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Regulatory Reform
Lessons from Western Europe for Eastern Europe

Peter Nijkamp
André Oosterman

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REGULATORY REFORM

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Peter Nijkamp

André Oosterman

Dept of Economics
Free University
Amsterdam
The Netherlands

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1 Introduction

Since the mid **1970s**, a number of Western European countries has actively been engaged in substantial regulatory reform. Unnecessary regulation has been removed from various areas of the economy in which public control was previously rigorously applied, while in other areas where regulation still remains appropriate at least the methods and the intensity of regulation have been reassessed. The process of regulatory reform has been most actively pursued in France and the UK, but it has been undertaken to varying degrees in virtually all European countries. The poor performance of many public enterprises' (hereafter **PEs**) has been the main impetus for this reform movement, but reform has also been pursued to improve the performance of private firms (cf. Amsden, 1994). In recent years, regulatory reform has become a big political movement in Eastern Europe (see also Domanski, 1992, and Domanski and Judge, 1994).

The growing interest in regulatory reform is based on two ideas: (1) the efficiency of an enterprise - public or private - is higher as the enterprise is forced to maximize profits in a competitive market, and (2) public enterprises are more likely to deviate from profit maximization than their private counterparts. Proponents of regulatory reform argue that **the removal of market restrictions**, together with **various forms of privatization**, will improve the economic performance of both public and private enterprises and thereby of an economy as a whole (e.g., nation, region or city). Both forms of regulatory reform will be discussed in Section 2.

In some circumstances however, it is either impossible or inefficient to create competitive markets. These circumstances, which justify public ownership or other forms of government regulation, are elaborated upon in Section 3. In most cases however, regulatory reform is likely to lead to more efficient enterprises. Section 4 focuses in more detail on the reasons for reform, notably improved efficiency and the reduction of public sector deficits.

¹ A public enterprise is a government owned productive organization that:

- (i) is expected to **earn** a significant portion of its revenues from the sale of goods it produces;
- (ii) possesses an accounting system separate from any government agency that controls or supervises it; and
- (ii) is a distinct legal entity.

While the first half of this report considers regulatory reform from a more general and theoretical point of view, the remaining sections present the facts. Section 5 examines the main effects of reform on the performance of now deregulated sectors in Western Europe, with an emphasis on the important influence of competitive pressures. Section 6 then pays attention to the basic prerequisites for reform in a non-market economy. This section draws heavily on the recent privatization experiments in the Central and Eastern European countries. Concluding remarks are presented in section 7.

2 What is Regulatory Reform?

In this paper, we define regulatory reform as all government actions concerned with procedural, legislative or controlling aspects of economic life which intend to improve the economic efficiency of public and private enterprises. We distinguish two broad types of regulatory reform: (1) competition policy, and (2) privatization.

The most far reaching control is of course a transition from a centrally planned economy to a market-oriented economy, but also deregulation policy (e.g., in the aviation and **telecommunications** sector) is a good example of regulatory reform.

2.1 Competition policy

The notion of ‘a level playing field’ is central to competition policy. Product markets are most efficient if all enterprises in the market place are essentially in the same position to compete. In many economic sectors, there is no such level playing field. Public enterprises often operate in sheltered markets. They enjoy distinct advantages over their competitors, such as preferential access to credit, subsidies to cover operating losses and privileges of tax exemption (in principle, private companies might enjoy similar advantages, but this is seldom the case). These public enterprises are not exposed to the discipline of the market and are therefore less motivated to increase efficiency than firms operating in competitive markets.

The aim of competition policy is in general the creation of conditions approximating those of efficient and effective private markets. Important instruments to abolish barriers to competition are the removal of regulations on prices, entry and exit, output, international

trade, the amount of profit companies are permitted to earn, etc. Another instrument is the relaxation of public or private monopolies (antitrust law). In some circumstances though, competitive markets are either impossible or inefficient (see for details Subsection 3.3). But even then, competition policy can still play a role in improving the performance of **PEs** and private firms.

It is important to note that full competition is not essential to achieve desired competition: the threat of competition may be sufficient. A monopolist is said to operate in a **contestable** market when his behaviour approximates that of a competitive firm. If other firms can easily enter this market, the monopolist is forced to keep prices close to costs. It goes without saying that even the existence of contestable markets creates substantial transition problems to firms which have always been operating in protected markets, as is witnessed by many experiences in Eastern Europe.

