REGULATION AND PRIVATIZATION

E. Avalos-Villarreal
Instituto Politécnico Nacional, México City, MÉXICO,
eavalosv@ipn.mx

Abstract

Privatization is the process to transfer a property or responsibility from the public sector to the private sector . The term can refer to partial or complete transfer of any property or responsibility held by government. Through privatization, governments seek to become more efficient in running enterprises, both in terms of cost and quality of services. There are two basic sets of economic arguments for pro-privatization and anti-privatization. The first of them is that governments have few incentives to ensure that the enterprises they own have a good performance and the second one is that governments do have an incentive to maximize efficiency in nationalized companies, due to the pressure of future elections.

Socialist, liberal, conservative have different positions about the role of government. They propose greater or minimal state involvement and proper matters for public or private sectors. System approach helps politicians to make better decisions in possible privatizations.

Regulation and regulatory functions are related to the definition of concepts, bases and techniques for a possible privatization process in a given sector.- A subset of regulatory functions is assigned to manage the privatization of that specific sector. In this way it is possible the regulation of monopolies, entry, network pricing, access conditions, rules for operation and quality and performance standards.

This paper is designed to give the widest possible overview of the system sciences applied to regulation and privatization issues. System approach is applied in order to have an interdisciplinary appreciation of this phenomena. The relation between privatization and regulation is analyzed to achieve the best outcomes in privatization after the study of experiences, designs and implementation of many cases in several countries.

It has been shown that the greatest gains from privatization are achieved in the pre-privatization period as reforms are made to prepare for the transfer to private hands. As changes may include reforms such as greater transparency and accountability of management, improved internal controls, information systems and better financing, those actions improve performance rather than privatization itself.

DEFINITIONS

Privatization is the transfer of property or responsibility from the public sector to the private sector . The term can refer to partial or complete transfer of any property or responsibility held by government. A similar transfer in the opposite direction could be referred to the nationalization or municipalization of some property or responsibility.

The public sector [1] is the part of economic and administrative life that deals with the delivery of goods and services by and for the government, whether national, regional or local.

OBJECTIVE

This paper is designed to give the widest possible overview of the system sciences applied to regulation and privatization issues. System approach attempts to increase the efficiency in the privatization solving problem by means of an interdisciplinary appreciation of this phenomena. The proper focus for this analysis is holistic :Two main positions are considered: Pro-privatization and Anti-Privatization. The relation between privatization and regulation is analyzed to achieve the best outcomes after the study of experiences and implementation of many cases in several countries.

PUBLIC SECTOR ORGANIZATION

The organization of the public sector to manage the services or responsibilities held by government can take several forms. All of them require technical studies to determine and implement the best method to achieve successful privatization programs with expertise, strong political leadership, clear policies, robust institutions and proper decision-making frameworks.

Direct administration.

Organization and production decisions are determined by government. Such organization generally has no specific requirement to meet commercial success criteria.

State owned enterprises

This form exists in some activities of manufacturing or delivering services . It is different from direct administration in that they have greater commercial freedoms and are expected to operate according to commercial criteria.

[1] **From Wikipedia, the free encyclopedia**

Partial or Complete outsourcing

Many public and private enterprises do it for IT services. Other contract out with a privately owned corporation delivering the entire service on behalf of government. This solution is a mixture of private sector operations with public ownership of assets.

PRIVATIZATION STRATEGY

Through privatization, governments seek to become more efficient in running enterprises, both in terms of cost and quality of services. They try to achieve this by better allocating risk and absorbing resources of private capital and technology.

PRIVATIZATION TECHNIQUES AND LEVELS

There is a variety of alternative privatization techniques that can be employed to develop a process in order to maximize efficiency and increase service quality. Some of such techniques are more appropriate than others depending on the activities or services. Privatization covers a wide range of approaches - from asset sales to initial public offerings (IPOs). Following a list of alternatives are presented:

