THE EFFECT OF MARKET REGULATION ON NEWLY PRIVATIZED STATE-OWNED COMPANIES

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Abstract

Before the '70s the regulation economy was focused on antitrust laws. In 1962, the economists George Stigler and Claire Friedland [1] shaped the regulation idea on state-owned utilities companies (especially in the energy sector). They answered to the following question: can some regulatory agencies to achieve their goal of decreasing the cost of electric energy? Stigler and Friedland had shown „the inability to find some concrete effects of regulations on the price of electric energy".

This fact corroborated with the idea that the public sector is an efficient instrument for reaching targeted goals in European and emergent countries and the privatization phenomenon. This research paper tries to answer the question of what is happening when state-owned companies are privatized, are they getting along at the same pace in the regulated market economy or are they on an ascending trend for peak performance.

Key words: market *regulation, privatization, state-owned companies, deregulation, economic growth*.

JEL classification: *D47, I38, L51, L94, P48.*

1.Introduction

The public sector or the state owned is seen as an efficient instrument for distributing and achieving proposed objectives in European countries and especially in emergent ones through the fact that this sector helps reach allocation efficiency, a higher rate of employment and developing the entire economy, to which is added the development of the corporate behavior that involves: promoting exports and replicating state governance through corporate governance. Opposed to the European vision we find the Japanese and the American vision that underline small involvement in nationwide execution in the public sector [2]. In the '90s the largest number of privatizations was seen at global level, fact stressed by a lower level of governmental trust in state owned companies and also in higher budgetary expenses.

In Europe the privatization was executed at large scale in the '90s, starting with France and United Kingdom in 1986, followed by Italy, Spain and Germany in 1993 [2]. Between 1979 and 1999 in Europe the privatization changed the economic vision because it gave a powerful private sector and it streamlined remaining state owned companies [3]. These changes in vision were also according to political and ideological changes for those times, like "*Thatcherism"* and *"Reaganism"*, but the crisis from the year 1987 and the one started in 2007 were delayed by some unsolved issues had by the private sector in the relation with the public sector to which was added technological advance that eliminated some monopoly positions from the market.

To technological advance we could add the advance of telecommunications and manufacturing and distribution of energy. Information technology helps neutralize natural monopoly or even streamline some oligopolistic position by increasing allocation efficiency. The modern monopoly case study could be seen through the nationalization of a company, similar to TARP in 2009 (US) [3]. In the case of oligopoly we have the evolution towards a market by replicating oligopolies of companies by new comers through technological advance. AT&T in 1984 is an example of a monopoly that was sliced in smaller entities to reduce costs and streamline the economy. In both cases (monopoly or oligopoly) we have the state owned company that shouldn't have as primary purpose to obtain profits because it could operate also with losses, loss that couldn't be seen as a negative fact because it is connected to the main objective of the public company. The company should operate on the idea that the price is equal with the marginal cost, fixed costs are marked losses that are covered by the public budget allowing this way allocation efficiency.

2. The Comparative Analysis between Regulating or Deregulating the Market

The founder of modern economics, Adam Smith, deployed in "*Wealth of Nations"* the idea of regulation, based on the fact that a seller has some advantages, but with a cost transferred to the large audience [4].

Stigler realized in the '70s that regulation has two major consequences, it reallocates wealth and creates waste costs in the economy. Interest groups demand regulations from the government and try to reach a goal on the behalf of the public good, but meanwhile try to involve the government in regulating the market for their own sake. Stigler [5] wrote that when an industry is empowered by the state, the industry's benefit will decrease and the losses will grow for entire branch. Politicians create regulations not for lowering market imperfections that are associated with natural monopoly or to lower social inequality, on the contrary the answer the demand of interest groups that could offer complementary benefits to politicians, for example increasing their chances to be reelected (financial support, moral support, etc.). the purpose and the goal of regulating actions show the interest of entities that are in the position to influence politicians. Stigler modeled regulation as an enterprise that is in search for profits by managing its influences for the good the interest group that it represents [6].

The development of electric energy and telecommunications at the beginning of the 20th century was similar to the development of actual monopolies at the end of the 20th century and the beginning of the 21st century, because they all started as manmade monopolies [7]. Companies like Chicago Commonwealth Edison and AT&T invited the American government to supervise and regulate their industries from the desire to securitize on the long run their market share. These companies supported the birth of regulatory entities for industries, market development and geographical penetration. Stigler stressed the fact that modern economic regulation is another type of mercantilism, but with the same of bad faith towards the general interest [8].