2.2 Privatization

Privatization is the general process of involving the private sector in **the ownership** or **operation** of a public enterprise. There are various ways in which the private sector can assume the responsibility of activities which were formerly undertaken by the public sector. In case the private sector assumes ownership of (part) of a public enterprise, a **sale** is involved. But a change in ownership is not a necessary element of privatization. **Contracting out** is perhaps the most common form of privatization, having been widely used in the local public services (such as refuse collection, catering, and cleaning). Finally, it should be noted that there is also the possibility that the private sector will assume responsibility for the management of an enterprise, which continues to be owned by the state (**lease, franchise, management contract**). **Thus**, there is a wide spectrum of privatization initiatives and forms.

In order to understand the reasons (or even necessities) for regulatory reform, it is important to know why - and under which conditions - regulation of economic life is desirable. Some principles for market intervention will be outlined in Section 3.

3 Reasons for Regulation

A major justification for government regulation of economic markets is the view that private markets can fail to secure efficient outcomes. Under certain well defined conditions (such as full information, large number of firms, free entry to the market etc.), competitive markets cause firms to produce efficiently goods that meet consumers' requirements at prices which reflect the relative costs of supply. At the same time, only firms that operate on a cost-efficient basis are able to ensure their continuity, while those operating in a non-efficient way will be vulnerable to takeovers, or eventually will even go bankrupt. When the above conditions do not apply however, markets may fail. In such circumstances, governments frequently intervene through public ownership or other forms of regulation, intending to remedy the *market failure*. Before discussing the main economic reasons that warrant regulation, we first turn to reasons of a social and political nature.

3.1 Social reasons

Historically, regulation has been justified on a variety of non-economic grounds related to the public interest, such as the need to maintain a particular industry for reasons of national security to ensure a nationwide network of services or to protect and encourage a new industry (the 'infant industry' argument), or • in the case of banking and insurance • to maintain the prudential supervision of people's savings. In addition, regulations on entry, prices and profits in particular industries, such as road haulage and airlines, grew significantly already in and after the Great Depression period when it was thought that excessive or destructive competition would occur, resulting in price wars, bankruptcy and unemployment. This claim of instability was often advanced by the industry itself, but seldom justified by empirical and observed facts.

3.2 Political reasons

In some countries, political groups have used regulation to pursue various objectives, which are often in conflict with sound economic management. Regulation has enabled them, among other things, to appoint loyalists as managers, to set prices in order to

satisfy certain distinct interest groups, to create employment or to foster regional development. In many such cases, the motives behind policy intervention did not rest on economic grounds, but on political power or election arguments. The remainder of this paper will now focus on the economic rationale for regulatory reform.

3.3 Economic reasons

Two broad types of market failure can be identified which can justify regulation on economic grounds: circumstances where competitive solutions do not exist (natural monopoly) and circumstances where they exist but are not efficient (because of externalities and information asymmetry). Each will be discussed in turn, beginning with those markets in which competitive solutions do not appear to exist.

Natural monopoly

A natural monopoly arises when the least cost method of production can be achieved by a single plant or firm rather than by multiple plants or firms. If only one output is produced, a condition for a natural monopoly is the existence of economies of scale. In the event that more than one output is produced, then a necessary condition is the existence of economies of scope (the cost of producing several outputs jointly is less than the cost of producing them separately). Natural monopolies are most common in industries with major distribution networks, which imply substantial fixed costs, such as gas, electricity and railways. In these sectors, provision by a single supplier is the most efficient outcome, because it avoids wasteful duplication. Competition would appear incompatible with efficient production.

A natural monopoly however, should not be seen as a static concept that is **fixed** forever. Rather, it is determined by technology, market developments and organizational structure. The effect of changing technological developments can be demonstrated in the broadcasting industry. Here, monopolistic supply, based on a natural monopoly (i.e., the scarcity of available wave lengths) has been ended by the development of competitive cable and satellite broadcasting systems. Conversely, technological developments may give rise to new natural monopolies due to the existence of significant economies of scale (e.g. airline reservation systems).

Furthermore, the existence of a natural monopoly could tempt the regulator to regard all

operations of the company as a natural monopoly. However, many parts of such a business may be competitive; for example, electricity supply includes a natural monopoly in transmission, but potential competition in the generation and supply of user equipment. To treat these activities as if they were all natural monopolies would bring about considerable efficiency losses.

