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REGULATION AND COMPETITION POLICY IN THE EUROPEAN UNION – FUNCTIONS OF THE REGULATORS

MA Thesis

Işıl GÜVEN

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ABSTRACT

The purpose of this study is basically to emphasize the EU regulatory policy regarding natural monopolies in the liberalization process and regulatory agencies which are having a post of great responsibility.

In the first section of this study, the main features of regulation as a concept will be outlined. Thereby the aim of regulation, principles of good regulation, and types of regulation will be examined. In addition to regulatory regime will be associated with competition law. In the second section of this study, regulators (defined as regulatory agencies), their objectives and functions will be mentioned thoroughly; regulatory models clarified. On the other hand relationship between regulatory agencies and competition authorities will be analyzed. The European Union perspective regarding regulatory agencies in the network industries will be outlined.

In the third section, the definition of natural monopoly will be indicated. In this context, the concept of public service in the context of European Union law will be analyzed. In this section also relationship between regulation and privatization and liberalization of natural monopolies will be outlined.

In the fourth section, general survey on liberalization process in The European Union will be analyzed briefly. Hereafter, the structure and regulation of energy sector-electricity and gas industries will be examined particularly in detail. In this respect, functions of regulators in the mentioned sector will be outlined in the context of legal framework. In the fifth section, liberalization and privatization process in Turkey will be analyzed. Regulatory agencies in Turkey will be also examined.

Following that, in the last part of the study, it will end with concluding remarks in the context of analyzed points above-mentioned.

ÖZET

Bu çalışmanın amacı, Avrupa Birliği içerisinde serbestleşme süreci yaşayan doğal tekellerin regülasyon (düzenleme) kurallarının ve bu süreçte büyük bir sorumluluk altında olna düzenleyici kurumların incelenmesidir.

Çalışmanın birinci bölümünde, kavram olarak regülasyon çerçevelendirilecek. Bunu ek olarak, regülasyonun amacı, iyi regülasyon ilkeleri ve regülasyon türleri üzerinde durulacaktır. Ayrıca bu bölümde, regülasyon rekabet hukuku ile ilişkilendirilecektir. İkinci bölümde, düzenleyici kurumlar, amaçları, fonksiyonları ele alınacak; düzenleyici modellerden söz edilecektir. Bunun yanında, düzenleyici kurumlar ile rekabeti düzenleyici kurumlar arasındaki ilşki üzerinde durulacaktır. Son olarak, Avrupa Birliği içerisinde doğal tekellere ilişkin faaliyet gösteren düzenleyici kurumlar incelecektir.

Üçüncü bölümde doğal tekellerin tanımı yapılacak; bu bağlamda Avrupa Birliği Hukuku çerçevesinde kamu hizmeti irdelecektir. Regülasyon ve özelleştirme ilişkisi ile doğal tekellerin serbestleşmesi ele alınacaktır.

Dördüncü bölümde, Avrupa Birliği kapsamında serbestleşme süreci incelecek; daha sonra doğal tekel özelliği gösteren sektörlerden enerji sektörü üzerinde durulacaktır. Bu bağlamda, söz konusu sektörde faaliyet gösteren düzenleyici kurumlar hukuki çerçeve dahilinde ele alınacaktır. Beşinci bölümde, Türkiye'de serbestleşme ve özelleştirme sürecine göz atılacak; bu bağlamda Türkiye'deki düzenleyici kurumlar hukuki çerçeve dahilinde incelenecektir.

Son olarak yukarıda sözü edilen konular bağlamında tespitler yapılacaktır.

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Art.	Article
DG	Directorate General
DSO	Distribution System Operator
EC	European Community
ECB	European Central Bank
ECJ	European Court of Justice
EEC	European Economic Community
EU	European Union
EML	Electricity Market Law
EMRA	Energy Markets Regulatory Authority
ERGEG	The European Regulators Group for Electricity and Gas
HICP	Harmonized Index of Consumer Prices

LNG	Liquefied Natural Gas
LRAC	Long run Average Cost
OECD	Organization for Economic Co-operation and Development
OJ	Official Journal of the European Union
OJL	Official Journal of the European Communities. L, Legislation
MS	Member States
p.	Page
PA	Turkish Privatization Administration
PHA	Turkish Privatization High Council
Sec.	Section
SOE	State-Owned Enterprises
TEU	Treaty of the European Union
TPA	Third Party Access
TSO	Transmission and System Operator

v.	Versus
Vol.	Volume
WB	World Bank

I. INTRODUCTION

The term competition policy refers to measures intended to promote and protect competition. This is accomplished by preventing collusion among firms and by making it difficult for firms to exercise excessive market power. That is, competition policy refers to the set of rules designed to promote and protect competition and restrict monopoly practices and these include oversight of mergers, prohibition of price fixing and agreements (tacit or explicit) for sharing the market and other behavior that might restrain competition.[1]

On the other hand, both the law and economic theory recognize that there are some industries (such as natural monopoly) in which the competitive model will not achieve either the welfare maximization or economic efficiency. The solution in order to maintain the welfare maximization and economic efficiency in such markets is regulation rather than competition policy supervision.[2] Regulation is an art and craft of governance controlling nearly every significant economic variable through regulatory bodies due to the market structure of some industries, including price, quantity, safety, quality, firm size, market areas and even the right to go out of business.

Natural monopolies are the industries regulation mostly focuses on. In the final two decades of the twentieth century, liberalization of industries which for many years had been preserved of state-owned natural monopolies (such as electricity, gas, and telecommunications) maximizes the importance of regulation. Within this process, regulatory bodies struggle to adapt former monopolist industries into the competitive free market.

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[1] http://pluto.ecom.unimelb.edu.au/ednetwork/competitionPolicy.cfm retrieved on 17.01.2007. The Australian Research Council Economic Design Network; "Competition Policy and Regulatory Economics", 2007

[2] Barnes David W. & Stout Lynn A., "Economic Foundations of Regulation and Antitrust Law". St. Paul, Minn. : West Publishing Co., 1992, p. 85

Regulation attracted widespread attention within the European Union (EU) in the final two decades.[3] In this context, the present study concentrates on the EU regulatory policy regarding natural monopolies in the liberalization process and EU regulatory agencies functioning of completion common market in the mentioned sectors.

[3] Kassim Hussein, "Regulation, Competition Policy and Political Science", An ESCR Research Center Centre for Competition Policy Newsletter, Issue Number 8, May 2005, p. 7

II. THE CONCEPT OF REGULATION

2.1. Definition of Regulation

The main function of any democratic government is to promote the economic and social welfare of its people. Governments seek to meet that objective in a wide variety of ways, including through policies aimed at macroeconomic stability, increased employment, improved education and training, equality of opportunity, promotion of innovation and entrepreneurship, and high standards of environmental quality, health, and safety.[4]

At this point, the two tasks are required to perform by governments with the aim of enhancing the economic set up of the community: (i) government investments (without looking to profit margin) which are necessary to carry on the public order, (ii) to maintain the performance in the markets that are perfectly competitive according to the rules.[5]

In the light of foregoing explanation, approaches related to the role of the government in the economy changes consistently through the years. The government interventions in economy were required strictly because of arising inefficient market structures in the market-based developed countries, especially after the economic crisis in

[4] Organisation for Economic Co-operation and Development (OECD), "The OECD Report on Regulatory Reform", Paris, 1999, p.1

[5] Uçar Özge P. & Karatepe Ahmet, "OECD Ülkelerindeki Rekabet Otoriteleri Örgütlenişlerinin Karşılaştırılması", Ankara, 1999, p. 3

the1930's.[6] In this period of time, Keynesian theory[7] affected above-cited. Until the end of the 1970's, governments took an active role directly in the market.[8]

In the last few decades, however, the role of the State in relation to the economy and society is in transition. The reduction of direct State intervention in the economy (*i.e.* through liberalization and privatization of State ownership of enterprises, the reduction of price controls etc.) implied a change in the mode of intervention by reason of "efficiency" problems on the areas that the State is a sole supplier of a specific good & service and facing with difficulties in finding "competitive solutions" while carrying out public enterprise management.

In terms of regulatory policy, this has given rise to the concept of the "regulatory state": a State still strategically responsible for the economy and society, but with a more arms' length relationship to citizens and the economy.[9]

Regulation generally refers to policies where the government acts as a referee to oversee market activity and the behavior of private actors in the economy. Such government intervention in the marketplace is usually justified on the basis of market failures and the need to achieve desirable economic, environmental, and social outcomes.

Regulation as an art and craft of governance[10] is more outstanding and celebrated nowadays than ever before. Since the mid-1980s governance through regulation has ceased to be a peculiarity of the American administrative state but has become a central

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[6] Mankiw Gregory N., "Principles of Economics", Orlando: The Dryden Press, 1998, p. 702-703

[7] Keynesian Theory, also called Keynesianism, or Keynesian economics, is an economic theory based on the ideas of 20th century British economist John Maynard Keynes. Keynesian economics promotes a mixed economy, where both the state and the private sector play an important role. Keynesian economics differs markedly from laissez-faire economics (economic theory based on the belief that markets and the private sector operate well on their own, without state intervention).

[8] Ardıyok Şahin, "Doğal Tekeller ve Düzenleyici Kurumlar, Türkiye İçin Düzenleyici Kurum Modeli", Ankara: Rekabet Kurumu, 2002, p. 1

[9] OECD, "OECD Reviews on Regulatory Reform, Background Document on Regulatory Reform on OECD Countries", Paris, 2006, p. 3

[10] Jacintt Jordana & David Levi-Faur, (2004). "The Politics of Regulation in the Age of Governance". Jacintt Jordana & David Levi-Faur (Eds.), "The politics of Regulation – Institutions and Regulatory Reforms for the Age of Governance", (pp. 1-28). Cheltenham, UK and Northampton, USA: Edward Elgar Publishing

feature of reforms in the European Union, Latin America, East Asia and developing countries in general.[11] EU regulation was relatively weak in the 1960s to 80s, while US regulation was strong and authoritative; yet in the past two decades the positions have virtually reversed.

In legal and economic literature, there is no fixed definition of the term 'regulation'.[12] Economists are wary of defining regulation and their usage of the term can cover almost any external control of business; on the other hand, for lawyers it has more precise connotations, being identified with instruments of public law enforced by government or semi-autonomous, but public, agencies.[13]

The scope of regulation in modern economies is extensive. According to the "OECD Report on Regulatory Reform: Synthesis"[14], regulation refers to the diverse set of instruments by which governments set requirements on enterprises and citizens. Regulation includes laws, formal and informal orders and rules issued by all levels of government, and rules issued by non-governmental or self-regulatory bodies, which enjoy delegated regulatory power. At this point, regulation occurs every moment in one's daily life. For instance, on average each American adult and child eats seven pizzas a year. To protect these consumers, 310 separate rules, filling over 40 pages of federal documents, govern what goes on a pizza and how these toppings may be described on labels and menus.[15]

Describing regulation extensively as any set of rules to organize society can show that regulation is indeed as old as society itself. The primitive societies established norms to be followed by all members of the group (or at least most of them). The old Latin maxim "*ubi societas ibi ius*" clearly summarizes this: "where there is society, there is

[11] Ibid., p. 1
[12] The literal, dictionary definition (denotation) of regulation is "rule in order to control the way something is done or the way people behave".
[13] Ogus Anthony I., "Regulation, Economics and the Law", Cheltenham, UK and Northampton, USA: Edward Elgar Publishing, 2001, p. ix
[14] OECD, "OECD Report on Regulatory Reform: Synthesis", Paris, 1997, p. 2
[15] Carlton Dennis W. & Perloff Jeffrey M.. "Modern Industrial Organization", 3rd Edition. California: Addison-Wesley, 2005, p. 650

law". At this point, regulation is a popular subject of study in several disciplines across and beyond the social sciences. The tendency to categorize regulation as legislation, governance and social control affirms that the study of regulation coexists with law, economics, political science and sociology.[16]

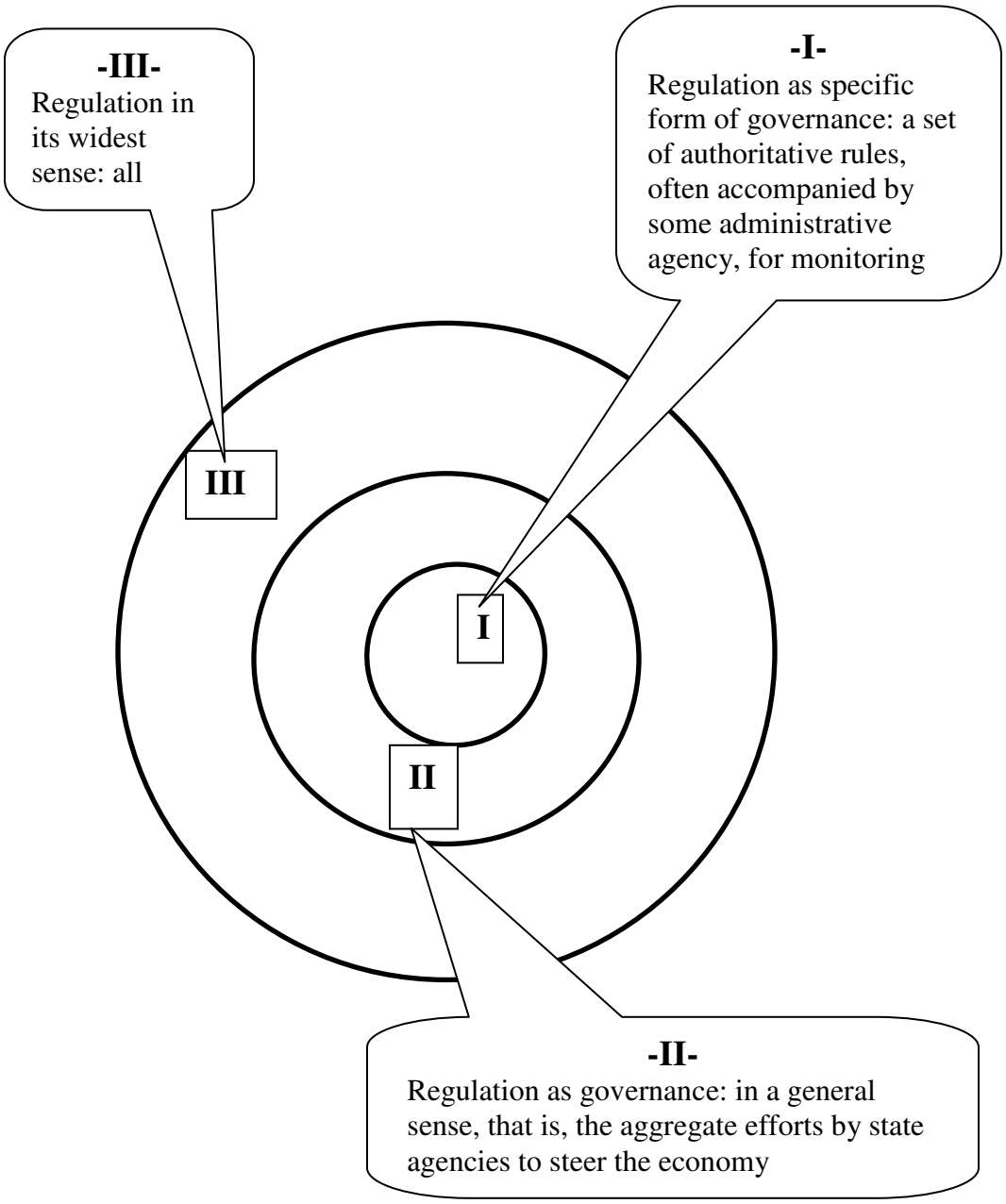
Regulation can also be very broadly identified with a "continuous and focused control exercised by a public agency over activities that are valued by a community". On the other hand, some scholars suggest that regulation ought also to be regarded either as a specific set of essential orders, for example on health and safety; as deliberate state influence, such as taxation and subsidies, and finally as all forms of social control or influence.[17] In the first case, regulation is in its simplest form and relates to the enactment of a set of rules together with the mechanisms to enforce them. Such commands are grounded on social or economic aspects, such as the protection of consumers in terms of quality of foodstuff for example, or the citizens in general in relation to negative externalities of industrial production like pollution. Regulation as deliberate state influence is generally linked to the provision of services and goods by the state itself (state owned enterprises are a good example of this) or by the state creating favorable conditions for the private entrepreneurs that allow this provision of services and goods to happen.[18]

The three meanings of regulation are described below in Figure 1. in three circles that expand from the narrowest meaning of regulation (I) to its broadest (III):[19] In its narrowest and simplest sense, 'regulation refers to the promulgation of an authoritative set of rules, accompanied by some mechanism, typically a public agency, for monitoring and promoting compliance with these rules'. A second meaning of regulation refers to 'all the efforts of state agencies to steer the economy'. This meaning is broader than the first since it includes, in addition to rule-making, measures such as taxation, subsidies,

[16] Majone Giandomenico, (1996). "Regulation and its Modes". Majone Giandomenico (Ed.), "Regulating Europe", (pp. 9-27). London: Routledge
[17] De Moura Marcelo Gameiro, "Regulatory agencies: some theoretical concerns on their creation", (2002) VII Clad Conference in Lisbon, Portugal, 8th-11th October, p. 1
[18] Ibid., p. 2
[19] Baldwin R., C. Scott & C. Hood (1998), "Introduction", Baldwin R., Scott C. and Hood C. (Eds.), "A Reader on Regulation", pp. 1–55. Oxford: Oxford University Press

redistribution and public ownership. The third meaning of regulation is broader still, and encompasses all mechanisms of social control, including unintentional and non-state processes.

Figure 1. Three meanings of regulation[20]



[20] adopted from Jordana & Levi-Faur, p. 3

Emerging the concept of a regulatory state in the past two decades of the 20th century is an essential step to maintain the modern industrialized democracies. Through regulation, governments obtained big gains in preserving economic and social values.[21]

The concept of regulation is narrowed to include exclusively the set of rules for controlling the provision of services and goods characterized as public utilities. As stated in the introduction part, this study focuses on basically the economic regulatory approach of major industries (mostly called as network industries) which are characterized natural monopolies at the time of liberalization. It is obvious that government intervention is necessary to ensure satisfactory performance in these sectors because regulation is applied to correct continues market breakdowns.[22]

Competition is thus not a viable regulatory mechanism under conditions of natural monopoly.[23] For this reason, set of controls has been applied mainly to gas, water, electricity, telecommunication, rail transport, postal service. Under natural monopoly, the operation of a single service provider in a market can lead to cost-efficient production, but as with all monopolies there is the potential for abuse of market power.[24] Mostly and traditionally, network industries which are characterized natural monopolies are publicly owned sectors because of sector characteristics.

Besides, technological changes in network industries have, however, mitigated natural monopoly concerns. The liberalization process has modified, and altered the traditional regulatory systems, which have historically been built especially around monopolies, ministerial regulation of dominantly publicly owned companies.[25]

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[21] Ardıyok, p. 4
[22] OECD, "Regulatory Reform, Privatisation and Competition Policy", Paris, 1992, p. 13
[23] Posner, Richard A., "Natural Monopoly and Its Regulation". 30th Edition. Washinghton D.C.: Cato Instıtute, 1999, p. 1
[24] Ergas Henry & Mathewson Frank, (2005), "Establishing an Efficient Regulatory Regime for Telecommunications in Canada", Telecommunications Policy Review Panel, 11th April, p. 23
[25] Finon Dominique & Midttun Atle**, "**Reshaping European Gas and Electricity Industries". Elsevier Science & Technology Publishing, 2004, p. 1

In Europe, manufacturing activity in these sectors formerly was publicly owned. Because of this, there was no need to apply regulatory governance. Contrary to Europe, in USA, these sectors were belonging to private utilities from the beginning. Hence, regulation activities were executed through regulatory agents.[26]

In the course of the 1990s, the European Union (EU) embarked on an ambitious regulatory reform programme for a number of European network industries, such as telecommunications, energy and transport. All these sectors are characterized by the presence of a bottleneck infrastructure with natural monopoly characteristics, which makes it difficult to introduce and safeguard competition in these industries. However, further progress with regulatory reforms in these sectors designed to enhance the level of competition was an important part of the Lisbon agenda for economic reform launched by the European Council in 2000.[27] The European Union Commission has announced its regulation policy "less action, but better action".[28]

As is described above, regulation denotes the policies which are submitted to government in observing the market activities and behaviors of private sector as a judge (arbitrator). Thence in the light of the relationship between economic regulation and market economy, describing the market economy is relevant in point.

2.1.1 Market Economy

In this context, market economy is being accepted by a great many of countries despite the difference in practice. A market economy (also called a *free market economy*, *free enterprise economy*) is an economic system which the production and distribution of

[26] Utton,Michael, "The Likely Impact of Deregulation on Industrial Structures and Competition in the Community", (1987), Office for Official Publishings of European Communities, p. 19
[27] Reiner Martin & Moreno Roma &Vansteenkiste Isabel, "Regulatory Reforms in Selected EU Network Industries", (2005), European Central Bank, Occasional Paper Series April, No.28, p. 6
[28] OECD, The OECD Report on Regulatory Reform , Volume II: Thematic Studies, Paris, 1998, p. 194

goods and services takes place through the mechanism of free market guided by a free price system rather than by the state in a planned economy.[29]

In a market economy, producers and consumers decide what they will produce and purchase, as opposed to a planned economy where the government decides what is to be produced and in what quantities.

a. Supply and Demand

Supply and demand are the forces that make market economies work. They determine the quantity of each good produced and the price at which it is sold.[30] Profit motive leads producers to sell the goods and services. On the other hand, consumers make purchasing decision according to market price.

As shown in Figure 2. below, the demand curve shows how the quantity of a good demanded depends on the price. According to the law of demand, as the price of a good falls, the quantity demanded rises. Therefore, the demand curve slopes downward. The supply curve shows how the quantity of a good supplied depends on the price. According to the law of supply, as the price of a good rises, the quantity supplied rises. Besides, the supply curve slopes upward.

The intersection of the supply and demand curves determines the market equilibrium. At the equilibrium price, the quantity demanded equals the quantity supplied. In economy, the price ensures that supply and demand are in balance.[31]

[29] Boone Louis E. & Kurtz David L., "Contemporary Business". 9th Edition. Orlando: The Dryden Press, 1999, p.90
[30] Mankiw, p. 61
[31] Mankiw, p. 85

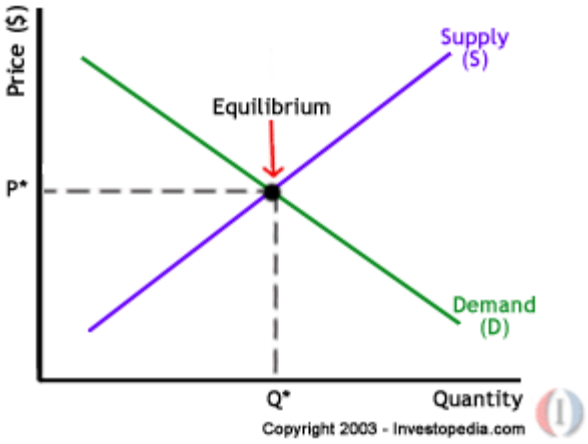

Figure 2. Equilibrium of Supply and Demand

b. Social Welfare

In market economy, economic activities are executed by private individuals and establishments. Standard economic theory tells us that competitive forces work best and deliver the expected outcomes when a market exists that is not overridden by distortions. The key objective of market economy which is given preference throughout the world is obtaining optimum resource allocation and thereby the maximization of social welfare.

