

Understanding Issues in Regulating Privatized State-owned enterprises

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Abstract

In the recent decades, the privatizations of state-owned enterprises have becoming a global trend. There are many nations privatized their infrastructure and services, such as gas, electricity, water, railway, sewerage...etc. However, the privatized monopoly enterprises have achieved the fruit of super-profit; the general public began to question the effectiveness of the privatization towards the newly created monopoly enterprises. So the regulations of the public utilities required immediate attentions from government.

The main objective of this research is to review on literature on the privatization of the monopoly enterprises through its procedures and investigate whether the government required to apply necessary regulations onto it. As a result, the governments of the developed nations are relying on the effective control to create more economic benefits.

At last, this research would combine all the regulating models used in the developed nations and may use as a reference to any government or who else required such relevant findings towards to privatization in their nations.

1.1 Motivation

In the recent decades, the privatizations of state-owned enterprises have becoming a global trend. There are more and more nations privatized their infrastructure and services after UK made a lead, such as gas, electricity, water, railway, sewerage...etc. However, the privatized enterprises are not simply transferring the ownership from public owned to private enterprises but required governmental regulation onto it. Each nation was expecting better economic performance from the private ownership and effective governmental regulation.

However the public started to question the super profit from the privatized enterprises (so called "privatized monopoly enterprises") achieved, and doubts the effectiveness on the regulation of the privatized enterprises. In the recent years, UK government has raised over £ 5,000 million of 'windfall tax' from the privatized enterprises and its shareholders. Due to the public discontent, the labor government has set up an inter-departmental committee to launch investigations to study this phenomenon. The key point of this research is to study whether regulatory office may stop the

privatized monopoly enterprises from huge profits and make sure the service quality are maintained.

State-owned-enterprises (shorten as S.O.E. hereafter) are commonly monopolized characteristics due to its network economics of scale and scope. If competitors would like to enter the industry, they must rebuild the whole distribution network repeatedly. The result from that would be a great waste and increase the costs and lowering the general public's interests and the economic efficiency. (Chanter, 1993) Based on this factor, most nations controlled the monopolized industries directly or nationalized to solve the monopoly issues. However, the operation performances of S.O.E. have shown some severe flaws on: governmental direct control and the ownerships of the S.O.E. There are also some flaws on S.O.E. over the years: 1) lack of sufficient profit motivation; 2) lack of own decision-making power; 3) politics intervention operational decisions to cause the increase of costs and capital wastage. (Aharoni, 1986)

Thus, privatization is an important scheme to solve the flaw of the public asset ownerships. However, it may affect the consumers' rights inevitably in the post-privatization era. Thus, the general public believed the intervention of the governmental regulations onto the private monopoly enterprises is highly necessary. In theory, the effective governmental regulation shall establish a virtual near competition environment. Thus the effective regulation can lower the costs of public services, increase the efficiency, and maintain the near market competition standards. (Shapiro & Willig, 1990) In another word, the goal of the effective government regulation is to replace the market competition, and the general public will be benefits from total market competition efficiency. (Burton, 1997) The privatization and appropriate governmental regulation are the two key actions to expect to solve the monopoly and the issues derives from the public ownerships. This paper will review on the nature of the privatization regulation in the post-1984 era and explore the experiences from the other developed nations. It is highly beneficial to some nations, which have not initiated the privatization, or as a reference towards to their privatization legalization.

2. Paper Review

The remarkable case of privatization in UK is the British Telecom (hereafter named: BT) in 1984. Prior 1984, the privatization in UK remained small and unnoticeable. Post-1984 is a great move towards to the privatization era. During the privatization of BT in UK, government also established the Office of Telecommunication, which shortens as Oftel, as a regulatory office for the new privatized monopolized industry. It regulated the licenses for new telecommunication industry, call charges, wholesale rates. The Oftel model was also adopted in the privatization of the other large-scale state-owned-enterprises in UK. Thus, the industry, which regulated by the office, would be termed as “regulated enterprises”.

During 1984-1991, the ruling party, conservative party, overturned the trend of the nationalized the state-owned-enterprises since WWII. The government began to privatize the infrastructure of a nation, such as telecommunication, gas, water, waste-sewerage, electricity. After that, the follow on governments also privatized the British railway while it was in government. The UK Government appointed one industry regulatory office to regulate the operation of the privatized monopoly industry after privatized one infrastructure. The UK regulatory office is operating different from the US governmental regulation commission. On the contrary, the regulation office was lead by a single administrator in the office. The office was empowered with high independence and jurisdiction even though it is a governmental office. The administrator is not entitling as public servant and the budget of the office is collecting from its regulated enterprises.

