Public property, political regulation and independent regulation for the public services

Pippo Ranci

Università Cattolica, Milano

Florence School of Regulation, European University Institute, Florence

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1. Public services: definition, development
2. The History of Public Ownership
3. Network services
4. The rise of regulation
5. Are uniformity or coordination necessary?

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1. **What is Public Service**
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What is “public service”?

- Traditional definition: **all services provided by public entities**

- Referring to contents: services
  - which are necessary or very useful to life (of individuals, of the community) so as to be included in the area of public responsibility
  - which will not be provided by an unregulated market in a satisfactory way because of:
    - **inequalities (in income, wealth)**
    - **externalities (benefit / damage to third parties)**
    - **public goods (non-rival, non-excludable)**

Public services in the European Union

- 1957: the Treaty of Rome (6 countries) established the European Economic Community (Common Market)
- 1987 Single Market Act
- 1991 the Maastricht Treaty established the European Union (12 countries)
- 2007: Lisbon Treaty reformed the EU
- Now 28 countries have a Single (Internal) Market

Public services in the European Union

The treaties refer to "services of general interest" **identified by the Member states**, and distinguish:

Economic services (services of general <u>economic</u> interest, SGEI)

–Economic activities that public authorities identify as being of particular importance to citizens and that would not be supplied (or would be supplied unsatisfactorily) if there were no public intervention

–Examples: transport networks, postal & social services

–SGEI are **subject to the rules of the EU Treaty**: open market, competition or competitive bidding

Non-economic services of general interest

–Usually provided by public entities, not subject to specific EU legislation, except basic principles such as non discrimination

Public services: increasing or shrinking?

- Needs grow
- Expenditure for services increases (health, education, networks)
- Services increasingly provided by private companies, under concession and often in competition
    - *(in the EU terminology: within the SGIs, the share of the SGEIs increases)*
- Direct public provision is shrinking

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2. The historic role of public ownership: the reasons in favour

a. a substitute for missing private initiative and an engine for development
    - (the "infant industry" theory, basic industries)

b. a provider of public goods

c. a remedy to monopoly, externalities, inequalities

d. a remedy to "natural" monopoly (network services)

The declining role of public ownership

- Public ownership justifies a monopoly (benevolent?)
- Most objectives may be attained with other means:
  - Legal obligations, limitations
  - Economic incentives
  - Competition among suppliers

- ideology: “public is <u>always</u> better”
  - The market is simply bad, an engine for inequality
- an opposite belief: “private is <u>always</u> better”
  - A symmetric ideology?
  - A consequence of a disappointing public sector?

The basic weaknesses of public ownership

- Conflict between profit maximisation and implementation of political directives
  - **Evaluation of results: which benchmark? how to assess the responsibility of managers?**
  - **Government-owned company expected to behave different from private and to compete at the same time**
- State aid: contrary to trade agreements (and to EU law), hard to define in the case of a public company

When a decision to privatise is taken

- Half-hearted privatisation:
  - when originated not from a programme for improvement
  - but from Government need for revenue or inability to fund company growth
- Sale of minority shares
  - An opaque compromise?
  - Or a step towards a competitive market?

The alternatives to public ownership

- promote development: good rules, infrastructures
- provide public goods: contracting out
- correct externalities (taxes, incentives)
- correct inequalities (obligation to serve)
- **contrast monopoly: large open markets, antitrust law and competition authority**

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3. Network services

- In presence of a network (physical or virtual), competition may be impossible or uneconomic: this is a classic case of “natural” monopoly
- Traditional consequence: a legal monopoly and a concession of the whole service to a public-owned or to a private-owned company

objections

Even a public monopoly does not escape the monopoly's weaknesses:

•no contest, no incentive to efficiency, no choice, no room for entrepreneurship

•moreover: political interference, investment is a burden on public finance

•size of company limited by political boundaries

Alternatives: a) private monopoly + regulation

- Prices (tariffs) set by a public body
  - This is the traditional notion of “regulation”
- Also quality levels, environmental standards should be set
  - Regulation is complex
- A regulated monopoly is better than an unregulated monopoly, yet some important faults remain:
  - **No choice**
  - **Little room for initiative and entrepreneurship**
  - **Risk of political patronage**

Alternatives: b) tendering out the service

- Tendering introduces competition among bidders
- The service is provided under (a temporary) monopoly
- Monopoly power is limited by terms of tender and by contractual obligations
- Monitoring of tariffs and of performance is required

Difficulties and Requirements:

- duration od contract
- public administration's capacity for tendering, monitoring
- sufficient competition in bidding is necessary

Problem: local preference for local company may distort the tendering

Alternatives: c) network unbundling, free access, competition in services

Networks (monopolies) regulated and accessible:

- Unbundling (accounting, legal, ownership)
- Contents of network regulation: tariffs, rules for access
- A role for the industry regulator
- A role for the competition authority

Problems:

- Brand names
- Why should the network remain under public ownership instead of being tendered out? **A combination of (b) and (c)**

Competition for services works well if …

- A sufficient number of competitors
- A market large enough to allow optimal size of company
- Transition in liberalisation: divesting the public company or parts of it is controversial, may create conflicts
- Transition problems in pricing: from regulated tariffs to free market prices

- **Problem:** protection of low-income or otherwise disadvantaged customers

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4. The rise of regulation

- the US tradition of regulation
  - **Public Utilities Commissions since early 20th century**
- in Europe
  - **public (or semi-public) ownership made regulation seem unnecessary**
- a revolution started around mid-1980s
  - **deregulation, opening of markets, privatisation**
  - **objectives: efficiency through competition, shrinking and re-orientation of State functions**
  - **an independent authority has been seen as necessary**
  - **rise of regulatory authorities 1990-2005**

Political regulation vs. independent authorities

- reference case: the rise of independent central banks
- the case for “tying one’s hands” in the regulation of public services
  - useful as a defence against demagogic temptations
  - necessary in presence of Govt-owned companies
- the importance of independent regulation in transnational investment in infrastructures (view of the World Bank)

The task of a regulator

- set tariffs for monopolistic services
- promote competition where possible
  - access to networks
- set technical standards for safety, interoperability
- promote development of infrastructures using obligations and incentives
- protect weak consumers
- advise Government

Local services, competition and regulation

- The local area is too small for setting up a regulatory authority
- The local administration may be weak in contracting out the service, in designing and managing a tender
- Potential conflict between the national regulator and the local administration
- New ways must be explored to reconcile localism and good use of the market

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5. Are uniformity or coordination necessary?

- the extreme cases:
  - high uniformity needed in financial markets
  - low uniformity needed in local services

- instruments for coordination
  - top-down: treaties, legislation, institutions
  - bottom-up: cooperation, information, best practices

- Problem: the “regulatory gap” between multinational companies and national (local) regulation

bibliography

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