Sectoral Regulation in Austria before and after EU Accession – The Network Industries as a Case in Point

Jürgen Janger

The network industries, which had been organized in a monopolistic fashion up to Austria's EU accession, were opened to competition following a number of EU Directives and are now mostly regulated by sector-specific authorities. This fundamental change to the regulatory system has so far developed quite positively, both in economic terms and from a regulatory perspective regarding the transparency of these authorities' decision-making processes. Accession to the EU served as an essential catalyst for reforming the relevant regulations, which had come to meet their original purpose of correcting market failures only in part. Thus, Austria's EU entry extended the principle of competition from the already exposed manufacturing sector to other sectors of the Austrian economy. However, chances are that the network industries would have been opened to competition even without Austria joining the EU, e.g. on account of its WTO membership or the discrimination against other sectors which would eventually have demanded such reforms.

1 Introduction

This study uses the term *regulation* in its economic sense as the sum of all regulations which the state employs to interfere in the decision-making autonomy of economic agents. On the one hand, this basically encompasses the creation of prerequisites for efficiently functioning markets, which can yield positive results (correction of market failure in the form of falling average cost, of externalities or information asymmetries, etc.) as well as negative effects (regulatory failure). A complete lack of regulations impedes markets, translating into legal uncertainty for transactions and thus high transaction costs, just as much as ineffective regulations that may, for example, isolate markets and thus provide an unfair advantage for the regulated industries. Regulations may be adequate when they are introduced, but can lose their function over time. Given the ever changing environment for functioning markets (e.g. technologies, advances in regulatory practice), the regulatory debate will continue to evolve. On the other hand, regulation may be used to consciously restrain market forces with a view to enforcing societal or governmental objectives.

Regulation is closely related to *deregulation*, *privatization*, and *liberalization*. The term *deregulation* is to be understood economically as a qualitative reduction of market barriers to introduce or reinforce competition; however, it may go hand in hand with a purely quantitative increase of the body of regulations ("re-regulation" of the sectors opened to competition)[1] (Mantl, 1995a).

The issue of regulation is currently the subject of heated debates as a supposed phenomenon accompanying globalization, cropping up, for instance, in the discussion of the liberalization of public services. However, the issue has been a factor in economic policy since the 19th century, when rail tariffs were regulated in the U.S.A.; fundamental contributions in the field of economic theory were published between 1960 and 1980. Air traffic was the first U.S. sector to be opened to competition under President Carter (1978 Airline Deregulation Act). In Austria, too, discussions of the topic can be traced back a while (see, for example, Kaufer and Smekal, 1983), e.g. with regard to the industrial production plant law, the Industrial Code (*Gewerbeordnung*) and the regulation of free-lance professionals.

Refereed by Werner Teufelsbauer, ret. Head of Economic Policy Department, WKO (Austrian Federal Economic Chamber).

[1] *From a legal perspective, deregulation denotes the actual quantitative reduction of government regulation (e.g. when laws are revised for obsolete stipulations).*

This study offers only an excerpt from the regulation discussion in looking more closely at the development of regulations concerning market entry and market behavior in the network sectors in Austria before and after EU accession (section 2), its economic effects (section 3), as well as the agents of change (section 4). Network industries are especially interesting as they underwent the most sweeping changes. Section 5 draws conclusions and offers an outlook on future developments.

2 Sectoral Regulation in Austria before and after EU Accession

2.1 Shift to External Regulation and Opening of Markets

Based on the assumption of a natural monopoly, grid-based services have traditionally been provided by private-sector companies in the U.S.A., regulated by sector-specific authorities. Like anywhere else in Europe (Majone, 1996), Austria originally pursued an approach of state-owned enterprises directly accountable to ministers and government, i.e. classic command-and-control regulation. In simple terms, the systemic contrast was described as internal versus external regulation (Nowotny, 1999). Teufelsbauer (1983) summarizes the pillars of internal regulation in Austria based on the example of energy supply.

