

Deregulation vs. Re-regulation

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“The exclusive privileges of corporations, statutes of apprenticeship, and all those laws which restrain, in particular employments, the competition to a smaller number than might otherwise go into them, have the same tendency... They are a sort of enlarged monopolies, and may frequently, for ages together, ... keep up the market price of particular commodities above the natural price, and maintain both the wages of the labor and the profits of the stock employed about them somewhat above their natural rate. Such enhancements of the market price may last as long as the regulations of police which give occasion to them.”

Adam Smith¹

I. Economics of regulation

Economists have devoted attention to the economics of regulation for a long time. Even the founder of modern economics, Adam Smith, devoted considerable part of his famous work (book IV of the Wealth of Nations) to regulation issues, especially to showing how special privileges might enrich the merchant, but impoverish the general public.

Prior to 1970s the economics of regulation was focused mostly on antitrust regulation. In 1962, Chicago economist George Stigler along with Claire Friedland wrote a classic paper on state regulation of electric utilities. They surprised many economists with their answer to an absurdly simple question: Do the various state regulatory agencies achieve their intended objective of lowering the cost of electricity? Stigler and Friedland proved their “inability to find any significant effects of regulation of electric utilities”.²

In 1971 Stigler published his seminal work on regulation.³ According to Stigler, regulation has two substantial consequences: it reallocates wealth and it imposes deadweight costs on the economy. Interest groups demand regulatory actions from the government, and try not to pursue “public interest” goals, but rather to get the government to impose regulations that benefit these groups at the expense of others. “When an industry receives a grant of power from the state, the benefit to the industry will fall short of the damage to the rest of the community.”⁴ Politicians supply regulatory actions, not to ameliorate market imperfections associated with a natural monopoly or to increase aggregate social welfare, but

¹ Smith, Adam: The Wealth of Nations, The University of Chicago Press, Chicago 1976, p. 69.

² Becker, Gary S. and Nashat Becker, Guity: The Economics of Life, McGraw-Hill, 1997, p. 309.

³ Stigler, George J.: “The Theory of Economic Regulation”, Bell Journal of Economics and Management Science, 2(1), Spring, pp. 3-21.

⁴ *Ibid.*, p. 10.

rather to respond to the desires of interest groups that are in a position to deliver benefits to the politicians (for example increasing their probability of being reelected). The scope and character of the regulatory actions reflect the interests of those groups that are in the best position to influence politicians. Stigler modeled regulation “as a profit-seeking enterprise in which self-interested groups and individuals attempt to gain via the use of coercion.”⁵

Before Stigler’s contribution, the vast majority of economists shared the idea that government regulation was instituted primarily to protect and to benefit the general public, and that it represented a social response to various kinds of “market failures”. Historical facts, however, are different. The development of electroenergy and telecommunications at the start of 20th century was similar. These network industries were not originally monopolies, and they were not natural monopolies at all.⁶ Business people, two chiefs of leading companies at that time, Chicago Commonwealth Edison and AT&T, invited the government to supervise electroenergy and telecommunication industries in order to to secure a long-term market share for their companies. They initiated the later establishment of regulation agencies for individual industries, administrative market sharing, and the rise of regional and local monopolies. Stigler considered modern economic regulation to be “mercantilism in a new costume, still masquerading as public interest.”⁷

Another substantial contribution to the economic regulation theory was made by Sam Peltzman in 1976.⁸ Peltzman proved that politicians “sell” regulation to the highest “bidder,” in a market where “bids” take the form of money bribes, votes and other resources valuable to political decision makers. Peltzman admitted the possibility that government regulation does not have to be solely affected by producer interest. This is why government regulation is usually designed to appeal to both the organized producer and the organized consumer interests. Not all producers and not all consumers benefit from a particular regulation, but rather the subgroups that are able to push through the regulation in such a form, that it fits

⁵ Anderson, Gary M.: “The Economic Theory of Regulation” in *The Elgar Companion to Austrian Economics*, Edited by Peter J. Boettke, Edward Elgar, Cheltenham, UK, 1998.