Externalities

Externalities arise in situations where the production or consumption of a certain good has effects which extend beyond those who are directly concerned with that production or consumption. The most commonly used example is that of pollution, whereby a producer imposes on the wider community costs that are not reflected in its own costs. This particular form of market failure has led to a host of government environmental or safety regulations or to the regulation of a number of particular industries (e.g., water).

Asymmetric information

One of the preconditions for a market to be competitive is some degree of equality of information between consumers and producers. This equality is often absent however, particularly when the good or service being provided has a large information content or is purchased infrequently. Complex goods and specialist advice inevitably suffer from information asymmetry. It is the additional information possessed by the specialist that the consumer is purchasing; thus the consumer faces considerable difficulties in evaluating the quality of the information provided. The supplier may therefore be able to perform inefficiently, yet not be penalised by loss of business. Again, there is a *prima facie* governmental role in remedying this particular market failure, particularly by requiring the provision of information by suppliers or by facilitating an independent market for information to purchasers.

3.4 Competition policy and market failure

In case of market failure, competition policy can still be useful to prevent economically inefficient behaviour of monopolistic suppliers. In this setting, competition policy encompasses both ***structural regulation*** - concerned with the structure of an industry - and conduct ***regulation*** - concerned with the behaviour of actors within an industry.

Structural regulation takes place when the regulatory authority determines which firms are allowed or required to engage in particular activities. It seeks to rule out business options which may be desirable from the company's perspective, (e.g., entry into another industry), but which are undesirable from a public interest viewpoint.

Thus, in order to prevent excess capacity in certain sectors, entry regulation has sometimes been introduced (for instance, by limiting the number of licenses awarded to firms to operate in a certain industry). Likewise, exit regulation can ensure that a company does not withdraw from activities that have a social benefit but are inefficient from the company's viewpoint.

In some countries, governments have attempted to direct the behaviour of monopolies by focusing on particular aspects of their conduct. The most common approach is to require monopolies to carry out their activities without earning the 'abnormal' profits that normally follow monopolistic competition. Since however, in various cases such monopolistic profits flow into the government's pockets (e.g., in case of public telephone companies), governments are not strongly encouraged to change this situation. However, the protected nature of such monopolies makes them often inefficient, inert and bureaucratic without a view on the efficient provision of client services. And therefore, some form of deregulation may still be necessary. This will be discussed in slightly more detail in Section 4.

4 Reasons for Deregulation

As said before, the main impetus for the reform movement has been the poor performance of **PEs**. Later on, deregulation has also been undertaken to improve the efficiency of private firms. It is assumed that privatization can lead to increases in *productive efficiency* (that is, to lower production costs), while the removal of market restrictions can increase both productive efficiency and *allocative efficiency* (that is, to lead to a structure of output that is more highly valued, given the social costs of production). To illustrate these concepts: a chemical company that invests heavily in labour-saving machinery, but economizes on pollution controls, will probably increase its productive efficiency (lower **labour** costs), but reduce its allocative efficiency (more pollution).

Both competition policy and privatization are primarily seen as a means of improving the efficiency of enterprises. Next to this argument, there are other reasons for privatization, which will also be discussed in this section.

4.1 Improving efficiency

Productive efficiency

A number of different arguments suggests that the privatization of a PE will increase productive efficiency. The major arguments, which we will discuss below, are: (1) the impact of reduced political interference, (2) a change in property rights, and (3) a more effective financial management. It is important to note that these arguments hold for monopolistic markets as well as for markets where competition is possible and desirable. Thus, from an economic point of view, privatization is practically always desirable. The question whether or not to involve the private sector, is therefore mainly a social one (cf. Subsection 2.1).

If PE managers cannot make decisions independently of the demands of political expediency, privatization should improve the quality of managerial decision making. Effective regulation can remove sources of economic inefficiency, such as anticompetitive practices and attempts by politicians to affect economic decisions. Such attempts include: social obligations to provide essential services, sales of products below costs, and the provision of employment. To the extent that these objectives must be traded off against commercial objectives, **PEs** are bound to be less efficient than private firms. In addition, the existence of private shareholders, who have a strong interest in the performance of public enterprises, will force politicians to act more responsibly.

Generally speaking, private shareholders are better informed and more demanding principals than governments, because they share more directly the benefits and costs of the way a firm is managed. They will therefore set up efficient monitoring and incentive systems (such as bonus payments or profit sharing), that will force managers to be more efficient. It is unlikely that such systems will evolve without pressure from a group of private shareholders. In various countries, PE managers have been reluctant to devise monitoring and incentive systems, primarily to evade accountability and retain control.

