

# WORKING PAPER

*Stadtwerke Köln: a market-based approach  
towards public service provision*

Dorothea GREILING



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*Stadtwerke Köln: a market-based approach  
towards public service provision<sup>1</sup>*

Dorothea Greiling

*University Professor, Johannes Kepler University Linz (Austria)*

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## **Abstract**

*In the last two decades there has been a strong drive by the EU-Regulation of liberalizing the service delivery of Services of General Economic Interest. Public enterprises are under pressure to be more market-orientated. In Germany there has been a long tradition that public enterprises are seen as an instrument by the public owners to achieve a variety of economic and non-economic policy objectives. This creates an inherent tension between market- and public service orientation. Against this background an in-depth case study was carried out in order to investigate how one of the biggest local public enterprises reacted to these pressures. The SWK group is a positive example where market orientation and public service provision goes hand in hand since the founding days. The existence of the SWK group was never questioned by the public owner who regards it as its entrepreneurial arm for providing local infrastructure services.*

**Keywords:** Case study, Germany, governance, local public enterprises, regulation, Services of General Economic Interest, performance.

## Introduction

During the last 20 years, the provision of Services of General Economic Interest (SGEIs) has changed considerably. A starting point for these changes was the Single Market Act which was enacted in October 1992. In general, EU legislation on SGEIs is influenced by the belief that regulation is an adequate substitute for public ownership in those areas where market failure occurs. The substitution of public ownership by sector-specific regulations is fully in line with the privatisation agenda of NPM with its promises of greater allocative efficiency and better customer orientation. These changes in the regulatory framework led to the situation that utilities in public ownership are under pressure to demonstrate that they create value added for the society. The EU market liberalisation policy has brought along that the provision of public services by public enterprises is no longer taken for granted.

Traditionally, public enterprises were seen as an instrument of the public owners for achieving commonweal objectives in Germany. Their existence has not been limited to areas of market failures, they are rather seen as an instrument used by the public owners to achieve a variety of economic and non-economic policy objectives, as expressed by the “Instrumentalthese” by Thiemeyer (1975). According to this author, public enterprises were regarded as an effective instrument for fulfilling a variety of economic policy objectives ranging from competition policy (monopoly control and simulating competition), through regional policy, industry-specific stabilisation and growth policy, labour market and social policy to environmental and supply policy (Thiemeyer, 1975; Greiling, 1996). Additionally, public enterprises were also seen as a tool for stimulating innovations and economic growth (Greiling, 1996). Conduct regulation and intensive interference by the public owners were regarded as appropriate instruments for ensuring that public enterprises acted in line with the public owners’ objectives. This brief enumeration of the common good objectives of German public enterprises shows that the public mission went far beyond providing public services in those areas where the market offered no efficient allocation.

Unlike in other EU-countries (e.g. in France or Italy) the local provision of SGEI has a long tradition in Germany. This fact served as rationale why a local public utility was chosen. Against this background a longitudinal case study of the Stadtwerke Köln GmbH (SWK group - Stadtwerke Cologne group) was conducted in order to observe the development of focus, public missions, governance structure including owner’s policy, regulatory framework and entrepreneurial policies over the past 20 years. The SWK group was selected because it is among the biggest public utility providers at the local level. According to the annual report 2011, the SWK group had 11,348 employees and the turnover of the SWK group added up to 5 103 million EUR in 2011.

In order to provide an in-depth insight, a qualitative research design was chosen. Based on a documentary analysis and expert interviews with managers of the SWK group, conducted in January 2013, the results were compiled. The case-study approach allows addressing the issues at hand from an evolutionary perspective. The time span of the analysis ranges from 1990 to 2011. The collection and analysis of the material was carried out between October 2012 and April 2013.

### **Portrait of the SWK Group**

The SWK GmbH is situated in the City of Cologne. It has the legal form of a Gesellschaft mit beschränkter Haftung (GmbH - private limited liability company). As a legal form under private law GmbHs exist independent of individual shareholders. The liability is limited to the capital invested. For the establishment of a GmbH at least one shareholder is required. In the case of the SWK group the sole owner is the City of Cologne.

In its present legal form the SWK Group has existed for 52 years. The Stadtwerke Köln GmbH was founded in 1960 by the Council of the City of Cologne as a 100% city-owned enterprise. Cologne's public ownership goes back much longer (SWK 2010, p. 49). Already back in 1849 the city built a modern city port, followed by the first water works in 1872. In 1873 a formerly privately operated gas company was municipalized. The city's activities regarding public swimming baths started in 1887 and its involvement in street cleaning and waste collection began in 1890. It was followed by the first electricity company in 1891 and in 1900 by the municipalisation of a formerly privately owned streetcar company. This brief review of the history does not take into account Cologne's Roman times when municipal infrastructure (e.g. ports, bathing houses, water supply) was provided to an amazing extent.

The SWK Group, including the many subsidiary companies, offers quite a variety of public services in the areas of energy supply (gas, electricity) mobility and public transport, waste collection and street cleaning. The SWK GmbH as the parent company provides central services for the subsidiary companies. Employee-wise the SWK GmbH as the holding company is quite small with only 164 employees according to the annual report 2011. The SWK GmbH is an example of a merely financial holding – not of an operating holding – offering a small number of centralized services for the SWK group such as legal services, insurance, central personnel services, central management accounting services and central policies towards the subsidiaries.

The most important subsidiaries within the SWK group are:

- GEW Köln AG (Gas, Elektrizitäts- und Wasserwerke Köln AG – gas, electricity, and water works Cologne public limited company) as an intermediate holding company with its holdings RheinEnergie AG, NetCologne GmbH, BRUMATA GmbH and additional shares and holdings under the umbrella of RheinEnergie AG.