⁶ Samuel Insull, the president of National Electric Light Association (in Zajicek, Miroslav: *Competition within Czech Gas Industry*, Liberalni Institut, Prague 1999, pp. 75-76) and at the same time the head of an electricity company Chicago Commonwealth Edison operating on the competitive market, gave a presidential address on June 7th 1898, in which he proposed the third way between socialism and predatory competition (in Bradley, Robert J., Jr.: “The Origin of Political Electricity – Market Failure or Political Opportunism?”, *Energy Law Journal*, Vol. 17/59, 1996) “The best services for the lowest prices can be achieved...by exclusive control of a certain territory that will be concentrated in the hands of the only electricity company...To protect public these exclusive licences have to be connected with public inspection and complete regulation of all prices for services...The higher security will be provided the lower will be interests and total costs. Consequently prices for supplied services will be lower for public as well as public consumers.” All these arguments are alive and are frequently used by supporters of regulation still today. By 1915 regulation agencies were established in 33 of the US states. A similar role to the one Samuel Insull played in electroenergy was played by the head of AT&T Theodore Newton Vail in telecommunications. He was convinced that telephones shall connect each user with somebody else. Universal service was his term for this concept. Vail started to buy out his competitors. Because Sherman Act was valid since 1890, Vail was afraid of being blamed for monopolization. Vail changed his strategy, declared that competition within telecommunications did not lead to universal service development, but rather to inefficient duplication of mutually disconnected telecommunication networks. In 1913 an agreement was signed by the government and AT&T, known as the Kingsbury commitment. Consequently the telecommunication market was commercially divided and local monopolies arose. Such was the start of the end of competition in telecommunications. The end was closely connected to the passing of the Communication Act in 1934 and the foundation of the Federal Communications Commission (FCC). (in Stastny, Dan: “(Don’t) Be afraid of monopolies!”, *Terra Libera*, Nov. 2000, pp. 1-3)

⁷ High, Jack: “Regulation as a Process: On the Theory, History, and Doctrine of Government Regulation” in *Austrian Economics: Perspectives on the Past and Prospects for the Future*, (Champions of Freedom, Vol. 17), edited by Richard M. Ebeling, Hillsdale College Press, Hillsdale, Michigan, 1991, p. 268.

⁸ Peltzman, Sam: “Toward a More General Theory of Regulation”, *Journal of Law and Economics*, 19, August 1976, pp. 211-240.

with their interests. Regulators allocate benefits across organized producer and consumer groups so that the regulators' total utility is maximized. According to Peltzman, all politically effective groups share the rents at the regulator's disposal.

The effect of interest group competition on the economic efficiency of government regulation was presented by another Chicago economist Gary Becker.⁹ Becker adds a significant limitation to the inefficiency of the regulation. He assumes that groups exert pressure on politicians in order to obtain benefits for themselves or to exempt themselves from paying benefits to others. The actual regulatory regime at any given time represents an equilibrium in the competition between these opposing forces.¹⁰ Competition between pressure groups contributes to the survival of public policies that raise output in the long run.

Both Becker and Peltzman recognized that the continuation of a given regulatory regime requires a continuing investment of resources by its beneficiaries as they lobby to fight off attempts on the part of anti-regulatory interests to reduce the regulatory burden.

Both Peltzman and Becker extended their economic theory of regulation to the problem of deregulation. They assumed that government regulation of particular industries tends to relax in cases where marginal benefits or marginal costs, or both at the same time, shift in relation to relevant interest groups on either side of the policy. The most significant examples of deregulation in the past were marked by a decline in the marginal benefits from regulation for producers and an increase in marginal costs for consumers. This fact shifted the political equilibrium, which evoked a change in the regulatory regime – the re-regulation.

Regulation was an interesting topic discussed during the 1st meeting of the Mont Pelerin Society in April 1947. There was a session entitled "Free Enterprise or Competitive Order?" in which Hayek read the main paper.¹¹ A very stimulating discussion followed with the participation of many former distinguished Society's members. Controversy about regulation, specifically antitrust, between Chicago economists and their associates on one side and Austrian economists on the other side, has already appeared.¹² The economic theory of

⁹ Becker, Gary. S: "A Theory of Competition among Pressure Groups for Political Influence", *Quarterly Journal of Economics*, 98, August 1983, pp. 371-400.