In a privatized environment, an enterprise will be subject to the discipline imposed by the private capital market and the market for corporate control. This again, will force managers to improve economic efficiency, in order to prevent a bankruptcy or takeover.

Allocative efficiency

While privatization may be expected to produce some gains in productive efficiency, there is no reason to expect improvements in allocative efficiency. Allocative efficiency is a function of market structure rather than ownership. In the initial absence of competition, gains from allocative efficiency can only be expected if privatization is accompanied by competition policy to remove market restrictions.

This can be illustrated by the following example: if a government keeps interest rates artificially low, enterprises will be stimulated to engage in capital-intensive activities. Privatization will not solve this problem, since a profit-maximizing private firm will still respond to this wrong signal. Moreover, the pressure of competition - which requires private enterprises to seek out opportunities to make profits in order to minimize the risk of takeover or bankruptcy - rather than changes in ownership may be a more significant source of productive efficiency. Figure 4.1 summarizes the appropriate actions and results in situations where market failure is either absent or present.

Figure 4.1 The reform matrix

SITUATION	ACTION	RESULT
Market failure	regulate monopoly (and privatize if socially acceptable)	improved productive efficiency
No market failure	privatization	improved productive efficiency
	competition policy	improved allocative efficiency

4.2 Other reasons for deregulation: the benefits of privatization

Through privatization, an enterprise can **gain access to private sector financing**, and private owners may create access to new markets (for instance, Exxon buys an Albanian oil company). If the sale of public sector assets can be made attractive to small investors, this will **broaden share ownership**, which may be thought desirable (this argument has played an important role in recent UK discussions). Privatization may also spur the **development of domestic capital markets**.

Privatization may also benefit enterprises that remain within the public sector. For these enterprises, increased efficiency will result principally from **improvements to existing monitoring and incentive mechanisms**. If a significant number of public enterprises can be transferred to the private sector, the government should be better placed to **focus on the performance** of those enterprises that it remains responsible for.

A very important benefit of privatization, and indeed **the** reason why many governments have become interested in regulatory reform, is that it may lead to a **reduction in public sector benefits**. This benefit must not be overestimated, however. If a government sells a public enterprise, the future income streams of the company are foregone. In competitive capital markets, the sale proceeds will equal the discounted income streams. Thus, all things equal, the public sector deficit will improve in the year of the sale, but will slightly deteriorate in the years following the privatization.

We know that the main argument to support privatization is that an enterprise's income stream will improve if ownership is transferred to the private sector **because of increases in efficiency**. These improvements do not arise simply from a transfer in ownership, but from concrete actions and strategies that raise productivity or reduce costs. Such actions can in principle be taken in either the public sector or the private sector, and when they occur in the public sector they will directly benefit the government. When efficiency gains are only feasible under private ownership, governments selling a PE can share these gains by (1) setting the sales price to a level that reflects at least part of the improvement, and (2) by taxing the higher profits that result. In other words, the sale of a PE has only a positive effect on public finances if the sale leads to improved efficiency. It goes without saying that especially the recent transfers of previous **PEs** in Eastern Europe have provoked many discussions on the degree of efficiency to be achieved through a transition

to a market economy.

5 Lessons from Western Europe

5.1 A changing pattern

Since the late 1970s the pattern of government intervention in the economy has altered across most West European countries. There has been a movement away from public ownership towards the removal of market barriers and towards privatization. Two key factors were underlying this changing approach towards regulation. The first is the growing awareness of regulatory failure. The experience of several decades of government regulation has led to a growing recognition that failure is not confined to markets - governments can also fail (see Button and Barde, 1991; Fokkema and Nijkamp, 1994). Interventions intended to correct market failure have often adverse, although unintended consequences for the achievement of efficiency. The second factor centres around technological changes and a better understanding of organizational structure and **behaviour**. This factor has already been discussed in Subsection 3.3: governments have become aware of the fact that natural monopolies are not fixed forever, nor that the existence of a natural monopoly should lead the regulator to regard all operations of the company as a natural monopoly.

This changing approach has altered the scope of regulatory reform. Historically, attention was mainly paid to the rehabilitation and restructuring of individual companies. But since the **1980s**, sector-wide and economy-wide actions have been undertaken in many European countries.

5.2 Five lessons

There have been numerous studies concerning the effects of regulatory reform on the performance of public and private enterprises. The outcomes of these studies must be treated with caution, since (1) it is difficult to isolate the effects of reform from other influences, and (2) it is difficult to establish the counter-factual story (what would have

happened if the reform programme were not undertaken). Still, these studies may lead to a number of general strategic conclusions.

