

# State Ownership, Privatisation and Regulation

## Lectures 15 and 16

Connolly and Munro (1999): Chps 21, 22

Stiglitz (2000): Chp 8

# Outline

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- Privatisation process
  - Pioneering role of UK
- Motives for privatisation, for nationalisation
- Change in ownership and efficiency
- Consequences of privatisation
  - Role of govt: from state ownership to regulator
- Regulation and Competition Policy

# Public v Private Ownership: Efficiency

- Two sources of efficiency losses associated with monopoly

- 1. Monopoly power

–  $P > MC$



Fig 1(a) **Efficiency loss: ↓ consumer surplus**

- 2. X-inefficiency

– actual cost v lowest cost



Fig 1(b) **Efficiency loss: ↑ producer surplus**

- Opposing policy outcomes

– Nationalisation

– Privatisation

# In favour of Nationalisation

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- Rationale for state ownership
- 1. Monopoly power
  - Profit motive of monopoly v state motives
  - Anti-competitive behaviour of monopoly v competition policy v regulation
- 2. Equity
  - Economic viability v universal access and pricing policies
- 3. Political motives
  - ‘Capitalist greed’ v ‘power to the people’
  - Political patronage
  - National security

# In favour of Privatisation

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- Rationale for privatisation
- 1. X-inefficiency
  - Bureaucracy → ↑ costs v profit maximising behaviour
- 2. Financial motives
  - Proceeds from privatisation → ↓ public borrowing
- 3. Political motives
  - Free markets: incentives and entrepreneurship
  - Employees and consumers as shareholders
  - Political support

# Change of Ownership and Efficiency

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- **Principal-agency (P-A) problem**
    - P delegates task to A
    - Without ability to monitor A, maximise P's goal is unlikely
  - **Private sector goal: maximise profit**
    - Pay related performance to overcome delegation problem
  - **Public sector**
    - Complex P-A relationships
    - Variety of goals, which may not be mutually consistent
- ⇒ P-A problems more easily overcome in private sector
- ⇒ Performance targets to improve efficiency
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# Change of Ownership and Efficiency (contd)

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- Nationalisation and efficiency
  - 1. Profitability
    - Private sector profits > public sector profits
  - 2. Nationalised industry goals
    - White papers: replicate conditions of competitive financial market
    - 1961: financial targets and return on investment (ROI)
    - 1967: marginal cost pricing
    - 1978: external financing limits
- Privatisation and efficiency
  - Post-privatisation performance: inconclusive evidence
- $\Delta$  ownership requires  $\uparrow$  competition and close regulation

# Privatisation in the UK

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- 1979-83: partial sales; council houses
  - Sale of assets into competitive markets
- Mid-1980s: monopolies
  - Transfer of monopoly power to private sector?
- Early 1990s: regional supply companies
  - Yardstick competition, regulation
- **Change of ownership and method of privatisation**
- 1. Post-privatisation structure
  - Monopoly status v split up
- 2. Sales of assets
  - Bidding process to maximise revenue v maximise nr of new shareholders
  - UK: fixed price and sell shares widely

# Effects of Privatisation

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- Privatisation and capitalism
    - Retention of shares by private shareholders?
    - Home ownership
  - Privatisation and corporate culture
    - Globalisation, market share expansion and diversified activities
  - Privatisation and welfare
    - Welfare privatised?
    - Govt as major provider of social security and social policy; ↑ choice
  - Welfare concerns
    - Geographic coverage
    - Residual role of govt and two-tier welfare system?
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# Regulation

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- Regulation of privately owned firms
  - Note: regulation applicable to all firms eg competition policy
- Regulation to overcome market failure
- 1. Industry structure and market power
  - Monopoly power: ↑competition; no regulation
  - Natural monopoly: competition wasteful; regulation
- 2. Externalities
  - Positive externalities and prices eg network coverage
  - Cream-skimming; equity; negative externalities
- 2. Asymmetric information

# Privatisation and Regulation

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- Two-stage regulatory process
- 1. Point of privatisation
  - Determined by govt; govt-mgt discussion
- 2. Post-privatisation regulation
  - Industry watchdog; regulator-mgt bargaining process
- Elapse of time and technological change
- UK: 'light-handed regulation'
  - Cost
  - Ideology

# Regulatory Failure

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- **Conflicting objectives**
  - Price regulation v quality assurance
  - Profitability v cream-skimming
  
- **Asymmetry of information**
  - Monopoly v yardstick competition
  
- **Regulatory capture**
  - Regulator interests v firm interests

# Regulatory Bodies

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- Industry regulatory bodies

- Responsibilities

- Issue licences to monitor nr of firms in industry
- Regulate price and quality to protect consumer
- Equity: rural area access and limit discrimination
- Asymmetric info: good practice, disseminate info
- Account for externalities and environment

# Competition Policy

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- Monopoly issues

- Scale: 25% of supply
- Complex: prevents, distorts or distorts competition

- Market power v the public interest

- Promote competition
- Consumer interests
- New products and ↓ cost via competition
- Balanced distribution of industry and employment
- Promote competitive activity in overseas markets

# Summary

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- Motives for privatisation
  - Efficiency
  - Ideological
  - Political
- Privatisation and regulatory role of govt
  - Competition policy
  - Price control
  - Quality control
- Paradox: ↑ or ↓ role of govt?