However, economics refer to Adam Smith's[32] warning about the need to "cultivate" free competition.[33] Because of some negative impacts of competitive market economy, setting the rules of market is needed. Thence, to a certain extent, regulatory state intervention is not contrary to market economy. For this reason, most of the countries set their regulatory politics.

[32] Adam Smith is often regarded as the father of modern economics. According to his "Invisible hand" theory, Adam Smith assumed that consumers choose for the lowest price, and that entrepreneurs choose for the highest rate of profit. He asserted that by thus making their excess or insufficient demand known through market prices, consumers "directed" entrepreneurs' investment money to the most profitable industry.

[33] United Nations (UN), "Competition, Competitiveness and Development: Lessons From Developing Countries", New York & Geneva, 2004, p.1

The principal objective of attaching importance to market economy and regulation is maximization of social welfare.[34] Posner believes that agencies of government, and particularly courts, should make political decisions in such a way as to maximize social welfare.[35] Social welfare refers to the overall utilitarian state of society. It is often defined as the summation of the welfare of all the individuals in the society. Maximizing the overall satisfaction is provided in an economic system.[36]

c. The Concept of Economic Efficiency and Requirement of Economic Regulation

Assessing the appropriate role of government in economy requires recognition of the need for and the limitations of government action. Economic theory provides valuable guidance on the appropriate role of the state: market failure and distributional equity are the two frequent reasons for government intervention.

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[34] Ardıyok, p. 6

[35] Dworkin Ronald, (1989). "Why Efficiency?". Mark Kuperberg & Charles Beitz (Eds.), "Law, Economics, Philosophy: a critical introduction, with applications to the law of torts", (pp.123-143). Rowman & Littlefield Publishers Inc.

[36] The problem of maximization of summation of the welfare of all individuals brings up the debate of measurement of utility. Utility can be measured either cardinally, or measured ordinally in terms of relative utility. The cardinal method is seldom used today because of aggregation problems that make the accuracy of the method doubtful, as well as strong underlying assumptions. However nowadays, generally accepted approach is ordinal measurement. According to this approach, utility is a subjective fact and can not be measured in cardinal. Ordinal utilities can not be summed. At this point, problem of measurement of welfare is passed over by "Pareto Optimum" analysis. We can't compare or, a fortiori, add utilities, we can define society's welfare (also called "society's real income") only when there is unanimity: social welfare increases when at least one individual is better off and no one is worse off, a condition known as *Pareto improvement,* in recognition of Italian economist Vilfredo Pareto (1848-1923), who invented this approach. Alternatively, social welfare decreases when at least one individual is worse off and nobody is better off – Pareto *deterioration.* When at least one individual gains and at least one other loses, we cannot make any welfare judgment in the Pareto sense. The Paretian concepts allow us, albeit in a restricted way, to make some individualistic sense of the concept of "society's welfare," an otherwise a scientific and troubling concept inasmuch as society is nothing apart from the individuals who compose it. The modern notion of economic efficiency is borrowed from Pareto: an action or a policy is efficient if it brings about a Pareto improvement; a situation is efficient if all possible Pareto improvements have been made so that nobody can be made better off without at least one individual being made worse off. An efficient situation is often called *Pareto optimal.*

If elucidated, in a market economy, it is assumed that markets are competitive. In the world, however, competition is sometimes far from perfect. In some markets, a single buyer or seller may be able to control market prices. This ability to influence prices is called *"market power"*.[37] Market power can cause markets to be inefficient because it keeps the price and quantity away from the equilibrium of supply and demand.[38]

The social planner might care about *equity* – the fairness of the distribution of well-being among the various buyers and sellers. In essence, the gains from trade in a market are like a pie to be distributed among the market participants. The question of efficiency is whether the pie is as big as possible. The question of equity is whether the pie is divided fairly. Evaluating the equity of a market outcome is more difficult than the evaluating the efficiency.[39]

Furthermore, the outcome in a market matters only to the buyers and sellers in that market. Yet, in the world, the decisions of buyers and sellers are sometimes affect people who are not the participants in the market at all. Pollution is the classic example of a market outcome that affects people not in the market. Such side effects, called *"externalities"*[40], cause welfare in a market to depend on more than just the value to the buyers and the cost of the sellers. Because buyers and sellers do not take these side effects into account when deciding how much to consume and produce, the equilibrium in a market can be inefficient from the standpoint of society as a whole.

Market power and externalities are examples of a general phenomenon called market failure – the inability of some unregulated markets to allocate resources inefficiently. When markets fail, government intervention can potentially remedy the problem and increase economic efficiency.

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[37] Mankiw, p. 150
[38] See Figure 2. Equilibrium of Supply and Demand
[39] Mankiw, p. 146
[40] Ardıyok, p. 10

In conclusion, the aim of economic regulation is to correct deficiencies in the market system in meeting public interest goals.[41] Besides, at the time of liberalization and privatization process of the natural monopoly sectors, it is strongly required to apply economic regulation policy in order to ensure stable market economy and competitive market.

Liberalization of the sectors having the characteristics of natural monopoly in Europe and the introduction of new and more homogenous regulatory frameworks have for the last decade been part of the vision of an integrated internal market economy in Europe.[42] Economic regulation policy during the liberalization process of the public utilities enhanced the competition and opened markets to increase productivity, reduce prices, stimulate new and higher quality products and services and boost output. Following liberalization in 1993 under the European Single Market, 800 new licenses were granted in Europe, and more people are using lower-cost economy fares.[43]

2.2. Principles of "Good" Regulation

Actual objectives of regulation in different parts of the world may diverge from each other. However, in most cases, governments and their regulatory policies do attempt to meet the "long-term" and "efficiency" criteria, although some are more successful at doing so than others.[44]

When we discuss "long-term" objectives, this implies that regulators should not be able to forfeit consumers' long-term interests (e.g. investment to secure a reliable

[41] Ogus Anthony, (2001). "Regulation: The Public Interest and the Private Interest. Deffains Bruno & Kırat Thierry (Eds.) "Law and Economics in Civil Law Countries", (141-145) Amsterdam: Elsevier Science B.V.
[42] Finon & Midttun, p. 1
[43] OECD, (1997), p. 7
[44] Williamson Brian & Mumssen Yogita, "Economic Regulation of Network Industries". (2000), London: National Economic Research Associates, p. 12

supply in the future) in favor of short-term interests (e.g. price reductions during the regulator's term of office).

Many countries have moved on today to regulatory reforms that apply across the economy and to a broader range of policy areas, and that involve many thousands of existing and proposed regulations at multiple layers of government. Like de-monopolization, these reforms require long-term political commitment in the face of sustained opposition from vested interests inside and outside governments.[45]

When we discuss "efficiency", this implies the achievement of efficiency in operations and investment is a key objective which overlaps with other objectives (e.g. competition, where introduced, should be efficient; minimization of regulatory risk encourages efficiency; the minimization of transaction costs is a component of efficiency.)

As is known, a fundamental objective of regulation policy is to improve the efficiency of national economies and their ability to adapt to change and to remain competitive.[46] If the regulatory agencies ensure the efficiency, social welfare maximizes.

Regulation needs to provide monopolies with proper incentives in order for them to aspire to the objectives of meeting long-term customer needs through efficient investment and operations. Companies will only have proper incentives if regulators can demonstrate some degree of commitment and stability.[47] Commitment and stability in turn come from processes that require openness, transparency, consistency and accountability.

[45] OECD, (1997), p. 8
[46] OECD, (1997,) p. 5
[47] Williamson & Mumssen, p. 13

Thus, regulation should be:

– - open: a process which allows interested parties to put forward their views and be challenged by others, providing maximum access to relevant information; The public needs to be informed as to why reform is considered so important to their future well-being and that of their children. An open, informed debate involving all major stakeholders is needed to explain the benefits of reform and to offset the voice of powerful interest groups which seek to defend the status quo.[48]

- transparent: Transparency and fairness are essential to establishing a stable regulatory environment that promotes competition, trade and investment. If governments are to maintain credibility and effectiveness, they must use their regulatory powers no more than the minimum necessary to protect important public interests; apply rules transparently.[49]

The demonstrable use of available information where a regulator reaches decisions on the basis of observable data sources and a replicable (mechanistic) formula, in order to minimize the scope for discretion (otherwise the system might be prone to opportunistic decisions and regulatory risk);

- consistent: whereby the regulator uses a stable set of decision criteria to ensure that when change in regulatory methodology/practice is required, this can be done in a manner that is as acceptable and predictable as possible; and

- accountable: "Who regulates the regulators" is a reference to the issue of accountability.[50] Decisions should be reasoned and justified by reference to defined criteria (such as a list of regulatory objectives), so that they can be effectively challenged. This provides an incentive to reach good decisions.

[48] OECD, (1997), p. 13
[49] OECD, (1997), p. 31
[50] Carlton & Perloff, p. 652

The independence of a regulatory body is often cited as one of the most important characteristics of a regulator for ensuring long-term consumer interests and efficient business decisions. Where there is a perceived risk that there will be political pressure to tighten the deal for private investors (which would increase the cost of capital), good regulatory governance is critical[51]; a regulatory agency must not be able to be dismissed or deprived of funds simply for making politically unpopular decisions. However, independence is difficult to achieve. Regulators must be appointed, and therefore regulation is inherently tied to the political process

It is also questionable whether absolute independence is desirable. Ultimately the regulatory agency's decisions must be legitimate in a democratic society.[52] The requirement to balance the need for regulatory independence with the need to demonstrate legitimacy is critical. What gives legitimacy to regulatory decisions is process, not personnel:[53]

· guiding principles for decisions (consistency & accountability);

· broadening the degree of participation in agency decisions (openness);

· transparent analytical procedures for decision-making (transparency); and

· appeal mechanisms (accountability).

By specifying the regulator's duties and powers in law, the regulator can more easily be held accountable for its actions. Scholars conflict on a key question: Whither does regulation serve? In general, there are three major theories of economic regulation: public interest theory, capture theory, and special interest theory.

[51] Ogus (2001), Deffains & Kırat (Eds.), p. 142
[52] Oğuz Fuat, "Regülasyon Ekonomisi Nereye Gidiyor?" , Finans Politik & Ekonomik Yorumlar Dergisi Haziran 2004 Yıl 41, No. 483, (pp. 75-79)
[53] Williamson & Mumssen, p. 13

Public interest theory was bequeathed by a previous generation of economists to the present generation of lawyers.[54] Public interest theory explains government intervention in markets and associated regulatory rules as responses to market failures and market imperfections. This theory argues that regulation promotes the general welfare rather than the interests of well-organized stakeholders.

In contrast to public interest theory, in other two approaches industries and companies actually demand regulation in order to create conditions for greater profitability. At this point, the companies in an industry want to be regulated because in this way they can have chance to capture (persuade, bribe, or threaten) the regulators, so that the regulators do what the industry want.[55]

Thence for the avoidance of bad consequences, good regulation should have a sound legal basis.[56] This will help ensure some degree of independence from political and market pressure.

2.3. Types of Regulation

In theory and practice, different types of regulation exist. Nevertheless, it is common internationally to divide regulations into three categories – economic, social and administrative.

At its most broad-ranging, reform of economic, social, and administrative regulations often brings major changes in the attitudes and behavior of firms, workers, and individual citizens.[57]

[54] Posner Richard A., (1974), "Theories of Economic Regulation", The Bell Journal of Economics and Management Science, Vol. 5, No. 2, (pp. 335-358)
[55] Carlton & Perloff, p. 652
[56] OECD, (1997), p. 28
[57] Ibid. p. 11

2.3.1. Economic Regulation

Economic regulation, the focus of this study, aims to guarantee the functioning of markets. Economic regulation is mainly exercised on natural monopolies and market structures with limited or excessive competition.[58]

Economic regulation intervenes directly in market decisions such as pricing, competition, market entry, or exit. Despite the fact that almost all economic activity today occurs in markets where competition can work efficiently, economic regulations that reduce competition and distort prices are pervasive.

Economic regulation consists of two types of regulations[59]: structural regulation and conduct regulation. Structural regulation is used for regulating market structure. Examples are restrictions on entry and exit, and rules against individuals supplying professional services in the absence of recognized qualifications. Conduct regulation is used for regulating behavior in the market. Examples are price control, rules against advertising and minimum quality standards.

Economic regulation is used to influence the allocation of resources with the view to improving the efficiency of markets in the delivery of goods and services. It includes[60]:

(i) Restrictions on entry and exit to markets – registration requirements and procedures, permits and licensing laws, laws and regulations on choosing the business activity, form of the business, business location, choice of production process and machinery.

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[58] Den Hertog Johan, (1999),,"General Theories of Regulation", Bouckaert Boudewijn & De Geest Gerrit (Eds.), "Encylopedia of Law & Economics", Cheltenham: Edward Elgar & Gent: University of Genth Publishing, (pp. 223-270)

[59] Kay, John A. and Vickers, John S. (1990), 'Regulatory Reform: An Appraisal', Majone Giandomenico (Ed.), "Deregulation or Re-regulation", London: Pinter Publishers, (pp. 223-251).

[60] Ouertey Peter, "The Impact of Regulation &Competition on SME Development", (2001), DSE Conference on Different Poverty, Different Policies, 10-12 September Manchester, p. 8

(ii) Monetary and Credit Policies: This includes inflation and money supply policy, interest rates policy, and requirements on collateral and security, banking and financial intermediation laws.

(iii) Trade regulation

As is stated above, economic regulation focuses on correcting market failures, and strengthening the enabling business environment. Furthermore, economic regulation can also have consequences for poverty reduction and environmental protection.[61]

Besides, in recent years, there has been significant deregulation as many countries have moved to replace monopolies with competitive markets, often accompanied by privatization. This trend is backed by strong evidence that vigorous competition is the best way to produce dynamic and innovative industries that can meet consumer needs and compete in expanding global markets, and is further reinforced by trends toward European integration and free trade. More progress has been made in some sectors, such as financial services and telecommunications, than in others, such as energy and transport, but the need for more competition is today accepted almost everywhere.

Just as important as the need to maintain the momentum of de-monopolization is the need for transitional regulatory frameworks in some sectors to ensure access to networks and to promote the emergence of effective competition; for new prudential regulations to oversee more competitive markets; and for an effective competition policy framework. For example, prudential banking regulation reduces risks of systemic failures that affect economic stability; countries that have failed to get prudential regulation right before reform have suffered costly crises.[62]

[61] Kirkpatrick Colin, "Regulatory Impact Asessment in Developing Countries: Research Issues", (2001), Centre on Regulation and Competition Manchester, Working Paper Series Paper No.5, October, p. 6
[62] OECD, (1997), p. 8

The most far-reaching application of such reforms has been in the newer Members in Central and Eastern Europe, who have combined massive deregulation with construction of legal systems and institutions to support markets.[63] There is tremendous experimentation underway today, and continued monitoring will be useful in reducing the risks of major structural reforms. Many countries have moved on today to economic regulatory reforms that apply across the economy and to a broader range of policy areas, and that involve many thousands of existing and proposed regulations at multiple layers of government.

In late 1992, the Director-General[64] responsible for the Internal Market summed up the Commission's general orientation on industrial policy matters as follows: ''we are on our way to creating an effective, decentralized but interactive, common approach to economic regulation across Community''.[65]

2.3.2. Social Regulation

Social regulation protects public interests such as health, safety, the environment, and social cohesion. The economic effects of social regulations may be secondary concerns or even unexpected, but can be substantial.

Reform regarding social regulation aims to verify that regulation is needed, and to design regulatory and other instruments, such as market incentives and goal-based approaches, that are more flexible, simpler, and more effective at lower cost.[66] It includes[67]:

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[63] Ibid., p. 8

[64] The Internal Market and Services Directorate General (DG MARKT) is one of 37 Directorates General and specialised services which make up the European Commission. Its main role is to coordinate the Commission's policy on the European Single Market, which aims to ensure the free movement of people, goods, services and capital within the Union.

[65] Hancher Leigh, (1996), ''The regulatory Role of the European Union'', Kassim Hussein & Menon Anand (Eds.), ''The European Union and Industrial Policy'', London &New York: Routledge, p. 61

[66] Ibid, p. 6

[67] Ouertey, p. 11

(i) Health and safety: Health and safety are two important areas where regulation cannot be removed because the consequence of ineffective or unapplied in these two areas will be too harmful.

(ii) Environmental Protection: Governments act to regulate the operations of companies especially waste disposal and the use of up-to-date machinery to minimize pollution.

(iii) Controls over labor contracts and employer employee relationships: This usually comprises of wage policies, labor legislation, skills training system and many others. The processes through which the three types of labor regulation affect market is examined below:

a. Minimum wages

b. Non-wage Compensation: This includes housing bonuses, transportation allowance, family wage allowances, extended paid maternity leave, employers insurance contributions, end-of-year bonuses, sick pay or leave and other forms compensation.

c. Job Security: This includes severance pay requirements, laws governing the hiring and firing of workers, etc.

An increasingly high priority is reform of social and administrative regulations, which are expanding rapidly in OECD countries. Because markets do not properly value some public interests that citizens deem important, social regulations will continue to be essential in preserving the environment, saving lives, and protecting consumers and vulnerable social and economic groups.[68] More competitive markets will justify in some cases more government action. For example, as they are faced with more choice, consumers may require better information and confidence building measures.

Economic regulation and social regulation are strongly connected because they both have the same goal to direct economic activity in such a way that welfare is maximized.[69]

[68] OECD, (1997), p.

[69] Ogus Anthony, "Regulation – Legal Form and Economic Theory", 1994, New York: Oxford University Press, p. 46

2.3.3. Administrative Regulation

Administrative regulation refers to administrative formalities through which the government collects information and allocates its funds.[70] These are paperwork and administrative formalities -- so-called "red tape" -- through which governments collect information and intervene in individual economic decisions. They can have substantial impacts on private sector performance.[71]

It is often instituted to control how governments collect, manages and appropriates its revenue and property. The principal objective of such controls is to promote administrative efficiency of the public and private sectors. It includes taxation; patent protection for interventions, designs and products, copyright protection, trademarks protection and bankruptcy acts.[72]

Taxation is a major field of government activity that has significant impact on economy. Tax policies include investment and tax incentives, taxes applying to starting and operating a business, capital-based and income-based taxes.

2.4. Relationship Between Regulation and Competition

Not only the meaning of regulation but also the relations between regulation and competition have changed in the last two decades. It was only in the early 1970s that George Stigler could write with much conviction and force that 'regulation and competition are rhetorical friends and deadly enemies.[73]

[70] Valkonen Laura, "Deregulation as Means To Increase Competition and Productivity – Some Finnish Experiences", Helsinki: ETLA, 2006, p. 5
[71] OECD, (1997), P. 6
[72] Ouertey, p. 15
[73] Jacintt & Levi-Faur, p. 6

In the past, regulation has sometimes been considered as a synonym for a fragmented and inconsequential set of norms, which might eventually lead to a situation where the development of competition is held back rather than supported.[74] However, it moved firmly to an approach which envisages that regulation is essentially economic regulation. Economic regulation is based on the perspective that intervention on the market is necessary and beneficial only when it offers the solution to certain sorts of market power, and in particular to market failures which derive from formerly monopolistic market structures.

With rise of the 'regulatory state', regulation-for-competition approach has become significant. It might be useful to start with a clarification of five notions that are used in the literature to capture the relations between competition and regulation. Deregulation, re-regulation, regulation-of-competition, regulation *for*- competition and meta-regulation convey different and sometimes conflicting dimensions of the much wider fact of regulatory reform and liberalization.[75]

These are five forms of relationships between regulation and competition:

(i) Deregulation – reduction of economic, political and social restrictions on the behavior of social actors. The term "deregulation" is a misnomer: deregulation does not signal the end of regulation, especially in crucial areas of transport such as safety, and deregulatory measures are invariably accompanied by new and often more explicit regulatory structures.[76] In the United Kingdom, for example, following the privatization of public utilities the State established more effective control over some aspects of these industries than the previous indifference associated with nationalization. In many cases deregulation signals a change of emphasis between structure and conduct regulation, or a functional separation of ownership, operation

[74] Monti Mario, (2003), "Competition and Regulation in the new Framework". Public Workshop on The Electronic Communications Consultation Mechanism. Brussels, 15 July, (pp.1-7)
[75] Jacintt & Levi-Faur, p. 6
[76] Turnbull Peter, (1999), "Regulation, deregulation or re-regulation of transport?", Symposium on the Social and Labour Consequences of Technological Developments, Deregulation and Privatization of Transport**,** Discussion Paper No. 4, Geneva, p. 7

and regulation. For example, the State may continue to own a particular transport service (as the principal shareholder) but a private company now runs the operation on a commercial basis.

(ii) Re-regulation – implies that regulatory reforms and liberalization result in new settings of regulation rather than in deregulation. The notion of re-regulation is vague as to the nature and goals of the new regulation

(iii) Regulation-of-competition – positive relations between regulation and competition with intervention by the state authorities to monitor and enforce competition – e.g. national competition authorities.

(iv) Regulation-for-competition – positive relations, equally, between regulation and competition with more intrusive state intervention e.g. strict sector-specific regulation. In regulation-*for*-competition, the responsibilities of regulatory authorities are narrowly confined to a sector or industry, but they usually give those authorities much more influence over market actors.[77] Unlike the reactive approach of competition authorities, these sector-specific authorities are today proactive and involved in market design and market control to an unprecedented extent.

(v) Meta-regulation – the process of regulation itself becomes regulated e.g. governments monitor the self monitoring of corporations and other organizations e.g. broad government oversight over self-regulatory professional bodies etc. Broad processes of regulatory reform can result in any of the five subsets of relationships between regulation and competition.

As regard the regulation-for-competition approach, competition and regulation have the common aim. The principal purpose of regulation is to ensure free competition. Thus, the neo-liberal position can be summarized by the maxim: "Competition where possible, regulation only where necessary".[78]

[77] Jacintt & Levi-Faur, p. 6
[78] Turnball, p. 4

The absence of competition in a monopoly industry induces the private agent to decrease production and increase prices above costs of production.[79] In this case there is an unfair redistribution of rent from consumers to producers and also there is production loss where the value for consumers is higher than its production cost plus a reasonable rate of return. Therefore the purpose of regulation is to attempt to create surrogates for a perfectly competitive market, either temporarily (to allow entry) or permanently (in the case of natural monopolies). Even though competition and regulation may be often regarded as substitutes where the aphorism stated above: "competition where possible, regulation where necessary" is valid in many occasions regulation in enforced not as a substitute for but as a guarantee to a competitive market.