- Contracting Out or outsourcing. The government competitively contracts with a private organization, for-profit or non-profit, to provide a service.
- Management Contracts. The operation of a facility is contracted out to a private company. Facilities where the management is frequently contracted out include airports and wastewater plants.
- Public-Private Competition . When public services are opened up to competition, in-house public organizations are allowed to participate in the bidding process.
- Franchise. A private firm is given the exclusive right to provide a service within a certain geographical area.
- Internal Markets. Departments are allowed to purchase support services such as printing, maintenance, computer repair and training from in-house providers or outside suppliers. Internal customers can reject the offerings of internal service providers if they don’t like their quality or if they cost too much.
- Vouchers. Government pays for the service; however, individuals are given redeemable certificates to purchase the service on the open market. These subsidize the consumer of the service, but services are provided by the private sector to supply high-quality and low-cost services.
- Commercialization or service shedding. Government stops providing a service and lets the private sector assume the function.
- Self-Help or transfer to non-profit organizations. Community groups and neighborhood organizations take over a service or government asset. Governments increasingly are discovering that by turning some non-core services—such as zoos, museums, fairs, remote parks and some recreational programs—over to non-profit organizations, they are able to ensure good performance in these institutions..

- Volunteers. Volunteers are used to provide all or part of a government service. Volunteer activities are conducted through a government volunteer program or through a non-profit organization.
- Corporatization. Government organizations are reorganized along business lines. Typically they are required to pay taxes, raise capital on the market and operate according to commercial principles. Government corporations focus on maximizing profits and achieving a favorable return on investment.
- Asset Sale or Long-Term Lease. Government sells or enters into long-term leases for assets such as airports, gas utilities or real estate to private firms. Another asset sale technique is the employee buyout. Existing public managers and employees take the public unit private, typically purchasing the company through an Employee Stock Ownership Plan

- Private Infrastructure Development and Operation. The private sector builds, finances and operates public infrastructure such as roads and airports, recovering costs through user charges. Several techniques commonly are used for privately building and operating infrastructure.
    - *Build-Operate-Transfer* (BOT) arrangements, the private sector designs, finances, builds, and operates the facility over the life of the contract. At the end of this period, ownership reverts to the government.
    - *Build-Transfer-Operate* (BTO) model, under which title transfers to the government when construction is completed.
    - *Build-Own-Operate* (BOO) arrangements, the private sector retains permanent ownership and operates the facility on contract.

Other Alternatives to privatization . Municipalization, Sub- contracting and Partial ownership

Transferring control of a nationalized business to municipal government is an alternative sometimes proposed to privatization.

It is possible that national services may sub-contract or out-source functions to private enterprises. A notable example of this is in the UK, where many municipalities have contracted out their garbage collection or administration of parking fines by tender to private companies.

An enterprise may be privatized, with a number of shares in the company being retained by the state. This solution is a partial ownership. But , it is more often a stepping stone to full privatization. It can offer the business a smoother transition period .

.Pro-privatization and anti-privatization arguments

Pro-privatization

Proponents of privatization believe that private market actors can more efficiently deliver many goods or service than government. In general, over time this will lead to lower prices, improved quality, more choices, less corruption, and quicker delivery. A small minority thinks that everything can be privatized, including the state itself.

The basic economic argument given for privatization is that governments have few incentives to ensure that the enterprises they own are well run. It is difficult to know if an enterprise is efficient or not without competitors to compare against. Another is that the central government administration, and the voters who elect them, have difficulty evaluating the efficiency of numerous and very different enterprises. A private owner, often specializing and gaining great knowledge about a certain industrial sector, can evaluate and then reward or punish the management in much fewer enterprises much more efficiently..

If there are both private and state owned enterprises competing against each other, then the state owned may borrow money more cheaply from the debt markets than private enterprises, since the state owned enterprises are ultimately backed by the taxation and printing press power of the state.

Privatizing a non-profitable company which was state-owned may force the company to raise prices in order to become profitable. This would create the need for the state to provide tax money in order to cover the losses.

- Performance. State-run industries tend to be inefficient. may only be motivated to improve a function when its poor performance becomes politically sensitive.
- Improvements. Conversely, the government may put off improvements due to political sensitivity and special interests.
- Corruption. A monopolized function is prone to corruption; decisions are made primarily for political reasons, rather than economic ones
- Accountability. Managers of privately owned companies are accountable to their owners and to the consumer, and can only exist where needs are met.
- Goals. A political government tends to run an industry or company for social goals rather than economic ones.
- Capital. Privately held companies can sometimes more easily raise investment capital in the financial markets when such local markets exist . While interest rates for private companies are often higher than for government debt, this can serve as a useful constraint to promote efficient investments by private companies.