The companies, which were public-sector enterprises but organized as limited liability companies under private law, were obliged to act in the economic interest of the public. The regulatory authority was spread in a decentralized manner across various government departments and several regional authorities (central government and provinces). Political participation was effected in part via the supervisory boards, to which representatives of the social partners, the public administration, banks, and other bodies were delegated. Ministries and governments had direct access to the management of the companies. Both market entry and market behavior were regulated: The public-sector enterprises usually enjoyed a monopoly position; either there was only one company to begin with (post and telecommunications), or their business activities were separated geographically (energy providers). Their market behavior was confined within the prescribed parameters of their regulated quantity, price, and investment policies (Aiginger and Peneder 1998). Austrian regulation was considered to be strict. According to an assessment by Puwein (1994a), among OECD countries, only Iceland and Turkey regulated the telecommunications sector in the network area as rigorously as Austria.[2]

Before and after 1995, there was a fundamental systemic change toward market opening and external regulation. In many sectors, services were no longer provided by public-sector enterprises but by a market, similar to the U.S. system (Burger and Handler, 2001). The accounting groups of production and grid operations, the only natural monopoly, were separated (unbundled) in the public-sector enterprises, while production and distribution were gradually opened to competition. To ensure access to services that were of general interest, a number of universal services were defined that the former monopolists would con-

[2] *In terms of competition and removing regulatory authorities from ministries, most progress had been made by Sweden, Japan, the U.S.A., and the U.K.*

tinue to provide. Newly established sectoral regulatory authorities aimed at encouraging market entry, removing market entry barriers, and shaping market conditions. Table 1 presents an overview of the degree of liberalization and legal foundations in the network sectors. In view of the large number of new laws and authorities, it is inappropriate to talk of deregulation in a *legal* sense. The term liberalization in the sense of opening markets to competition accompanied by concurrent re-regulation or regulatory reform (Knoll, 1999) – i.e. deregulation in an economic sense – appears to be far more appropriate.[3] The legal foundations generally followed EU directives and regulations, but sometimes went far beyond Community requirements, as for example in the 1999 Rail Traffic Market Regulation Act (Segalla, 2004).

Table 1

Regulation and Degree of Liberalization of Network Industries

Sector	Austrian Legal Basis	EU Legal Basis	Regulator	Degree of Liberalization
Telecommunications	Telekommunications Act 1997 and 2003	Green Book 1987, Directive 1990, package of Directives 2002	RTR	Complete (1998)
Electricity supply	ELWOG 1998 Energy Liberalization Act (ELG) 2000; ELWOG 2004 Amendment Act	Directive 1996, Directive 2003	Energie-Control	Complete (2001)
Gas supply	Gas Act (GWG) and ELG 2000; GWG 2002 Amendment Act	Directive 1998, Directive 2003	Energie-Control	Complete (2002)
Air traffic	Numerous amendments to the Aviation Act (1992 to 1999)	Regulations 1987, 1990, 1992; Directives 1995 and 1996	Austro Control	Complete (1997), with Single European Sky being planned
Rail traffic	Rail Law Adaptation Act *(Eisenbahnrechtsanpassungsgesetz)* 1997, Rail Traffic Market Regulation Act (*Schienenverkehrsmarkt-Regulierungsgesetz*) 1999, Rail Act Amendment 2004	Directive 1991, 1995 Rail Packages I (2001) and II (2004)	Schienen-Control	Incomplete (plan: freight traffic by 2006, passenger traffic by 2008)
Postal services	Post Act 1997, three amendments by 2003	Green Book 1992; Directive 1997; Directive 2002	BMVIT	Incomplete; step-by-step liberalization of the mail market planned by 2006, to be followed by an evaluation
Public local and regional passenger transport	ÖPN Regional Traffic Act 1999	Draft Regulation 2002	BMVIT	Not liberalized (tendering obligations)
Water supply	Water Act Amendment 2003	Water Framework Directive 2000; Green Book 2003	BMLFUW	Not planned, but Single Market must not be affected

Source: OeNB.
Only the most important regulations are listed, there are many other amendments.
RTR = Rundfunk und Telekom Regulierungs-GmbH (Austrian Regulatory Authority for Telecommunications and Broadcasting).
BMVIT = Bundesministerium für Verkehr, Innovation und Technologie (Federal Ministry of Transport, Innovation and Technology).
BMLFUW = Bundesministerium für Land- und Forstwirtschaft, Umwelt und Wasserwirtschaft („Lebensministerium"), (Federal Ministry for Agriculture and Forestry, the Environment and Water Management, „Ministry of Life").