¹⁰ „Becker's key argument is that under these conditions deadweight losses are a constraint on inefficient regulatory policies. Deadweight loss is the winner's gain from the regulation minus the loser's loss. These gains and losses are what motivate the competing pressures on the political process. Therefore rising marginal deadweight costs reduce the incentive to pursue more regulation and power the incentive to oppose it as well, from the perspective of the respective interest groups. In other words, the regulatory outcomes which reduce deadweight cost (economic waste) tend to dominate because reducing deadweight cost makes size of the "pie", for distribution between competing pressure groups bigger. Rational self-interest on the part of the competing pressure groups tends to force more efficient outcomes.“ (in *The Economic Theory of Regulation* by Gary M. Anderson in *The Elgar Companion to Austrian Economics*, Edited by Peter J. Boettke, Edward Elgar, Cheltenham, UK, p. 296)

¹¹ From the e-mail message "Austrian vs. Mainstream Views on Antitrust" posted by Richard Ebeling on *mises.org* on Sept. 4, 2001, at 18:18.

¹² Ludwig Mises said at one point: „If it is true, as has been suggested, that I am defending the orthodoxy of the 18th century, then it is true that I am defending it against the orthodoxy of the 17th century. ... Interventionists all wanted different types of intervention. Therefore they thought they were in opposition. ... We are discussing monopolies from the viewpoint that governments are against monopolies, but they are not...“

Lionel Robbins then said: „We agree with Professor Mises that most of the interventions of the state in regard to the working of the market mechanism has been bad...“ And finally added: „It was an essential principle of the idea of a competitive society that freedom of contract should not be allowed to destroy freedom of contract...“

Mises replied, curtly: „All the troubles with monopoly springs from the way in which government policy is fostering monopoly. Why do people attack monopoly but not the patent law, tariffs, etc.?”

Mises later: „Should society be based on public ownership, or private? There is nothing between them which is permanently possible for society. I am in favor of private enterprise. If consumers buy something, so that a firm increases in size, I don't want someone to come along and prevent them from enjoying the results of this...“

regulation is a product of the Chicago school. Of course, it is based on methodological individualism and it extends market reasoning to the problem of explaining the behavior of government actors as rational, self-interested agents. This approach is generally consistent with the Austrian economic theory. However, differences in opinion between these schools of economics survive for more than 50 years and the controversy continues. Competition of ideas was to the benefit of both Chicago and Austrian schools. Nevertheless, free competition in ideas is of greater benefit than the regulated one, although “rational.”

II. Californian deregulation trap

No case of deregulation ever raised more interest and comment from the media than the Californian one. No wonder. If economic processes change the usual lifestyle, or even take it several decades back, then journalists and politicians have to react somehow. From their point of view, it was the 1996 electricity industry deregulation that caused blackouts in America’s largest and richest state. According to most of them, this was just another example of how markets cannot operate without proper regulation. Politicians recognized that it was their responsibility to solve the problem, and suggested further regulation of the deregulated and collapsing Californian electricity market.

What exactly did the Californian electricity deregulation involve? The state government freed the wholesale, but not the retail prices. Moreover, the state prohibited utilities from closing long-term purchase contracts, instead requiring them to buy power on the spot market through the monopoly state agency, called the Independent System Operator (ISO). ISO took over operational control of California’s electricity transmission grid. There exists a mandatory bidding pool, in which all the sellers of electricity are paid the price of the last bidder able to meet the total demand. This bidder, of course, offers the highest price. The law basically created a micro-managed pseudo-market, in which the suppliers of electricity had the ability and incentive to manipulate prices to their advantage. The largest customers – utilities – were forbidden to shop for better prices. A system of this sort naturally effected an increase in electricity prices.