- The Kölner Verkehrsbetriebe AG (KVB AG - Cologne public transport public limited company) transports more than 850,000 passengers per day in streetcars-, busses and via the public underground system.
- The HGK Köln AG – Häfen und Güterverkehr Köln AG (ports and freight transport Cologne public limited company) offers a huge variety of logistic services in the Cologne region. After Duisburg the HGK AG is the second largest inland port operator in Germany. The SWK GmbH holds 54.5% of the shares of the HGK Köln AG, the City of Cologne 39.2% and the Rhine-Erft-County 6.3%.
- Köln Bäder GmbH (Cologne public swimming baths private limited company) and
- WSK GmbH – Wohnungsgesellschaft der Stadtwerke Köln GmbH (housing society of the local municipal public utility Cologne private limited company) mainly provides housing for the employees of the SWK group.
- In the area of waste collection and street cleaning there are three fully consolidated subsidiary companies. The AWB – Abfallwirtschaftsbetriebe Köln mbH & Co KG (waste management services Cologne private limited company & limited partnership) is in the sole ownership of the SWK GmbH. AWB’s slogan is “always to work for a clean Cologne”. Another 100% subsidiary is the AWB Verwaltung-Abfallwirtschaftsbetriebe Köln GmbH which is the management company of the waste management services Cologne private limited company. For household waste collection and recycling a third subsidiary, the AVG GmbH – Abfallentsorgungs- und Verwertungsgesellschaft Köln mbH (waste collection and recycling Cologne private limited company) is responsible. Here the SWK GmbH owns 50.1%. 49.9% of the shares are held by the REMONDIS GmbH Rhineland, a subsidiary of the globally operating REMONDIS Group.
- The Moderne Stadt-Gesellschaft zur Förderung des Städtebaus und der Gemeindentwicklung mbH Köln (Moderne Stadt Köln GmbH - modern city company for urban and local development private limited company Cologne) is a small subsidiary wholly-owned by the SWK GmbH, focusing on urban and regional development within the SWK group and providing consultancy services.

Table 1 provides a divisional overview of the turnover in the main areas of activities within the SWK group:

**Table 1 – Divisional Turnover 2011**

in million EUR	2011
Energy and water	3,863.9
Telecommunication	253.7
Cleaning and waste collection	245.4
Public transport	201.1
Port and freight transport	214.6
Heat-metering service	80.0
Revenues from services	41.3
Public swimming baths	10.1
Income from letting company flats	8.9
<b>Total</b>	<b>4,919.0</b>

Source: author's compilation based on the SWK annual report 2011.

The ownership structure of major daughter companies is displayed in Table 2.

**Table 2 – Shareholding structure (in percent)**

Subsidiary	SWK	Cologne city
GEW Köln AG	90	10
Kölner Verkehrsbetriebe AG (KVB AG)	90	10
Häfen und Güterverkehr AG (HGK AG)	54.5	39.2
KölnBäder GmbH	74	26
Wohnungsgesellschaft der Stadt Köln mbH (WSK)	100	
AWB Abfallwirtschaftsbetriebe Köln GmbH & Co. KG (AWB)	100	
AWB Abfallwirtschaftsbetriebe Köln Verwaltung GmbH (AWB Verwaltung)	100	
AVG Abfallentsorgungs- und Verwertungsgesellschaft Köln mbH (AVG)	50.1	
Moderne Stadt Gesellschaft zur Förderung des Städtebaues und der Gemeindeentwicklung mbH	100	

Source: SWK (2012), Annual report 2011, p. 8.

Within the subsidiaries the GEW Köln AG acts as an intermediate holding company. Back in 1992 the operating part of the GEW Köln AG was integrated in the RheinEnergie AG which is a regional public utility provider. Table 3 lists all the subsidiary companies of the GEW Köln AG which are fully consolidated.

**Table 3 – Fully consolidated GEW subsidiaries**

Subsidiary	Equity in EUR	GEW's share
RheinEnergie AG Köln	400 million	80%
BRUMATA GmbH & Co KG Hürth	129.000	100%
METRONA GmbH & Co KG	25.000	100%
NetCologne Köln	9.21 million	100%

Source: SWK (2012), Annual report 2011, p. 16.



According to the interview partners, the SWK group is also an enterprise which, from the very beginning, embraced a market approach combined, on the one side, with a strong commitment to improving the quality of life of all citizens and to acting as a stimulus for the regional economy, on the other side. The market-orientation also manifests itself in the creation of economic value added for the City of Cologne. From 1996 onwards the SWK Group had a surplus which was used for reinvestment and was partly transferred to the City of Cologne.

The SWK group is also a typical example of a local public municipal company where the surpluses of one division are used for cross-subsidizing the deficits in other areas. Such cross-subsidization can be found among others in many local public-owned public utilities in Germany. Historically, tax advantages and the fact that direct transfers by the owners are minimized, are the main reasons for this construction.

The 1960s were the founding years of the present SWK group. In November 1960 the legal form of the GEW Köln AG and the KVB AG was changed to that of a public limited company. Already then intergroup agreements specified that any profits from the GEW Köln AG and the KVB AG belong to the SWK GmbH. The losses of the subsidiaries have to be covered by the SWK GmbH. As early as at that time the profits of the GEW AG were used to cover the losses in the public transport section (KVB AG). The 1960s were also years of huge investment in the modernization of the public infrastructure. In 1964 the WSG housing company of the SWK group was established. Documents from this time show that one central reason behind this move was to provide and improve the city's attractiveness as an employer by providing adequate, modern and comfortable flats for the employees of the SWK group (SWK 2010, p. 9). The labour market of the 1960s, which were also the boom years of the German Wirtschaftswunder (economic miracle) was a market, where private and public employers competed for employees. In the sector of waste collection and street cleaning personnel was recruited in Southern Europe. As early as in 1964 one third of the personnel working in this sector were immigrants (SWK 2010, p. 6).

The 1970s and 1980s did not bring any new subsidiaries. The 1970s were years when the enlargement of the city boundaries following the local municipal reform resulted in the fact that for the first time Cologne had one million citizens in 1975. Infrastructure-wise the high commitment of providing up to date infrastructure continued. Huge sums were invested in the public transport network. In energy and water production investments were made in order to expand the networks and to provide these services in an ecologically efficient way. The focus on safe and eco-efficient energy production facilities was strengthened further by an energy concept in 1980 (SWK 2010, p. 50). Already in 1981 the GEW Köln AG developed a strategic concept which put the focus on long-distance heating and natural gas as main energy sources. In 1985 the

GEW Köln AG and partner companies presented a concept of energy-saving measures for Cologne, including incentives for thermal insulation in private households, which aimed at reducing the total amount of energy used for heating by 20% till 2000. In 2000 this target was exceeded by 12%.

In the area of waste collection the AWB GmbH & Co. KG started to expand the separate collection of glass bottles by providing additional containers for the collection of waste paper back in 1984. In 1989 the city and the SWK GmbH passed the first integrated waste management concept.

Also in line with the promotion of ecological objectives were the investments made in the area of public transport. The regional expansion and the provision of park and ride facilities helped to increase the annual number of passengers by 20% (SWK 2010, p. 27) in 1980.

Intensifying the market-orientation of the public-owned ports was a very relevant topic in the mid 1980s. To improve their efficiency the city council decided to increase the managerial and legal autonomy of the ports in Cologne in 1985 (SWK 2010, p. 25).

