Argentina. The French companies are now growing and reshaping themselves along the lines that are much closer to the original structure of the French utilities in 1990, before the process of international expansion began.

The companies have also moved in and out of different sectors: RWE and E.on both entered, and then left, the telecoms market; EdF for a few years held a 50% stake in the third largest French water company SAUR; E.on entered the water sector by acquiring Gelsenwasser, and then sold it (as a result of a regulatory condition of its acquisition of Ruhrgas); RWE has repeatedly considered selling its waste management division, and at the time of writing was reported to be considering exiting the water sector by selling Thames.

The companies have frequently formed joint ventures, as a way of spreading risk, as well as reducing competition. In water, Suez and Veolia created a number of joint subsidiaries: in July 2002, the French competition council (»Conseil de la concurrence«) ruled that Suez and Veolia had been abusing their market dominance through joint ventures in 12 cities such as Marseilles and Lille (two of these joint ventures also involved SAUR, the third largest water company).[3] Beyond France their nearest competitor, RWE/Thames, is a partner to Veolia on three of their major water operations – Berliner Wasserbetriebe, Budapest Sewerage (FCSM), and United Water in Adelaide, Australia – and a partner to Suez in Budapest Water. In electricity, EdF and RWE formed a joint venture to acquire control of the Swiss company Atel, and all the electricity companies formed a number of ventures with US and other companies in the mid-90s.

The companies themselves have claimed that they are creating ›multi-utilities‹ crossing a number of sectors, and thus delivering synergies. It should be noted that the form of a multi-sectoral operator is not an ›innovation‹ by the private sector, but an established form of organisation of utility functions developed in Germany and elsewhere through municipal utilities. The benefit of this came partly through cross-subsidy from profitable services, such as electricity, to others such as public transport; or partly through structural innovation, such as the shared services division of Gaz de France and Electricite de France. The multinationals have used cross-subsidisation, but for financing commercial not public service objectives, e.g. Veolia re-assigned all its debt, accumulated through acquisitions in media, to the utilities division. It should further be noted that the services concerned – water, electricity, waste – are almost never tendered, licensed or structured as combined operations, and so the private operators cannot deliver this form of operating synergy. The potential for efficiency thus consists simply of creating shared units, which may be arbitrary, for

Chart 2: Joint ventures between leading water multinationals, 2002



Source: PSIRU database, 2002. Generated by Vladimir Popov (PSIRU), using Social Network Analysis software.

example the savings made by RWE in the UK by combining management divisions of the functionally separate National Power and Thames Water.

3. The role of the state

The role of the state can be seen in three different ways. Firstly, because the companies concerned have all developed out of state activities and entities. Secondly, because the state, both nationally and at EU level, has played a key role in creating and sustaining the international markets, which have enabled the expansion of the companies. And thirdly, because states have been important in supporting companies as national champions in these international markets.

3.1. Development from state activities and entities

The development of the companies out of state activities can be clearly seen in France. Suez and Veolia developed over a long period as private agents of municipal public services in France, especially where a high level of investment was required, such as water: in other countries these services developed as municipal activities financed through investments raised by municipal bonds or operating surpluses. This form of outsourcing is known as »gestion déléguée« (delegated management), around which French public administrative theory has developed a notion of a trust relationship between the municipality and its selected providers, which has been used to argue against the subjection of such concessions to competitive tendering. The groups had accumulated by the early 1990s a wide range of public services, including water, district heating, waste management, car parks, toll roads, and grew to become two of the largest construction companies in Europe (the construction divisions have now been sold). As well as the two dominant national groups, there is a third, smaller operator, SAUR, part of the Bouygues construction group.