Competition policy also aims at ensuring access to essential infrastructure; this is crucial during the transition from a monopolistic environment to a competitive one, since the knowledge or information possessed by incumbent and incoming companies may be asymmetric.[80] During this period of transition, regulatory policies must seek to encourage the creation of a competitive environment, in the most neutral way possible for agents.

In this respect, an important point is regulating access to certain infrastructure features that are crucial for the sector. In conclusion, the evolution of the analytical framework for regulation has gone hand in hand with the evolution of market structures, from state-owned monopolies to increasingly liberalized and pro-competitive environments.[81]

Since regulation has been increasingly determined by a competition policy perspective, using both regulatory and competition tools cannot be seen as inconsistent. Competition instruments and regulatory tools can be considered as complementary

[79] Monti Mario, p. 3
[80] Oliveira Gesner, Machado Eduardo Luiz, De Santana José Ricardo, Werneck Bruno Dario, (2004), "Regulatory Design and Competitiveness: Evidence from a Sample of Brazilian Infrastructure Sectors", Alvarez Ana María & Cernat Lucian (Eds.), "Competition, Competitiveness and Development Lessons From Developing Countries", Geneva: United Nations Publishing, (pp. 111-143)
[81] Monti Mario, p. 3

means.[82] They deal with a common problem and try to achieve a common aim. Only through a combination of both tools can states ensure that market power does not distort and hamper the development of competition in the communications markets. This in turn allows end users to drive and steer such development, as well as to benefit the most of it.

[82] Ibid., p.6

III. GENERAL SURVEY ON REGULATORY AGENCIES

3.1. Regulatory Agencies (Regulators)

One of the most notable characteristics of the change in governance of the past two decades has been the restructuring of the state, most notably the delegation of authority from politicians and ministries to technocrats and regulatory agencies. Especially the era of liberalization and privatization is also the era of regulation. This seems paradoxical since liberalization & privatization and the family of policies that were associated with it was supposed to lead to deregulation and them promotion of free markets. Yet, with the advance of privatization, it became clear that free markets often imply more rules, regulatory agencies and regulators. A quarter of century after the launch of the Thatcherism revolution, it is possible to conclude that the new economic order involves everything but deregulation.[83]

Regulatory agencies are a sub-group of central agencies and one of their main tasks is to control the power of the market, ensure fair competition, and protect consumers and citizens by guiding and implementing policy regulation.[84]

As countries compete for capital, they are more likely to create regulatory agencies to improve their credibility in domains where attracting private investment is important, that is, in economic regulation in general, but especially when markets in utilities are opened.[85] About 200 regulators in some 130 countries are regulating infrastructure sectors such as electricity, water and telecommunications.[86]

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[83] Gilardi Fabrizio & Jordana Jacint & Levi-Faur David, (2006), "Regulation in the age of Globalization: The Diffusion of Regulatory Agencies across Europe and Latin America", Madrid: IBEI Publishing, p. 4

[84] Christensen Tom & Laergreid Per, (2005) "Regulatory Reforms and Agencification", Stein Rokkan Centre for Social Studies Unifob AS Working Paper - 6, November, (pp. 1-42)

[85] Ibid., p. 15

[86] Ebenhard Anton, (2006), "Infrastructure Regulation in Developing Countries: an Exploration of Hybrid and Transitional Models", African Forum of Utilities Regulators 3rd Annual Conference, 15-16 March, (pp.1-39)

One of their features is that they often seem to be constitutional hybrids having both statutory power and incorporated status.[87] Strong and effective institutions require expert staff and resources to provide all core functions. Expertise and experience need to be developed and maintained over time so that officials responsible for policy development and institutional design are more aware of and better able to identify what is necessary for high quality regulation that provides a better framework for investment. [88]Synergies among regulatory institutions are crucial for policy coherence and effective coordination.

In the large majority of EU states, regulatory authorities are specialized by sector, even if there are obvious economies of scale between certain regulated industries in the process of regulation.[89] Moreover, technological progress tends to smooth the traditional boundaries between sectors. For example, gas and electricity are easily interchangeable since gas is used to generate electricity. Telecommunications and postal services are competitors in some markets. These issues become crucial in the process of assessing which is the optimal number of regulators authorities and which industries should be grouped together.

3.1.1. Designing of Regulatory Agencies

Regulatory agencies can be designed in many different ways. Components include the role (or "mission") they are assigned, their governance, the specific regulatory functions and processes, the resources and internal management of the agency, the start-up strategy and other factors.[90]

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[87] Christensen & Laergreid, p. 10

[88] OECD, "OECD Reviews of Regulation of Regulatory Reforms; Background Document on Regulatory Reform in OECD Countries", Paris, 2006, p. 22

[89] Buigues Pierre-André, (2006), "Competition Policy Versus Sector-Specific Regulation in Network Industries – The EU Experience", Submitted to UNCTAD's Seventh Session of the Intergovernmental Group of Experts on Competition Law and Policy, Geneva, 30 October-2 November, (pp. 1-34)

[90] Ocana Carlos, (2002), "Trends in the Management of Regulation: A Comparison of Energy Regulators in OECD Member Countries", Energy Diversification Division of IEA, September, (pp. 1-19)

The main components are summarized in Table 1.[91]

Table 1. Designing Regulatory Agencies

Area	Design Issues	Key Options
Mission	Objectives	● One or several among: Consumer protection Investor protection Economic efficiency Competition advocacy
	Jurisdiction (powers)	● Regulatory powers only or, additionally: - Mergers - Other competition law - Policy on entry, investment, privatization
	Industry Coverage	● One industry or multi-industry
Governance	Decision-making Structure	● Single regulator or Commission ● Odd or even number of commissioners ● Staggered terms or not
	Appointment of Regulators	● Made by parliament or by government ● Stakeholders allowed or not ● Based on professional competence criteria or not
	Independence safeguards	●Irrevocable mandates ●Prohibition of conflicts of interest during and after mandate ●Stable funding

[91] adapted from Ocana (2002), p. 5-6

Regulatory Activities	Functions	●One or several among: Regulation of monopolies End-user tariffs and quality standards Monitoring Dispute resolution Advisory role to government
	Process and Appeals	● Process based on: - Rule-making - Negotiation among stake holders - Monitoring and remedial action ●Rules to promote transparency of decision making such as hearings and publication of decisions ● Designation (or not) of an independent appeals body ● Grounds for appeal restricted to complaints on undue process or not
	Coordination with Other Authorities	● Formal or informal mechanisms for consultation and referral
Resources, Management and External Control	Funding	● Earmarked or not ● From state budget or from industry ● Size ● Stability of time horizon
	Human Resources	● Salaries at market levels or subject to civil service rules ● Competence and specialization of staff ● Use of external resources
	Reporting and Auditing	● Reporting to parliament, to line ministry, to other ministry ● External audits

Transition Issues	Start-up strategy	● Timing: set up before or after reform ● Initially, staff on secondment from industry or ministry allowed or not

3.1.2. Objectives of Regulatory Agencies

A large set of regulatory and related functions can be assigned to a regulatory agency including consumer protection, investor protection, economic efficiency, competition advocacy. The goals of regulatory agencies are generally restricted to economic issues. Two common goals are protecting users and protecting investors.[92] Users need to be protected from abuse by firms with substantial market power, while investors require protection from arbitrary action by government, such as setting tariffs that are not financially sustainable. Regulatory agencies have to balance these two objectives. For instance, prices are set with the aim of protecting users from monopolistic pricing while allowing investors to recover their investments and earn a return on them.

Regulatory agencies are endowed with more general goals, such as promoting economic efficiency or market-oriented reforms. Institutions specifically serving these goals may be useful, especially since the greatest impediments to enhanced competition in many key sectors of the economy are often restrictions imposed by government laws and regulations.

Consequently, key issues in this respect include considerations on how to establish institutions that are[93]:

- Competent, accountable, independent;

[92] Ocana, p. 7
[93] OECD, (2006), p. 21

- At arms length from short-term political interference;
- Capable of resisting capture by interest groups, but still
- Responsive to general political priorities; and;
- Have decision-making procedures that take into account the particularities of the area being regulated, while at the same time maintaining transparency and accessibility for all stakeholders.

3.1.3. Functions of Regulatory Agencies

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

- the regulation of monopolies (unbundling, network pricing and access conditions, rules for operation and reliability)
- end-user tariffs
- quality and performance standards
- monitoring of market behavior and performance
- enforcement of rules
- regulation of entry (licensing and authorizations)
- advising the government and
- dispute resolution

The actual allocation of functions depends both on the regulatory framework (what is regulated?) and on the institutional structure (how regulatory functions are divided among the agency, ministry and others?).[94]

Regulatory functions can be allocated according to their "economic" or "social" nature. In this case the industry regulator is responsible for economic regulation dealing with imperfect competition or monopolies or may be further restricted to cover only monopolies. Less frequently, regulatory agencies may have some responsibility for social

[94] Ocana, p. 9

regulation including distributional issues such as promoting "universal service" in basic telecommunications services and alleviating “fuel poverty” by facilitating low income household access to basic energy services. Regulatory functions may also be allocated so that the organization making the rules is not the organization enforcing them. Separation of rule-making from rule implementation is intended to avoid conflicts of interest.

3.1.4. Regulatory Models

In the light of declared issues above, range of possible regulatory models will be scrutinized below.

A review of international experience indicates that most regulatory models fall into four broad categories: regulation by government, independent regulation, and regulation by contract and outsourcing regulatory functions to third parties:

a. Regulation by Government

Traditionally, governments have assumed responsibility for regulation in areas where there is obvious market failure and/or where governments seek to achieve specific social, economic and environmental objectives. Network industries such as electricity transmission lines or gas and water pipelines tend to be natural monopolies. Governments are able to exercise full regulatory discretion in determining, monitoring and enforcing maximum tariffs and minimum service standards.

Additional challenges arise where government regulators seek to regulate state owned utilities. The different objectives, roles and functions of government in relation to state-owned utilities can be indefinite and conflicting.[95] First, governments represent political constituencies and wish to offer low cost or free services to these constituencies. Second, governments, as owners of utilities, need a sufficient return on assets for

[95] Ebenhard, p. 9

maintenance and expansion. Finally, governments also have to play a third role of regulator, balancing the need for financial viability with customer protection through ensuring affordable and reliable services. These different roles are seldom separated explicitly, with the result that one or more functions could be compromised. Effective regulation of state-owned utilities requires clarification and separation of government roles and functions - as illustrated below.[96]

Government's political role in relation to utility services should be made explicit through transparent policies and public funding streams. Finally, role clarification can be strengthened through government transferring its regulatory functions to an independent agency or a regulatory contract - as discussed below.

b. Independent Regulatory Agencies

Independent regulatory agencies are defined as autonomous public bodies empowered to regulate specific aspects of an industry. Regulatory agencies may also have judicial or quasi-judicial powers such as setting fines and penalties for noncompliance or acting as an arbitrator in disputes among industry participants. Independent regulators have become more significant over the last decade. The doctrine is that regulatory agencies are most effective if they are independent from the ministry, operate according to a clear regulatory policy, and are staffed by experts.[97]

Independent regulatory agencies have been established in fields as diverse as telecommunications, railways, civil aviation, postal services, market competition, electricity, water, the media, the pharmaceuticals sector, the environment, food safety, data protection, occupational safety, homeland security, insurance, banking, education, and health care.[98]

[96] Ibid., p. 10
[97] Christensen & Laergreid, p. 20
[98] Christensen & Laergreid, p. 11

Independence, in this context, specifically means that the regulatory agency is protected from short-term political interference.[99] Political independence is primarily meant as a commitment to provide for a stable regulatory framework over time. This commitment protects investors against opportunistic government intervention**.** The establishment of autonomous regulatory authorities is interpreted as a signal to investors. This signal conveys the following message: we are serious about private investment and we assure you that we are committed to a stable institutional design that separates technocratic decision-making from political decision-making, and puts constraints on any reversal of policies.[100] Delegating regulatory competencies to an agency that is independent from political pressure is a possible solution in that it is meant to enhance the credibility of commitment after market decisions were made

Regulators are also meant to be independent from stakeholders in the sense that regulated parties should not be able to influence regulatory decisions.[101] This is necessary to ensure that regulation is fair and does not favor one group of stakeholders over the others. Almost all approaches to regulation are based on the principle that regulators should not be "captured" by the interests of industry players. Unlike political independence, which is an attribute of independent regulatory agencies, independence from stakeholders is sought for all public bodies involved in regulation. In addition to independence dimensions mentioned above independent regulatory agencies have *financial independence* where the regulator has an earmarked, secure and adequate source of funding.

The effectiveness of separate regulatory agencies depends on the degree of independence enjoyed by the agency. Their effectiveness depends also on a number of linked governance issues such as clarity of roles and objectives, accountability, transparency, participation, predictability, proportionality and non-discrimination.[102]

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[99] Ocana, p. 3
[100] Fabrizio & Jordana & Levi-Faur, p. 9
[101] Ocana, p. 3
[102] Brown A. & Stern J. & Tenenbaum B. & Gencer D., (2006), "A Handbook for Evaluating Infrastructure Regulatory Systems", World Bank, Washington D.C., p. 59

Clarity of roles and responsibilities is critical to good regulatory design. This principle requires that there be a separation between regulation and policy making. The role of regulators should be defined by law and there should be no overlaps between the regulator and the minister's duties.[103] Regulators should have precise objectives that are accompanied by clear measures of success and failure.

The principle of *accountability* requires that the regulator be accountable to parliament, the government and to the public. *Transparency* requires that regulators have clearly defined, published procedures under which they take and announce decisions and their justifications.[104] The decision making process should be outlined and documented and the rationale for decisions should be explained.

Participation is a process whereby interest groups are able to present their views and inputs into key regulatory processes and decisions. *Predictability* implies that the regulator will follow published regulatory procedures and methods in a consistent and timely fashion. The credibility of the regulatory process depends on predictability and consistency of decision-making. Thus, reduce the need for both political control and for the direct participation and involvement of citizens in the regulatory process.[105]

Non-discrimination implies that regulators do not discriminate between either service providers or within customer categories: i.e. regulatory decisions should be similar for utilities facing similar contexts and for the same types of consumers. Regulation should be fair. *Proportionality* means that regulation should involve the minimum level of controls necessary to achieve regulatory objectives: i.e. regulation should be light handed and should involve incentives where possible.[106] An independent regulator is feasible where there is a strong effort to implement the principles mentioned above.

[103] Ebenhard, p. 13
[104] Ocana, p. 9
[105] Christensen & Laergreid, p. 15
[106] Brown & Stern & Tenenbaum & Gencer, p. 61

c. Regulatory Contracts

In regulatory contracts (or regulation by contract) regulatory regimes, including multi-year tariff setting systems, are pre-specified in detail in one or more legal instrument such as basic law, secondary legislation, licences, concession contracts, power purchase agreements, etc.[107] Regulation may be governed by detailed procedures to determine the obligations and rights of stakeholders ("regulation by contract") or it may be based on more general rules.[108] These legal matters are largely determined by the administrative and legal systems of each country.

Regulatory contracts are generally constructed within the context of private sector participation. Regulatory contracts may also be used to improve the performance of state-owned utilities.

There are three variants to this model. In the first case, key contract provisions, such as tariff setting formulae, are self-administered by the parties to the contract i.e. regulation without a regulator or the assistance of third parties. A difficulty with this model is that parties to the contract are both "players and referees". They are responsible for fulfilling certain contractual obligations - but also tracking their performance. In the second case, provision is made for aspects of the contract to be undertaken by third parties. In the third variant, a detailed tariff-setting agreement, although embedded in a law, license, concession or contract, is administered by a regulator. In this case the regulatory contract complements but does not eliminate the regulator. Regulatory discretion is limited. While the contract may specify a definitive price path for the initial years, it is not common that actual prices are specified. What is generally prespecified is a pricing formula with parameters that determine average tariff levels or average total revenue in subsequent tariff reviews.

[107] This section relies heavily on the publication of Ebenhard (2006).
[108] Ocana, p. 11

A regulatory agency can co-exist successfully with a regulatory contract where the contract is incomplete and additional regulatory mechanisms are needed. Or there could be situations where the law and/or the contract explicitly define the role of the regulator - for example in periodic tariff setting, or monitoring of performance or mediation and arbitration. The regulator can also play a role in enhancing the transparency of regulatory contracts by collecting, analyzing and publishing performance data.

However, problems can also arise when these two very different legal traditions are welded together. While tariff-setting formula may be specified in the contract, the regulator may feel obligated in terms of its legislative mandate to intervene in the public interest.[109] In these cases, it is essential that regulatory mandates and functions are clarified.

Regulatory contracts are usually established as part of the privatization package. There are number of key provisions that typically make or break regulatory contracts, including: pass-through of bulk purchase costs; indexation of key costs, foreign exchange risks; efficiency targets; poor initial data; investment obligations; subsidies for pro-poor service; unexpected and extraordinary events; periodic and emergency adjustments; resetting of values at the end of the multi-year tariff period; monitoring and enforcement; dispute resolution and arbitration provisions; and termination clauses.

Regulatory contracts usually specify arbitration mechanisms. The contract may require the regulator to rule on disputes - but situations may also arise where there is disagreement with the regulator and then the question is whether these go to mediation, expert panels, a specialized appeals tribunal or local or international courts. Highly specified contracts may provide comfort to investors, but may later have to be renegotiated. Increasing discretion in regulatory systems can facilitate adjustment to new events, but exposes investors to political and regulatory risk. In the end, there will be an unavoidable need for some form of discretion. Finally, a regulatory contract will not

[109] Ebenhard, p. 16

work if the economics are unsecured. There has to be an appropriate balance between investor interests and development outcomes.

d. Outsourcing regulatory functions

Outsourcing or contracting-out of regulatory functions is the use of external contractors, either by regulatory agencies or as stipulated in a regulatory contract, to perform certain functions such as tariff reviews, bench-marking, monitoring of compliance or dispute resolution. Outsourcing may be considered when there are challenges or problems regarding a regulator's independence, capacity or legitimacy or where regulatory contracts require additional support for their effective administration.[110] Outsourcing or contracting-out may also be employed for cost-benefit reasons.

Outsourcing or contracting-out has many potential benefits.[111] It can increase regulatory competence through access to specialised skills and knowledge, and can leverage international experience. If well managed, contractors can build core, inhouse skills. The regulator's independence and legitimacy can also be enhanced through the external contractor's reputation. Regulatory studies may be perceived to be more credible. Regulators are not then fully dependent on inexperienced staff, some of whom may have been foisted on the regulator through political patronage.

Contracting-out models take two broad forms. First, they may involve primarily consulting or technical support for regulators or the parties to a regulatory contract. Second, they may involve the contracting by government of separate advisory regulators or expert panels. Most regulators outsource at least some regulatory functions, which most frequently take the form of technical support, rather than any formal role in regulatory decision-making.

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[110] Trémolet Sophie & Shukla Padmesh & Venton Courtenay, "Contracting Out Utility Regulatory Functions", London: Environmental Resources Management (ERM), (2004), p. 17

[111] Ebenhard, p. 18

e. Advisory Regulators and/or Expert Panels

As mentioned above, one form of contracting-out or outsourcing may involve the creation of advisory regulators or expert panels.

The advisory function may be expressed either strongly or weakly.[112] In a weak advisory regulator model, advice is usually given confidentially and the minister or appropriate authority is under no obligation to explain rejection or modification of recommendations, or indeed to respond within a specified period of time. The terms of reference and directives to the advisory regulator or expert panel are not made public. There is little or no public consultation with affected parties. And the advisory function might be funded from the general Ministry, rather than separate, earmarked budgets. Unfortunately, the experience of this model is that the Minister or the relevant authorities frequently overrule advice and the model quickly loses credibility with investors, and perhaps also consumers.

In a strong advisory regulator model, the regulator or expert panel's advice must be given in a publicly available document that provides a clear statement and explanation of the decision. The minister or relevant authority may request reconsideration of the recommendations, but must do so within a specified time period. If the minister or relevant authority fails to react then the recommendations are enacted. The minister or relevant authority must provide a written, public explanation if the recommendations of the regulator are rejected or modified. The minister's policy directives and other communications to the regulator or expert panel must be in a public document. The regulator or expert panel has public consultations with affected parties and is funded from an earmarked budget outside of the line ministry. The second model is clearly stronger in terms of transparency and accountability and could help build a political constituency for independent regulation at a later stage. Expert panels may also be used to arbitrate disputes between regulators and utility operators or disputes that arise out of contested interpretations in regulatory contracts.

[112] Brown & Stern & Tenenbaum & Gencer, p. 100

The functioning of expert panels or advisory regulators needs to be governed by a set of rules (embedded in a regulatory contract or in primary or secondary legislation).[113] The rules need to attain an appropriate balance between constraining the discretion of the expert panel - but still allowing them to undertake the regulatory function that has been outsourced to them. This is particularly important in comprehensive price reviews. For example the rules may define the regulatory regime and regulatory methodologies - and even tariff structures - but would empower the expert panels to undertake cost studies and do the necessary revenue requirement calculations.

An important design question is whether to create a standing panel or to set up the expert panel anew each time it is needed to carry out a price review. Although standing panels may be costly (if a retainer has to be paid), they have obvious advantages in terms of continuity and predictability.[114]

3.1.4.1. General Overview on Regulatory Agency Models in Conjunction with Points Mentioned in Section 3.1.4.

A number of regulatory methods have been reviewed including direct regulation by government, regulation by independent agencies, and regulation by contract and outsourcing of regulatory functions on third parties. These models embody varying degrees of regulatory discretion.

These regulatory models are not mutually exclusive and often coexist.[115] Hence, regulatory contracts (such as concession agreements) may be administered by government; they could also be overseen by independent regulatory agencies. Independent regulatory agencies and regulatory contracts may also be supported or strengthened by various forms of outsourcing. Specific regulatory functions, such as tariff reviews, developing quality of service standards, monitoring and arbitration, might be

[113] Ebenhard, p. 20
[114] Ibid, p. 20
[115] Ibid, p. 21

outsourced to consultants or expert panels. Independent regulators may also (and typically do) contract consultants to assist with tariff reviews or with other technically complex functions or tasks.

The description and analysis of the various regulatory models and options has also highlightened potential problems and challenges. The crucial issue is how do countries then make choices between these or decide on the appropriate combination of options. The point is regulatory should be securely located within the political, constitutional and legal arrangements of individual countries.

3.1.5. Negative Aspects of Regulatory Agencies

The process of regulatory reform has gained some momentum over the past decades in order to reduce the distortion impacts of regulations, while achieving the policy goals at which the original regulations were aimed. Inappropriate regulations can impose substantial costs and inefficiencies on firms, sectors and the economy as a whole.