In the 1990s three subsidiaries were integrated into the SWK group. In 1992 a new logistics company was founded. The HWK AG was established as a merger of two regional train freight companies and the port of Cologne. The KölnBäder GmbH was included as a subsidiary into the SWK group in 1998. This was seen as a step leading out of the permanent crisis of the public swimming pools in Cologne (SWK 2010, p. 27.). With the KölnBäder GmbH a second area of activities was integrated into the SWK group which is still not profitable but offers services improving the quality of life for the citizens of Cologne. According to the interview partners, it was a strategic decision by the city council to use the management experience and the economic potential for internal subsidizing within the SWK group for integrating the loss-generating public swimming pools. This decision was carried by the trust that the management of the SWK group and the surpluses of the GEW AG would be the most advantageous solution and that it would be also a step towards a professionalization of the management of the KölnBäder GmbH. At the time of the integration of KölnBäder GmbH the public swimming pools also had a severe investment backlog. As “functional” buildings in line with a swimming pool design of the 1960s they did not meet the needs for fun pools with extensive wellness facilities. With the integration into the SWK group a modernization process of the swimming pools was started aiming at creating modern leisure facilities (SWK 2010, p. 27).

In 1998 the GEW Köln AG also acquired a stake in the BRUMATA METROMA Hürth GmbH (SWK 2011, p. 7). The involvement of the GEW Köln AG in the area of broadband telecommunication also dates back to the 1990s. The integration of new companies has continued through the first decade of this century. Already in 2001 the AVG GmbH & Co KG and the AVG Verwaltung Köln GmbH were integrated as fully consolidated subsidiaries into

the SWK group (SWK 2010, p. 7). In 2002 a major reorganization took place at the GEW Köln AG. Until then the GEW Köln AG had been an operating company. In 2002 this changed as the GEW Köln AG became an intermediate holding company within the SWK group. As a regionally-oriented energy company the GEW RheinEnergie AG (GEW RhineEnergy public limited company) was established. The stakes in this GEW Köln AG subsidiary belong to 80% to the GEW AG and to 20% to the Rheinisch Westfälische Elektrizitätsgruppe AG (RWE group - Rhineland and Westphalia Electricity Group public limited company).

The involvement of the GEW Köln AG in the telecommunication sector increased in 2004. Since then the GEW Köln AG has been the sole shareholder of NetCologne AG. A minority share of 20% of the local municipal enterprise in Düsseldorf was acquired by the GEW Köln AG in 2005. As a regional enterprise the SWK group also holds shares in companies outside NRW. The biggest involvements can be found within the subsidiaries of the GEW Köln AG; outside North Rhine -Westphalia the RheinEnergie AG holds shares of a wind-park operator in South Germany and Spain. In 2011, 49.62% of the highly ecologically efficient coal-heat plant in Rostock were acquired. The interview partner stressed that this acquisition is seen as a strategic investment in modern technology and as a step towards being less dependent on the highly volatile energy trading market. The RheinEnergie AG is also a minority share holder (16.3%) of the MVV Energie AG, the municipal public utility in Mannheim (SWK 2012, p. 11).

## **1. Public Mission**

The scope of the SWK group as mentioned in the annual report 2011 (SWK 2012) is the following:

- electricity, natural gas, water and heat supply,
- participation in to companies that run telecommunication networks, including telecommunication services,
- running charitable foundations to promote science, research, education, culture and family,
- operating public and non-public transport,
- operating ports,
- implementation of functions including the collection and disposal of waste, street cleaning and winter maintenance, and the provision of services in the sector of waste management,
- development and promotion of real estate, primarily of properties of affiliates,
- advertising and broadcasting,
- and the running of public swimming pools and ice sports facilities in Cologne.

This enumeration of the SWK group’s objectives shows that the scope of the SWK goes well beyond a traditional local public multi-utility. Pars pro toto the involvement in the areas of telecommunication, radio broadcasting and city planning shall be mentioned. The involvement in the area of telecommunication has to do with Cologne’s profile as a media city. The range of public services offered by the SWK group is rather comprehensive. Only waste water treatment is missing among the municipally provided public infrastructure services.

The mission statement of the SWK GmbH gives an idea of the key external stakeholders. It states the following:

- “We are a fundamental contributor to the quality of life of the citizens and provide an important stimulus for the economy in Cologne and the region.
- The SWK group creates a substantial value added for the City of Cologne.
- We work for Cologne and the region.”

## 2. Key Performance Data

Table 4 provides an overview of key service provision indicators from 1995 to 2011. For 1990 no data were available.

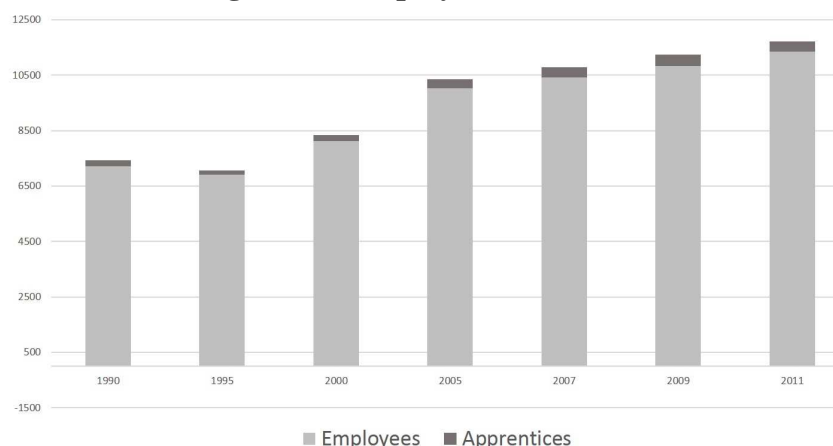
**Table 4 – Service Provision indicators (1995-2011)**

SKW	1995	2000	2005	2011
Electricity sales (incl. trading) in GWh	5,855	7,773	38,405	37,407
Heat sales in GWh	4,889	4,863	1,523	1,161
Steam sales in GWh	n.d.a.	554	631	617
Gas sales (incl. trading) in GWh	9,143	8,667	10,367	11,098
Water sales in 1,000 m <sup>3</sup>	54,866	54,216	99,144	88,814
KVB passengers in million	218.2	230.9	247.1	274.4
Freight transport in million t	4.7	5.8	21.6	22
Visitors in public baths in 1,000	n.d.a.	2,117	1,999	2,269

Source: author’s compilation based on the annual reports of the SWK GmbH.

The development of the number of employees is displayed in Figure 1.