Another interesting contribution was seen in regulatory research by Sam Peltzman in 1976 [6], because he offered the idea that politicians "*sell"* regulation to highest bidder on a market that bids are equal with bribes, votes or other quantitative sources valid for decisional administrative and legislative entities. The ideal regulation attracts the both benefits of the producers and consumers. Not all producers and consumers benefit from niche regulation, but some small subgroups are more competitive through them. Regulators allocate benefits towards the producer and the consumer through the maximization of marginal utility of regulations. All involved political parties have a rent seeking behavior towards the given regulator's dispositions [9].

The competition effect between interest groups creates an accelerated pressure on economic efficiency and on government regulation [10]. Becker stressed the fact that borders created through regulations develop into economic inefficiency and interest groups put pressure on politicians for obtaining some benefits. All the newly developed competition creates supplementary pressure on public policies for growing output on the long run. Both Becker and Peltzman observed that the regulatory flow could be streamlined through continuous investment in lobbying for regulatory development against deregulation.

Here we could observe the deregulation issue in the economy. Becker and Peltzman extended the economic theory on sector segmenting versus regulatory easing for obtaining marginal benefits and shifting pressure on initial interest groups. In the past we could have seen deregulatory examples that led to lowering marginal benefits through the regulation of manufacturers and the growth of consumer's marginal costs. This way even political equilibrium is shifted as a re-regulative behavior.

The Chicago school of thought stressed the idea of an regulative economy, based on methodological individualism and extended on market behavior seen as a hole, shaping the issue of rational behavior of governments and economic agents' interests. This approach is also based an Austrian economy, but the fundamental difference is that between these two schools there is the existence of unstrained competition that develops a higher marginal benefit then regulated competition.

3. The Trap of Total Deregulation

The best negative example for total deregulation is the case study of the state of California regarding the deregulation of the power grid and energy market. Energy market deregulation in the state of California led to free trade between Supply and Demand, fact seen only on perfect markets. Long term contracts between producers and consumers were banned this way everyone was obliged to trade on the spot market through a monopoly operator, the ISO (Independent System Operator) [3]. The trade wasn't directly executed, but only when a threshold was reached, this way a secondary market works within the market, and the producers/suppliers could manipulate the prices to their advantage. The market reform shifted the asymmetry from the energy traders' area towards the entire economy, from which players like Enron and Dynegy got a chunk of profits.

The Deregulation Law led to excessive growth of prices for electrical energy. These costs were determined by the classic regulatory system for the energy sector. The law developed regional monopolies and created entry barriers for new energy producers, be them even green energy producers. This law represented a setback for electric facilities' development in the state of California during the years 1985 – 2005 and led to increased imports from Canada for satisfying the state's needs. In the year 2001 this law was abrogated by the revalidation of the "black swan" theory [11], because that year was negatively influenced by a sum of factors: extremely hot summer, cold winter, the increase of natural gas' prices and the greed of Enron, all these led to an accelerated crisis. The maximum regulated price for the consumer was surpassed and suppliers stopped delivering electric energy. This way the law that was intended to put an end to monopoly and open the energy market [12] was a bust. The implementation failure and the approach on how the

regulation was seen led to the failure of the "deregulation law", this way transforming into the biggest example of inefficiency created by deregulating instead of regulating a market.

4. Conclusion

Some countries in Central Eastern Europe are mesmerized by the magic of deregulation. The majority of the politicians, businessmen, scholars and mass-media from developing countries are deregulation fans and intensively work at international lobbying, being the followers of the idea that actual regulatory measures need newly developed regulations from time to time [2]. The case of CEE countries is special because these are countries that are part of the European Union, which is an inter and intra national entity that has the most regulated economy from all existent economic unions and this way the interest groups need to invest largely into a powerful lobbying mechanism [13]. Most of these countries were part of the communist experience and have an active economic and political class that knows to surpass some of the EU's visions if it is in the interest of its interest groups. This way is created a cartel for reshuffling the regulations developed against monopolies development (banned in the EU). The cartel's structure is given by independent regulators or by the leading political class where the interest group has its headquarters and with ramifications in the political class that leads the European Union.

Lowering the political influence inside public utilities' companies should be done for developing an efficient economic hybrid. Ending government regulation, not by obtaining better regulation is the sustainable solution [14] for creating a regulated market especially for the energy sector and for utilities companies that are state owned.

Politics plays an important role in influencing the nature and the performance of regulations, and also on the speed and work flow for regulations and deregulations [15]. Politicians and their actions will decide if actual regulatory dissatisfaction will lead to the deregulation or re-regulation of a market and if they are only solutions for some asymmetries that were seen in a previous situation [16].

We could conclude that regarding deregulation, with some small exceptions, it could lead to smaller costs, increasing the quality of some services and allowing newcomers to enter industries, but those small exceptions could transform into real life black swans if politicians and interest groups go rogue or some unregulated innovations from the financial sector develop into systemic risks [17].

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