Because of that, the regulatory office is being defined as “independent” office. However the operation of the office is never independent and not empowered with necessary power. The totally “independence” literally means its zero liability to the public, because the office only report to parliament via the minister while the members of parliament have to liable to the general public. Thus, the administrators have to publish its annual operation report to define its progress on regulation in the assigned industry. The office also needs to make public hearing requested by its not parliament commission and/or auditing department. However, the UK government was not entitled to overturn or amend the established rules and the behaviors of the administrator/regulation office. The undoubtedly fact is the parliament does have certain influence towards to regulation office and the ministers do have the actual power to intervene by exercising his/her entitlement. Until now, there was no obvious evidence to prove that any ministers ever intervene the regulation offices’ decision and its behaviors.

Apart from the independence in the politics, the regulation office shall be a highly specialized

organization in its field. Each regulation offices are consists of many specialized experts, such as economists, accountants, and lawyers. The UK government was trying its best efforts to maintain the independence of the regulation office, but the office shall consult the public to maximize the coverage in its policy. For instance: the consumer councils of each monopolized enterprises shall raise some reference opinions on behalf of the consumers’ benefits. Thus, the regulation system in UK does not represent any parties, but playing a totally independent, fair role to legislate the regulation rules to the general public. It may not be an easy task to maintain with these two key factors, but it has been achieved in UK. It is due to both the regulators and ministers to obeying the rules strictly to maintain such equilibrium. This may not be an easy task in some nations where politics are severely involved with all legislations and operations throughout the government system.

In the UK, the authority of the regulation office was empowered from the legislation of the privatization and the Competition and Services (Utilities) Act, 1992. In this Act, it forces the public utilities to follow the regulation on its service quality and the supplying. The UK laws request the regulation office to complete two basic targets:

1. To ensure that public services/utilities can meet all the reasonable demands from public.
2. To ensure that all regulated enterprises to maintain the sufficient financial operation to supply high quality public utilities/services.

Generally speaking, the regulation criteria are varying from industry to industry. For instance in the gas industry (Gas Act, 1995), the first priority is to intensify the competition, while this is second priority in other industries.

In UK, the legislation of the regulation rules does not just empower the regulation office to enforce the regulation rules, but to leave more space for regulation office to operate with norm. (Colmon, 1997; Parker, 1997) In most privatization legislation, it is commonly seen the similar clause such as: *“the minister and regulator were empowered to exercise their duty... and take the relevant necessary action...”*. According this clause, we can foresee that all the regulation bodies would take different approaches and subject to the terms of regulation administrator. For instance, the current Gas Supply industry regulator has different measure in their term in office with their former regulators, although the regulations were all based on the Section 42(b) of 1986 Gas Acts. Thus it can be seen that the regulators are empowered with huge power to exercise. However, in many countries, it is difficult to accept that an authorized single regulator with huge authority to exercise. While the US model would be a more acceptable model, and the regulation offices were consisted of many committee

members to operate according to their prior legislations.

Apart from the relevant regulations, each regulated enterprises must obtain the licenses from the ministers or its regulation office. It must state the terms and conditions of operation in full details on the license, such as pricing, the wholesale rate, the rate of distribution network to other competitors. In another words, the licenses are generally over hundred pages and have all details within. However, the regulator remained power to define or amend the terms and conditions if necessary.

Key difference between UK & US models

When UK government began to privatization, they have studied the long established regulation system in US. But the UK regulation system is varying in four basic structures than US system:

1. UK system centralized its authority to a single administrator rather authority-shared committee system.
2. The UK government established one regulation office for each individual industry; while one US regulation commission is generally controls over number of industries.
3. The level of juridical authority. The UK system offers less likelihood of legal appeal for its regulated industry than US model.
4. The profit regulation of pricing capping.

The reason why the UK parliament adopted the single administrator model rather than US model? There are three main reasons:

1. At the time UK government establishing regulation commission, there were not many regulation experts available at the time. Thus, the UK government has to assign the regulation experts more precisely due to the human resource scarcity.
2. The single administrator model can adopt into the regulated industry faster and enable an effective regulation.
3. The ease of the accountability: it is relatively easy to measure the performance of the administrator. The UK model is the appropriate model for those nations without prior-privatization-experiences. In contrast, the advantages of the US model enable the inter-industries regulations commission to transfer its effective regulations experiences to other industries. While US model can also build a systematic regulations across the industry.