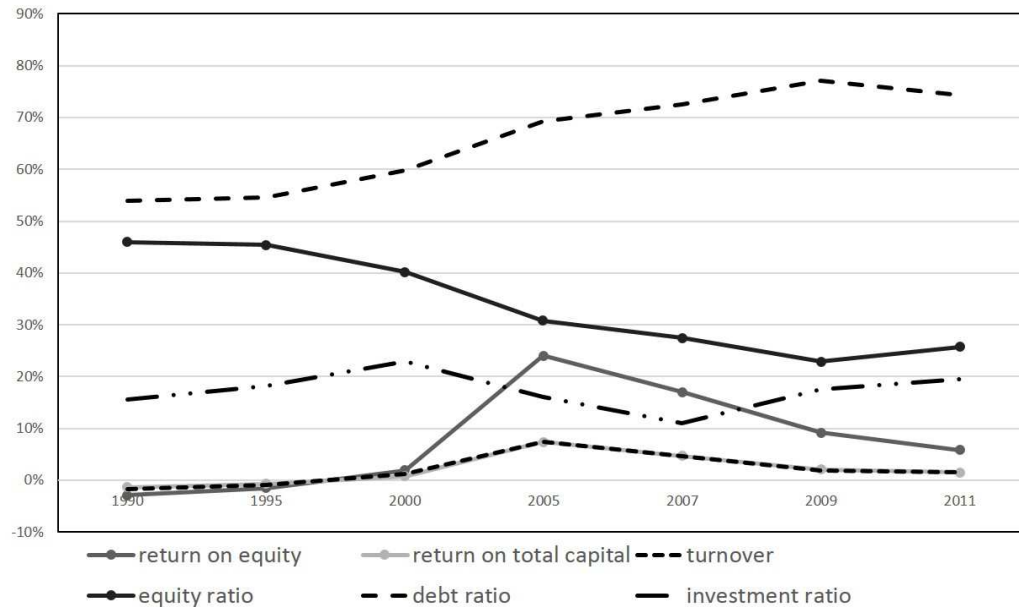
**Figure 1 – Employees (1990-2011)**



Source: author’s compilation based on the annual report of the SWK group.

Figure 2 presents the development of key financial ratios over time and figure 3 the annual results of the SWK GmbH group.

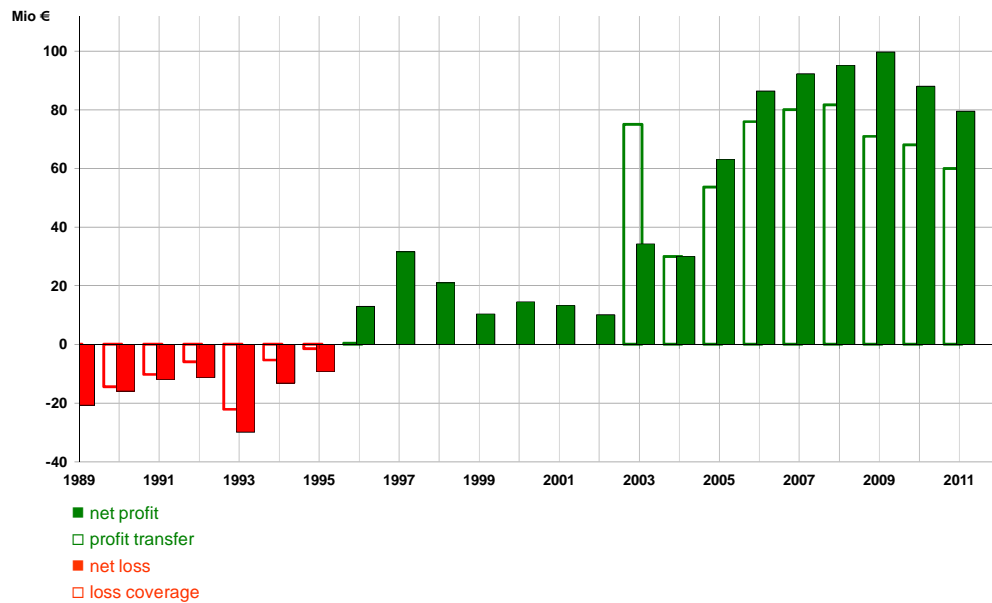
**Figure 2 – Key Financial Ratios (1990-2001)**



Source: author's compilation based on the annual report of the SWK group.

**Figure 3 – Annual results**

Annual results Stadtwerke Köln GmbH 1990 - 2011

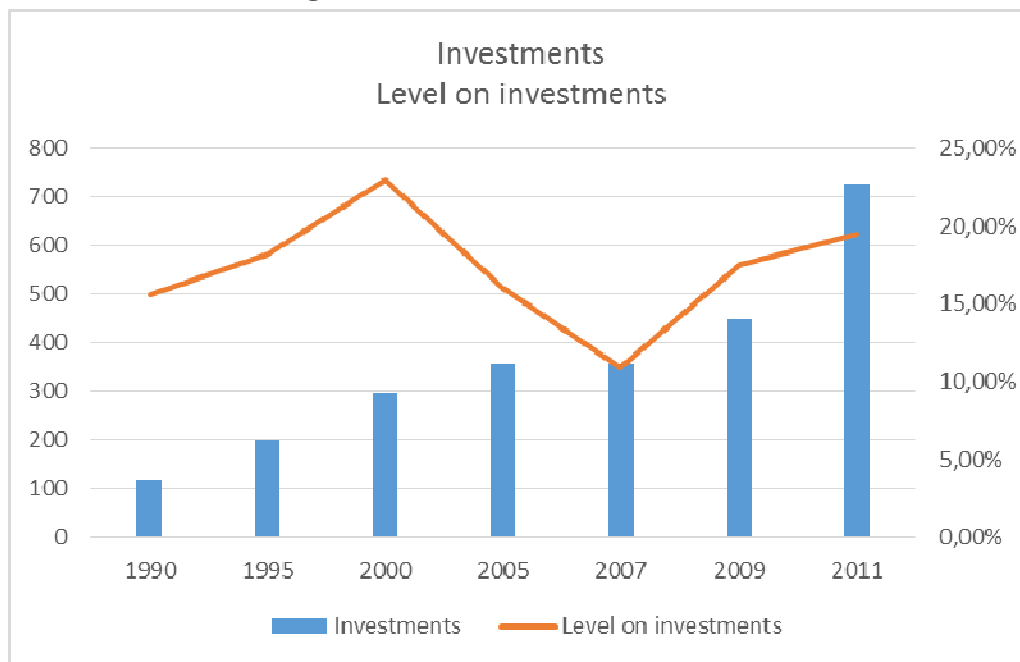


Source: author's compilation based on the annual report of the SWK group.