The process of acquiring these concessions and contracts involved developing intimate relationships with all political parties. Suez developed particularly close relations with the rightwing RPR, symbolised by the fact that Jérôme Monod , former chief executive of Suez, is still (in 2004) the political adviser of President Chirac. Suez and Veolia however dealt with all political parties in developing these relationships, which have often developed in corrupt fashion. In Grenoble in 1996, a former mayor and government minister and a senior executive of Lyonnaise des Eaux (now Suez-Lyonnaise des Eaux) both received prison sentences for receiving and giving bribes to award the water contract to a subsidiary of Lyonnaise des Eaux; in Angoulême, the former mayor was jailed in 1997 for two years, with another two years suspended, for taking bribes from companies bidding for contracts, including Générale des Eaux; and executives of Générale des Eaux were also convicted of bribing the mayor of St-Denis (Ile de la Réunion) to obtain the water concession.[4] The same groups – Suez-Lyonnaise and Veolia, together with Bouygues – have been investigated in France for corruption practiced by their construction divisions, in a scandal described as ›an agreed system for misappropriation of public funds‹. The companies ran a corrupt cartel over building work for schools in the Ile-de-France region (around Paris) between 1989 and 1996. A regular monthly meeting between the three groups and an official representing all the municipalities shared contracts between the three groups at agreed prices, in return for which 2% of contract value was given to be distributed between the political parties pro rata to their representation in the region. [5] On the energy side in France EdF was created as a nationalised electricity company, which was central to the economic growth and policies of postwar France, being a nationalised industry. It was inevitably closely linked to the States overseas, as well as at home, and acquired concessions in former French colonies in Africa, contracts in China for its nuclear expertise, and later acquisitions in Latin America and central and eastern Europe.

In Germany, by contrast, the two dominant companies RWE and E.on developed as a result of gradual privatisation and consolidation of ›Stadtwerke‹ (municipal companies), reflecting the strength of local government in Germany, and retain strong connections with the municipalities and ›Länder‹ (federal provinces), which still had controlling stakes in both RWE and Viag until the mid-1990s. By virtue of their size and dominance in a key sector, they became highly influential with federal government too, as was dramatically demonstrated in the early days of the Schroeder administration, when the finance minister Oskar Lafontaine was forced to resign after protests from the energy companies over the demands being made on them in respect of taxation and accounting for reserves for decommissioning.

3.2. Creation of new markets

The second key function of the state is the creation and extension of international markets, which depend for their existence on political initiatives. Some key initiatives have come from national governments, most obviously the Thatcher privatisations in the UK, but the EU has played a central role. The clearest examples are the EU directives aimed at creating liberalised markets in electricity, gas, telecoms, rail and other sectors, which have the effect of forcing liberalisation on all EU countries, and also the secondary effect of encouraging privatisation or commercialisation of public service operations.

Even in sectors where there is no formal directive requiring liberalisation, the EU has attempted to encourage private activity – for example encouraging the development of PPP's in all parts of the public sector. In all of the above services and beyond , the use of private companies as co-financiers and arm's-length operators has been encouraged by the EU stability pact restrictions on public sector borrowing and hence on government investment or subsidy (see Jäger/Tomassovits in this issue). Any such borrowing that can be shifted from governments to private operators becomes a welcome instrument for achieving national reductions in government borrowing. The fiscal effects of EU stability pact restrictions are reinforced in accession states in central and eastern Europe – and globally in developing countries – by IMF restrictions on general government borrowing and also by the economic orthodoxy for transition States, which requires the sale of state-owned enterprises in all sectors. As a result, central and eastern Europe became a key early market for all five multinationals, in both water and energy, with respect to international expansion.