In situations where product markets are competitive, public and private enterprises perform more efficiently than when competition is absent.

This means that in cases where there has been effective (i.e., market-orientated) regulation, there have also been efficiency gains for all actors. Almost all evidence concerning deregulation supports the view that competitive behaviour tends to stimulate overall economic efficiency. In the UK, for example, competition in such sectors as express coach services, telecoms apparatus and domestic air services has widened choice, and, to varying extents, cut prices. New entry has occurred on a number of domestic air routes, and new routes have been established in long-distance express coaching. As regards road haulage, which several Western European countries have deregulated over a period of 20 years or more, the positive results have clearly outweighed any disbenefits. Typically, following deregulation there have been an influx of new entrants **socalled incubent** firms, a fall in rates, and increased level of services and increases in employment.

In cases where product markets are competitive, the performance of PEs may match that of privately owned rivals.

The reason is that **PEs** cannot allow themselves to act inefficiently, as then competitive forces would drive them out of the market. In the UK, again, regulatory reform in the form of contracting out, such as refuse collection and hospital cleaning, has resulted in significant cost savings. However, public sector suppliers have been able to win contracts by matching the efficiency of private sector competitors. The more important influence on performance is competition rather than ownership. Nevertheless, publicly owned companies in competitive markets may be hindered by regulatory constraints. Some of the most successful UK privatizations have been of companies operating in competitive markets, where management seems to have taken advantage of the greater freedom and incentives available in the private sector.

In situations where product market competition is absent or partial, the results are mixed.

Competition is **the** general driving force for efficiency gains. Studies of sectors ranging from electric utilities in France and insurance services in West Germany show no general support for the view that private firms are more efficient than **PEs** in noncompetitive circumstances. On the other hand, UK utilities which were publicly owned in 1979 and

subsequently privatized have improved their efficiency over the last decade. All industries concerned appear to have registered substantial productivity gains, and in most cases the improvement has been considerable.

In case of a drastic regulatory reform, the transaction costs of privatisation of **PEs** may be extremely high (including loss of employment in the short run), but most sectors have in the medium-term gained efficiency through competition.

There are several countries which have witnessed drastic changes in regulatory systems regarding public utilities, public transport companies etc. In most countries the resulting privatisation has led to an increase in service levels or a decline in prices (or in both). Thus it seems a plausible assumption that transaction costs can be offset by efficiency gains in the long run.

Expected negative social and economic consequences of deregulation, namely that safety standards would fall and unemployment would rise, are not supported by experiences in those sectors where information is available.

In British road transport, for example, the search for efficiency has resulted in a reduction in real wages to drivers, but employment seems to benefit. In the UK, drivers' wages were above the average industrial level before deregulation, but have since tended towards the average, suggesting that drivers were sharing in the rents created by entry restriction under regulation. Employment in the industry has generally increased or has declined less than the average for manufacturing industry during recession.

In terms of safety, the record is also positive. Countries which have begun economic deregulation in either the airline or road transport sector have uniformly maintained and improved existing safety regulations. Further, accident rates have nowhere increased following regulatory reform and in some cases have actually decreased, typically following a downward trend established prior to deregulation.

In the next section we will outline the relevance of these lessons from Western Europe for Eastern Europe.

6 Regulatory Reform in Non-Market Economies

So far, regulatory reform has been discussed within the framework of a market economy. In the Western European market economies, the share of public enterprise output in gross domestic product (GDP) has always been relatively small. In the mid **1970s**, for instance, it varied from 4 percent in the Netherlands to 15 percent in Austria. In non-market and notably centrally planned economies, the process of regulatory reform is a much more difficult and complex process. Virtually the entire economy has been (or still is) controlled by the state. It has also led to an outdated infrastructure (Jenkins, 1993).

In recent years, many former socialist economies have gone through a process of substantial reforms. Despite country-specific features, the common basic feature of this transformation is greater decentralization and more reliance on market forces. Especially the countries of Central and Eastern Europe (**CEEs**) are moving rapidly to transform their economies from socialist systems based on centralized ownership towards a **market-oriented** system characterized by relatively unregulated activity. Within the scope of this study, it is interesting to point out various lessons these countries have learned in the meantime. It turns out that essentially there are two basic prerequisites for effective implementation of regulatory reform: (1) a solid macroeconomic support framework, and (2) a strong and commonly accepted political will.