These costs can arise in four ways.[116] First, firms can have less incentive to economise on resources. This can take the form of over-investment in capital or employing excess labour, or of inefficient internal organisation of production. Second, a lack of competition can result in excess rents accruing to capital or labour, or both, implying that profits and/or wages are higher than they would be under competitive conditions. Third, regulations on service and product type can prevent firms from taking advantage of economies of scale, and especially scope in networking. Finally, there is increasing evidence that lack of competition tends to provide little incentive for firms to pursue technological innovations in production or in creating new goods and services, and especially can make firms less willing to adapt the quality and mix of goods and services delivered to changing consumer needs.

[116] Blöndal Sveinbjorn & Pilat Dirk, (1998), "The Economic Benefits of Regulatory Reform", OECD Economic Studies No.28, (pp. 1-41)

The direct results of inappropriate regulation in a particular sector are likely to be higher costs, higher prices, misallocation of resources, a lack of product innovation and & poor service quality. The key point is that regulators will have to exercise careful judgments about when and how to intervene.[117]

Regulatory agencies were created to remove regulation from direct political control and as an alternative to public ownership. Some academics thinks that their autonomy, however, left them vulnerable to capture by the interests they were designed to regulate.[118]

The emerging regulatory agencies has been accused of lacking legitimacy and criticized for undermining political accountability, individual participation, and universal services.[119] A main challenge is how agency autonomy and democratic accountability can be made into complementary and mutually reinforcing rather than competing values.

On the other hand, the regulators need to be much better informed ex ante and to get general, detailed and updated information of the sector concerned. This may have a huge informational cost and supposes a long term relationship with the industry incumbents which have the disadvantage to facilitate regulatory capture.[120] In this scenario, regulators might be captured by the interests they were designed to regulate, leading regulated organizations to lobby for regulation from which they will benefit.[121]

Despite the some negative aspects of agencies, in most cases, however, the issue is not whether or not to regulate, but how to regulate.[122] Thence, the regulatory agencies are feasible where there is a strong effort to implement the principles of being an appropriate regulatory agency such as independence, accountability, transparency, public participation, predictability, proportionality etc.

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[117] Brown & Stern & Tenenbaum & Gencer, p. 209
[118] Christensen & Laergreid, p. 17
[119] Ibid., p. 19
[120] Buigues, p. 9
[121] Sentom & Laergreid, p. 21
[122] Blöndal Sveinbjorn & Pilat Dirk, p. 38

3.1.6. Relationship Between Regulatory Agencies and Competition Authorities

The horizontal nature of competition authority and the sector specific nature of regulatory authority imply that the two authorities have different qualification of personnel.[123] The comparison between two bodies is shown below.[124] In the regulatory authorities, greater decisional power lies in the hand of engineers. On the contrary, in the competition authority, greater decisional power lies in the hands of lawyers and, sometimes, economists. Of course, lawyers assist regulators and judges rely on technical experts. The main difference is that for regulation, decisional power lies in the hand of policy makers rather than courts and competition policy has power vested in courts. In this context, the functions of regulatory agencies and competition authorities will be defined[125]:

competition authorities - practically economy-wide in coverage, these agencies administer framework laws primarily intended to protect consumer interests by prohibiting firms from reducing competition through colluding or merging with their rivals, or seeking to eliminate competitors by means other than offering superior products to consumers; and

regulatory agencies - these cover one or a small number of sectors where the government believes the public interest would not be adequately advanced merely by relying on private markets supervised by a competition agency, and decides therefore to empower an individual or institution to directly specify acceptable technologies, marketing methods and/or prices charged.

[123] Buigues, p. 8
[124] adapted from Buigues (2006), p. 11
[125] OECD, (1999), "Relationship Between Regulators and Competition Authorities", OECD Committee on Competition Policy, Paris, (pp. 1-332)

Table 2. Comparison between competition authority approach and sector-specific regulatory agency approach[126]

	Competition authority approach	Sector-specific regulatory approach
General approach	Ex-post, harm based approach	Ex-ante, prescriptive business conduct
Institution design	Horizontal institution Lawyers and economists	Sector-specific institution: sector-specific engineers and economists
Amount and nature of information required	Only information on the allocated abuse	General and detailed information on the sector
Nature of the remedies imposed on undertaking	Structural remedies addressed to specific conduct	Detailed conduct remedies requiring extensive monitoring
Nature of public intervention	Permanent based on general competition policy principles	As competition is more effective, part of sector specific regulation replaced by competition law

Most of the countries are undertaking major reforms aimed at narrowing the scope of regulation and ensuring that regulations better serve public interests.[127] These reforms have been particularly concentrated in the following industries: communications, electricity, natural gas, water/sewerage, transportation, financial services, professional services and agriculture. Although there are important differences across countries and industries, the reforms have generally included market opening privatization, rethinking universal service obligations, and liberalizing restrictions on entry, prices and normal business practices. One of the principal objectives behind the reforms has been to broaden the scope for private markets to allocate resources thereby improving general

[126] Buigues, p. 11
[127] Ibid, p. 17

economic efficiency. Given this thrust, it is not surprising that competition agencies are vitally interested in and affected by the reforms.

In many countries regulatory reform has induced important debates about the degree to which sectors being opened up to greater competition should also be subject to general competition laws enforced by the same competition agency responsible for protecting competition in other sectors of the economy.[128] In a great number of situations policy makers have adopted the view that competition must be fostered by a new kind of regulation which may or may not be intended to be strictly transitory. There are many examples of new or existing regulators being given mandates to promote competition and even being charged with formulating and, or applying general or customized competition "laws" in various sectors. In a considerably smaller number of countries, competition authorities have been assigned tasks that had previously been performed by government departments (acting as owners) or by sector-specific or general regulators.

3.2. European Union Perspective Regarding to Regulatory Agencies in the Field of Network Industries

For the last two decades the European Commission has engaged in a major effort to demonopolize and liberalize network industries which for many years had been the preserve of state-owned monopolies, in many cases this process was coupled with privatization or partial privatization of state-owned undertakings.[129]

The Directorate-General (DG) for Competition which is a Directorate-General of the European Commission[130] is responsible for establishing and implementing a coherent

[128] Ibid, p. 17
[129] Whish Richard, ''Competition Law''. 5th Edition, New York: Oxford University Press Inc., 2003, p. 934
[130] In the European Union, the staff of the main institutions (Commission, Council and Parliament) is organized into a number of distinct departments, known as Directorates General (DGs), each of which is responsible for specific tasks or policy areas. The administrative head of a DG is known as the Director General. In the European Commission a policy area that is within the responsibility of a Commissioner may affect several DGs. Some commissioners are consequently responsible for policy that affects several DGs.

competition policy for the European Union. One of the most dramatic DG Competition policy areas is liberalization (Art. 3, Art. 10, Art. 86 and Art. 226 of EC Treaty). National regulatory authorities of the member states must comply with directives declared by DG Competition.[131]

While network industries had, for often over a century, been controlled by (State) monopolies, it was believed that the opening of the network industries markets to competition would bring significant consumer benefits and enhance the competitiveness of the European Union.

This effort essentially relied on three pillars.[132] First, liberalization directives had to remove the exclusive rights, which were granted to incumbents. Second, these directives provide for the development of regulatory frameworks designed to create facilitate the arrival of competition, as well as the setting up *regulatory agencies (regulatory authorities)* in charge of implementing such frameworks. Finally, the application of EC competition rules has played a significant contribution to the promotion of competition in network industries.

Liberalization directives typically contained provisions mandating Member States to create independent regulatory authorities. Under monopoly; the regulatory framework was generally limited to price control and quality of service regulation, which were often carried out by a ministerial department (for instance, the ministry of energy or telecommunications). But in a liberalized market, regulation is typically more important (because, one needs to create a level playing field between the incumbents and new entrants) and to avoid conflict of interests should be carried out by an independent entity.

There are fewer commissioners in the European Commission than there are DGs. A Directorate-General is comparable to a government ministry. Most Directorates-General are divided into directorates which cover a specific part of a policy area.

[131] Ardıyok, p. 101

[132] Geradin Damien, (2006), ‘‘The liberalization of network industries in the European Union: where do we come from and where do we go?’’, prepared for the Secretariat of the Economic Council, Finland, (pp. 1-21)

These agencies have to be independent not only from the operators[133], but also from the government as the latter typically maintain holdings in the incumbents.[134] A specific feature of the EU model is that regulation is carried out at the Member State level. One difference between regulatory bodies at the national and the European level is that the latter also focus on regulation of the regulators.[135]

At the time of liberalization, a limited number of independent authorities already existed in the Member States, such as for instance agencies in charge of controlling financial markets, but most Member States did not have agencies controlling network industries. Two main reasons have traditionally been advanced to justify the creation of such agencies. First, it was thought that some regulatory matters (e.g., the regulation of money supply or the media) should be removed from politicians (who might be tempted to base regulatory decisions on short-term electoral goals) and placed in the hands of independent regulators. Second, it was also believed that some regulatory issues were so complex and specialized that they should be handled by a body of experts.

Liberalization thus led to the creation of numerous new national regulatory agencies (NRAs) both in all Member States of the EU and in the European Union. It can also be witnessed at the EC level where the number of agencies has increased from four in 1993 to fifteen in 2003.[136]

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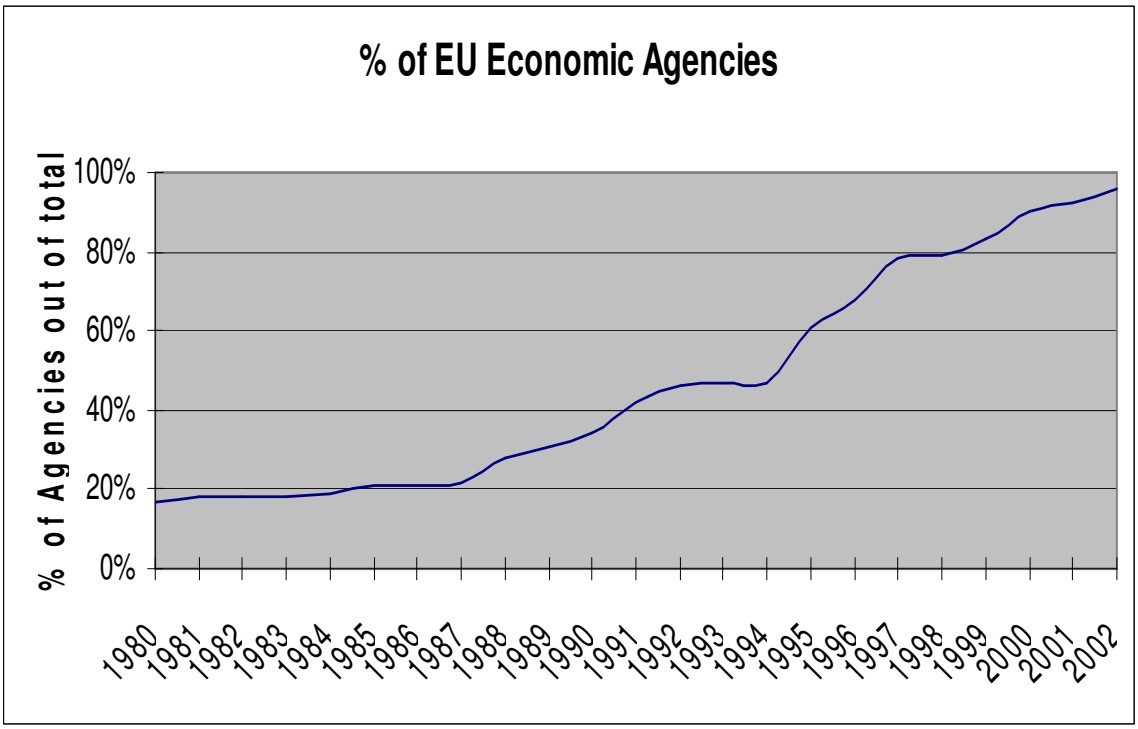
[133] See ECJ, 13 December 1991, RTT vs. GB-Inno-BM, C-18/88, ECR 1991, p.I-5491 at §28: "Articles 3(f), 90 and 86 of the EC Treaty preclude a Member State from granting to the undertaking which operates the public telecommunications network the power to lay down standards for telephone equipment and to check that economic operators meet those standards when it is itself competing with those operators on the market for that equipment".

[134] Article 22 of Directive 97/67: "Each Member State shall designate one or more national regulatory authorities for the postal sector that are legally separate from and operationally independent of the postal operators. Member States shall inform the Commission which national regulatory authorities they have designated to carry out the tasks arising from this Directive."

[135] Sentom & Laergreid, p. 19

[136] Geradin Damien & Petit Nicolas, (2004), ''The Development of Agencies at EU and National Levels: Conceptual Analysis and Proposals for Reform'', New York: New York School of Law, (pp. 1-64)

Figure 3. % of EU Economic Agencies Between 1980-2002[137]



3.2.1. The National Regulatory Agencies (NRAs)

As mentioned above, the development of regulatory institutions at the national level is not a new phenomenon; however, a major factor of growth in the creation of NRAs was the process of liberalization of State monopolies, which was engaged by the Commission in the late 1990s in the area of network industries.

This new process required not only the removal of special or exclusive rights, but also the adoption of a set of rules designed to facilitate the arrival of competition in contestable market segments, as well as to regulate remaining natural monopolies. The implementation and enforcement of such rules could not be entrusted to the incumbents since these companies would remain players in the market once it is open to

[137] adopted from Jacintt Jordana & David Levi-Faur, (2006), "Strengthening Regulatory Agencies: Institutional Designs for Autonomy, Accountability and Professionalism". Mexico, (pp. 1-74)

competition.[138] In addition, in countries where the government retains ownership rights on the incumbent, regulatory tasks could not be entrusted to it as this would create an obvious conflict of interest.[139] Independent mechanisms of regulation had thus to be provided for. Meanwhile, the choice of legislating through directives led to the consequence that MS were left free to choose the designs of such mechanisms.[140]

Pursuant to these requirements, most MS decided to set up independent structures taking the form of NRAs. In the telecommunications sector, this took place in the early 1990s, with the creation of regulatory institutions in all of the MS. In the energy sector, the emergence of these entities dates back from the second half of the 1990s. As will be seen below, the vast majority of the MS have now created energy regulators. Finally, in the railway sector, agencies are currently being established in most MS as a response to the ongoing liberalization process.

The creation of NRAs under the impulsion of EC law is still a relatively new phenomenon and both the Commission and the MS are still in a learning phase. Thence, there are indeed a number of significant bottlenecks.

As we have seen, EC law provides for the creation of agencies at both national and EC levels. Although in theory a NRA and an European Agency (EA) could deal with

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[138] See ECJ, 13 December 1991, RTT vs. GB-Inno-BM, C-18/88, ECR 1991, p.I-5491 at §28: "Articles 3(f), 90 and 86 of the EC Treaty preclude a Member State from granting to the undertaking which operates the public telecommunications network the power to lay down standards for telephone equipment and to check that economic operators meet those standards when it is itself competing with those operators on the market for that equipment".

[139] See Article 3(2) of Directive 2002/21 on a common regulatory framework for electronic communications networks and services (hereafter, the "Framework Directive") of 7 March 2002, OJ L 108 of 24 April 2002, pp.33-50: "Member States that retain ownership or control of undertakings providing electronic communications networks and/or services shall ensure effective structural separation of the regulatory function from activities associated with ownership or control."

[140] For a good discussion on the main features of directives, see Paul Craig and Grainne de Búrca, ''EU Law – Text, Cases and Materials'', (2003) 3rd Ed., Oxford University Press, p.99. From a legal perspective the choice of a directive as a legislative instrument implies a division of competences between the EC and the MS. The EC institutions set the legislative goals to be achieved, while the MS are left free as to the form and method of achieving these goals. In the field of network industries, the institutional requirements provided for by first generation directive were particularly limited. The new directives tend to define more precise requirements.

similar matters, there is in practice little overlap between NRAs and EAs. While the NRAs created through the impulse of the liberalization directives only operate in the field of network industries, EAs deal with a wide range of matters which are not necessarily connected to economic regulation.[141] The current state of affairs is, however, disturbing. There seems to be a mismatch between the level at which regulatory authority has been allocated and the type of issues that needs to be treated. This should not come as a surprise as there has never been any comprehensive Commission study on the allocation of regulatory powers in the EC. Of course, this issue was examined a few years ago in the area of telecommunications when Directive 97/33 required the Commission to investigate the added value of the setting up of a "European Regulatory Authority".[142] To this purpose, the Commission ordered a study, which was based on a dubious methodology relying on surveys among stakeholders, which found that there was not among these enough support for the creation of a European Regulatory Authority. In its so-called "1999 Review", the Commission then concluded that such an authority would not bring sufficient added value to justify the costs.

Perhaps, the most effective way to address issues regarding the level for the allocation of powers is to rely on the tools offered by economic analysis.[143] Scholars specialized in the economics of federalism generally argue that there are two main types of circumstances where centralized intervention is desirable.

The first relates to the presence of externalities. Legislators and regulators generally fail to bear sufficient attention to the impact of their legislative/regulatory decisions outside their jurisdictions (hence, the term "externalities"). It seems that many decisions taken by NRAs are likely to create externalities, either because the matter to be dealt with is in its very essence of a cross-border nature (e.g. the regulation of cross-border regulatory exchanges) or because the decision to be taken will affect the

[141] Geradin Damien & Petit Nicolas, p. 11
[142] Pursuant to Article 22 of Directive 97/33, the Commission shall address a report to the European Parliament on the review of the directive and, shall also investigate in the added value of the setting up of a European Regulatory Authority to carry out those tasks which would prove to be better undertaken at Community level. This provision was adopted following the pressures by the European Parliament on the Council of ministers.
[143] Ibid., p. 12

competitiveness of market players and can thus impact the conditions of competition in the internal market (e.g. the adoption of interconnection rates in telecommunications).[144] In both sets of circumstances, there is obviously much to be gained by having decisions taken at the EC level.

The second argument in favor of centralization relates to the presence of economies of scale and transaction costs savings. Economic theory teaches that if economies of scale are important, a single supplier may be more efficient than several competing suppliers.[145] When regulatory economies of scale are present, centralized standard-setting and enforcement procedures may thus be more efficient than decentralized action. In technically complicated or analysis-intensive regulatory fields (such as network pricing, capacity allocation etc.), economies of scale can be realized by entrusting regulatory duties to a centralized authority even if the implementation is carried out at the national level to ensure that concrete decisions take into account local circumstances.[146] Similarly, centralization and uniformity can, under certain circumstances, reduce transaction costs.

In this context, there is a strong case in favor of centralization of regulatory decisions. It is true that the Commission is already assuming some regulatory duties. Yet, it is not clear that the Commission is well placed to undertake these tasks as it might not necessarily have the expertise and the independence (e.g. the insulation from political and industry pressures) to act as a regulator. It is thus subject to question why so little consideration has been given to the creation of regulatory agencies at the EC level.

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[144] This has been acknowledged in the Green Paper on Services of General Interest, COM (2003) 270 final of 21 May 2003, Annex at §53. This is, for instance, the case of cross-border exchanges of electricity. An EC regulation has recently been adopted to deal with the issue of cross border electricity flows, i.e. the physical flows of electricity on a transmission network of a MS that results from the impact of the activity of producers and/or consumers outside that MS on its transmission network.

[145] Economic activities where large economies of scale can be achieved (e.g., electricity transmission) are generally considered "natural monopolies".

[146] Geradin Damien & Petit Nicolas, p. 13

In fact, the creation of European regulatory agencies in the above sectors raised political and legal problems. With regards to political aspects, the creation of EC agencies (this is particularly true in the field of network industries) has been seen by many as a movement towards deeper centralization, as well as a risk of increasing bureaucracy. MS have therefore often opposed the creation of European regulatory agencies. They have generally preferred a system of decentralized regulation on the basis of NRAs in line with the principles of subsidiarity. In the field of network industries, MS pressures for decentralization have probably been even stronger because of the fact that most these industries were, until a few years ago, State controlled.[147] In addition to this, it seems that some institutions have feared a taking away of their powers and the apparition of rival entities.[148]

The EC Treaty does not explicitly provide for the formation of regulatory agencies, nor does it set out a special procedure to this end. Agencies are therefore instituted on the basis of the classic legislative procedures provided by the EC Treaty. Thus, agencies emerge thanks to the intervention of other EC institutions. The recourse to the creation of such entities is, however, subject to limitations. In other words, EC institutions cannot entrust agencies with powers they do not themselves enjoy.[149]

Instead of the more centralized approach we recommend, the Commission has opted for a model of "managed decentralization" whereby NRAs are entrusted with important regulatory powers with, however, a certain degree of supervision by the Commission.[150] The directive 2002/21 (hereafter Framework Directive[151]) on electronic communications strengthens the powers of the NRAs, which will be ultimately responsible for defining markets and identifying the operator significant market power to

[147] For further information See Damien Geradin, "Institutional Aspects of EU Regulatory Reforms in the Telecommunications Sector: An Analysis of the Role of National Regulatory Authorities", (2000) 1 Journal of Network Industries, (pp. 1-64)
[148] Such as the Council and the Commission.
[149] See ECJ, 13 June 1958, Meroni vs. High Authority, 9/56, ECR 1957/1958
[150] Geradin Damien & Petit Nicolas, p. 16
[151] Directive 2002/21 on a common regulatory framework for electronic communications networks and services of 7 March 2002, OJ L 108 of 24 April 2002

which the heavier regulatory obligations contained in the specific directives will apply.[152] In exchange for the increased discretionary powers granted to NRAs, the directive provides for a cooperation mechanism whereby whenever a NRA intends to take a specific measure in a field where it is granted a certain margin of appreciation (definition of the market, analysis of the market, etc.), and whenever this measure is liable to affect trade between MS, it has to inform the Commission and the other NRAs.[153] The Commission as well as the other NRAs may then make comments to the relevant NRA concerned within a certain period of time.[154] The NRA has to take the utmost account of these comments when adopting its measure. In some cases, the Commission can even force the NRA to withdraw its draft measure.[155] In addition, cooperation between authorities has been further institutionalized with the setting up of formal network. A Commission's decision of July 2002 established a European Regulators Group for Electronic Communications Networks and Services with a view to ensure the consistent application of the regulatory framework.[156]

This last aspect of the directive is interesting as it provides a good illustration of a new pattern in EC law, which is to give national agencies greater discretionary powers, but to combine this form of decentralization with cooperation mechanisms designed to create a partnership among the national agencies, but also between the national agencies and the Commission. This "networking" approach is, for instance, at the core of the new Regulation 1/2003 which, in the field of competition law, transfers substantial powers to the National Competition Authorities (hereafter, the "NCAs"), but combines this transfer with cooperation mechanisms among NCAs, as well as between the NCAs and the

[152] See Article 14, 15 and 16 of the Framework Directive,
[153] Id. at Article 7(2).