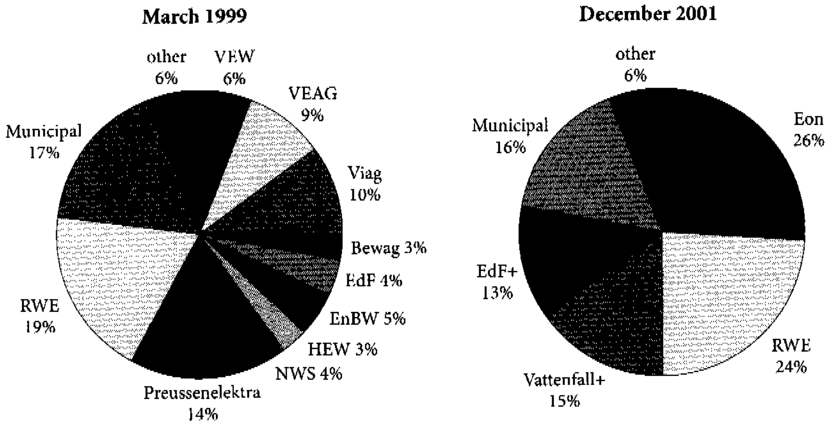
Wider international market opening is also supported and sustained through the initiative of state institutions at global level. Most notably, conditionalities imposed by the World Bank and the IMF created new opportunities for privatisation and new market in infrastructure services such as water and energy . Latin America was a particularly important case, where, under IMF policies, Argentina and other countries privatised and liberalised their utility sectors to the benefit of European based multinationals, until the Argentinian economy collapsed. The home states – principally France and Spain – were also very important in negotiating with the IMF and the Argentinian government to protect as far as possible their companies' investments in Argentina. These markets were politically conditioned in yet one more sense, because political support from governments in developing countries was also important to developing these markets: and so, where the local political climate has turned against privatisation policies, these markets have been shown to be vulnerable to political risk.

3.3. National champions

The third way in which the state has been important is through supporting the creation of national champions in the sectors to get business internationally.

The mechanisms by which states support these companies include the protection of home markets, and the promotion of external conditions favouring the champions' expansion. One example of protection of the home market is the successful activity by the French government to keep water concession contracts exempt from competitive procurement requirements, which has the effect of protecting the home market for the French water companies; EdF's home market has been protected by imaginative but slow implementation of the electricity directive. Another example can be seen in Germany, where the rapid concentration of the energy companies around the year 2000 was encouraged by the government (it even overruled the European Commission (DG Competition), which had proposed blocking the E.on/Ruhrgas merger). This can be seen as prioritising the creation of national champions, prioritised above the protection of consumer interests through supposed competition between separate companies.

Chart 3: Concentration of electricity ownership in Germany following liberalisation



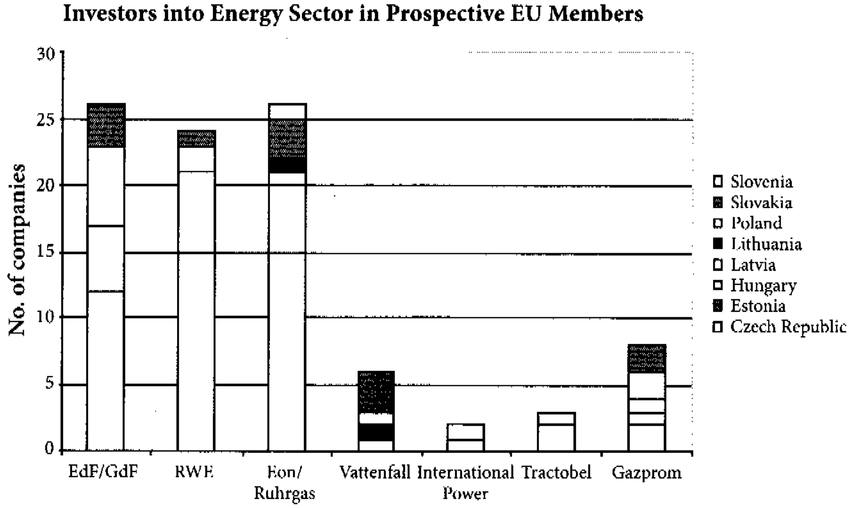
Source: Bower/Bunn/Wattendrup (2001)

The UK. governments, despite the active creation of private companies in these sectors as a result of the Thatcher government policies, did not take a clear decision to create national champions capable of international expansion, either in water or energy. The UK preferred to focus on the national market and the ideology of ›regulated competition‹, and so preferred to keep its privatised companies separate so that regulators could prefer competition. Now the UK's electricity industry has been reassembled into less than six groupings of integrated operators, half owned by RWE, E.on and EDF.