6.1 A solid macroeconomic framework

In Western Europe, most conditions for effective regulatory reform have been existent, even before the reform movement began. Two very important conditions for such a transformation process are an appropriate legal framework for market activities and principles and a fairly developed capital market. A *capital market* is essential for monitoring the performance of private enterprises. Banks and shareholders only invest in viable firms, thereby ensuring that only efficient firms will remain in the market (Pronk, 1994). Furthermore, it is the main vehicle for the valuation and subsequent sale of **PEs**.

Many laws that are a sine qua non for competitive markets, did simply not exist in many Central and European countries (**Bos and Oskam, 1994**). In a market economy, a legal framework has at least four basic economic functions: (1) to define the universe of

property rights in the system (constitution, specific property laws), (2) to set a framework for exchanging those rights (contract law), (3) to set the rules for the entry and exit of actors into and out of productive activities (company law and foreign investment law, bankruptcy and liquidation law), and (4) to oversee market structure and market **behaviour** to promote competition (antimonopoly law, unfair competition law). After some period of sometimes desparate experimentation most **CEEs** have now recognized that also a market needs regulation and have wisely embedded privatization in a programme of broad liberalization and reform.

Another stumbling block for **CEEs** has been the enormous number of market barriers (notably overvalued exchange rates, negative real interest rates, excessive protection and widespread price controls). As regulatory reform in Western Europe meant the removal of a few barriers in a small part of the economy, for **CEEs** it has meant the removal of numerous barriers throughout the entire economy. Because of the sheer magnitude and complexity of deregulation, (which was found necessary to be undertaken), the outcomes of the reform measures were difficult to predict. Regulatory reform though, has almost always inflicted severe and visible social costs on the short term (i.e., unemployment). Most **CEEs** have accommodated this by social safety nets. To overcome this insecurity and adverse effects in the short run, a strong political will is essential. Such a dedication appeared to be a sine qua non in order to make the step forward to a promising market system.

6.2 Strong political will

Regulatory reform is expected to bring about better economic performance. This has indeed happened in former **CEEs**. But it was also soon recognized that regions with a high concentration of state-owned companies were facing unprecedented rises in unemployment (see Jalowiecki, 1994 and Szlachta, 1995). To solve such painful processes, much sociopolitical will and dedication is needed, as otherwise the societal basis for transformation will be eroded (Onyszkiewicz, 1993).

Regulatory reform is a highly political process, for which a single institutional pattern does not exist (**Gacs** et al., 1993). Broad-based public support is needed in order to sustain rapid progress. Regulators, and especially privatization institutions, should aim for the highest degree of support and publicity for their objectives and achievements. Even

more important is the direct involvement of the public in the privatization process, either through mass privatization schemes or specific incentives for small domestic investors. Otherwise, countervailancy powers will delay the transformation process. Broad social commitment can be built by informing and consulting all interest groups involved. Most CEEs have also found it important to design a reform package which is perceived as equitable for all segments of society.

7 Conclusion

Since the **mid-1970s**, many Western European countries have undertaken substantial regulatory reform. The growing appeal for competition policy and privatization is based on the ideas that (1) the efficiency of an enterprise is highest when the enterprise strives for profits maximization in a competitive market, and (2) public enterprises are more likely to deviate from profit maximization than their private counterparts. Thus, it is assumed that regulatory reform can in principle be a powerful weapon to improve the efficiency of both private and public enterprises and thereby of an economy as a whole.

These ideas have largely been confirmed by studies on the effects of regulatory reform on the performance of public and private firms. The following general lessons can be learned for Western European experiences:

- Where product markets are competitive, public and private enterprises perform more efficiently than when competition is absent.
- Where product markets are competitive, the performance of **PEs** - if they are not hindered by regulatory constraints - may match that of privately owned rivals.
- Where product market competition is absent, or partial, the results are mixed.
- A frequently voiced fear that safety standards would fall and unemployment would rise after regulatory reform, do not find empirical support in those sectors where information is available.

To summarize these lessons: competition is more important than ownership.

It should be added that there is a variety of regulatory reforms, not only in the framework of a market economy but also in that of centrally planned economies. Reform is a much more difficult and complex process in non-market economies. Competition policy and privatization appear to be only effective when they are backed by a solid macroeconomic

framework and a strong political will. In this respect, due support from the West for **CEEs** will be necessary for many years to come, a plea also made in a recent study of the Philip Morris Institute (1994).

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