[154] Id. at Article 7(3).
[155] Id. at Article 7(4) at b
[156] See Commission Decision of 29 July 2002, establishing the European Regulators Group for Electronic Communications Networks and Services OJ L 200 of 30 July 2002, pp.38-40 (Amendment Commission Decision 2004/3445/EC of 14 September 2004 amending Decision 2002/627/EC establishing the European Regulators Group for Electronic Communications Networks and Services. A similar network has been established in the electricity and gas sectors, see Commission Decision of 11 November 2003 on establishing the European Regulatory Group for Electricity and Gas, OJ L 296 of 14 November 2003 pp. 34-35. Its members are the heads of national regulatory agencies.

Commission.[157] In substance, a number of reciprocal consultation and information mechanisms between the NCAs and the Commission are set up. NCAs are, for instance, required to inform the Commission when they investigate a case or adopt a formal decision.[158]

Furthermore, there exists a huge extent of diversity in the structure of the NRAs.[159] In the field of network industries, first-generation directives left MS free to shape the institutional structure, as well as the powers and the scope of competence of the NRAs.[160] As a result, MS have opted for different models based on legal, economic, political, and cultural factors. Second, there are important differences among NRAs with respect to the allocation of regulatory powers between the NRAs and other authorities. Third, the scope of industry coverage by the NRAs has also proven to be very heterogeneous.

On the other hand, there exists a degree of asymmetry between the levels of independence, competence, resources, and accountability of the national agencies. While some authorities, such as OFCOM (Office of Communications) or OFGEM (Office of Gas and Electricity Markets) in the United Kingdom, are well resourced and independent, authorities in several Member States are still closely associated with their national

[157] See Council Regulation 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty, OJ L 1 of 4 January 2003, pp.1-25, See Directive 2003/54 of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in electricity and repealing Directive 96/92, OJ L 176 of 15 July 2003, pp.37-55 and Directive 2003/55 of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in natural gas and repealing Directive 98/30, OJ L 176 of 15 July 2003, pp.57-78.

[158] See Article 11 of Regulation 1/2003. A number of additional cooperation mechanisms are provided for. NCAs have the possibility to ask the Commission's opinion when EC law is at stake. The Commission shall disclose the most relevant documents it has collected to NCAs. NCAs and the Commission can exchange all kinds of information, including confidential ones. For a good description of these mechanisms, see the articles mentioned.

[159] Geradin (2006), p. 18

[160] See Commission Directive 90/388 of 28 June 1990 on Competition in the Markets for Telecommunications Services, OJ L 192 of 24 August 1990, pp.10-16; See Directive 96/92 of the European Parliament and of the Council, 19 December 1996 concerning Common Rules for the Internal Market in electricity, OJ L 27 of 30 January 1997, pp.20-29. See Directive 98/30 of the European Parliament and of the Council of 22 June 1998 concerning Common Rules for the Internal Market in Natural Gas, OJ L 245 of 4 September 1998, pp.1-12.

government and their resources may be insufficient to adequately perform their missions.[161] This may be another source of distortion in the internal market.

Of equal concern is the fact that national authorities seem poorly adapted to deal with cross-border issues as their scope of action is typically limited to their Member State borders. Yet, there are a certain number of regulatory issues of a cross-border nature, such as, for instance, the regulation of electricity flows across Member States. The lack of EU-wide regulatory authorities has been somehow compensated by various forms of cooperation between the Commission and the national regulatory agencies, but it is not clear that such cooperation is as effective as fully-fledged European agencies would be.[162] There are, of course, European agencies in fields, such as air or rail transport, but these agencies' competence is essentially limited to safety and inter-operability issues.

Problems regarding cross border issues, the other significant bottleneck which prevents competition to take place is economic patriotism which has pressure power on NRAs. One of the key objectives of the European Commission when it initiated the liberalization process was the creation of truly integrated EU markets. Yet, while liberalization has introduced a degree of competition within national markets, it has so far failed to create such EU-wide markets.[163] The flow of goods and services is thus impeded by the lack of cross-border infrastructures. However, they are relatively few EU-wide operators in network industries. Airlines or rail companies are still largely national. The same can be said of telecommunications, energy and postal operators. Network industry sectors in Europe are thus composed of dozens of operators, some relatively small, and most of which operate in one Member State only. The number of cross-border mergers in these sectors has remained relatively modest although things are progressively changing.

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[161] Geradin, (2006), p. 17

[162] Another model, which has been used in the energy sector, is for the Commission to encourage market players to cooperate in order to find solutions to the main cross-border issues through voluntary measures. This led to the creation of the so-called Florence Forum (dealing with cross border issues in electricity) and the Madrid Forum (dealing with cross-border issues in gas). The Commission realized, however, the intrinsic limits to this cooperative approach and decided to deal with cross-border issues through EC legislation. See Regulation 1228/2003 of the European Parliament and of the Council of 26 June 2003 on conditions for access to the network for cross border exchanges in electricity OJ L 176 of 15 July 2003, pp.1-10.

[163] Geradin (2006), p. 19

In recent months, however, one has observed a powerful movement in certain Member States for the protection of their national champions. One can cite, for example, the efforts of the[164]:

• French government to merge Suez with GDF as a way to counter a bid by Enel on Suez;

• Luxembourg, French, Spanish, and Belgian governments to block a hostile takeover of Mittal on Arcelor;

• Spanish government to advance a merger between Endesa and Gas Natural to which it was favorable;

• Polish government to prevent Unicredito to take over BHP, a large local bank, though its acquisition of HBV, a German bank controlling BHP.

This has triggered strong reactions from certain Member States, opposed to this new form of protectionism, but also from the Commission, which considers that the above efforts could run counter internal market rules and competition rules.49 Economic patriotism is a serious issue because it is fundamentally at odds with the creation of EU-wide firms operating on an EU-wide market.

While the European Commission has the power to initiate proposals for new legislation, the ball is essentially in the hands of the Member States. Faster and better implementation of EU directives, the putting into place of independent and well-resourced regulators, investments in network infrastructures, and the absence of protectionist policies are principles/actions that should significantly contribute to the development of competitive network industries markets.

3.2.2 The European Agencies (EAs)

The EC Treaty does not provide a specific legal basis for the creation of EAs. Thus, Article 308 of EC Treaty has been used in order to create agencies at the EC level. In December 2002, the Commission defined its views regarding European agencies on

[164] Ibid., p. 20

the content of such inter-institutional agreement with the adoption of a Communication on the Operating Framework for the European Regulatory Agencies.[165] In substance, the Commission draws a distinction between two categories of agencies. The first category comprises the "executive" agencies, which are defined as those responsible for purely managerial tasks, i.e. to assist the Commission in implementing the Community's financial support programmes. They are characterized by their limited autonomy and are governed by Regulation 58/2003.[166] An example of such agencies can be found in the European Agency for Reconstruction which has been entrusted with the management of European aid towards Kosovo.

The second category comprises the "regulatory" agencies, which are defined as those "required to be actively involved in exercising the executive function by enacting instruments which contribute to regulating a specific sector". Within this category of regulatory agencies, the Commission proposes to make a further distinction between the "decision-making" agencies, i.e. those empowered to enact legal instruments binding on third parties, and the "executive" agencies, i.e. those who have no independent power of decision vis-à-vis third parties but perform all other regulatory tasks.

Considering that in the categorization outlined above, the Commission distinguished between "executive" agencies and "regulatory" agencies, it is simply absurd that within the second category it re-introduces a distinction between "decision-making" agencies and "executive" agencies.[167] An "executive" agency sounds nothing else than a contradiction in term. It is obvious that Commission is reluctant to create EAs enjoying a wide range of powers. In this context, Commission is the only effective agency regarding liberalization of network industries both as legislator and supervisor.

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[165] See Communication from the Commission on the Operating Framework for the European Regulatory Agencies of 11 December 2002

[166] Council Regulation 58/2003 of 19 December 2002, OJ L 11 of 16 January 2003, pp.1-8. Pursuant to this text, the powers of the subcontracting agencies are quite limited. See recital 5, Article 2 and Article 3 of the Regulation.

[167] Geradin & Petit, p. 47

The creation of a growing number of agencies at both national and European levels is one of the most significant developments in the administrative structure of the EC and its Member States. At any rate, these agencies have generally played a useful role even expected more effective. While NRAs have contributed to the creation of competitive markets in liberalized sectors, EAs have allowed the Commission to decentralize a number of scientific, technical or observatory functions to specialized bodies. Yet, we believe that several steps could be taken to enhance the methods of functioning of these agencies with a view to improve their performance, as well as to ensure a greater degree of coherence in the way they are organized, interact with each other, and comply with good governance principles.

IV. REGULATION AND NATURAL MONOPOLIES

4.1. The Concept of Natural Monopoly

Markets have been subjected to economic regulation for four reasons[168]: (i) when a natural monopoly exists; (ii) when there is need to conserve a natural resource that is publicly owned; (iii) when the structure of a market is conducive to market conduct that sparks public indignation (for example, discriminatory price structures); (iv) where there is a desire among some to dilute or control large power blocs in the economy.

Ideally, regulation is applied to natural monopolies because economic regulation emerged in order to regulate natural monopolies.[169] Regulation of natural monopolies is a challenging task because it should provide incentives for optimal capacity expansion, efficient operation and power quality improvements.[170]

Both the law and economic theory recognize that natural monopolistic sectors in which the competitive model will not achieve either the wealth maximization or equitable goals. In these sectors, enforcement of the antitrust laws will be unproductive because there is insufficient demand to support multiple competitors of efficient size.

Where demand is insufficient to purchase the output of more than one efficient producer, the market is described as natural monopolistic.[171] As in other markets, where there is only one supplier, policy makers are concerned with enhanced prices that result in allocative inefficiencies and the transfer of wealth from consumers to the monopolistic

[168] Shepherd G. William, "The Economics of Industrial Organization", 3rd Edition, Prentice Hall Int. Inc., 1990, p. 341
[169] Ardıyok, p. 32
[170] Viljainen Satu & Tahvanainen Kais & Lassila Jukka & Honkapuro Samuli & Jarmo Partanen, (2004), "Regulation of Electricity Distribution Business", Nordic Distribution and Asset Management Conference/August 23rd in 2004, (pp. 1-10)
[171] Barnes & Stout, p. 85

producer on one hand.[172] The administrative solution to these problems in natural monopoly markets is regulation – regulation of entry into the market and of the price charged by the monopolist.

Fundamentally, the term does not refer to the actual number of sellers in a market but, as mentioned above, to the relationship between demand and technological of supply.[173] In other words, if the entire demand within a relevant market can be satisfied at lowest cost by one company rather than by two or more, the market is a natural monopoly, whatever the actual number of companies in it. If such a market contains more than one company, either the companies will quickly shake down to one through mergers or failures, or production will continue to consume more resources than necessary.

In the first case, competition is short-lived and in the second it produces inefficient results. Competition is thus not a viable regulatory mechanism under conditions of natural monopoly. Hence, it is said, direct controls are necessary to ensure satisfactory performance: controls over profits, specific rates, quality of services, extensions and abandonment of service and plant, even permission whether to enter the business at all.[174]

In spite of privatization and liberalization movement in network industries, there are still many states in which publicly owned utilities exist. When you switch on a light or mail a letter, natural monopolistic sectors occurs. The typically quoted examples of natural monopoly are utilities (electricity, telecommunication, water, gas, and oil), transport (railways), with natural monopoly elements being centered on networks.

The most typical characteristic example for natural monopoly can be defined by use of economies of scale theory. Economies of scale characterize a production process in which an increase in the number of units produced causes a decrease in the average cost of each unit. In the below figure, the increase in output from Q to Q_2 (Q refers to

[172] Ibid., p. 85
[173] Posner (1999) 30th Edition, p. 1
[174] Ibid., p. 1

quantity) causes a decrease in the average cost of each unit from C to C_1 (C refers to Cost). In this way, long run average cost (LRAC) decreases and long run marginal cost decreases as well.[175]

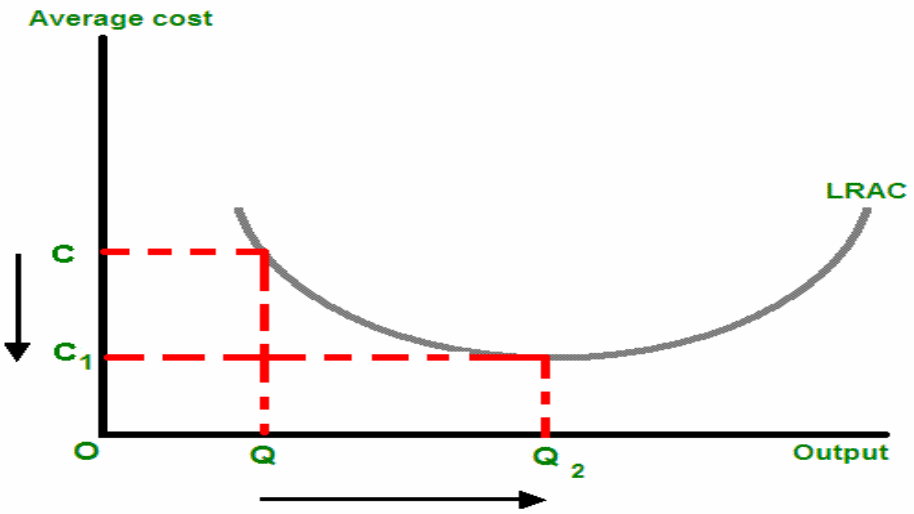

Figure 4. Economies of Scale

In the last two decades, a modern view regarding natural monopoly emerges parallel to Posner's point of view which is called "Subadditivity of Costs".[176] In respect of this view, fixed costs do not raise entry barriers. However, "fixed costs of sufficient magnitude do guarantee that an industry will be a natural monopoly in the sense of "subadditivity of costs". [177] That is, output can be more efficiently produced by a single firm, than by any combination of firms.[178]

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[175] Ardıyok, p. 33

[176] Çakal Recep, "Doğal Tekellerde Özelleştirme ve Regülasyon", DPT Uzmanlık Tezi, DPT Pub. No. 2455, 1996, p. 17

[177] Baumol, W.J. & R.D. Willig (1981), "Fixed Costs, Sunk Costs, Entry Barriers, and Sustainability of Monopoly", Quarterly Journal of Economics", August, (pp. 405-431)

[178] Dahlgren Henrich, (2002), "Industrial Network Dynamics & the Role of Sunk Costs", CEBR, Center for Economic and Business Research, Danish Ministry of Trade and Industry, January, (pp. 1-23)

There are several approaches to regulating such monopolies. A traditional approach to the regulation problem is public ownership.[179] In Europe, traditionally state-owned monopolies, directly controlled by the government were in a majority. On the other hand, in some markets, one or several companies are given exclusive franchise and then supervised by regulatory authorities. These authorities have power to scrutinize the companies and control the prices.[180]

Regulation can focus either on profits of monopoly companies or prices of monopoly services. In general, profit regulation gives incentives for capacity expansion whereas price regulation gives incentives for cost reductions. In practice, regulatory models often have elements of rate-of-return regulation, price regulation and yardstick regulation.[181]

Rate-of-return regulation focuses on profit and is often applied when regulation is first implemented. It does not require that the regulator has detailed knowledge about the cost factors of monopoly companies. Regulators often use this period to gain more information of the regulated business.[182]

Price cap (RPI-X-Y) regulation sets limits on prices of monopoly services. In price cap regulation the prices of regulated services are adjusted annually by an inflation factor, an X-factor that reflects annual efficiency improvements, and a Y-factor that allows for pass through of specific cost items outside of the company's control.[183]

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[179] There is little evidence that government monopolies behave optimally because of absance of profit motive and addition to that public enterprises can likely been subject to political pressures. See Ardıyok p. 37 and Barnes & Stout p. 657

[180] Regulation has been mainly applied to gas, water, electric power companies where it is known as "public utility regulation; and to providers of public transportation and telecommunications, where it is known as "common carrier regulation". See Posner (1999) 30th Edition, p. 1

[181] Viljainen & Tahvanainen & Lassila & Honkapuro & Jarmo, p. 2-3

[182] Ibid., p. 3

[183] Çakal, p. 28

On the other hand, revenue cap regulation is a special case of price regulation. It gives companies more freedom in setting prices and this is considered to promote more efficient price structures. A rate moratorium is also a special case of price regulation. Y-factor is set equal to zero, which forces the regulated company alone to face the risks of external price shocks.

In yardstick regulation the allowed prices or revenues of a company depend also on the performance of other companies. A special case of yardstick regulation compares companies to a hypothetical efficient company, or 'model' company.[184] In profit sharing, excess profits or profit shortfalls of the regulated companies are dealt by ex post refunds or price reductions. Banded rate-of-return has certain resemblances to profit sharing with the exception that only returns above or below the pre-specified band result in ex post refunds or price reductions. Regulation by menus allows the regulated companies to choose between different incentive regulation plans, e.g. between combinations of price caps and profit sharing.

Utilities such as water supply, gas, electricity and telecommunications and certain modes of transport, e.g. rail, all have natural monopoly characteristics arising from pervasive economies of scale and scope as mentioned above. These characteristics mean that competition is unlikely to develop or, if it develops, it will be uneconomic because of the duplication of assets.

Natural monopolies, however, can lose their natural status only one of the two market conditions that define natural monopolies change – either market demand grows significantly or technologically erodes economies of scale.[185] Although technological advances[186], notably in telecommunications, have whittled away some of the natural

[184] Ibid., p. 31
[185] Gal Michal S, "Competition Policy for Small Market Economies", Cambridge-Massachusetts-London: Harvard University Press, 2003, p. 113
[186] Development of new technologies such as wireless telephony and optic-fiber cable has created new scope for competition even with regard to basic line networks. In electricity, with combined cycle turbine generators, we have a low-capital-cost source of power.

monopoly characteristics in utilities, permitting economic competition in certain areas of service delivery, each of the utilities retains some natural monopoly features.[187]

As a consequence, privatization of these industries, in whole or in part, risks the introduction of private sector monopolies that will exploit their economic power, leading to supernormal profits (high "producer surplus") and reduced consumer welfare (a lower "consumer surplus"). Consumers may suffer from no – or a limited choice of – goods and services and face monopoly prices.[188] In order to prevent such an outcome, governments need to develop strong regulatory capabilities so that they can police the revenues and costs of production of the privatized utility firms and protect consumers from monopoly exploitation. As a result, a growing number of developing countries have introduced new, dedicated regulatory agencies to supervise the activities of their privatized utilities.

The focus of regulatory policy concerning natural monopoly has clearly shifted with the evolution of technology and globalization of markets, which led to a steady breakup of natural monopoly and made more competition technically feasible. Instead of merely focusing on problems surrounding "inevitable" monopolization such as the pricing problem, the current regulation policy hence encompasses, above all, issues related to the design of regulatory policy accompanying the restructuring, privatization, and expansion of competition into the area formerly occupied by legal monopolies.[189]

In particular, the issue of how to replace regulation with competition, which is deemed as the best regulator, now occupies a central place on the current agenda of natural monopoly regulation.

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[187] Gal Michal S, "Competition Policy for Small Market Economies", Cambridge-Massachusetts-London: Harvard University Press, 2003, p. 113
[188] Ibid., p. 145
[189] United Nations Report (UN), (1999) "Privatization and Regulation in the Developing Countries and Economies in Transition", Department of Economic and Social Affairs Division for Public Economics and Public Administration, (pp. 1-275)

4.2. The Concept of Public Service in the Context of European Union Law

Public service is a term usually to mean services provided by government to its citizens either directly (through the public sector) or financing private provision of services. Historically, the widespread provision of public services in developed countries usually began in the late nineteenth century, often with the municipal development of gas and water services. Later, other services such as electricity and healthcare began to be provided by governments. The notion of public service (or service of general interest) has undergone a considerable evolution, both in Europe and other mature welfare states.

The concept of public service has a different terminology according to EU law.[190] The term public service is only declared literally in Article 73 of the EC Treaty.[191] The approach in the framework of integration regarding to public services is liberalization and privatization of these services.

In the European Union's founding treaties, the basic principle of competition remains though ample room is made for 'general interest economic services' by allowing national governments to determine, with a relative autonomy, the scope of their public services. In practice, the Commission's directives have interpreted the founding documents. Since the early 1990s, they have dealt with the issue of public services, taking each sector separately.[192] The basic reason taking the sectors separately was Member States' conservative views on liberalization in the public service sectors.[193] These directives have essentially consisted of liberalizing whole economic sectors of activities and they have led to a gradual opening to competition as well as contributed to a contraction of the scope of the public service sector. On account of the great variety of

[190] Karakılıç Hasan, "Hukuki Açıdan Elektrik Piyasası-Avrupa Birliği ve Türkiye Örneği", İzmir: Güncel Yayınevi, 2006, p. 34
[191] Article 73 (EC Treaty): "Aids shall be compatible with this Treaty if they meet the needs of coordination of transport or if they represent reimbursement for the discharge of certain obligations inherent in the concept of a public service."
[192] Karakılç, p. 36
[193] Ibid. , p. 36

national models and the necessity to harmonize competition, the public service issue has not been wholly examined.[194]

In consideration of a debate in the in the European Union about liberalization was subject to how public services should be delivered and how far competition principles should be modified as regards public services.[195] Commission highlights the liberalization of the public sectors Europe-wide in White Paper (1985).[196]

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Therefore, EU Commission presently makes an effort to lighten the solid structure of public services through creating new terms. Commission tries to make the term "universal service" generalized. Authorities believe that without integration in the sectors which are subject to natural monopolies, the Union can not complete its single market task. Besides, competition policy plays hugely important part in the overriding goal of achieving single market integration.[197]

On the other hand, Art. 31(EC Treaty) has been revised in order to impede the possible difficulties can be shown by Member States which have state-owned undertakings. According to the Art., Member States shall adjust any State monopolies of a commercial character in order to ensure that no discrimination regarding the conditions under which goods are procured and marketed exists between nationals of Member States. The rules on competition follow very closely those of the EC Treaty to ensure equal conditions of competition for economic operators throughout the Area.[198]

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[194] Mazier Jacques, (2006). "Assessment and Alternative Proposals on European Structural Policies: Why Is It Right to Support Both the Common Agricultural Policy and Research and Innovation Policy", Arestis Philip & Sawyer Malcolm (Eds.), "Alternatives Prspectives on Economic Poicies in the European Union". (pp. 1-38), Hampshire: Palgrave Macmillan Ltd.

[195] Jones Alison & Sufrin Brenda, "Text, Cases and Materials EC Competition Law", Oxford New York, Oxford University Press, 2001, p. 474

[196] Completing the Internal Market. White Paper from the Commission to the European Council (Milan, 28-29 June 1985). COM (85) 310 final, 14 June 1985

[197] Whish, p. 21

[198] Cameron Duncanson Peter, "Competition Energy Markets: Law and Regulatipn in the European Union", Consultant Ed.: Brothwood Micheal, Oxford. Oxford University Press, 2002, p. 74

Art. 86[199] (EC Treaty) is a specific manifestation of the duty of Community loyalty contained in Art. 10[200] (EC Treaty) which requires Member States to take all appropriate measures to ensure fulfillment of their Treaty obligations, facilitate the achievement of the Community's tasks and abstain from measures which could jeopardize the attainment of the Treaty's objectives.[201] The prohibition in Art. 86/1 is addressed to Member States.[202] In Art. 86/2 it gives limited specific and exclusive rights to the undertakings, besides if any universal service conditions exists.