The “deregulation law” set up unbelievably high charges for covering stranded costs. These costs were determined by the former system of regulatory rules for the electricity industry when power generation was also an object of direct regulation. The mandatory charges were supposed to cover the former loss-making investments.

The “deregulation law” has preserved the obligation to provide electricity for demarcated areas. The distribution companies have retained their regional monopoly, but they are liable for the provision of electricity to all customers.

The state government mandated that the utilities sell their generator facilities, but did nothing to create conditions for the construction of new plants with competitive electricity supply. No new plants in California have been built in 15 years because of unclear rules, excessive environmental regulation,¹³ growing not-in-my-backyard activism, and increasing bureaucratic delay. California currently produces less power per resident than any other state

Finally the session ended by the following remark by Aaron Director, of the University of Chicago: „I don’t think we shall ever get anywhere in defining what the rules of the game should be, if we don’t know whether there should be any rules at all. Professor Mises seems to think that past rules are good rules. I should like to know, how far back?“

¹³ Ralph Nader, the would-be patron of consumers and an ecology activist, usually received the largest amount of election votes in California.

in the U.S. and imports one-quarter of its energy from places as far away as Quebec. These types of barriers contributed to an increase in electricity prices last year.¹⁴

Forecasts of government bureaucrats, ecologists and power engineers that new technologies and the Internet would decrease the total consumption of electricity proved to be completely wrong. Electricity consumption grew by up to 25 percent and more in some Californian regions in 90s.

A number of factors (a hot summer and cold winter, drought and high natural gas prices) contributed to California's 2001 energy crisis. However the design of the market, which prohibited the passing of appropriate price impacts on to end costumers, made the crisis worse than it needed to be. Price regulation for end customers (price ceilings on electricity prices) was a bottleneck that contributed to growth in the demand for electricity. The supply side could not react because of excessive regulation, which resulted in a lack of electricity. The Californian energy crisis became reality.

This was not the envisioned when the state government passed a law on the deregulation of the utility industry in 1996. California was the first state that publicly declared "the end of a monopoly and opening of an electricity market."¹⁵ However, restructuring based on detailed, centralized micromanagement, rather than real deregulation was realized. The government succeeded in imposing more regulations on electricity transactions than ever before, and it changed the structure of the electricity industry, but it did not deregulate it. Ignoring this fact, politicians and journalists now blame deregulation for the current electricity crises in California. The expected reaction has appeared – an endeavor at re-regulation. Misunderstanding, misuse, and confusion of the deregulation concept moved California closer to the Third World than blackouts.

The "deregulation" of the Californian electricity industry is a prime example of a regulatory failure.

III. EU deregulation mockery

The restructuring of network industries within the EU is incorrectly termed deregulation.¹⁶ The EU "deregulation" (i.e. restructuring) consists of several practical measures that form the substance of the so-called deregulation mainstream. Just as mainstream economics, its principles are acceptable to regulators, regulated companies, the majority of politicians, and mainstream economists. The EU "deregulation" could not be realized without the following features:

1. Regulator

A national regulatory agency plays the key role in the EU deregulation. Individual EU utility mega-regulators play this role in different industries under the supervision of the European Commission. Almost no one in Europe (except for some libertarians) is able to conceive of a functioning utility market without an explicit regulator. Instead of checking whether new deregulatory legislation is being adhered to during a period of replacement of a monopolistic market structure with emerging competitive market structure, the role of regulators should be reduced with subsequent deregulation, and the duration of their appointment should be limited by a sunset clause.¹⁷ No European country was able to pass

¹⁴ Bandow, Dag: "Power Out", The Washington Times, January 22, 2001.

¹⁵ Zajicek, Miroslav: Cohesion of Energy Markets, Liberalni Institut, Prague 2001, p. 104.

¹⁶ The electricity industry is one of the leading industries connected with deregulation in the EU. That is why I will use the practical examples from that particular industry.

¹⁷ Sunset clause is a time limit for the regulatory agency or any other government entity existence determined by the law. The existence cannot be prolonged without proving further usefulness.

this clause in its deregulation legislation. The regulatory agencies seem to be here forever. In order to demonstrate the necessity of their existence for network industries, national regulators strive to design a new structure for the industry. That is a task at which regulators have been, and are likely to continue to be, incompetent.