Continuous investments in eco-efficiency and network enlargement, in line with the growth of the City of Cologne and regional expansion have determined the investment policy since the 1970s. Between 1988 and 2008 the SWK group invested more than EUR 5.2 billion in the region (SWK 2010, p. 42).

The development of investments over time is displayed in Figure 4. The lowest investment quota was 11% in 2007 the highest level was 23% in 2000. In 2012 the SWK group invested EUR 727.8 million in energy production facilities, distribution networks (energy, water, and telecommunication) and public transport infrastructure.

**Figure 4 – Investments (1990-2011)**



Source: author's compilation based on the annual report of the SWK group.

### 3. Regulation

As stated above, the SWK group has been affected by the EU market liberalization in the area of the provision of SGEIs since the 1990s, in particular in the energy markets and public transport. Within the SGEIs water provision has so far been the least liberalized one in Germany.

In an EU 27 comparison the European Commission comes to the conclusion that the electricity market in Germany is reasonable well developed (European Commission 2012, p. 2012). Unlike in other countries a national electricity monopoly has never been established in Germany. The ownership structure of the four super-grid providers is a mixed one. The majority of shareholders of EnBW AG are the state of Baden-Wurtemberg (46.75%) and Swabian local communities (46.75%). The state-owned Swedish Vattenfall group holds 89% of Vattenfall Europe (von Danwitz 2006, p. 428). Local authorities own one-third of RWE AG, which holds 20% of the RheinEnergie (von Danwitz 2006, p. 428).

The GEW Köln AG holds 5.03% of the RWE AG (equity EUR 74,363 million). On the second tier of the German electricity provider system there are 54 regional utilities (European Commission 2012, p. 73), one of them is the RheinEnergie AG. These regional suppliers transmit the energy which they have produced themselves in their own power plants or which they have bought (von Danwitz 2006, p. 428). On the third tier one finds the vast majority of local providers (circa 800 municipal distributors) (European Commission 2012, p. 73).

In 2011 the German gas market had 18 transmission system operators, 27 regional network operators and 743 local distribution operators (European Commission 2012, p. 73). Again the RheinEnergie AG is a regional network operator. There have been significant developments towards more competition in the last few years but competition is not as intense as on the electricity market (European Commission 2012, p. 73).

The starting point of the liberalization of the energy market in Germany was the year 1998 when a new *Energiewirtschaftsgesetz* (Energy Industry Act 1998) came into force. Its major objectives were the promotion of competition, the reduction of energy costs, the improvement of energy efficiency and an increase in the market share of renewable energies (Rotaru 2013, p. 105). The amendments in EU and national legislation also affected the structure of the GEW Köln group. In 2002 the GEW Köln AG became an intermediate holding company. As a regional operating company the RheinEnergie AG was established. The second energy directive led to a fundamental amendment of the Energy Industry Act on 13, July, 2005. The unbundling of networks from other areas of activities was stringently enforced. In the case of the RheinEnergie this led to the establishment of the RheinEnergieNetz GmbH in 2005. The Energy Industry Act also substantially changed the conditions for the access to networks and the regulation of the tariffs for network access. It put an end to the German option that network access and access tariffs were determined by the “consensus of the sector” where network access conditions and tariffs were determined by a private agreement between the German industry association and associations of the energy suppliers. Since 2005 the calculation of tariffs for network access has been based on the costs of an efficiently operating network provider of a comparable size. This includes an adequate and risk-appropriate return on the invested capital stock (von Danwitz 2006, p. 447). The German regulation of access tariffs is based on the idea of an incentive regulation where upper limits for tariffs for networks access or the resulting revenues are determined *ex ante* for a fixed period of time (van Danwitz 2006, p. 447). Since 2005 access tariffs have been on a decline.

With the Energy Industry Act 2005 the structure of the regulatory agencies changed in Germany. Traditionally, the supervision of energy suppliers was carried out by state authorities of the German *Länder* (states). In 2005 the Federal Network Agency for Electricity, Gas, Telecommunications, Post and

Railways was founded as a federal regulator. The Federal Network Agency performs tasks that have not been assigned to the Land regulatory authorities. The Land regulatory authorities regulate supply companies with fewer than 100,000 electricity and gas network customers and those companies whose grids do not extend beyond a federal state's borders. Today's main regulatory tasks of the Federal Network Agency are to ensure non-discriminatory network access, the monitoring of the unbundling activities, the control of network usage rates and the supervision of anti-competitive practices. A major current challenge on the markets for energy and gas is the fact that the majority of the more than 20,000 concession contracts for electricity and gas will expire in 2015 and 2016 (Reck 2013). In recent years more than 170 private concession contracts for energy distribution networks have returned to public hands (Reck 2013). In the case of the RheinEnergy AG most concession agreements will run out in 2014.

A second major influence on the regulation of the energy market is caused by the German policy for the promotion of renewable energy as a move against the climate change. In 2011 the Fukushima tragedy caused a revision of this "exit from the exit" as a binding political solution. Immediately afterwards eight nuclear power plants were shut down. Already in 2001 the Renewable Energy Sources Act (EEG), served as the starting point of a massively subsidized expansion of renewable energy production. Compared to other countries, Germany has quite ambitious objectives with respect to climate protection which bear the German label "*Energiewende*" (energy turnaround). The *Energiewende* is having its impact on the SWK Group. The program "Energy & Climate 2020" will lead to investments in the area of climate protection of approximately EUR 100 million. The City of Cologne has committed itself to very ambitious CO<sup>2</sup> emission objectives. Here the SWK group is an important partner.

The second sector of the SWK group which is most affected by market liberalization is the *local public transport* sector. Providing good public transport within the cities is also a core element of the "*Energiewende*". In the past decade EU directives on local public transport led to amendments in the German Local Public Transport laws. Already in 2001 the European Commission (2001) published a white paper "*European transport policy for 2010: Time to decide*" which contained basic principles. The main objective is to guarantee a safe, efficient and high-quality passenger transport service through regulated competition.