The Commission considers that grants made by states to public enterprises (and thus, also the increases in capital provided by the state to those firms in which it owns a stake to balance operating losses) contain an element of state aid.[203] From the point of view of economic efficiency, state aid are justified if used to correct certain failures even if they are often based on equity and social consideration, in particular for network industries subject to Universal Services Obligations, State aid received by the undertaking as compensation for the universal service cost must be analyzed.[204] These conditions are analyzed only by Union authorities. Therefore, ECJ assisted in the clarification of exemptions under Art. 86/2 (EC Treaty) including Höfner[205], Port of

[199] Art. 86 (EC Treaty) "1. In the case of public undertakings and undertakings to which Member States grant special or exclusive rights, Member States shall neither enact nor maintain in force any measure contrary to the rules contained in this Treaty, in particular to those rules provided for in Article 12 and Articles 81 to 89.
2. Undertakings entrusted with the operation of services of general economic interest or having the character of a revenue-producing monopoly shall be subject to the rules contained in this Treaty, in particular to the rules on competition, in so far as the application of such rules does not obstruct the performance, in law or in fact, of the particular tasks assigned to them. The development of trade must not be affected to such an extent as would be contrary to the interests of the Community.
3. The Commission shall ensure the application of the provisions of this Article and shall, where necessary, address appropriate directives or decisions to Member States."
[200] Art. 10 (EC Treaty): "Member States shall take all appropriate measures, whether general or particular, to ensure fulfilment of the obligations arising out of this Treaty or resulting from action taken by the institutions of the Community. They shall facilitate the achievement of the Community's tasks. They shall abstain from any measure which could jeopardise the attainment of the objectives of this Treaty."
[201] Jones & Sufrin, p. 431
[202] The first steps towards an opening to competition of postal markets in the EU have led to an increased influx of complaints to the European Commission. These complaints alleged that certain Member States have put into place a national legislation which is incompatible with Article 86 of the Treaty.
[203] Bianchi Patrizio, "Industrial Policies and Economic Integration - Learning from European Experiences", London/New York. Routledge Publications, 1998, p. 107
[204] Buigues, p. 25
[205] Case C-41/91 Höfner v. Macratron [1991] ECR-I-1979, [1993], 4 CMLR 360

Genoa[206] and Corbeau[207] (Belgian Postal Monopolies). The ECJ ruled that the grant of a special or exclusive right was lawful even if it gave the undertaking concerned a dominant position in the relevant market, but that the exercise of that right was subject to the provisions of Art. 86 and the exercise of that right could in itself be held to be unlawful.[208]

As mentioned above, Commission tries to provide new terms instead of public service. The term "universal service" has been first declared in the Union literature in 1987 through Green Book written for communication sector and then through the other Green Book[209] written for Postal sector. Universal service defines as "service which is provided in the whole Union to everybody with reasonable price and standard quality". In addition to Green Paper, in 1993 White Paper[210] had been submitted to Council by Commission and in this report the term universal service had been referred in many times in the Paper.

The other term is "services of general interest" which is declared in Art. 86/2 (EC Treaty) instead of public service. In September 1996 the Commission produced a Paper, Services of General Interest in Europe[211], stressing the importance of services of general interest to the European citizen and the role which they play in promoting social and economic cohesion.[212] Part of the Notice reads: "The Community's involvement with services of general interest is within the context of an open economy which is based on commitment to mutual assistance (solidarity for short), social cohesion and market mechanism".

[206] Porto di Genova Case, C-179/90 [1991] ECR I-1979
[207] Case C-320/91 Criminal Proceedings against Paul Corbeaua [1993] ATDK, I-2533
[208] Cameron, p. 45
[209] Commission of the European Communities, Green Book on the Development of the Single Market for Postal Services, 11 June 1992,
[210] European Commission, White Book on Growth, Competitiveness and Employment, 1993
[211] Commission Communication on Services of General Interest in Europe, OJ 1996 C281/3.
[212] Jones & Sufrin, p. 474

The Judgment of ECJ in the Corbeaua case and Commune d'Almelo[213], "services of general interest" term has been also declared in detail. According to the judgment, services in the EU need clear rules, to ensure continuity of supply and fair access for everyone. Services of general interest must be of the highest standard, accessible to everyone at an affordable price, and subject to democratic control and accountability involving both consumers and workers in these crucial sectors.

As said, the structural reform started in the EU with the liberalization of network industries and the introduction of competition generated new forms of regulation and new traditions in the public service sector which differ from those that existed in the past.[214] The liberalization focused on removing the monopoly status enjoyed by public undertaking in network industries. However, the public service issue has not been wholly completed; there is a long path to pass over.

4.3. Privatization and Regulation

Traditionally, public utilities such as electricity, gas, and telecommunications, postal service, certain modes of transport and rail etc. were the exclusive province of the public sector, with large, state-owned enterprises being responsible for investment and service delivery. Typically, state-owned enterprises were costly and inefficient providers of infrastructure services in most developing countries. Since the mid-1980s, however, governments around the world have pursued policies to involve the private sector in the delivery and financing of infrastructure services. Encouraged by international organizations such as the World Bank, privatization has been a major component of the economic reform programmes pursued by many developing countries over the past two decades.[215]

[213] Case C-393/92 Municipality of Almelo and others v. NV Energiebedriifljsselmij [1994] ECR I-1477
[214] Buigues, p. 26
[215] Kirkpatrick, C. & Parker, D. & Zhang Yin-Fang, (2005), "Privatisation in Developing Countries: A Review of Evidence and Policy Lessons", Journal of Development Studies, vol. 41(4), (pp. 143-171)

Privatization was thought to promote more efficient operations, expand service delivery, reduce the financial burden on government and increase the level of foreign and domestic private investment.[216] Early privatization measures were, on the whole, concentrated in the manufacturing sector but, in recent years, the private sector has become increasingly involved in the financing and delivery of infrastructure services. A large number of developing countries have introduced private participation into their infrastructure industries and by the end of 2001; developing countries had received over $755 billion in private investment flows in nearly 2,500 infrastructure projects.[217]

There is a change from public monopoly to regulated private monopoly. It is a change which has often seen increases in productivity and consumer welfare, especially when accompanied by robust, targeted regulation. Hence, regulatory reform and privatization processes need to be closely coordinated, and their sequencing and coordination will have to be thought through from the outset.[218] Therefore, governments need to develop strong regulatory capabilities to police the revenues and costs of the privatized utility firms, while, at the same time, establishing regulatory credibility among investors and protecting consumers from monopoly exploitation.[219]

Ideally, privatization of large network companies offers the government a unique opportunity to rethink and reform the entire organization and structure of the sector. Activities or services that were provided by an integrated, monopolistic enterprise will have to be unbundled and competition introduced in those segments that can sustain it. Divestiture will very often be less important in itself than effectively demonopolizing and opening up the sector to competition.[220] After all, the efficiency impact of privatization depends on the quality of government regulation and its ability to harness competition for sectoral reform.

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[216] World Bank (1995). "Bureaucrats in Business: The Economics and Politics of Government Ownership", Oxford and Washington, DC: OxfordUniversity Press and World Bank

[217] World Bank, (2003). "Private Participation in Infrastructure: Trends in Developing Countries, 1990 – 2001", Washington, D.C.: World Bank and Public Private Infrastructure Advisory Facility

[218] UN (1999), p. 190

[219] Kirkpatrick & Parker & Zhang, p. 145

[220] Ibid., p. 175

Where privatization policy and regulation is perceived as being necessary, the first stage is to outline the objectives of policies and roles of sectors, particularly between government and privatization and regulatory agencies. This should make governance mechanisms more effective, by removing any possible confusion about which roles and functions are carried out by agencies and which are carried out by Ministers or others.[221] Agencies should have a clear statement of both their roles and their objectives in carrying out those functions by which these are to be achieved in a way that will minimize costs. Under the traditional direct regulation (command and control regulation), strictly defined objectives and decision-making processes should incorporate into the legislation. The implication is that there is certainty and tight control by government over the objectives, which could otherwise be compromised if the provisions were opaque and did not give agencies freedom and decision-making power.

Besides, it is significant to set which utility sectors will be privatized first in order to reach to the effective point. The table shows this arrangement having regard to supply and demand structures of these sectors.

[221] Cheng Kuo-Tai, (2006). "Researching Regulatory Governance for Privatisation of Public Utilities: Issues and Reflections", Journal of National Taipei University of Education, Vol.19, No.2 September, (pp. 133-160)

Table 3. Categorization of Utilities in the Phase of Privatization[222]

		DEMAND STRUCTURE	
		Good	Bad
SUPPLY STRUCTURE	Single	**A-**Electricity Distribution, Telecommunications (Local), Gas Distribution , Airports	**B-** Railways, Postal Services, Waterways
	Multiple	**C-** Electricity Production, Telecommunications (except local), Gas Production, Coal, Air-line	**D-** Iron and Steel, Automotive, Shipyards, Bus Services

According to this table, sectors in group D engender monopolistic structure. Public enterprises in these sectors operate already in competitive markets. For group C, in these sectors there is no long-term demand structure. For this reason privatization of these sectors will be effective in increase in output. For group A, expectations for demand are high, but on the other hand supply can not be competitive for the present. The biggest problem occurs in group B, because of low demand expectations and uncompetitive supply structure. In this group, expectation for demand is low because of demand growth of service substitutions.[223] In this way, this table shows that the acceptable order of arrangement for privatization is group D, C, A, B. This arrangement is required a completely targeted regulation.

[222] Adopted from Ardıyok, p. 53
[223] Ardıyok, p. 53

In the EU area giving telecommunications sector as an example, with the exception of the UK, which had privatized British Telecom in the early 1980s, most of the EU Member States begun selling state owned telecommunications service providers during the 1990s. National struggles between proponents and opponents of privatization resulted in different patterns and outcomes.[224] All European nations but Luxembourg sold shares of Public Telecommunications Operators (PTOs) to private investors. To avoid stressing the stock market and bolster sales revenues, privatization typically occurred in partially.[225]

By the end of 2000, EU member states had conducted 33 partial sales. Britain and Denmark had fully relinquished ownership rights; Portugal and Spain had only retained a "golden" share. In Ireland and Italy the public sector had reduced its holdings to a minute 1.1% and 3.5% of equity capital, respectively. In some countries, for example, Germany and France, tentative plans for the privatization of further parts of the PTO were announced but delayed by political developments and the unpredictability of the stock market. Austria, Belgium, and Ireland sold minority stakes to publicly owned or partially privatized PTOs from other EU countries.

In order to safeguard liberalization, the EU mandated the separation of operation and regulation that historically were vested in the state owned PTOs. By 1990, only the UK had established an independent regulatory agency. As a precondition for the full liberalization of the telecommunications markets in 1998, all member states were required to set up regulators.[226]

As mention in Section 3 of this study, NRAs differ with respect to their degree of functional and organizational independence and consequently their susceptibility to government influence. Within the framework of European directives regarding liberalization of utility sectors, NRAs affect important aspects of competition in these

[224] Bauer Johannes M, (2005). "Regulation and State Ownership: Conflicts and Complementarities in EU Telecommunications", Annals of Public and Cooperative Economics, 76/2, (pp. 151–177)
[225] Ibid., p. 160
[226] Ibid., p. 163

sectors; Commission on the other side makes great effort to fulfill common market task in mentioned sectors.

Consequently, the 1990s saw an unprecedented increase in private foreign investment in infrastructure projects in developing countries. Much of this investment was in the telecommunications and electricity industries. For the private sector, infrastructure investment is associated with a sizeable investor risk linked to the long-term sunk cost characteristics of infrastructure projects.[227] For the government, the involvement of the private sector in "natural monopolies" raises new challenges in designing regulatory structures that can control anti-competitive or monopolistic behavior, while at the same time maintaining the attractiveness of the domestic economy to potential foreign investors in the infrastructure industries. Briefly, where regulatory institutions are weak and vulnerable to "capture" by the government (or the private sector), there is no chance to introduce fully effective and successful privatization and competing enterprises to the market.

4.4. Liberalization of Natural Monopolies

Throughout most of the twentieth century, government regulation and public ownership were considered as mutually exclusive alternative means of correcting forms of market failure and achieving non-market social objectives in network utility industries. This started to change during the 1990s, when in many countries liberalization (the opening of monopoly markets to competition) progressed faster than privatization (the sale of state-owned companies).

Since 1990, more than 35 countries have enacted anti-trust laws around the world, including several centrally planned economies. To do this, countries promote deregulation and liberalization, and prevent anti-competitive business conduct, both for

[227] Kirkpatrick & Parker & Zhang, p. 166

State-owned and private enterprises.[228] Competition policy is characterized by its general application to all sectors and all firms.

Liberalization and technological innovations are significantly changing the market structure of regulated industries highlighting the need to redefine the nature of public interventions. In this context, as important segments of network utilities, such as the electricity transmission network or the local access networks in telecommunications, did not allow effective competition (at least not immediately), regulation was established in parallel with these restructuring measures. The newly created agencies were granted jurisdiction over both privately and publicly owned firms.[229] The single most important factor to successful liberalization is clear government goals for the liberalized sectors and adoption of policies to achieve those goals.

The objective of liberalization is to induce competition in prices, creating incentives to lower production cost and increasing product innovation.[230] If authorities apply the liberalization process correctly, then liberalization may have greater potential to reduce industry costs when the incumbent monopoly supplier is owned primarily by the government than when it is owned primarily by private investors.[231] Before liberalization of the network industries began, regulation protected national incumbents from competition. Today, after extensive liberalization, regulation is mainly used to curb anti-competitive behavior of firms.[232]

The design of liberalization policy is of paramount importance in settings where competition is deemed to be a superior alternative to a prevailing monopoly regime. The most appropriate liberalization policy can vary considerably according to the institutional setting in which it is being implemented. Therefore, an important role for future research

[228] UN (1999), p. 147
[229] Bauer, p. 152
[230] Buigues, p. 4
[231] Armstrong Mark & Sappington David E. M, (2005), "Regulation, Competition and Liberalization", Journal of Economic Literature, American Economic Association, vol. 44(2), June, pp. (325-366)
[232] Noaksson Niklas, (2005), "Taking stock of the liberalization of public utilities Can structural reforms bring the Lisbon strategy back on track?", European Trade Union Institute for Research, Education and Health and Safety (ETUI-REHS) Brussels, (pp. 1-33)

is to develop detailed maps of the best route to competition, i.e., to specify the precise details of liberalization policies that will work well in specific institutional settings.[233]

On the other hand, liberalization and privatization are often linked. In fact, they are related but distinctly are different in regard to certain basic policies and fundamental issues.[234] At its core, privatization is the conversion of a state enterprise to private-sector ownership. The state enterprise may be privatized as either a monopolistic or competitive entity. Liberalization, in contrast, is the opening of a monopolistic market to competitive provision of facilities and services. Whether the former monopoly operator is a state enterprise or a private enterprise is not the primary consideration.

In the early stages of industry restructuring, the pattern was privatization first; liberalization later. This was largely due to the pressure to increase flotation price through continuation of monopoly. As experience has been gained by developed countries, "information and communications and technologies has become more important to economic growth, the ideal model recently is liberalization first; privatization soon after liberalizing allows competitive market conditions to be settled before flotation; this enables more accurate assessment of regulatory risk and potential market opportunities.[235]

Liberalization has largely been a successful process, which should be led to completion. Lower prices, higher quality, greater innovation, and more customer-friendliness are some of the main achievements of this process, although of course exceptions can be identified on some markets.

At the time of liberalization process, it is significantly necessary to adopt regulatory policy. Recent studies explain shortcomings of liberalization in terms of the

[233] Ibid., P. 355
[234] http://www.gipiproject.org/telco/ Retrieved on 18.01.2007. Garrison William B. "Telecom Privatization and Liberalization", The Kenan Institute of Private Enterprise (pp. 1-16)
[235] Ibid., p. 12

lack of "quality" of the regulatory framework following liberalization.[236] The New Zealand experience, where the government had initially decided to liberalize the telecommunications market without adopting a proper regulatory framework only to realize later than liberalization was a failure and adopt regulatory framework.[237]

[236] Noaksson, p. 9
[237] Geradin (2006), p. 13

V. LIBERALIZATION IN THE EUROPEAN UNION

5.1 General Survey on Liberalization in the European Union

Already the Rome Treaty promotes economic integration between countries in Europe as a vehicle assumed to produce prosperity and peace.[238] To that end, the creation of a European Single Market[239] is the single most important EU achievement. The legislative road map for free movement of people, services, goods and capital was realized in 1987. It is based on the 1985 famous European Commission (EC) White Paper – Completing the Internal Market.[240]

The ambitious objectives are set in the introductory paragraph of the White Paper as follows:

- "Unifying this market (of 320 million) presupposes that Member States will agree on the abolition of barriers of all kinds, harmonization of rules, approximation of legislation and tax structures, strengthening monetary cooperation and the necessary flanking measures to encourage European firms to work together…".

The completion of the internal market was due in 1992. Yet, today it is known certainly that this was not a realistic goal.[241] In addition, it has become the core element of the Lisbon strategy.[242] The strategic goal is defined: the Union shall by 2010 become

[238] The Treaty of Rome established the European Economic Community (EEC) and was signed by France, West Germany, Italy, Belgium, the Netherlands and Luxembourg (the latter three as part of the Benelux) on March 25, 1957

[239] The Single European Market stands for 'free movement' of people, goods, services and capital. Since its inception in 1993, the Single Market has opened up economic and working opportunities that have transformed the lives of hundreds of millions of Europeans.

[240] See supra note 196

[241] Noaksson, p. 7

[242] In March 2000, the EU Heads of States and Governments agreed to make the EU "the most competitive and dynamic knowledge-driven economy by 2010"

the most competitive and dynamic knowledge-based economy in the world capable of sustainable economic growth with more and better jobs and greater social cohesion.

'Sustainability' has a particular meaning for the energy, water and transport sectors.[243] From a legal point of view, most of the public utilities – more recently referred to as 'network industries' – are now fully or largely subject to competition.[244] The network industries energy, transport, water and telecommunications are identified as major sectors in the Commission's White Paper.

Meanwhile, members of the European Union increasingly came to see state-owned monopolies as hindrances to international trade in goods and services.[245] Early experiences of liberalization in the United States and the United Kingdom also convinced European authorities that the liberalization model was workable and could provide positive economic results. Thus in the 1990s a series of directives were issued to create a single market where goods, services, people, and capital could move freely. These directives spelled out rules for telecommunications, railways, electricity, and natural gas markets across EU member states, mapping out a common regulatory framework and liberalizing these industries.

A new model, based on the opening of network industries to competition, combined with regulation through independent agencies, offered an interesting alternative to the much criticized and loss-making monopolies created at the turn of the 20th century.[246]

Since then, the European Commission has initiated liberalization reforms in a range of sectors with some success. Sectors, such as telecommunications and air transport, are now fully liberalized and are becoming increasingly competitive. Others

[243] Noaksson, p. 7
[244] Reiner & Moreno &Vansteenkiste, p. 6
[245] Kessides Ioannis N., (2005), "Reforming Infrastructure - Privatization, Regulation, and Competition", World Bank Policy Research Report, a co publication of the World Bank and Oxford University Press, (pp. 1-325)
[246] Geradin, (2006), p. 9

sectors, such as energy (gas and electricity), postal services, and rail transport, are not yet fully liberalized, but the market opening dynamic is now well under way. The liberalization process has not been without difficulties, however, and many challenges still lie ahead.

The European Commission took a number of policy initiatives, such as the publication of green papers, leading to the adoption of proposals for directives liberalizing the various network industries.[247] While in the area of telecommunications, the Commission managed to achieve quick results through its reliance on directives based on Article 86(3) of the EC Treaty[248], which provides the Commission with the power to adopt directives by itself, in other sectors, the Commission relied on the lengthy legislative process comprised in Article 95 EC (co-decision between the Council and the European Parliament). Directives in the energy and postal services sectors were thus the result of compromises between Member States and EU institutions, which were often short of the market opening ambitions of the Commission. On the other hand, in some sectors, there was a tension between Member States over the necessity and the speed of them liberalization of these network industries.[249]

EU Treaty provides for specific responsibilities at Community level for trans-European networks in the area of energy, telecommunications and transport as mentioned in order to achieve some goals which are declared in the Green Paper[250] in 2003[251]:

- "…the liberalisation of important areas of services under the internal market programme, that the liberalisation already initiated in the areas of

[247] See, e.g., Towards a Dynamic European Economy. Green Paper on the Development of the Common Market for Telecommunications Services and Equipment. Appendices. COM (87) 290, 30 June 1987; Green Paper on the development of the single market for postal services (communication from the Commission) COM(91) 476, June 1991
[248] See Section 4.2
[249] Geradin, (2006), p.10
[250] Report on the Green Paper on services of general interest (COM(2003) 270 – 2003/2152(INI)) Committee on Economic and Monetary Affairs
[251] Borbély Szilvia, (2004), "Services of General Interest (SGI) and EU enlargement Synthesis of the national surveys and seminars", European Trade Union Confederation/European Center of Public Enterprises and Enterprises of General Economic Interest (ETUC / CEEP), (pp. 1-58)

transport, electricity and gas should be implemented promptly; points out that moves to liberalisation hitherto have resulted in to better quality at more reasonable prices, improved the availability of the most advanced technologies, and boosted the competitiveness of European undertakings and efforts to safeguard jobs"

- "The Report welcomes the liberalisation in the fields of telecommunications, postal services, transport and energy, which has led to modernization, interconnection and integration of the sectors, has lead to price reductions through increased competition, and has lead to the creation of nearly one million jobs across the European Union"

On the other hand, two important remarks should be made here regarding liberalization process in the EU.[252] First, while liberalization has been largely driven by European directives, the degree of market opening tends to vary, sometimes significantly, between Member States. This is due to several reasons. First, unless they provide for full market opening, EC liberalization directives will only set up minimum opening thresholds, which can be exceeded by governments. This explains why some Member States have gone faster than others in opening their market to competition.[253] Second, even in the case of full liberalization, some Member States have dragged their feet in implementing liberalization directives.[254] This has created a degree of asymmetry between Member States as, in practice, firms in some Member States managed to escape for several years the obligations imposed by EC law.

Second, it is interesting to note that while liberalization has been particularly fast in some sectors (air transport and telecommunications), it has been much slower in

[252] Ibid., p. 15

[253] Several Member States, such as Estonia, Finland, Sweden, and the United Kingdom have, for instance, fully liberalized their postal market although EC law still allows Member States to maintain a reserved area.