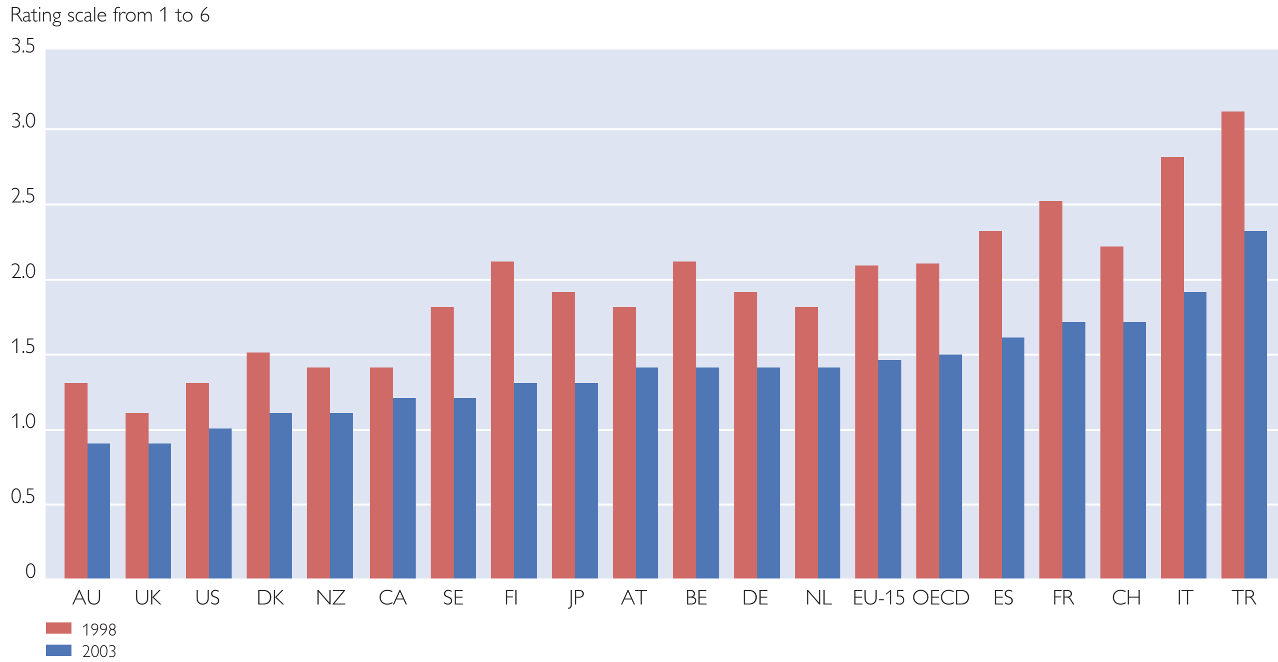
This market opening, together with other reforms such as amendments to the Industrial Code, is reflected in general indicators of product market regulation.

According to chart 1, Austria is slightly less strictly regulated compared with the EU-15 and the OECD countries, while other countries, e.g. Finland and Sweden, have liberalized even more.

[3] *See Wimmer and Mederer (1993, p. 42): Creating an open and functioning market [requires] a dual strategy of deregulation and regulation. Regulatory interventions to safeguard competition are the stabilizing agents of a working market which often has just been opened by deregulatory measures. In other words: Shared responsibility of the state, not relieving it from its obligations, guarantees an open market.*

Chart 1

Product Market Regulation in 1998 and 2003[1])



Source: Conway et al. (2005).
[1]) Strictness of regulation declines with lower values.

2.2 Comparison of Regulatory Systems: More Transparency in External Regulation?

An assessment of the effectiveness and transparency of internal versus external regulation – without regard to economic effects – would require sector-specific investigations. In the following, we will only briefly touch upon the aspects of technical know-how and means of control as well as the legitimacy of independent sectoral regulatory bodies.[4]

Teufelsbauer (1983 and 1986) criticizes internal regulation. From his point of view, consumers and the academic community were widely excluded from the process, and the supervisory powers were ineffective in the light of cross-participation in company management and regulatory authorities. Members of supervisory boards in public-sector enterprises were often not familiar with the given industry, and the staff of regulatory bodies lacked expertise. Knoll (2001, p. 2) is also of the opinion that building up expertise in the regulatory authorities appears to be superior to the individual ministerial authorities which tend to focus only on administrative law. Teufelsbauer (1983) reports further that criticism from the Austrian Court of Audit was often refuted by dubious counter-opinions.

Majone (1996) offers a similar assessment of the situation in Europe. In the U.S.A., thanks to sector-spe-

[4] *Time plays an important role in such a comparison. After World War II, the network industries were used to pursue many general goals, which would not have been possible under strict procedural external regulation.*

cific authorities, consumers were thus supposedly better protected against private monopolies than in Europe, where ministries directly regulated public-sector enterprises. Accountability was nonexistent in the nationalized industries ("…detailed ministerial interventions in the decisions of public managers usually exercised through informal and even secret processes, reduced accountability to vanishing point. [sic]"; p. 300) He also opposes the view that independent sectoral regulatory authorities would not be subject to democratic control. First, he argues, proportional election systems are characterized by not placing powers solely in the hands of the government, but – quite to the contrary – spreading them as widely as possible to safeguard minority rights. Second, regulatory authorities may have procedural and factual legitimacy. Procedural legitimacy rests on the mandatory legal basis for the respective authority, which should be adaptable and should, among other things, hold the authority accountable for its decisions. This facilitates transparency and supervision by courts and allows the public to take a critical stand. Factual legitimacy exists when the regulatory authority decides only on issues of efficiency, but not of redistribution.