- Lack of market discipline. Poorly managed state companies have the same problems of discipline as private companies,. They could go bankrupt or be taken over by competitors. Private companies are also able to take greater risks and then seek bankruptcy protection against creditors.
- Concentration of wealth. Ownership of and profits from successful enterprises tend to be dispersed and diversified -after privatization. The availability of more investment vehicles stimulates capital markets.
- Profits. Corporations exist to generate profits for their shareholders. Private corporations typically profit more if they serve the needs of their clients well. Corporations of different sizes may target different market niches in order to focus on marginal groups and satisfy their demand.

Anti-privatization

Opponents of privatization insist on the alleged lack of incentive for governments to ensure that the enterprises they own are well run. They think that a government which runs nationalized enterprises poorly will lose public support and votes. That means democratic governments do have an incentive to maximize efficiency in nationalized companies .

Opponents of privatization believe certain parts of the social terrain should remain closed to market forces in order to protect the country from the unpredictability of the market.

Many privatization opponents also warn against the practice's inherent tendency toward corruption. As many areas which the government could provide are essentially profitless, the only way private companies could, to any degree, operate them would be through contracts.

Opponents of privatization think that it is undesirable to transfer state-owned assets into private hands for the following reasons:

- Performance. A government is interested in safeguarding the assets of the nation. It is no convenient that profit be subordinated to social objectives.
- Improvements. the government is motivated to performance improvements as well as to contribute to the State's revenues.
- Corruption. Government ministers and officials have the responsibility to uphold the highest ethical standards. However, the selling process could lack transparency, allowing the purchaser and civil servants controlling the sale to gain personally.
- Accountability. The public does not have any control of private companies.
- Goals. The government may seek use state companies as instruments to achieve social goals for the benefit of the nation as a whole.
- Capital. Governments can raise money in the financial markets most cheaply for state-owned enterprises.
- Lack of market discipline. Governments have chosen to keep certain companies under public ownership because of their strategic importance..
- Cuts in essential services. When a government-owned company is delivering an essential service and is privatized, its new owner could lead to the abandoning of the social obligation to those who are less able to pay, when that service is unprofitable.
- Existence of monopolies. Privatization will not result in true competition when monopolies exist.
- Concentration of wealth. Profits from successful enterprises end up in private, often foreign, hands instead of being available for the common good.
- Political influence. Governments may more easily exert pressure on state-owned firms to help implementing government policy.
- Downsizing. Private companies often face a conflict between profitability and service levels. A state-owned company might have a longer-term view so it is hard to save money in maintenance or staff costs, but it is possible to make good profits while the enterprise has downsized.
- Profit. Private companies do not have any goal other than to maximize profits. A private company will serve the needs of their clients .

Outcomes

There are a lot of experiences in privatizations. Many of them with good balances on the desired social and economic effects. Many of them did have many problems and only side effects.

Several authors have shown that in competitive industries with well-informed consumers, privatization consistently improves efficiency. Such efficiency reduce costs and increase the rate of economic growth. The type of industries to which this generally applies is manufacturing. Although there are social costs associated with these efficiency gains so, many experts think that it is necessary to implement an appropriate government support for improve training and redistribution.

Regarding political corruption, it is a controversial issue that depends on the size of the public sector and the successful of the privatizations. Also regarding corruption, the sales themselves give a large opportunity for grand corruption. Privatizations in Russia and Latin America were accompanied by large-scale corruption during the sale of the state-owned companies.

It is known that the greatest gains from privatization are achieved in the pre-privatization period when several actions are made to prepare for the transfer to private hands. Changes included in this period are greater transparency, accountability of management, improved internal controls, information systems, and better financing.

REGULATION AND REGULATORY AGENCIES

Some countries restructured their industry simultaneously with the introduction of competition. In the remaining countries, regulatory organizations are either less powerful or non-existent. This can be explained by the fact that fewer regulatory tasks need to be performed in countries where companies remain vertically integrated and price are set by them.

Independent regulatory agencies vary significantly from those with a general mandate to oversee and regulate the energy sector to those with a specialized function such as regulating network access or end-user tariffs.