[254] For instance, on 21 April 2004, after nine months of delay and two warnings, the Commission decided to take six Member States - Belgium, Germany, Greece, France, Luxembourg and the Netherlands - to the European Court of Justice for failing to implement fully new rules on electronics communications. See IP/04/510.

others. This is due to several factors. First, in the mid-1980s, there was a general belief that liberalization of the air transport and telecommunications sectors were really needed to stimulate the development of the internal market (this is particularly true for the air transport sector) and the competitiveness of the industry (this is particularly true for the telecommunications sector, which in Europe was lagging behind the United States). In contrast, the benefits of liberalization of sectors like energy, postal services, and rail were disputed. Energy is a highly strategic sector and, thus, several Member States, such as France, were reluctant to the market opening process and devoted significant efforts to delay it.

Furthermore, it is expected that liberalization will bring advantages on prices in the network industries. One of the report[255] prepared regarding the issue which uses a simulation based approach to examine the cost savings to be generated by the introduction of a single European market for electricity. Price reductions of 5-11% for industrial consumers and 2-4% for residential consumers are expected. These cost savings originate mainly in lower construction and operating costs for generating plants and optimal fuel choice. Further gains can be realized by introducing supply (retailing) competition and national electricity pools.

Overall, from January 1998 to February 2005 consumer telecommunications prices in the EU fell by 30.0% relative to the EU HICP (Harmonized Index of Consumer Prices. The electricity sub-index also shows a downward trend. However, it is clearly weaker than that of telecommunications and was interrupted on several occasions, due to either increases in energy taxation or higher oil prices. Between January 1998 and February 2005 the electricity price index for the EU fell by 1.6% relative to the overall EU HICP. By contrast, the gas price sub-index rose by 17.1% relative to overall EU HICP over the same period.[256]

[255] London Economics (1997), "The Single Market Review, Vol. 10: Single Energy Market", Luxembourg.
[256] Reiner & Moreno & Vansteenkiste, p. 26

As above-mentioned, sectors, such as telecommunications and air transport, are now fully liberalized and are becoming increasingly competitive. Others sectors, such as energy (gas and electricity), postal services, and rail transport, are not yet fully liberalized. Sectors which were completed the liberalization process have diverse of gains regarding economic results such as efficiency, price reductions, cost reductions etc..

The other basic issue is regulatory agencies. In this study, a detailed survey has been made in Section 3. Series of directives to achieve internal market in the mentioned sectors typically contained provisions mandating Member States to create independent regulatory authorities. Liberalization thus led to the creation of numerous new agencies in all Member States of the EU.

One of the most vexing tasks facing infrastructure regulators is designing the terms of access to bottleneck facilities for competing service providers.[257] For this reason, EU is in a great effort to maintain the cooperation among regulatory agencies. For regulatory agencies in the EU, market transparency and competition generally are the core objectives for the regulators.[258]

One of the significant network industries in the EU recently is energy sector; in the below energy-electricity and gas sectors will be analyzed in the context of legal framework in order to exemplify the EU liberalization process thereby functions of the regulatory agencies will be also explicated .

[257] Kesside, p. 71
[258] Larsen Anders & Pedersen Lene Holm &Sørensen Eva Moll & Olsen Ole Jess , (), "Independent Regulatory Authorities in Europe", Akf Publications, (pp. 1-34)

5.2. Energy-Electricity & Gas Sectors

The Directives[259] on price transparency and energy transit were widely seen at the time as the firs steps towards the creation of an EU system of energy regulation in which the Commission, rather than the energy industry, would play the leading role. Although Member States supported the idea of liberalization and increasing competition in energy markets, there was much less agreement on the appropriate mechanisms and the manner and timing of their introduction.[260]

Recognizing this opposition at an early stage, Commission indicated that their introduction was accompanied by a very extensive process of consultation not only Member States and the utilities involved also the various consumers and the relevant Community institution.[261] Also, the Parliament played a significant role as a result its increased authority under the Treaty of the European Union (TEU), Council played a key role in brokering the final drafts. However, these efforts were insufficient and Commission showed significant tactics to complete the process in 1994.

The deregulation of the electricity industry started in 1989. In 1996 the EU adopted a directive for the internal market for electricity.[262] By 1999 the Electricity Market Directive was transposed into national legislation.

Competition was introduced to give incentives for efficiency improvements in the services delivered over the networks, where as regulation was to mimic competition in the monopoly sectors, where actual competition was absent.[263] Consequently, the market restructuring often resulted in an obligation to break the former vertical integration. As a

[259] Council Directive 90/377/EEC of 29 June 1990 concerning a Community procedure to improve the transparency of gas and electricity prices charged to industrial end-users; Commission Directive 93/87/EEC of 22 October 1993 amending Directive 90/377/EEC with regard to the survey locations and regions in the Federal Republic of Germany

[260] Cameron, p. 120

[261] Ibid., p. 120

[262] Directive 96/92/EC concerning common rules of the internal market in electricity was adopted by the Council of Ministers on 19 December 1996.

[263] Hannınenı K. & Vılјaınen S. & Partanen J, (2006), "Strategic Golas of Regulation – Distribution Business 30 Years From Now", International Council of Large Electric Systems, (pp. 1-8)

result, there are now open markets in electricity generation and selling, where as electricity transmission and distribution are still regulated natural monopolies.

Liberalization of the electricity industry involves what is known as vertical and horizontal separation. Vertical separation refers to the separation between potentially competitive activities, i.e. generation and retailing, from transmission activity, which is a natural monopoly (non-competitive). The horizontal separation is the break-up of similar activities formerly performed by the same company. For instance, dividing the generation capacities and allowing for new generators to enter the market.

Liberalization also involves allowing third party access (TPA) for all generators to the transmission grid (which is subject to available capacity).[264] As early as 1989, the Commission had declared its intention to consult all international parties to examine in depth whether TPA should be introduced in the EU electricity and gas networks.[265]

The EU directives called for 1/3 liberalization by 2003 in the electricity sectors.[266] Some countries have liberalized 100% - in these countries all customers could freely choose their supplier. But there is no legal obligation for Member States to introduce a free market for the supply of gas and electricity to households. Ownership of the electricity market is still partially public.[267]

The critical element relating to the classification is the transport infrastructure. As mentioned, the generator capacities may be opened for competition.[268] The generation stage consists of the transformation of primary energy sources such as coal, oil, gas and

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[264] Noaksson, p. 15
[265] COM (1991, "Completion of the Internal Market in Electricity and Gas", 21 January 1992
[266] European Commission (2004) Horizontal Evaluation of the Performance of the Network Industries Providing Services of General Economic Interest. SEC (2004)866.
[267] Ibid., p. 15
European Commission (2004) Horizontal Evaluation of the Performance of the Network Industries Providing Services of General Economic Interest. SEC (2004)866.
[268] Christiansen Arndt, (2005), "Regulation and EU Merger Control in the Liberalized Electricity Sector", http://www.wiwi.unimarburg.de/Lehrstuehle/VWL/WIPOL/Mitarbeiter/christiansen_en.htm retrieved on 25.01.2006. (pp. 1-33)

water power into electricity. Econometric analysis has repeatedly revealed scale economies to exist but has also found that these are rather limited leading to a large area of essentially flat average costs. Of much more importance, therefore, is the interconnection of individual plants, which allows economizing on reserve capacity and thus leads to cost reductions beyond single plants. These do, however, relate to the system level and can also be realized by properly devised coordination of several independent producers. Therefore, this stage is potentially competitive, although entry is capital intensive. In reality, markets of a reasonable size support varying numbers of producers. On the other side, the duplication of power cables would be too costly. And since electricity is not storable, the nodes are also a natural monopoly.

On the other side, the Gas Directive was due for transposition in 2000. It is planning to require a 20% opening of the market initially, increasing to 1/3 by 2008. In 2003, two important directives to liberalize the market were adopted. To monitor the effective implementation of the directives a European Regulatory Group[269] has been set up, acting as an advisory body. The transport infrastructure for gas, the pipelines, is difficult to duplicate.

The key objective of the Gas Directive was "to provide fluidity in gas flows and improve security of supply and industrial competitiveness" in Europe. Most of the Member States forming the Europe of Fifteen transposed this directive into national law on August 10, 2000. The Gas Directive lays down a set of common rules and procedures relating to the organization and functioning of the national gas sector. Its objectives are to:

– Establish a single natural gas market in Europe that is integrated, competitive and regulated at EU level. This objective was stated in the declaration made by the European Council in Lisbon (2000) aiming to make the EU economy the most competitive in the world. In order to create an internal gas market, national markets must be harmonized to

[269] See supra note 157

some extent and new rules must be adopted to run the gas sector, previously managed at national level.

– – Boost the competitiveness of European energy undertakings against international competitors by allowing the market to operate freely.

– Improve the overall structural efficiency of the European gas market and ensure that households and industrial users are free to choose their supplier. Competitive pressure must be such that operators are forced to realize productivity gains and/or decrease their margins, i.e. via economies of scale.

Looking to the long term, the purpose of establishing "gas-gas" competition is to allow a real market price for gas to emerge through the interaction of supply and demand. This implies the development of gas hubs on which adequate volumes of gas are traded in a transparent, fluid manner by different operators and on which benchmark prices emerge.

The EU directives[270] for opening up Europe's electricity and gas markets were adopted in 2003. The directives open were aiming the market for electricity and gas for all non-household customers by July 2004 and for all customers by July 2007. Also, a legal separation between producers and distribution were set up compulsory according to directives. However, the Commission criticized national governments for failing to implement the directives and there seems to be persistent reluctance on the part of some incumbent energy utilities to grant network access to new or foreign competitors.

These directives include:

[270] Directive 2003/54/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in electricity and repealing Directive 96/92/EC; DIRECTIVE 2003/87/EC of the European Parliament and of the Council of 13 October 2003 establishing a scheme for greenhouse gas emission allowance trading within the Community and amending Council Directive 96/61/EC; DIRECTIVE 2003/87/EC of the European Parliament and of the Council of 13 October 2003 establishing a scheme for greenhouse gas emission allowance trading within the Community and amending Council Directive 96/61/EC

- Full market liberalization for non-household customers by July 1, 2004 and all customers by July 1, 2007
- Unbundling of integrated transmission and distribution
- Transmission, distribution and liquefied natural gas (LNG) system operators
- Shift from negotiated to regulated third party access to electricity and gas networks, gas storage and LNG facilities
- Regulatory principles for cross-border electricity transmission tariffs and management of interconnector capacity
- Designation of independent system operators for gas and electricity networks
- Establishment of independent regulators in each Member States.

The provisions of this directive regarding gas sector are applicable to all Member States of the Europe of Twenty Five and took effect on July 1, 2004. Greece, Portugal, Finland, Cyprus and Malta derogate from this directive by virtue of their status as emerging or isolated markets. The Czech Republic benefited from derogation: the provisions on eligibility did not apply to it until December 31, 2004.[271]

Articles 23 and 25 of the Electricity and Gas Directives respectively provided for the duties of regulators. They broadly describe the functions as ensuring non-discrimination, effective competition and efficient functioning of the market. For the purpose of harmonizing the regulatory framework among member states, the Directives also provide for the responsibilities and competencies of the regulators. It further establishes the duties which the states may assign to regulators:

- Management and allocation of interconnection capacity
- Mechanisms for dealing with congestion
- Repairs by network operators
- Information publication
- Effective unbundling of accounts to avoid cross-subsidies

[271] Lecarpentier Armelle, (2006), "The Liberalization of Gas Markets in the Europe", www.ifp.fr/IFP/en/events/panorama/IFP-Panorama06_07-LiberalisationMarcheGaz-VA.pdf retrieved on 20.02.2007

- Connecting new producers
- Access to storage, line pack and to other ancillary services
- Level of transparency and competition
- Compliance with the Directives of the Transmission and Distribution System Operators (TSOs) and (DSOs)

Again, the Regulation 1228/2003[272] on cross-border electricity exchanges provides that the regulator must:

- Approve operational and planning standards including schemes calculating total transfer capacity;
- Decide on exemptions to normal access rules for new investments;
- Ensure compliance with all guidelines under the regulations The Directives additionally provide that the regulators shall:
- Approve or fix the methodologies for calculating or establishing the terms and conditions for connection and access to national networks;
- Approve or fix the methodologies for calculating or establishing the terms and conditions for the provision of balancing service;
- Have authority to require the TSO or DSO to modify the terms and conditions, tariffs, rules, mechanisms and methodologies for connection and access to the national network or for balancing services of any of the activities monitored by the regulatory authority under the Directives, ensuring that they are appropriate and applied in a non-discriminatory manner;
- Arbitrate on complaints against TSOs and DSOs.[273] It is also indicated in the Directives that regulators may also be assigned the following functions:
- Administering authorization for the construction of new generating plants;

[272] Regulation (EC) No 1228/2003 of the European Parliament and of the Council of 26 June 2003 on conditions for access to the network for cross-border exchanges in electricity

[273] Art. 23 (2) of the Electricity Directive and Art. 25(2),(3)& (4)

- Administering licensing arrangements to ensure compliance with regulatory controls and performance requirements;
- Reporting on market dominance and anti-competitive practices;
- Initiating appropriate measures where confidentiality rules are not respected;
- Ensure accuracy of information provided to customers.

In addition to these functions Member States may require the regulators to perform the following duties:

- Issuance of authorizations and licenses;
- Monitoring of security y of supply;
- Organization and control of tendering procedure for power generation;
- Deciding on derogation on take-or-pay gas commitments;
- Dispute settlement for access to gas pipelines;
- Ensuring consumer protection.38

On the other hand, applicability of Art. 81(EC Treaty) was relevant since the certain agreements were common in the electricity sector that raised competition issues under that Article. As an example, in Ijsselcentrale Case[274], the Commission prohibited an agreement concluded by electricity generating companies in the Netherlands, preventing both distribution companies and indirectly, private, industrial consumers from using imported electricity. Although Art. 86(2) (EC Treaty) applied, it was decided that this did not justify a monopolization of imports and exports.

Furthermore, the Almelo Case[275] brought before the ECJ served to highlight some of the frustrations felt by those in favor of liberalizing energy markets. It arose from proceedings brought by the Municipality of Almelo and other electricity distributors

[274] Commission Decision 91/50/EEC of 16 January 1991 relating to a proceeding under Article 85 of the EEC Treaty (IV/32.732 - IJsselcentrale (IJC) and Others)

[275] Judgment of the Court of 27 April 1994. - Municipality of Almelo and others v NV Energiebedrijf Ijsselmij. - Reference for a preliminary ruling: Gerechtshof Arnhem - Netherlands. - Competition - Agreement restricting the importation of electricity - Service of general interest. - Case C-393/92.

against Ijssemij (formerly Ijsselcentrale), an undertaking engaged in the regional distribution electricity, concerning the interpretation of an agreement on the public supply of electricity, its conditions and especially an equalization supplement charged by Ijsselcentrale to the local distributors. The distributors argued that the exclusive purchasing obligation imposed upon them from importing electricity. The national court referred the matter.

The ECJ held that the use of an exclusive purchasing obligation by the regional electricity undertaking contained in the general conditions of sale restricted competition and also had effects on inter-state trade because the regional distributor belongs to agroup of undertakings that occupy a collective dominant position in a substantial part of a the common market. The competition rules in Art. 81 and 82 (EC Treaty) precluded this and therefore were shown to be applicable to the electricity sector.

Legal framework of security of supply in the energy sector shows that a continuing source of constraint on actions to promote competition in the energy markets in the EU has been the availability of exemptions under Art. 30 and 86(2) (EC Treaty). [276]With the import and export of energy, there are obligations under Articles 28 and 29 (EC Treaty) that are subject to exemptions contained Art. 30.

In Campus Oil Case[277], the Irish Government defended a statutory requirement that Irish importers of petroleum products should purchase a percentage of their requirements through a national oil refiner. Its defense was based on grounds of public security. The ECJ upheld this defense. ECJ noted that recourse Art. 30 (EC Treaty) is not justified if Community rules provide for the necessary measures to ensure protection of the interests set out in that Article. National measures that hinder intra-Community trade can not therefore be justified unless protection of the interests of the Member State

[276] Cameron, p. 235

[277] Judgment of the Court of 10 July 1984. Campus Oil Limited and others v Minister for Industry and Energy and others. Reference for a preliminary ruling: High Court - Ireland. Free movements of goods - Supply of petroleum products. Case 72/83.

concerned is not sufficiently guaranteed by measures taken for that purpose by the Community institutions.

The European Regulators Group for Electricity and Gas[278] (ERGEG) is an advisory body set up in 2003 to advise the Commission on internal market regulation. Its members are the heads of the national energy regulatory authorities in the 25 Member States. National energy regulators from the 25 EU member states have launched a public consultation to improve information and transparency on electricity markets for large industrial consumers. The European Regulators Group for Electricity and Gas (ERGEG) on 15 March 2006 submitted a revised set of "Guidelines for Good Practice on Information Management and Transparency in Electricity Market. The draft guidelines aim to establish a minimum level of transparency for the provision of market-related information to wholesale market participants - suppliers, generators, energy traders, large customers and demand side participants.

As above-mentioned European institutions, chiefly Commission make an great effort to complete the internal market in energy sector, the Commission has issued today a warning on December 2006 to bring EU Member States on line with energy policy agreed in 2003.[279] In particular the Commission has addressed 26 "reasoned opinions" to 16 Member States: Austria, Belgium, the Czech Republic, Germany, Estonia, Spain, France, Greece, Ireland, Italy, Lithuania, Latvia, Poland, Sweden, Slovakia and the United Kingdom

Package of infringement procedures was the 2nd step of the procedure already started on 4 April 2006 with the sending 27 "letters of formal notice" to 17 Member States. The Member States have all replied to these letters of formal notice and after throughout examination of these responses, the Commission regrets that insufficient progress has been made by Member States in implementing in letter and in spirit EU 2003 directives setting up an internal market in gas and electricity. During the Summit of

[278] See www.ergeg.org
[279] MEMO/06/481 Date: 12/12/2006. "The Commission to act over EU energy markets"

8 and 9 March 2007, the European Council agreed on an Action Plan to develop an energy policy for Europe by 2009

The Directives required Member States to establish new regulatory authorities or widen the scope of existing authorities in their territories. However, the European dimension of energy liberalization dictated that the Commission play a key role in coordinating national regulators' actions to ensure harmonization.

The Directives also recognize that these duties cannot be efficiently executed unless the regulators are given some freedom to exercise their competencies. It therefore provides that their execution shall be by independent regulators set up by the member states. A fully liberated and competitive energy market cannot be attained without effective and independent regulators who are free from encumbrances, especially of industry operators and government. It remains to be ascertained who the independent regulators are.

VI. GENERAL SURVEY ON LIBERALIZATION & PRIVATIZATION IN TURKEY AND INDEPENDENT REGULATORY AGENCIES

6.1. General Information about Liberalization and Privatization in Turkey

For much of the 20th century most countries relied on government ownership and regulation to promote socially equitable access to network infrastructure services—including electricity, telecommunications, water and sewerage, natural gas, and transportation—using mechanisms such as nonexploitive pricing, nondiscriminatory coverage, and universal service.[280] Reflecting infrastructure's strategic importance and concerns about monopoly power, it was widely believed that these sectors could not be entrusted to the signals, motivations, and penalties of free markets. In addition, most governments relied on this public utility paradigm because they were convinced that state resources were required to finance large investments in service coverage.

However, in recent decades this consensus has changed, resulting in far reaching restructuring, privatization, and other reforms of crucial infrastructure sectors and services. This means that transmission from state ownership to regulation. For Turkey, this transmission process is a new era.[281]

Turkey experienced impressive progress in terms of privatization policy somehow. In the last two decades Turkey is very keen on this policy as a result of 'transition to strong economy'. The pace of privatization is also steadily accelerating in Turkey.

[280] This mainly refers to the period after World War II. Until then private ownership in electricity was the norm in many countries in Europe and North and South America. State ownership spread after World War II. Similar situations prevailed for railways, trucking, and water in many countries. Telephone services became captive of state-owned post offices in Europe and Japan but not Canada, the United States, or, initially, Latin America.

[281] Oğuz p. 78

On the other hand, for Turkey the dilemma is regarding, how to establish sustainable growth without repression and what role should the state play in achieving that goal. Hence, banking sector is dealing with a great issues most of the time. In order to transit to the strong economy, privatization policy goes before the liberalization. Although, the endeavors on the liberalization path have occurred in Turkey; privatization is the first preference to make the sectoral markets effective. Liberalization process has not been completed and needs more regulatory reform which is complied with good governance principles.[282]

However, especially uneven political decisions, inconsistent economic structure and successive financial crisis, insufficient legal infrastructure, and opposition from interest groups have stumbled and hindered especially the privatization progress of Turkey for a long time. As a result of these, Turkey has not taken necessary progress, and enough steps for this crucial issue.

The turning point in Turkish privatization experience can be considered as the passage of the Privatization Law[283] in 1994, which gives gains to the decision-making process.

The Government decided to further speed up the pace of privatization with a new Privatization Law containing the following objectives:

- To expand the scope of assets to be privatized,
- To provide an adequate framework/funds/mechanism to speed up Privatization and restructuring of SOEs,
- To protect the free market from anti-competitive mechanisms, in the event of dominant companies being privatized,

[282] In 2002, the Commission's White Paper on European Governance has identified a number core principles of good governance which include the requirements of independence, accountability, transparency and participation. See Commission of the European Committees, European Governance: White Paper from the Commission to the European Council, COM (01), 428 (July 2001). See also various documents adopted by the Commission in June 2002 and in December 2002, available at http://europa.eu.int/comm/governance

[283] Law No.4046, Published in Official Gazette on 27 November 1994.

- To established a social safety net for employees who lose their jobs as a result of privatization,
- To establish a special Privatization High Council and Privatization Administration.

Under the Privatization Law No. 4046, privatization process is carried out by two bodies: (i) Privatization High Council, (ii) Privatization Administration. The Privatization High Council (PHC) is the ultimate decision-making body for privatization in Turkey. The Council, headed by the Prime Minister, is composed of four ministers. PHC nominates the organizations for privatization through taking state-owned economic enterprises in and out of the privatization portfolio and is responsible from the methodology and timing of the privatization procedures by approving the final transfer procedure of the organizations to real people or/and legal entities. The Privatization Administration (PA) is the executive body for the privatization process. It is a legal public entity with an exclusive budget, reporting directly to the Prime Minister. PA's major duties include the execution of PHC's decisions, advising the PHC in matters related to the transfer of SOE's into or out of privatization portfolio and restructuring and rehabilitation of SOE's in order to prepare them for privatization.

There are varieties of SOEs in Turkey waiting to be privatized[284]; on the other hand there are some enterprises should not been placed under privatization programme because of future economic and social concerns. In Turkey, some SOEs still have monopoly in the domestic market, although the abolition of some legal monopolies on tradable goods has occurred since the mid-1980s, such as tea production and fertilizer distribution. Several SOEs are also the predominant domestic producers in such sectors as non-ferrous metals, newsprint, paper, sugar, petrochemicals, and bulk chemicals. A large number of SOEs are concerned with provision of non-tradable services and hold a monopoly situation in these areas. They include postal services, railways seaport administration, and until recently electricity distribution.