“A key issue with regulator-controlled deregulation is where will it end. The optimistic view is that once the changes start, the process will lead inevitably to full deregulation—the experience in transportation (freight transport) reform. The pessimistic view is that the regulator’s reluctance will severely hinder evolution and overextended battles will prevail – the telephone case.”¹⁸

2. Third-Party-Access (TPA)

The European directives strive to promote a non-discriminatory access by licensed economic agents to the network, which is considered to be a natural monopoly. There are two approaches to removing barriers to competition according to the deregulation mainstream:

a) Single buyer. This approach is based on the existence of one buyer appointed by the government. The single buyer purchases electricity from all producers involved in electricity transmission. The purchased electricity is sold to distribution companies or directly to end customers. There is competition in production – producers compete for the provision of their electricity to the single buyer. Purchase prices are determined by the single buyer, and the prices for end consumers are determined by the purchase prices, plus transmission costs, plus adequate profit for the single buyer. The greatest weakness of this method is the single buyer’s lack of responsibility. This lack of responsibility combined with the single buyer’s privileged position gives opportunity for corruption, because producers have an incentive to bribe the single buyer in order to get a better contract. This method brings to mind the famous matrix of Milton Friedman.¹⁹ According to this matrix, the worst scenario is when one spends other’s money for someone else. This scenario lacks positive incentives to spend money efficiently. The single buyer’s decision-making behavior is the same. “It purchases for somebody else’s money for somebody else. Money is supplied by customers.”²⁰ Of course, this is not the reason why most of EU countries prefer other methods (TPA) to the single buyer.

b) TPA assumes the existence of a natural monopoly only in distribution and transmission, and the separation of transmission and distribution from production and trade. TPA²¹ enables wholesalers and authorized customers to contract directly with producers and with one another. TPA creates conditions for the removal of discriminatory access, but it cripples incentives to own or build up new grids. The grids under such an operation regime prevent the further development of the energy sector.

3. Public service liability

This principle follows from the alleged existence of a public economic interest. Although the concept of public service is not precisely defined, this term is used very frequently by politicians. The public service liability principle concerns not only safety,

¹⁸ Gordon, Richard L.: “Don’t Restructure Electricity; Deregulate”, The Cato Journal, Volume 20, No. 3, p. 327.

¹⁹ Friedman, Milton & Rose, Free to Choose, Liberalni Institut, Prague 1992, Chapter 4, p. 118: “The simple classification of spent money shows why this process leads to undesirable results. When you spend you can spend your money or money of somebody else; and you can spend it to your benefit, or to benefit of somebody else.”

²⁰ Dusek, Libor: Competition: The Road to Efficient Production and Consumption of Electricity, Liberalni Institut, Prague 1998, p. 34.

²¹ There are two types of TPA: negotiated TPA and regulated TPA. The system operator in the negotiated TPA releases only indicative interval for rates for using the grid. The concrete price is negotiated with the client. In the regulated TPA the system operator issues fixed rates.

continuity, quality and price of delivery, but also environmental protection and a duty to deliver electricity, or gas, or voice service, in remote areas, or for selected people for a subsidized price. This liability seems to be a sacrifice for suppliers, but in reality it is not. It represents only the preservation of the supplier's monopolistic position toward a group of customers who are specifically selected or located in a certain area. As a means for the implementation of the public service liability principle, the EU countries may establish an institute for long-term planning. (Its mission is expected to include the planning of supply and the transfer of capacity, in order to satisfy demand in the long-term perspective, and to diversify energy resources and guarantee delivery to customers).