Diversity is even larger when ministerial and advisory agencies are considered intermediate options between a fully independent regulator and a ministry-only approach to regulation. Some of this variation can be explained by the regulatory framework.

Regulatory Functions

A large set of regulatory and related functions can be assigned to a regulatory agency :
:
)

- ï end-user tariffs
- ï quality and performance standards
- ï monitoring of market behavior and performance
- ï rules for operation
- ï regulation of entry

- ï regulation of monopolies
- ï dispute resolution

Regulatory functions can be allocated according to their "economic" or "social" nature. Separation of rule-making from rule implementation is intended to avoid conflicts of interest. It is also intended to underline the fact that setting the policy framework is a more "political" process than applying the rules once the framework is established.

Process can focus on the elaboration of *ex ante* regulations by the regulatory agency. In this case, the process aims to provide guarantees of impartiality. As a result, it tends to be explicitly regulated and formal.

Alternatively, process can focus on reaching a consensus among stakeholders. In this case it tends to be less formal. It can be based on a more light-handed approach in which the regulator's role is primarily to monitor the industry and to take remedial action as required.

All regulatory systems combine, to some degree, all three approaches. Certain procedural approaches are better suited for some regulatory functions than for others. For instance, a consensus-building approach may be appropriate for the development of technical and operational rules, while setting the allowed revenue for a regulated monopoly may require a more formal, procedure.

Regulatory agencies may deal with just one industry, such as electricity supply, a sector such as energy, or several sectors as in the case of network industries. The main advantages of multi-industry regulators are:

ï Savings from shared activities, such as information collection and administration.

ï Reduced risk of regulatory capture or undue political influence, because of the reduced dependency of the agency on any particular industry or group.

ï Avoidance of distortions in the investment of the regulated firms induced by regulatory inconsistencies across industries particularly when the activities concerned are substitutes as in the case of electricity and gas

ï Dealing with blurred industry boundaries, such as regulated companies with interests in both electricity and gas.

ï Using knowledge gained from one industry in a related industry, as would be the case in regulating third-party access in several network industries

On the other hand, industry-specific regulators may have the advantage of greater specialization and focus.

Policy Implications

Regulatory frameworks and regulatory institutions are changing .. This change reflects adaptation to a new environment characterized by open markets, new regulatory needs such as transmission pricing and increasing both regionalization and the links between industries. The allocation of power and responsibilities to different organizations makes objectives more explicit and decisions more transparent in each area of public intervention. It also provides for a framework that supports neutrality in regulatory decisions.

The co-existence of several institutions that have jurisdiction over the same industry creates complexity that spawns the need for increased co-ordination among the various authorities involved .

The multiplication of organizations also raises concerns about the efficiency of the public sector. Bureaucracies are costly, and tend to grow and self-perpetuate. A key challenge in this regard is to find the appropriate balance between general energy policy, industry-specific regulation and competition policy.

Periodical reviews of the institutional setting must take into account the changing boundaries of the energy industries. The need for harmonization across the gas and electricity industries as well as the trading areas will continue to put pressure on regulatory institutions. The scope of sector regulators may need to adapt in order to cope with these structural changes as has been the case in some countries with the merger of electricity and gas regulators.

Designing regulatory mechanisms will benefit greatly from international experience.

There are many precedents and examples in which improper privatization or failure of government to conduct certain functions, caused not successful privatization processes.

REFERENCES

1. Nellis J. and Kikeri-Sunita. Privatization in Competitive Sectors. The Record to Date, June 2002. World Bank Policy Research Working Paper No. 2860..WorldBank.
2. Diaz J. Privatización de empresas públicas.Joan Diaz i Associats. Spain.
3. Wikipedia.2007. The Free Encyclopedia/ Privatization
4. Martin B. 1997. Las raices de la privatización. Public World. London.
5. Birdsall N. & Nellis J. http://www.cgdev.org/docs/cgd_wp006 Winners and Losers: Assessing the Distributional Impact of Privatization. Center for Global Development. March 2006.
6. Piqué J. 1999. Reflexiones acerca del Proceso de Privatización del Sector Público Empresarial. Journal of Economic Literature. Spain.