As not all local public transport services that are required in the general economic interest can be operated profitably, there is a public services obligation. The relevant public authority, which is in the case under review the City of Cologne, can award exclusive rights to public service operators. The selection process for the enterprise which is granted exclusive rights must be based on the principles of transparency, equal treatment of the competitors and proportionality. For the public service obligation a financial compensation is granted. The local public authority either has the option to entrust a third party



with the provision of local public transport services or it can choose to entrust it to an internal operator without competitive tendering. By city council decisions on 15 December 2005 and 24 June 2008 the KVB AG was mandated with the fulfilment of the public service obligations till 2019. The decision of 2005 was necessary because of a decision by the European Court of Justice (case C/280/00 Altmark Trans GmbH). This ruling specified the criteria under which the provisions of Art. 87 of the EC Treaty are not applicable for local public transport. The four Altmark criteria are (European Commission staff working paper, 2011):

- Firstly, the receiving enterprise must actually have a clearly defined public service obligation to discharge.
- Secondly, the parameters for the compensation of the public service obligation must be established in advance in an objective and transparent manner to avoid that an economic advantage for the provider is created.
- Thirdly, the compensation cannot exceed the sum that is necessary to cover the costs incurred in the discharge of public service obligations. This includes a reasonable profit.
- Fourthly, the compensation is limited to the costs which are incurred by a well-run provider.

Whether these criteria are met, needs to be audited every three years by an auditor. A further milestone for the regulatory framework of local public transport was EU Regulation No. 1370/2007 of the European Parliament and the Council of 23 October 2007 on public passenger transport services by rail and road. The purpose of the regulation is the following: To define, in accordance with the rules of the Community, how a competent authority may act in the field of public passenger transport to guarantee the provision of SGEIs in a safer, qualitative better way than market forces would do. The EU regulation also specifies the conditions under which public service obligations are to be compensated. Since the enforcement of the EU regulation 1370/2007 in 2009, the City of Cologne has had to publish an aggregated report on the public service obligations once a year. The respective report of the City of Cologne as commissioning authority can be found on the homepage of the KBV AG. The report provides key figures with respect to the amount of transport lines (2011: 11 city railway lines, 43 bus lines and 8 on-demand lines (taxis and busses)), the compensation by public authorities for local public transport and the service quality. Key figures are compiled in Table 5.

**Table 5 – Compensations to the KVB (EU Regulation 1370/2007)**

Compensations	2009	2010	2011
Compensation busses	29.80 Mio €	31.3 Mio €	31.8 Mio €
Compensation city railways	78.97 Mio €	66.4 Mio €	58.7 Mio €
Lump-sum compensation by the state of NRW for investments and service quality (§ 11 PBefG NRW)	12 Mio €	12.0 Mio €	4.8 Mio €
Compensation for transport of pupils and disabled persons by the state of NRW	13.1 Mio €	13.9 Mio €	14.6 Mio €
<b>Total</b>	<b>133.87 Mio €</b>	<b>123.6 Mio €</b>	<b>109.9 Mio €</b>
<b>Total expenditures KVB AG</b>	<b>326.5 Mio €</b>	<b>363.22 Mio €</b>	<b>330.7 Mio €</b>
<b>Share of compensations in %</b>	<b>41.00 %</b>	<b>34.03 %</b>	<b>33.23 %</b>
<b>Passengers transported</b>	<b>265.8 Mio</b>	<b>272.4 Mio</b>	<b>274.4 Mio</b>
<b>Km of bus service lines</b>	<b>536 km</b>	<b>553 km</b>	<b>548 km</b>
<b>Km of city railway lines</b>	<b>237 km</b>	<b>240 km</b>	<b>240 km</b>
<b>Km of total network</b>	<b>775 km</b>	<b>793 km</b>	<b>788 km</b>

Source: author's compilation based on the reports by the Stadt Köln (2010-2012).

With respect to the promotion of market liberalization the interview partners regarded the Federal Ministry of Economy and Technology (BMWi) as more radical than the EU Commission. Compared to the initiatives from Brussels the BMWi is a much more difficult partner to cooperate with. Literally translated one interview partner said: "The EU Commission is as meek as an orphan child in comparison to the BMWi".

#### **4. Governance**

The SWK is organized in the legal form of a private limited company. As compulsory organs the German GmbH law requires the establishment of a shareholder meeting and a management board. A supervisory board must be established in GmbHs with a workforce above 500 full-time employees. According to the German co-determination laws there must be employee representatives on the supervisory board.

From an owner's perspective, the GmbH offers more opportunities to interfere in the management board's decision-making, compared to the Aktiengesellschaft (public limited company). The better chances to intervene in the decision-making process are the reason why the legal form of the private limited company is the preferred one for local enterprises in public ownership. Compared to other cities, Cologne can be regarded as pioneer in choosing a legal form under private law. On a larger municipal scale such legal forms for public utilities started to become popular in the 1970s. At that time they were

seen as an important step to increase the management board's autonomy and to limit the liabilities of the public owners.

Looking at the present supervisory board of the SWK GmbH, we find the following composition. 10 out of 20 positions are held by employee representatives. This is in line with the German law for co-determination in large companies. The employee representatives on the supervisory board either come from the companies within the SWK group or are trade union representatives. The chairperson of the supervisory board is a member of the city council of Cologne. The annual reports show that there is a long tradition that the vice-chair is an employee representative. Looking at the present supervisory board of the SWK group we see that eight out of 10 board members also belong to the city council (SWK 2012, p. 6). The other two non-employee positions are taken by the mayor of Cologne and an entrepreneur.

The current management board of the SWK GmbH has three members, all of them male. The Chief Executive Officer (CEO) is at the same time CEO of the three biggest subsidiaries the GEW Köln AG and also CEO of the biggest operating company within the GEW Köln AG, the RheinEnergie AG. Another member of the management board of the SWK GmbH is at the same time CEO of the public transport company, the KVB AG. The third member of the management board is at the same time CEO of the HGK AG. He is also the director for personnel of the SWK group. All three members of the management board spend most of their time as CEOs of subsidiary companies.

An informal but nevertheless highly important coordination organ is the monthly meeting of all managing boards of the SWK group. All sides attach great importance to these meetings. These meetings are used for coordinating the activities throughout the group.

Earlier than many other owners of municipal companies the City of Cologne made the providers of public transport and energy legally independent and granted them entrepreneurial freedom. This went along with the demand that the SWK group should act in a market-oriented way. This market-orientation became a trademark well before the EU market liberalization. Therefore the SWK group had an early mover advantage.

Throughout these more than five decades, the city has never questioned public ownership. Around the year 2000 there was a minority within the city council who wanted to privatize parts of the SWK group. However, this group did not succeed with their plans. Currently it is not part of the City of Cologne's policy to sell the family silver. The sole ownership of the City of Cologne has always been the backbone of the SWK group. The prerequisite is that the SWK group meets its annual financial and service provision targets.