4. Centralized control of investments

This principle is based on the EU bureaucrats' anxiety about excessive building of new generators and grids. They are afraid of overproduction, inefficient duplication and environmental protection. There are two ways to achieve "public interest" in the future provision of energy supply: proposal of tender and authorization. Proposal of tender is organized by the government. The organizer (the central planner) releases a specification of public demand for new energy resources, and specifies parameters such as safety requirements, environmental protection, type of primary fuel, investor's financial situation, etc. Only auto-producers and independent producers²² can avoid this procedure, but they have to take part in the authorization proceedings. In this approach, the producers make decisions about investments instead of the central planners. However, the final approval is in the hands of government bureaucrats, because investors have to apply for an authorization permit in order to build a new energy resource. Even if the government issues an authorization, it can still set up additional limitations for a new energy generator.²³ If the authorization is not issued, the government has to give its reasons for the rejection of the project. The centralized control of investments proves that Eurocrats have not relinquished their conviction that central planners have access to superior information.²⁴

5. Negative reciprocity

This principle reflects the different level of market openness in various countries. According to the negative reciprocity principle, a country with a more open market can reduce the access of electricity producers from a country with a less open market to its market. Although this seems fair, it is against the principles of a free market. It preserves the current monopolies in the more liberalized markets and slows down the liberalization of the international market.

The typical EU deregulation directive is in reality a re-regulation law the size of a big city phone book. Well-known European lobby groups greatly contributed to this. The Greens pushed through the idea that EU member countries can ask the system operator to prefer the suppliers of electricity from renewable energy sources. The coal lobby pushed through the clause that EU member countries can, of course for delivery safety reasons, prefer suppliers of electricity produced from domestic sources. Interests of monopolists are protected by the "transition period provision," which solves the stranded costs issue. If any government provides guarantees on nuclear power plant investments and these turn out to be unprofitable on the open market, then the government may ask the European Commission for temporary

²² The auto-producer is a person producing electricity for his own use. The independent producer is an entity that does not operate the grid or the distribution system in his country of origin, or it is an entity that is not exclusively subordinate to the electricity system hierarchy.

²³ Practically the same as in the proposal of tender.

²⁴ Hayek, Friedrich August: "The Use of Knowledge in Society", The American Economic Review, 1945, Vol. 35, No. 4, p. 519-530.

postponement of market opening. Such is the protection of national monopolies by European governments (for example, the French government protects EdF and GdF).²⁵

“True deregulation would have actually freed markets to operate according to supply and demand. It would have removed rules and barriers instead of creating a mass of new ones. It would have granted government less control, not more.”²⁶

IV. Deregulation Magic in the Transition Countries

All central, and some east European countries, with transition economies have applied for EU membership. A vast majority of political leaders, journalists, business people and academics in those countries strive to follow what could be termed the implicit 11th Commandment “You shall not doubt the EU and the necessity of our accession.”²⁷ In accordance with this approach, the state bureaucrats read and translate tons of EU laws, regulations and prescriptions and strive to change and adapt our legislation so that it is fully harmonized with the EU.²⁸ The same thing is happening in deregulation legislation. The magical EU acronym dominates almost every discussion about deregulation and the EU arguments are always the most convincing ones.

European directives embody the compromise resulting from complicated negotiations among EU member states, each of which has its own partial interests. Interest groups in transition economies` energy sectors with in-depth experience from command economies are very skillful in adopting extended and vague EU directives. They use their successfully tested communist know-how to negotiate the softest plan items with the government bureaucrats in order to pass national deregulation bills which follow the bottom line of EU deregulation directives. The bottom line can be defined as the status quo. In reality it is a connecting element between the former monopoly regulation and the new cartel re-regulation. The cartel structure is wilfully created either by the so-called independent regulators or by state bureaucrats by means of licence or authorization provisions.

The interest groups in transition economies are more successful in the legislation process than their EU competitors. The contents of the Czech energy legislation can serve as an excellent example of their lobbying abilities. The Czech laws contain almost all of the possible exceptions and postponements that the EU directives allow for.

What are the most pronounced features of utility industries deregulation in transition countries?

1. *The almighty state*

The government plays a schizophrenic triple-act as:

- the author of energy policy
- the owner of monopoly or dominant entities on the national energy market
- the regulator

²⁵ The EU directive 96/92/EC of European Parliament and European Council on general rules of electricity inner market and the EU directive 98/30/EC of European Parliament and European Council on general rules of gas inner market.