[284] For further information See http://www.oib.gov.tr/

There is an underlying consensus on the need to design an institutional framework for effective regulation as a critical precondition for welfare enhancing privatization as mentioned above. Besides, many scholars have drawn attention to the importance of creating a competitive environment as being more significant than the transfer of ownership per se. In spite of this apparent consensus in the theoretical literature on privatization, the regulation element, at least until very recently has constituted a neglected dimension of the Turkish experiment.[285]

However, competition is an important mechanism for the maximization of the consumer surplus. It is therefore necessary to take measures that encourage the development of a competitive environment to erode the SOEs' current monopolistic position.

Although the privatization program effectively started in 1986, the legal framework for regulation in Turkey could only be established in October 1994, largely to meet the obligations imposed by Turkey's entry into the Customs Union with the European Union. The Competition Board, the key institution responsible for regulation is creation of this Law. However, this institution could initiate its operations only with significant time lag.

The institution itself has generated a novel set of challenges. A striking example of these challenges became evident in the context of the proposed sale of POAŞ during late 1998 and early months of 1999. A conflict arose between the Privatization Administration (PA) and the Competition Board on the grounds that the latter institution had not been consulted for approval during the initial phase of the privatization process. Subsequently, the Competition Board has effectively blocked the divestiture of POAŞ through its actions. The consortium of bidders initially interested in buying the enterprise have later declared they were no longer interested allegedly because of the new

[285] Bakan İsmail & Eraslan İsmail Hakkı & Saraç Mehmet, (2002), "Turkish Vs Mexican Experience With Privatization", ERC/METU International Conference in Economics VI, September 11-14, Ankara, (pp. 1-24)

constraints imposed by the Competition Board that did not exist during the bidding process itself.

The POAŞ affair clearly highlights the dilemmas experienced in Turkey in terms of privatizing large-scale enterprises, on the one hand, and the problems encountered in terms of effective regulation and imposing rules of fair competition on the other. Following this incident, however, we observe much closer cooperation between these two key institutions, with the Competition Board from that point onwards being actively and formally involved in the privatization process.[286]

The Law No. 2983[287] set out the legal foundation that allowed the establishment of the Housing Development and Public Participation Administration (HDPPA) in 1984. The overt objective was to create a new institution vested with the authority to finance mass housing and major infrastructure projects as well as to implement privatization. However, an implicit objective was to create a new managerial bureaucracy as a means of by-passing the possible constraints on the implementation of the program by the principal layers of the "classical bureaucracy" that arguably form the "pro-public enterprise coalition".

In 1994, the new Privatization Law[288] has been introduced. To some extent, this has managed to overcome the deficiencies of the legal framework encountered during the initial years of program implementation. The new law provided greater flexibility in the choice of privatization techniques and emphasized transparency in all transactions. Another key innovation involved the explicit recognition of labor adjustment issues and redundancy payments for displaced workers. As part of the new legal framework, the proceeds of privatization could now be utilized for meeting the costs of divestiture, compensation of displaced labor and financial restructuring of enterprises in the PA portfolio.

[286] Ibid., p. 9
[287] Law No.2983. Published in Official Gazette on 17 March 1984
[288] Law No.4046. Published in Official Gazette on 27 November 1994

Strong opposition to telecom privatization manifested itself, on this occasion, as an opposition to the Telecommunication Laws of 1994 and 1995 themselves. In particular, it has been alleged that these laws have not conformed to the basic principles of the Constitution. This criticism, in turn, has been effective in the annulment of these laws.[289] Lack of institutionalized bidding procedures, especially in valuation techniques and the formation of valuation committees have been singled out as the critical missing elements underlying the decision to abandon the telecommunications laws. A new Telecommunication Law was passed in 1996 with no reversals to date. The Constitutional Court's rulings on valuation techniques led to the annulment of the related clauses of the Privatization Law of 1994. An amendment to deal with this problem was accomplished in 1997.

In 1999, the concept of privatization has, at last, been incorporated into the Turkish Constitution as a by-product of accepting the rules of international arbitration.[290] The acceptance of the rules of international arbitration heavily demanded by foreign investors for a long time illustrates the importance of the influence exercised by international actors, notably the transnational corporations.[291] From a broader perspective, an interesting question arises from the Turkish experience concerning the position of the Constitutional Court, as a key component of the state, in influencing the implementation of the privatization program.

The 'Law Regarding Making Amendments in Some Laws and in the Decrees With The Force of Law Dealing With Establishment and Duties of the General Directorate Turkish National Lottery' numbered 4971, prepared in order to speed up privatization, has been put into effect by being published on the 15th of August 2003. In the framework of the aforementioned Law, stipulations have been placed in order to accelerate privatization applications through the arrangements that have been made to the Law No. 4046. These include arrangements that have been made to privatize the Turkish National Lottery by way of handing out licenses for the planning, organizing and

[289] Ardıyok, p. 168
[290] Law No.4446. Published in Official Gazette on 14 August 1999
[291] Bakan & Eraslan & Saraç, p. 12

arranging of the draws of the games and those enabling the utilization of convertible bonds in the privatization of Turk Telekom.

On July 2005, Law No 5398[292] on the Regulation of Privatization Applications was passed. In a major policy change Article 22 of the law allows distribution companies to set up their own generation companies. Limitations imposed by the Electricity Market Law (EML) on distribution companies' ability to set up generation companies and purchase electricity from them have thereby been relaxed to a great extent. The constraints prescribed in Law No. 5398 are that there should be accounting separation between the generation and distribution activities and that the price of the electricity purchased by the distribution company from the generator that it owns or with which it is affiliated with cannot be higher than the national average wholesale electricity price.[293] Hence, subject to accounting separation, vertical integration between distribution and generation has been allowed.

It is understood that the change was introduced during discussions at the parliamentary committee, Energy Markets Regulatory Authority (EMRA) was either not consulted or the change has been introduced despite EMRA's negative opinion. No reason for this important change has been made available to the public. It was widely interpreted in the public opinion as a move to increase the privatization values of distribution companies and a concession given to potential buyers of those assets. It has later been stated by officials that the purpose of the change was to ensure supply security, however the requirement of accounting separation was not sufficient and that a new law would be passed to ensure that distribution companies and affiliated generation companies would be legally separated. As of December 2005 no new law has been enacted to ensure legal unbundling.[294]

[292] Law No. 5398 is entitled "Law Amending the Privatization Applications and Some Laws," published in the Official Gazette on 21 July
[293] Atiyas İzak, "Elektrik Sektöründe Serbestleşme ve Düzenleyici Reform", İstanbul: Tesev Publication, 2006, p. 14
[294] Ibid., p. 15

Law No. 5398 also allowed Organized Industrial Districts too enter Electricity Generation, distribution and trade activities. Thus a new player, not initially identified in the EML has been defined. In practice that means that the number of distribution companies may increase to over 100. It is not clear, for example, whether each district will sign a vesting contract. Apparently the main purpose for this change is to ensure cheap electricity to industry.

Effective regulation—including the setting of adequate tariff levels—is the most critical enabling condition for infrastructure reform. Protecting the interests of both investors and consumers is crucial to attracting the long-term private capital needed to secure adequate, reliable infrastructure services and to getting social support for reforms.[295] Crafting proper regulation is the greatest challenge facing policymakers in developing and transition economies. Briefly, Turkey needs proper and decisive regulation process for the future.

6.2. Independent Regulatory Agencies (IRAs)

IRAs are unfamiliar organizations for the traditional Turkish administrative system and there are numerous debates about their structures, functions, duties, and authorities. There is even no agreement on how to call them. Various names are being attached to these agencies such as “independent administrative authorities”, “regulatory agencies”, “regulatory boards”, “independent administrative agencies”, or “autonomous agencies” by different scholars.[296] In this study, independent regulatory agencies will be used as a name.

Moreover, the fact that there is also no clear explicit name given to these agencies in the legal documents, or in the laws regulating their establishments is another factor contributing to the confusion of terminology. For instance, in the law numbered 4743[297]

[295] Kessides p. 14
[296] Karakılıç, p. 112
[297] Law No.4743 regarding the Restructuring of Debts to Financial Sector and the Amendment of Some Laws

(Article 7) regulating the controls of these agencies, IRAs are defined as "boards, higher boards and institutions depended on them which are established by special law and endowed with public legal personality and administrative and financial autonomy". On the other hand, in the government decision about the implementation, coordination and monitoring of 2002 government program (Article 13/27), they are called as "regulatory and auditor agencies established by special law and endowed with public legal personality, and administrative and financial autonomy". In the circulation of Prime Ministry numbered 2002/46, they are called as "presidencies of boards and agencies constituted by laws and authorizations leaned on laws".[298]

In fact, the debates about the organizations, status, structures, duties, authorities and functions of these agencies will probably continue until a common definition and name are determined in legal documents. Yet, within the scope of this thesis, these agencies will be called as "independent regulatory agencies" which regulate the market.

IRAs themselves were specific and unfamiliar organizations for the Turkish administrative system and political culture, thus the creation of such highly autonomous authorities in the Turkish administrative system was problematic due to the Constitution of Turkish Republic, legal and juridical structure, and political and administrative systems.[299]

There are varieties of IRAs regulating the market, namely, the Capital Market Board (CMB) (Sermaye Piyasası Kurulu), the Competition Agency (CA) (Rekabet Kurumu), the Banking Regulation and Supervision Agency (BRSA) (Bankacılık Düzenleme ve Denetleme Kurumu), the Telecommunications Agency (TA) (Telekomünikasyon Kurumu), the Energy Market Regulation Agency (EMRA) (Enerji Piyasası Düzenleme Kurumu) etc..

[298] Türk Sanayicileri ve İşadamları Derneği (TÜSİAD), (2002). "Bağımsız Düzenleyici Kurumlar ve Türkiye Uygulaması". Issue no: 349/December, p. 150

[299] See Art. 123 of Turkish Republic Constitution, See also Karakılıç, p. 121-122 for further information

The IRAs in general has a relation with the economy, but those directly regulating the market are real authorities in their economic sectors and they are very important for their extensive decision-making powers directly shaping the conditions of the markets. By the year 2004, among IRAs, the CMB was organized board, others were organized as agencies whose boards constituted their decision-making organs. It is also important to note that the regulation of the CA is not restricted with a sector, but it is responsible for the regulation of the whole market about its function. Other IRAs are sectoral regulators responsible from the regulation of their related market domains only.

As already pointed out, one of the complexities making the analysis of IRAs difficult is the lack of agreement and clarity on many issues such as their definition, degree of independence, the scope of their authorities, the necessary control mechanisms on them; their organizational set up, their status, their pay and enrollment systems, necessary qualifications of their personnel, their place within the administrative system, their budget regimes, and finally their relations with executive, legislative and judicial organs. Another difficulty to analyze the Turkish case is that there are many IRAs in different sectors and they exhibit differences from the IRAs in other countries, and there are even crucial differences between the IRAs regulating different sectors.

Turkey has integrated IRAs into its administrative system in the 1990s and 2000s almost about two decades after its adoption of liberal economic policies replacing the previous state-led development policies.[300] The causes led policymakers to establish IRAs. Few of them are, firstly, the overwhelming and successive economic crises and the overpowering pressures coming from international agencies such as IMF and WB played the crucial role in the establishment of IRAs. Secondly, Turkey's accelerated drive for the European Union (EU) membership in the 1990s necessitated the meeting of some criteria of harmonization with EU Acquis[301], among which public sector reforms had a

[300] Sönmez Ümit, "Independent Regulatory Agencies: The World Experience and Turkish Case". Middle East Technical University Master Thesis, Ankara, 2004

[301] The term "acquis", of French origin, is used in European Union law to refer to the total body of EU law accumulated so far. During the process of the enlargement of the European Union, the acquis was divided into 31 chapters for the purpose of negotiation between the EU and the candidate member states for the fifth enlargement

considerable place. So IRAs are part of these reforms which aim at guaranteeing liberalization and competition in national markets.

IRAs were considered to be very functional to narrow the regulation authority of politicians in desired policy areas and indirectly, to insulate decision-making in key issues from the control of elected politicians. IRAs were propagated for increasing the capacity of government, rescuing markets from influence of elected politicians and providing an efficient, transparent and effective regulation in markets.[302] They were presented as the sole way of making credible commitments to the international actors for ensuring competition, impartial regulation and stable economic policies within the country. Though these functions and advantages of IRAs were voiced in the public and political agenda, other implicit goals of IRAs such as securing the maintenance of free market rules and taking the neo-liberal principles into consideration for determining of public policies were not claimed openly or were not discussed. Yet, IRAs would become vital initiator of the new public management reforms in Turkey.

Thirdly, in conjunction with the previous reasons, privatization process was also significant in the emergence and development of IRAs in Turkey. Starting from the 1980s, many public economic enterprises were privatized and some of the monopolized sensitive public policy areas such as telecommunications and energy industry were liberalized and opened to market competition. The uncontrolled provision of privatized public services within the conditions of free market, the fact that public companies run the risk of becoming private monopolies after privatization and the necessity of regulating of some strategic public policy areas in order to secure public interest and avoid the abuse of the basic rights and liberties of people played a key role in the emergence and justification of IRAs.

To correct the possible risks of the natural monopoly, externalities of private profit-seeking process, and to take necessary measures to make essential regulations and controls about the relations of firms within the market in accordance with market

[302] For instance See. TÜSİAD (2002)

principles were determined as the basic duties of the IRAs. In order to structures of IRAs in Turkey few utility sector agencies will be analyzed briefly below.

The Competition Agency (CA) which was established in 1994. CA was established by the law numbered 4054[303] for the protection of competition which was made in 1994 in order to avoid any contracts, decisions and applications that may hinder, spoil or restrict competition within the goods and services market and to make necessary rules, regulations and controls to provide maintenance of competitive relations. CA was authorized to provide competition, to determine conditions of competition and to implement the necessities of this law (Article 20).

Interestingly, CA was established in 1994, but could not start to function until 1997. As a result of the privatization process, CA was endowed with great rights to provide competition in the market and to avoid monopolization and malfunctioning of privatized public enterprises. The establishment of CA in 1994 and its delayed function for three years generated a critical debate. Turkey preferred to apply free market economy in the 1980s, but its basic institution (CA) was established lately in the 1994.

Three reasons may be allegedly stated for the late establishment of the CA.[304] the first one is that political authorities decided to change economic policies in the 1980s, but did not establish its institutions. Secondly, Turkey has been trying to become a member of European Union (EU) and this process accelerated by the 1990s. As a part of this process, Turkey applied to be a member of the Customs Union and the EU requested from Turkey to make necessary structural reforms for the provision of a competitive environment in its internal market and to make necessary adjustment changes in accordance with the European Customs Union Treaty. As a result, politicians decided to make a law regulating competition only after such a process. Turkey signed the Customs Union Treaty with EU on 6 March 1995 and establishment of a CA in compliance with

[303] It was published in Official Gazette on 13 December 1994.
[304] Sönmez, p. 156

competition authorities in Europe was a norm of that treaty.[305] Thirdly, privatization policies were initiated in the 1980s in order to create a free market economy and to achieve economic growth through market. Unfortunately, on the one hand, some privatized monopoly enterprises tried to maintain their monopoly status in the market and on the other hand, private firms, in general, tried to maximize their profits by not abiding by competition principles, welfare of society and the general norms of the market.

The absence of a competition authority deepened these problems. To sum up, CA was seen as an indispensable organ for both providing competitive relations in the market and accelerating the privatization process.

Telecommunications Agency[306] (TA) was established by the law numbered 4502 on 27 January 2000 to provide the functions stipulated in the Radiotelegram Law numbered 2813 and the Telegraph and Telephone Law numbered 406. It started to function on 15 August 2000. It was authorized to make regulations and control and to take necessary measures for the development and proper-functioning of telecommunications sector. The transformation of Turkish Telecom (Türk Telekom) from a public entrepreneurship into a joint-venture, and the liberalization and regulation reform program within the telecommunications sector was also promised in an economic credit contract made between the Turkey and the International Reconstruction and Development Bank in 2000.

Paradoxically, within the law of TA, it was stated that TA was both an independent and autonomous agency.[307] These concepts imply very different meanings in administrative and judicial regulations, but law-makers do not see a problem in using them interchangeably. When one looks at the functions of TA in the law, it is stated that it could use its authorities independently.[308] Similar paradoxes are also found in other

[305] Akıncı, Müslüm,. "Bağımsız İdari Otoriteler ve Ombudsman". İstanbul: Beta Publications. 1999, p. 225
[306] See www.tk.gov.tr
[307] Ulusoy, Ali, 2003. "Bağımsız İdari Otoriteler". Ankara: Turhan Publications, p. 145
[308] The Article 14 of the Law numbered 4502 making a change in the Article 5 of the Law numbered 2813.

laws of IRAs because of the very difficult task by the law-makers to adjust IRAs to the Turkish legal order and system.

Energy Market Regulation Agency (EMRA) was established by the Electricity Market Law numbered 4628 on 20 February 2001 in order to regulate the electricity sector. Then, another law numbered 4646 about the natural gas market was issued for the regulation of natural gas market two months later and the Electricity Market Regulation Agency was transformed into EMRA by a revision made in the law numbered 4628 by the law numbered 4646, and the EMRA started to function on 19 November 2001.

EMRA was authorized to make regulations and control on all the acts and actions related to energy sector, to contribute providence of enough, qualified, and less-costly electricity and natural gas to consumers and to provide a competitive, stable and transparent energy market. Similar to other IRAs, the establishment of EMRA was also promised to the IMF as a precondition of receiving debt in 2000.[309] There are a lot of inconsistent regulations about the EMRA such as confusingly establishing two different representation organs for the agency (in Article 4 of the law, the decision board of agency is regulated as representative of the agency, but in Article 5, the chairman of the agency is stated as the representative of the agency).

IRAs are endowed with extensive regulatory powers.[310] Their regulatory powers encompass the authority of giving permission, and the authority of issuing rules, circulars (genelge), by-laws (yönetmelik), communiqués (tebliğ), and qualified binding decisions (özel nitelikli bağlayıcı kararlar). First of all, IRAs are public legal personalities, so they can issue by-laws to determine the details and application of laws and regulations (tüzük) related with their policy areas, but these by-laws cannot include articles transcending the context and scope of the laws which they are leaned to (Constitution of the Turkish Republic, Article 124)

[309] Sönmez, p. 162
[310] For further information See Ardıyok, p. 176-209

On the other hand, IRAs are also authorized to control and supervise the acts and actions of actors within the market and impose sanctions on them in the case of adversity disobedience to rules and regulations or non-compliance with general principles of market.

IRAs are not only responsible for well-functioning of markets, but they are also responsible for development of markets. They are authorized to make all the necessary actions that will contribute to the development of market economy, and an important part of this duty is undoubtedly to provide consultative services to public organizations within the state sector, especially to the political and bureaucratic agencies determining macro economic policies, and the private organizations such as regulated firms and corporations. Furthermore, one of the specific functions of IRAs is their conflict resolution powers.

In Turkey, IRAs are legally defined as agencies having public legal personality[311], possessing administrative and financial autonomy and independent in performing their functions in general. IRAs are endowed with enormous regulatory, control and sanction authorities which have caused interpretations evaluating them as the 'fourth branch of government'.

There are still many legal deficiencies, inconsistencies and contrasting points about the role, status, authorities, functions and place of IRAs in Turkish legal system. There is even no consistency in terms of organization, independence rate or powers between the IRAs regulating different sectors in Turkey. However, it should also be taken into consideration that there is even no standard model of IRAs in the world

[311] They are organized as public legal personalities in Turkish administrative system (different from IRAs in France), because they can issue regulatory acts such as by-laws only by this way according to the Turkish Legal System.

In spite of the complicated and contrasting regulations about IRAs in Turkey and various discussions about what should be the suitable status, powers, functions, and place of them in Turkish administrative system, it is still possible to derive some general conclusions.[312]

First of all, all the IRAs enjoy an important degree of autonomy from the political control. This is done through statutory appointment procedures, and administrative, human resources and budgetary autonomy. Secondly, all of them are established by special laws, have public legal personality and possess crucial regulatory, control and sanction authorities in their policy-areas. Thirdly, the acts and actions of all IRAs are subject to judicial control. There is no hierarchical or administrative tutelage control on them. Fourthly, the members of the IRAs are appointed by the Council of Ministers directly (in EMRA), or among the candidates nominated by the ministers, representatives the capital and labor organizations and some NGOs related to regulated sectors (CA, TA, CMB, or only by the proposal of the related minister Banking Regulation and Supervision Agency (BRSA).

Fifthly, the number of the members of the decision-making boards of IRAs varies between five and eleven. Sixthly, there are important qualification requirements stipulated by laws and these include experience and professional credentials (e.g. degrees in law, economy, finance, business administration, political science). Seventhly, the members of IRAs are also governed by the civil service law, so they cannot be members of a political party. Eighthly, IRAs' resources are primarily funded on the basis of fees for licenses/permits, fines and levies. As above-mentioned, Turkey has a long path in liberalization process; however, regulatory reforms should be achieved and proper regulation should be applied decidedly.

[312] Sönmez, p. 195

VII. CONCLUSION

The main aim of this study is basically to emphasize the EU regulatory policy regarding natural monopolies in the liberalization process and regulatory agencies which are having a post of great responsibility.

One of the most dramatic economic developments in the final two decades of the twentieth century was the demonopolization and liberalization of industries which for many years had been preserved of state-owned monopolies; in many cases this process was coupled with privatization or partial privatization of state-owned undertakings. The problems for competition policy that arise where former monopolists are released into the free market are obvious. Therefore there is no effective competition, they may be able to charge excessive prices and they may also be able to adopt tactics intended to foreclose new competitors from entering the market. Besides, it is necessary to ensure that former monopolists provide adequate services of an appropriate standard. Thence, regulatory agencies emerge in order to maintain competitive market in these sectors.

In this context, in the course of the 1990s, the European Union (EU) embarked on an ambitious regulatory reform programme for a number of European network industries, such as telecommunications, energy and transport. All these sectors are characterized by the presence of a bottleneck infrastructure with natural monopoly characteristics, which makes it difficult to introduce and safeguard competition in these industries. However, further progress with regulatory reforms in these sectors designed to enhance the level of competition was an important part of the Lisbon agenda for economic reform launched by the European Council in 2000.[313] The European Union Commission has announced its regulation policy "less action, but better action".

[313] Reiner Martin & Moreno Roma &Vansteenkiste Isabel, "Regulatory Reforms in Selected EU Network Industries", (2005), European Central Bank, Occasional Paper Series April, No.28, p. 6

The EU recognize that these duties cannot be efficiently executed unless the regulators are given some freedom to exercise their competencies. It therefore provides that their execution shall be by independent regulators set up by the member states. A fully liberated and competitive common market cannot be attained without effective and independent regulators who are free from encumbrances, especially of industry operators and government. Liberation process of these sectors will have long run however, it will be completed.

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EC LEGISLATION

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