In order to make it possible to reconcile independence and public accountability of regulatory authorities, Majone (1996) therefore suggests a combination of several control mechanisms rather than centralized control. These mechanisms consist in legally mandated objectives, the obligation to justify decisions, clear process rules for settling disputes between the regulated companies, and technical know-how to fend off external intervention and to reduce the risk of arbitrary abuse of the authority's discretion in its decisions. Were this system of multiple checks in place, nobody would regulate the authority, but the authority would be "under control."

In consideration of the above arguments, the system of external regulation can effectively be preferable to internal regulation or the internal regulation as exercised in Austria in terms of transparency and ease of monitoring. Moreover, sector-specific regulatory authorities are tailored to the increasingly complex technological and economic environment, which requires functional specialization and thus the building up of technical expertise.

3 Economic Implications of the New Regulatory System

3.1 Positive Effects at the International Level

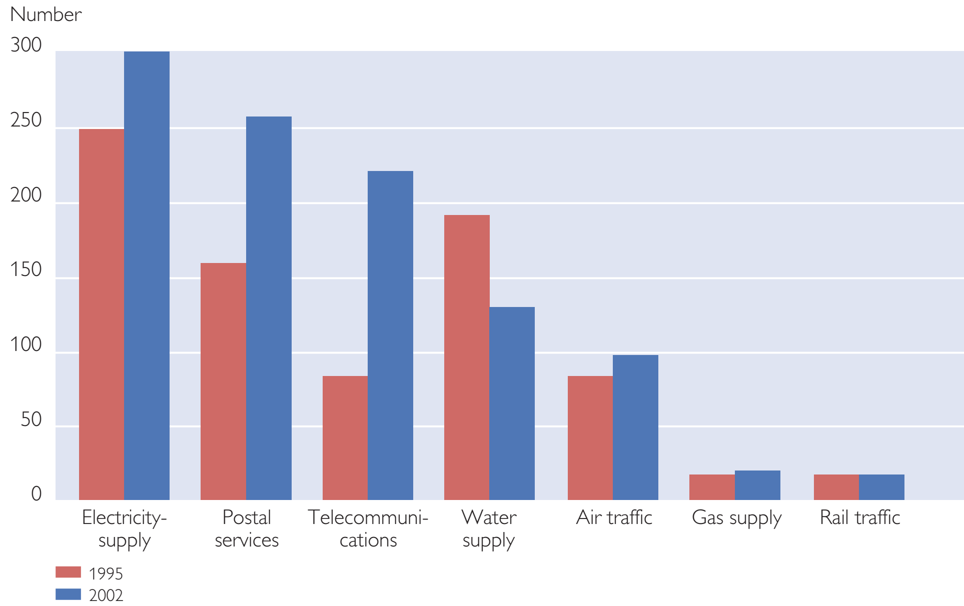
In general, theoretical and empirical economic research shows that competition yields positive economic effects, by increasing both static and dynamic efficiency, and thus finds its reflection in economic and productivity growth (for a recent overview, see Böheim, 2004).[5] A number of empirical studies have clearly substantiated the correlation between product market regulation and productivity developments. Nicoletti and Scarpetta (2003) simulate the effects of product market regulation[6] in the euro area converging to the level of those three euro area countries with the lowest degree of regulation and derive significant potential

[5] *With the exception of the natural monopoly, that is.*

[6] *For the three areas of privatization, entry barriers, and sector-specific regulation.*

Chart 2

Number of Companies in the Network Industries



Source: Statistics Austria.

productivity growth rates.[7] Alesina et al. (2003) prove that high market entry barriers in the network industries in particular have negative effects on investment activity.[8]

In an EU-wide study, the European Commission arrives at a generally positive conclusion on market opening in the network sectors (European Commission, 2004a). According to the study, not only prices and productivity, but also quality of services and stability of supply have improved. Concerns in view of the Californian energy crisis and the delicate safety situation of British rail traffic have proven unfounded so far. However, only air traffic and telecommunications saw significant price reductions, while especially gas prices even rose as a result of the increase in oil prices. In general, there are huge differences between countries and sectors. Mandatory market opening, as it is shown for Austria in table 1, does not automatically translate into effective competition or effective market opening.