²⁶ Reed, Lawrence W.: “The California Power Mess”, Ideas of Liberty, April 2001, p. 17.

²⁷ Hampl, Mojmir: “Why I am not an Euro-optimist”, Laissez-Faire, Prague, 11/98, p. 1.

²⁸ See Sima, Josef: “From the Bosom of Communism into the Claws of the EU Central Planners”, Journal of Libertarian Studies, Spring 2002 (forthcoming).

The result is inefficient governance control in state-owned companies,²⁹ lack of incentives for state bureaucrats to initiate progressive changes in the regulatory framework, and an absence of political courage to enforce any substantial structural changes.

2. Protected customer instead of the captive customer

The Czech energy law fully harmonized with the EU energy deregulation legislation uses the euphemistic concept of the protected customer. The Czech legislators assumed that households with small energy consumption have the right to be protected from giant energy suppliers. They did not comprehend that the equality of a contract does not depend on the size of contracting parties, but on the supplier's, as well as the customer's, freedom to choose.

These legislators do not understand that competition works beneficially in all market segments. Division of the market into captive and authorized customers will have a negative impact on the whole market, but especially on the captive customers. Price changes will be different for both segments. While prices for authorized customers can be expected to decrease, prices for captive customers will increase. Danger of cross-subsidies will be preserved, but in the opposite direction (from captive customers to authorized ones).³⁰

3. Perverted privatization

Privatization is often connected with industrial policy. Some governments have split up the state monopoly utility companies before privatization. The former electricity monopolies supplying electricity generation, power transmission, trade and distribution were usually divided into various monopolies dealing with a different part of the formerly consolidated business. The result of such an industrial policy is the existence of a dominant company on the electricity production market, monopolies supplying electricity distribution in demarcated areas, and a monopoly providing electricity transmission on the grid. Because privatization in transition economies did not immediately follow restructuring, and because in the meantime the international energy market substantially changed, the political cycle with constantly changing governments necessarily led to an industrial policy connected with the new government. Typical industrial policies during a transition period are non-systemic, half-way, unfinished and mutually incompatible. Every delay in privatization process decreases the price of state owned assets. The unfinished privatization contributed to deregulation delays.

Governments in many transition countries are willing to sell state property to the state owned company (for instance EdF or GdF) in order to obtain maximum income from the sale of state assets for the payment of irresponsible government projects. In order to get a greater amount of money, some governments do not hesitate to issue privileges to privatizers for the coming years and thus to restrain competition.³¹ Maximum income and maximum redistribution by means of budget expenses is usually the most preferred goal of the government.

Under tight state regulation the government does not lose its economic power, even after finishing privatization process. Only the specific mechanisms of government control have changed. Tight state regulation does not support the appearance of a competitive environment, which is always beneficial for customers.

4. Stranded costs

²⁹ The monopoly or dominant energy companies in the Czech Republic are joint-stock companies fully or partially controlled by the government or its agencies.

³⁰ The regulator will not be able to prove the level of qualified costs.

³¹ The case of the Czech Telecom, in Gary Becker in Prague, Liberalni Institut, Prague, 1995, p. 49.

During the pre-privatization agony of electricity companies controlled by the Czech state (more than 10 years) irreversible investment decisions that evoked stranded costs were made by the government bureaucrats.³² These relatively new stranded costs resulted in a fear of opening the markets. Politicians began to be afraid of getting the expected amount of money from state owned energy company privatization for their spending and vote purchasing. Fear of cheap electricity imports³³ from the East European countries delayed the opening of electricity markets. Absence of foreign competition increased the domestic price level. The biggest beneficiaries were the owners of power plants burdened by stranded costs.