The Spanish government pursued national champion policy by supporting the expansion of Spanish companies into Latin America in the 1990s, but Spain for a long time resisted approving a merger of its two largest energy companies, which could have had the effect of creating a more serious international player.

In central and eastern Europe liberalisation has largely prevented the development of national champions. These countries were generally encouraged to break up their electricity structures, following roughly the UK model, and to municipalise and enable contracting out of their water structures, following the French model. Both of these strategies created fragmented companies and operators, which are suitable subjects for takeover, but not suitable vehicles for building national champions which themselves could expand into other markets. For example in Slovakia and Hungary the electricity and gas distribution companies and generators have largely fallen into the hands of European multinationals, with the exception of Hungary's nuclear industry. One interesting exception to this is in the Czech Republic, where the Czech energy company was partly privatised before attempts to break it up, which had the effect of creating a private vested interest in maintaining a concentrated monopoly. As a result, the Czech electricity company CEZ is more active in trying to expand into other countries and operate as an international trader.

Chart 4: Dominant multinationals in central and eastern Europe



Source: Frogatt (2002)

Another form of the national champion policy can be seen in the phenomenon of publicly owned companies themselves expanding internationally into liberalised markets as commercial entities. The most striking example of this is EdF, and to a lesser extent Vattenfall, the Swedish state-owned electricity company, both of which have become major players outside their own home countries, while remaining 100% state-owned. This activity is not an expansion of public ownership into countries which have otherwise abandoned it, but has functioned simply as commercial growth. Even some municipal utilities have followed an internationally expansionist policy, again for commercial objectives rather than public service ones: examples include the Italian utilities Acea, from Rome, and AMGA, from Genoa, and the Austrian utility EVN.

4. Conclusions

In conclusion, the growth of these companies has not been the result of corporate innovation or competition in these sectors. The process has rather been driven by state initiatives in creating markets, providing protected home environments for the main players and supporting international trade liberalisation for the companies' expansion. We have politically created multinational private oligopolies, where previously we had politically created publicly owned monopolies.

Endnotes

1 This article draws on the work of the PSIRU (www.psiru.org) since 1998, including work by Steve Davies, Emanuele Lobina and Steve Thomas. It also draws on work carried out by PSIRU as part of the Watertime project (www.watertime.org), funded by the European Commission FP5: Energy, Environment and Sustainable Development Key Action 4: City

of Tomorrow and Cultural Heritage Thematic Priority 4.1.2: Improving the quality of urban life Contract No: EVK4-2002-0095). The author remains solely responsible for errors or omissions.

2 Company names change: the French water groups in particular have used various names for both the groups and their sectoral divisions since 1990. Throughout this article, for the sake of clarity, the two largest groups will be referred to respectively as ›Suez‹ and ›Veolia‹. Suez‹ water division has been known as Lyonnaise des Eaux, or Ondeo; the energy division has used the names Tractebel, Electrabel and Distrigas; and the waste management division is named Sita. Veolia has been previously known under the names of Generale des Eaux and Vivendi; its waste division is called Onyx; and its heating division is called Dalkia. E.on was formed by a merger of Viag – whose electricity division was known as Bayernwerk – and Veba, whose electricity division was known as Preussenelektra.

3 See also Conseil de la concurrence (2002), and ›Vivendi et Suez accuses de fausser le jeu de la concurrence‹, *La Tribune*, 18th July 2002.

4 Hall (1999)

5 Le Monde, 10 December 1998.

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