Why the UK parliament adopted the model, which assigned a single regulator per industry, rather than US model? There are three major factors:

1. At the time, UK established the regulation office for the privatization; there were not too many regulation experts available. Thus, the UK government has to assign precisely and thrifty due to the experts scarcity.
2. Single regulator can adopted into the characteristics of the industry much faster and perform the regulation more effectively.
3. Ease of measures the performance: it is relatively easy to measure the performance of the regulator. The UK model is appropriate to those countries, which never have privatization experiences. In adversely, the advantage of the US model is the possibility to transfer their effective experience to other industries via the inter-industries regulation commission. The US model can also build a more systematic regulation for other industries.

Until now, the UK government has no signs of showing to abandon the single administrator model, but there were some initiations to make amendments. For instance, the business of the Oftel has expanded to across all telecommunication categories and likely to combined all as one. The gas regulation office and electricity regulation offices may combine as one energy regulation office in the nearest future. In the fact, the reality has forced the UK government to make some amendments to combine its regulation system. For instance, the traditional telecommunication enterprises were challenged by the new emerging telecommunication enterprises. The multi-faceted UK gas corporation has initiated its business in its power generation business while some electricity companies on the market began to offer gas supply service. From these two cases, it has illustrated the UK regulations model would shift towards to US model in the future.

According to the US government regulation, all parties include the regulated enterprises, consumer groups, and other interest groups shall report in the regulation public hearing. According to the Federal Administration Act 1984, the US regulation model had developed in a model with more juridical contents.(Sappington, 1986) In adversely in UK, the juridical department played a minor role in the regulation system. It is almost impossible to challenge the regulation office's decisions. The Law can only offer the legal advises towards to the regulation decision procedure, such as obvious illegal and/or unreasonable policy making procedure rather than the comments on its decisions. Until now, it is rarely seen any juridical investigation towards to the regulation procedure.

Since the legal procedure can not offer any appeal opportunities to their regulated enterprises, thus the MMC. (Monopoly and Merging Commission, shorted as MMC) has become the important organization to

investigate any comments from the regulated enterprises. However, the MMC would involve to arbitrate only when the regulated enterprises conflicts with their regulated office in the license amendments. Since 1992, the MMC has involved in 6 pricing amendments and dissolutions between the regulator and the regulated enterprises. The MMC would only focus on any disciplines, which may obviously against public interests. If any of regulators' operations may against the public interests, then MMC would request regulator to amend the existing policy and/or take necessary actions to recover the loss to the public interests. However the MMC would not accept any appeals other than license operation conditions. The less effective appealing has turned down the regulated enterprises to take any actions to against its regulation office, regardless from legally nor administratively. Furthermore, the regulated enterprises are reluctant to solve any issues via MMC, because it normally makes the share prices fluctuate once the news disclosed to public. The regulated enterprises also concerned that the excess internal information may disclose to the public during the investigation. Thus, it is rarely seen any enterprises willing to appeal for a solution with its regulator via the MMC. Therefore the UK has limited results to appeal via the administration and legal methods. Since UK does not have appropriate formal law to regulate the regulator, thus there were many experts concerned that the UK regulators have been over-powered.

Veljoneski (1991, p.16) criticized the regulation office is a monster in the Constitution because the incompliance to its principles of control, audit, balance rule in the tradition democratic government system. This criticism is based on the viewpoints from the democratic regulation and the public liability. Thus, some researchers of the same viewpoints emphasized that all regulation office shall account for the public liability and accept the certain democratic procedures such as the formal governmental norms, assignment procedure, and public hearings. This statement may seem reasonable but may mislead to the general public.

Common regulation models

At the moment, the common democratic supervising procedures may not be appropriate to apply to the regulation office. In the contrast, the substantive model could be more appropriate than democratic supervising procedures. The legitimate of the substantive model shall acknowledge to the consistency of the government's policy, the specialization in problem solving, public interests, exact regulation goals, and clearly defined power. However, all these goals would be hard to achieve under the direct political controls. (Majone, 1996,1997) The UK regulation model is classified as this substantive model. The first goal the regulation is the effective regulation, which enhances the specialization in its practice, and maintains the independence in regulation. In adversely, the US public utility regulation model is a hybrid model of the

democratic model and substantive model. Thus, the specialization and independence of regulation have to subject to the outcomes from the public hearings and legal investigations.