Asked about the benefits of public ownership in the perception of the SWK group and the City of Cologne, the interview partners stressed that there is a shared understanding on both sides. The main benefits are:

- Private for-profit companies clearly have to prioritize the generation of shareholder value. Therefore service provision always has to take a profit margin into account.
- Private for-profit companies have an incentive to under-invest in the maintenance of network infrastructure.
- Contracting-out SGEs produces additional transaction costs.
- There is a high commitment on both sides and a trusting relationship.
- The security of service provision is higher in the case of public ownership.
- The SWK group creates a value added because there are economies of scope within the SWK group. Contracting-out services individually could not provide the same /results.
- Water is regarded as public service which should not be privatized.

With respect to economies of scope the interview partners mentioned the transport of waste by the HGK AG as it can operate a railway network which would not be profitable for a private investor. There is also a clear policy that the AWB does not charge the City of Cologne for street cleaning in the case of mega events. The expertise of the SWK in the areas of integrated public transport planning (KVB AG), city development planning (Moderne Stadt GmbH) and management expertise for providing public services in an entrepreneurial way is highly valued by the City of Cologne.

The relationship between the SWK group and the City of Cologne is described by the interview partners as close. On the one side there is a strong commitment of the city towards the SWK group. On the other side the SWK group clearly sees its obligation to provide an economic value added for the City of Cologne. According to the interview partners, the city trusts the SWK group that it will not use information asymmetries to outsmart the city. There is a clear preference of the city for conduct regulation instead of structural regulation. Under transaction cost aspects the first is preferred. The SWK group is regarded by the city as the entrepreneurial arm for infrastructure provision. The city trusts that the SWK group will act in entrepreneurial and professional way in accordance with the city's interests. The internal cross-subsidization within the SWK group is seen as an asset.

Although there is a clear preference for public ownership and therefore for the SWK group as a multi-public utility company, the interview partners stressed that it is essential that the SWK group creates an economic value added for the City of Cologne. Throughout the SWK group cost-efficiency is a key objective. Fulfilling the public mission in the most efficient and effective way is important for SWK group, according to the interview partners.

As the sole owner the City of Cologne negotiates every year with the SWK GmbH financial and service provision targets for the public services to be provided. The financial targets are ambitious but achievable with a stringent focus on a cost-efficient provision of the services. The interview partners

stressed that while the city sets ambitious annual financial targets, it does not squeeze out the SWK group like a lemon. Taking into account the current public debts such a policy can be found in many other German cities.

The management team of the SWK group uses these targets in their annual planning rounds with its subsidiaries, which are responsible for meeting these targets in their respective markets (SWK 2010, p. 43).

The financial obligations of the subsidiaries are regulated by executive contracts. Since 1996 the SWK group has been profitable. The transfer of profits to the City of Cologne has been possible since 2003. Between 1996 and 2003 net profits have been employed for strengthening the self-financing capacity.

Asked about the importance of financial objectives, the interview partners differentiated between the subsidiaries. For the GEW Köln AG Group and the HGK AG a clear priority of financial objectives exists. Asked about the relationship between financial objectives and service provision objectives, the interview partners came up with a relation of 70% to 30% in favour of financial objectives. This shows that both enterprises within the SWK group have to generate a profit to make the business model sustainable. While the GEW Köln AG has always been profit-generating, the HGK AG had to undergo some restructuring before it became profit-generating.

The relationship between financial objectives and public service provision objectives changes from 10% to 90% in the cases of the KVB AG and the KölnBäder GmbH. Here a clear dominance of public service provision objectives is apparent. Both subsidiaries went through phases of reorganization. In the cases of local public transport, the KölnBäder GmbH and the WSK GmbH, there is a clear commitment to social pricing. Reductions are granted to children, students and pensioners with the intention to make these services affordable. The amount of seasonal tickets in public transport is high. Although the KBV and the Köln Bäder are cross-subsidized, this policy is not called in question.

The documentary analyses as well as the interviews showed that in addition to the (economic) value-creation for the city, the value added for the citizens and the region is likewise accorded high priority. This is also expressed by the SWK group's slogan which is "Da sein für Köln". Literally translated this means "Be there for Cologne". The expression "Da sein" is also a play of words on the term "Daseinsvorsorge", a German notion for services of general interest.

Table 6 displays the financial value added for the City of Cologne.

**Table 6 – Transfers within the group SWK in millions**

in million EURO	2012
SWK group dividend to the City of Cologne	70.0
Internal loss coverage KVB	81.5
Internal loss coverage KölnBäder	18.9
<b>SWK group total</b>	<b>170.4</b>
Licence duty RheinEnergie	73.8
Licence duty (advertising fees)	2.7
Local business tax to the city of Cologne	15.4
<b>Total financial value added for the City of Cologne</b>	<b>262.3</b>

Source: information provided by SWK group.

The SWK is a typical example of a municipal multi-utility. Profits made in one subsidiary are used to cover losses in other areas. Table 7 provides a differentiated picture of internal cross-financing within the SWK group.

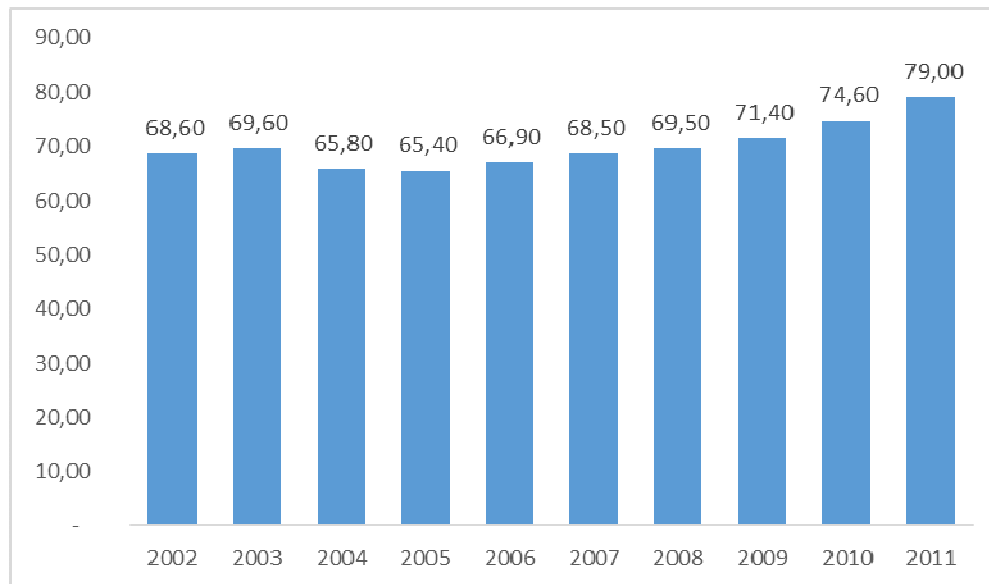
**Table 7 – Transfers within the group SWK in millions**

SWK	Deutsche Mark			EURO			
	1990	1995	2000	2005	2007	2009	2011
Profit transfer GEW	106.1	190.6	219.9	180.5	225.4	195.6	152
Profit transfer HGK	1.6	0.8	-3.9	0.1	-	-	3.5
Loss compensation KölnBäder	-	-	15	10.9	12.4	14.1	18
Loss compensation KVB	135.5	197.9	179.9	108.8	104.5	97	73
Profits AWK	-	-	-	-	7.7	12.2	12
Profits AVG	-	-	-	-	5.8	6	5.3
Profits KAW	0.1	-	-	-	-	-	-
Other shareholdings	-	-	-	-	2.4	1.8	2
Annual results	-31.3	-18.5	28.5	63	151.8	99.7	79.5

Source: author's compilation based on the annual report of the SWK group.