5. *Surviving cross-subsidies*

The irrational price structure was derived from the communist past. Many plans were adopted for price adjustments. The only result was an increase in energy prices for all consumers. The cross subsidies remained intact. Cross-subsidies and relatively cheap energy for households, in comparison to EU member countries according to the nominal exchange rate, are always an attractive tool in the hands of politicians, who use it to purchase votes. On the other hand, there was a lack of market pressure by big consumers for a price decrease. Such surprising behaviour, different from the standard behaviour of big energy consumers in EU countries, can be explained by the tighter relationship between business and policy in the transition countries. Direct state ownership, arbitrary and selected subsidies, and other non-transparent forms of state assistance affected the incentives for big energy consumers to press for a price decrease. Price cuts for big consumers are impossible without a rational price structure based on full price liberalization in the energy sector, a market opening, and deregulation.

The transition countries imitate the economic policy of EU countries, including welfare-statism. The EU standard of living is a great enticement for populations from transition countries. But the current economic policy of most EU member countries would not be capable of securing the present high living standards, because wealth is more redistributed than created in many countries. Imitation of contemporary EU economic policies by transition countries is the longest way how to achieve the present EU living standards. It is similar to deregulation processes. The EU way of deregulation looks to be the slowest one. Given the transition countries' deregulation peculiarities, the way to deregulation could be even longer. Hopefully technological progress³⁴ and new market practices will deregulate utility markets faster than politicians and government bureaucrats can even imagine.

V. Conclusions

There are at least two fundamental reasons for objecting to public utility regulation:

1. The natural monopoly (if it ever existed) has disappeared because of market growth and technological changes.³⁵

³² Examples include the decision to finish the nuclear power-plant Temelin in 1992 (the state owned company CEZ was the investor), that has not been finished yet, and the 15 years long contract (of "take or pay" type) on delivery of Russian gas to the Czech Republic through the mediation of state monopoly gas importer Transgas company.

³³ The official reason is an absence of environmental regulation in the countries East of the Czech Republic and their incomparable economic systems (especially lower taxation and social and health security payments).

³⁴ „New small generation technologies make self-generation a viable alternative to the traditional grid.” Michael Block (Goldwater Institute, Phoenix), in *Deregulation of Electricity Markets: An American Perspective*, Liberalni Institut, Prague, 1998.

³⁵ “Old concepts in economics die slowly, but the concept of natural monopoly is no longer of much relevance to economic policy. The sooner we get rid of this dated idea, the better off the average consumer and producer will

2. Whatever the circumstances, regulation is more likely to worsen, rather than to improve, the general economic and social situation.

The deregulation process involves the following steps:

1. Reduce state, regional and local “public utility” regulation .
2. Liberalize all prices (elimination of cross-subsidies).
3. Repeal regulatory authorities.
4. Abolish government “public utility” development plans.
5. End subsidies to some industries (rail transport, agriculture etc.)
6. Privatize all government-owned and controled economic entities and eliminate preferential access rules.
7. Drop requirements for demand-side management, integrated resource planning, or internationalization of costs as part of deregulation.
8. Rationalize environmental regulation.

Adoption of these steps will lead to real deregulation with unlimited positive effects on consumers and on producers as well. Depoliticization of utilities will be a substantial by-product. Ending government regulation, not aiming for “better” regulation, is the only to revitalize currently regulated energy, telecommunication, water supply, postal service and transportation markets.³⁶ As a result, consumers will be able to get the full benefit of new technologies, market practices and service provisions.³⁷

Politics plays the decisive role in influencing the nature and performance of regulation, and the speed and direction of regulatory reform and deregulation.³⁸ Politicians and their actions will decide whether dissatisfaction with present regulation will lead to deregulation or re-regulation. Unfortunately, they speak in support of the former, but they act upon the latter.

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be.” (Becker, Gary S.: There’s nothing natural about “natural” monopolies, Business Week, October 6, 1997, p. 12)

³⁶ See more in Gordon, Richard L.: “Don’t Restructure Electricity; Deregulate”, The Cato Journal, Vol. 20, No. 3, Cato Institute, Winter 2001.

³⁷ See “Congress, Set the Phone Companies Free” in The Economics of Life by Gary S. Becker and Guity Nashat Becker, McGraw-Hill, 1997, pp. 18-20.

³⁸ Peltzman, Sam: „The Economic Theory of Regulation after a Decade of Deregulation“, Brookings Papers on Economic Activity, 1-41.