We must admit that: the substantive model would be more appropriate than democratic model to reach the goal of "Economic efficiency" and "Pareto Optimum". However, it is more appropriate to adopt the democratic model if some social goals wish to be achieved, such as equilibrium between the wealth and incomes. Certainly, the regulation may result some resources re-distribution inevitably during the regulation, such as employment opportunities and the wealth. Thus, it may not be easy to distinguish the social goals of the "economic efficiency" and "re-distribution" strictly. Even though, the UK model can still view as a standard and substantive regulation model. Until now, we can understand that why UK regulators did not involved with any "social engineering" and the UK researchers' rejections to expand the regulation coverage to any social issues. (Foster, 1992, Ch.9) If there were too many social issues involved in the regulations, it means more political, society democratic issues would take into account of the regulation model. However, it may not be an easy task to seek an equilibrium state between the specialization independence and public liability. From the routine operation of the regulation office, it may highly likely that any political interventions may involve while political frequently over power of its operation in some nations.

In some nations, the society is difficult to accept any over-power economic forces, it would be necessary to induce some appropriate models to regulate. Therefore the appropriate model would suggest per: replaced the single administrator with panel of committee members, addition of the public hearings, judicial procedure, more intensify parliamentary supervision.

In UK, the most of the public enterprises had turned nationalize since 1945. The main motivation for such move was: the S.O.E. would perform better and fairer services because S.O.E. may not pursuit maximized profit as a goal. To fulfill this goal, the UK government established the board of directors to all S.O.E.. The purpose of establishing board of directors is to minimize the excess interventions from government. However, in reality, there were large numbers of political interventions remained existed and did not change even with the existence board of directors. Till late 1970s, the S.O.E. had a very low morale internally regardless of the level of positions. Furthermore, there were huge numbers of evidence and data has proved that the S.O.E. did not even meet the expected goals in its costs, capital investment ratio, and productivity. (Victors and Yarrow, 1988, p.151)

The Conservative party ruling government was blamed for the failure of the public ownerships in 1979.

General public are now viewing the privatization as a wonder solution towards the poorly performed S.O.E. but may not necessarily lead to an improvement of the economic performance. (Martin & Parker, 1997) For instance, the Jaguar automobiles had privatized in July 1984 but remained in poor economic status till the transferring of ownership to Ford in 1989. In reality, the S.O.E. would generally improve in its operation performance due to the newly entered competitors.

4. Discussions and Suggestions

Discussion

Generally, government is less likely to introduce too much competition from its S.O.E., because excess competition may influence the profits to yield to the government and may cause bankruptcy or requirement of restructure to the S.O.E.. If any of these situations happened, the government must be accountable for extreme liabilities and pressure. All these facts are understandable while the UK's experience in privatization also proved that it is rarely seen totally fair and effective competition for any S.O.E. in their industries. It is because the government may offer S.O.E. with some subsidies and other aids from government while the private competitors hardly receive any. For instance, UK began to liberate the market competition in the gas industry since 1982/3; however the real competition did not come into the game until the whole industry privatized. The privatization of the telecommunication, gas and electricity had speed up the pace of the competition in those industries for the two major factors: 1. Privatization; 2. the effective regulation. Under the efforts from the UK regulatory office, they have intensified the competition in one industry. UK gas has lowered its market share to 45% and the competition from its competitors remained growing. The whole gas market was liberated in 1998. In the electricity industry, the electricity generation has entered the era of competition as beginning; while the electricity distributions industry was fully liberalized after 1999. The competition in the telecommunication is never calm if compared to other infrastructure industries in UK. By the year of 1996, the telecommunication regulation office has issued 1,260 licenses, which included 3 public service licenses, 44 international call licenses and 18 international call resell licenses. (Oftel, 1997, p.96)

4.1 Suggestions

At the end, the performance measure of a regulated enterprises can be conducted from its productivity, profitability, price, service quality and numbers of staff employed. To summarize the available regulation models of the developed countries, it is found that all government expecting to create better economic benefits via its effective governmental regulation. As a result of that, the research is highly valuable for those developing countries or any government who are willing to conduct privatization in its nation as a reference.

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