Looking at the KVB as the biggest recipient of subsidiaries, the following can be said: While the average percentage of cost coverage in all local public transport providers was 77.9% in 2011, the KVB slightly outperformed this figure with 79% (see Fig. 5).

**Figure 5 - Cost recovery rates (2002-2011)**



Source: KVB 2012.

The risks and chances section in the annual report 2011 highlights the fact that the environment for the SWK group is getting more complex and more volatile. Major drivers for this development are (SWK 2012, p. 51):

- a substantial increase in competition in nearly all areas,
- the consequences of globalization, trade liberalization and the crisis of the financial markets,
- a growing scarcity of important natural resources,
- more extreme environmental risks with global warming as the most important one,
- very fast and resource-intensive technological developments,
- an increase in structural regulation,
- the growing influence of EU legislation on national legislations and its consequences for enterprises and
- the demographic changes.

In the upcoming decades demographic change will in many German municipalities lead to a situation requiring the down-sizing of service provision networks; Cologne is an exception of trend as the city will be growing over the next 10 years.

With respect to the development of energy tariffs within the GEW group, the interview partners stressed that before the German Energy Industry Act 1998 came into force, profit margins were not so high. From 1998 onwards things changed due to the policy of high prices pursued by the super grid providers. At that time they produced energy with depreciated production facilities. Compared

to the 1990s it is today much more difficult for the RheinEnergie AG to make profits. For the coming years there are some doubts whether the GEW Köln group will achieve the same surplus. According to the interview partners the years when electricity provision was a fat cash cow are over. The changes in the energy markets, the reduction of the prices of the electricity nets and the large amount of money that will be needed for multi-grid technologies pose some risks. The EU plans regarding service concessions are seen as a substantial risk for the business model of the SWK group.

### **Conclusion and lessons learned**

The SWK group is an example where public service provision and market orientation go hand in hand. The City of Cologne has clear expectations with respect to the economic value added to be created by the SWK group for the City of Cologne. Earlier than many other cities Cologne granted the SWK entrepreneurial autonomy by choosing private-law legal forms. From its foundation onward, the SWK, as the parent company, has been a private limited company and its first two subsidiaries, the GEW Köln AG and the KVB AG, were public limited companies, this clear preference for private-law companies continues till today. The main subsidiaries are either public or private limited companies.

The SWK group is seen as the entrepreneurial arm of the City of Cologne for the provision of infrastructure services. There is a marked preference on the part of the City of Cologne in favour of providing SGEIs in public ownership. That the SWK group is municipal and will remain municipal is a policy which is not questioned. The commitment of the City of Cologne shows a clear long-term orientation. The public service obligations in the field of local public transport are fulfilled by the KVB AG. Third party provision of SGEIs is not regarded as a viable option for the Metropolitan area of Cologne. The provision by its own public utility provider is seen as advantageous with respect to transaction costs, the dangers of being outsmarted by a private for-profit provider, safety reasons and the quality of service provision. Furthermore, it is assumed that there is less risk of under-investment.

In the past two decades the portfolio of the SWK Group has been expanded. The city has always used the SWK group for integrating financially problematic fields of public service provision, for enhancing their market-orientation and for professionalizing the management of the new subsidiaries.

There is a clear commitment by the SWK group to the creation of value added for the citizens and the region as well as for the City of Cologne. This is reflected by the commitment to delivering high quality public service provision with energy, drinking water, public transport, street cleaning and waste collection and other service areas. The SWK is one of the largest employers in Cologne. The fringe benefits for the employees include company flats and



group-wide health promotion at the workplace. The SWK group is also one of the biggest investors in the region.

From the 1960s onward it was the guiding principle for investments in the infrastructure to invest in modern and up to date infrastructure. The policy of the SWK group can be characterized that of an early mover in the field of eco-efficiency. The first combined heat-power production plant started its service in the 1960s. Today the RheinEnergie AG invests above average amounts in renewable energy production and smart grid technology. Green technology and highly efficient energy production is an important investment area for the GEW group.

Environmental protection and sustainability are also firmly anchored in other SWK subsidiaries. As stated above, there is a long-term policy safeguard sustainability. The KVB AG has a long history of EMAS certificates. The integration of the KölnBäder GmbH in 1998 was motivated by the necessity to modernize and enlarge the facilities which resulted in the next 15 years in an ambition investment policy. The three foundations of the RheinEnergie AG are important sponsors in Cologne. Activities aiming at being a good employer date back to the 1960s when the WSK AG was established.

The SWK is a typical example of a German multi-utility provider with a high degree of internal cross-subsidizing. This reduces the financial subsidies for the City of Cologne. The business model is regarded as sustainable as long as the GEW Köln group remains an economically powerful subsidiary. A further benefit of the SWK as a multi-utility provider is that of economies of scope.

In conclusion it can be said that the SWK group is an example of a profitable provider of SGEIs with a clear focus on economic, ecological and social sustainability. The SWK group is among the most successful municipal multi-utility providers in Germany with a clear commitment for creating added value for Cologne's citizens, the region and the City of Cologne. This policy ensures the city's continuous commitment to the SWK group. The example of the SWK group shows that even more than 20 years after the Single Market Act local public utility providers can position themselves in a way that their existence is not questioned if they combine market-orientation with a strong commitment towards local and regional welfare. In the eyes of the key stakeholders the combination of welfare and financial objectives secures the legitimacy of the SWK Group in the liberalized market for SGEI.

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Université de Liège au Sart-Tilman  
Bât. B33 - bte 6  
BE-4000 Liège (Belgium)

Tel. : +32 (0)4 366 27 46  
Fax : +32 (0)4 366 29 58  
E-mail : [ciriec@ulg.ac.be](mailto:ciriec@ulg.ac.be)  
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