3.2 Positive Results for Austria with Sectoral Differences

The situation described above is largely true for Austria as well. In 2002, the network sectors generated a share in the value added by the manufacturing sector and by market services (excluding public services) of almost 10%, 0.5 percentage point less than in 1995. In all liberalized sectors, the number

[7] *Aiginger et al. (2004) assume that also in Austria economic growth would benefit from opening the markets of network industries. In general terms, however, Aiginger and Peneder (1997) believe that, while Austria had more state regulation than other countries, the stability of the economic framework compensated for the cost of regulation.*

[8] *Overinvestment may occur in case of state-owned monopolies to serve interest groups outside of Parliament and thus avoid harmful transparency. This phenomenon is called "golden plating" and is also reflected in the findings of Alesina et al. (2003).*

Table 2

Productivity Developments in Selected Network Industries

Growth rate in %

	Sweden		EU-15		Austria	
	1979 to 2002	1998 to 2002	1979 to 2002	1998 to 2002	1979 to 2002	1998 to 2002
Total value added	1.7	1.7	2.1	1.7	2.9	1.7
Electricity, gas and water supply	2.4	4.2	4.1	6.8	3.8	5.4
Road and rail traffic	2.3	0.5	2.3	1.2	5.3	6.3
Air traffic	1.9	– 5.9	3.9	– 0.1	6.4	– 7.5
Telecommunications	6.3	10.0	6.6	9.5	6.3	8.3

Source: Groningen Growth and Development Centre, 60-industry database, February 2005, http://www.ggdc.net
Labor productivity per hour worked at chained 1995 prices.

of companies (chart 2) rose sometimes sharply, with the exception of the stagnant rail traffic and gas supply sectors. The water supply sector, which was not liberalized, saw the number of companies drop. The number of (independent) competitors is an indicator of effective competition (Böheim, 2004). Thus, the number of companies confirms the findings of still weak competition in gas supply and rail traffic.

Sectoral productivity performance in an international comparison (see table 2) is captured only as an aggregate based on data of the Groningen Growth and Development Centre. Given its advanced stage of market liberalization, Sweden was chosen as a benchmark in addition to the EU-15. Contrary to the general trend toward a marked slowdown in productivity growth from 1998 to 2002, growth in the opened sectors of electricity, gas, and water supply as well as telecommunications (post and telecommunications) accelerated. As for rail and road traffic combined, Austria was the only country which managed to increase productivity. Sweden, the EU-15 and Austria suffered a decline in air traffic, which can probably be put down to one-off effects.

Price developments are discussed in more detail by Fluch and Rumler as well as by Pointer in this issue.[9] Puwein (1994a) refers to an OECD comparison according to which Austria's phone charges for companies and private households exceeded the OECD average by 30% in 1993, leaving Austria in 20th position among 23 OECD countries. At 28%, the profit margin of what was then the Post- und Telegraphenverwaltung (PTV) was high by international comparison. In terms of service quality, it was possible to reduce the average waiting period to get a primary line from 13 months in 1980 to 3 months in 1990, but even at that time, most OECD countries did not have any waiting periods anymore. In 1997, Austria lay in part considerably above the price level of the EU-15 in the sectors of electricity, gas, local and long-distance calls (with the exception of electricity for private consumers) according to the data of the Eurostat structural indicators. By 2003, the price level for long-distance calls and electricity for industrial consumers stood below the EU-15 average. In the other sectors (gas and local calls), Austrian rates are moving toward the EU-15 average.

[9] *The price-reducing effect of market opening can only be established by comparing net prices, e.g. in Kratena (2004) and Haslauer and Gassler (2005), or by the Eurostat structural indicators.*

In a partial analytical study of the energy market, Kratena (2004) comes to the conclusion that, compared with the baseline scenario without liberalization, the price reduction of electricity for industrial and private consumers amounted to 40% and 20%, respectively, and the price reduction of gas equaled 15% and 4%, respectively. The price advantages from the liberalization of the energy market were partly offset by other factors such as high grid charges and increased taxes.[10] In addition, the increasing market concentration further restrains competition as a result of the horizontal integration of energy providers. The distribution of electricity and gas within the same companies produces a lack of important substitution options that would be important for competition (Böheim, 2004). The European Commission (2004a) cites the fact that consumers in the gas sector traditionally do not tend to switch to alternative suppliers ("user switching") as an additional reason for ineffective competition.

According to Böheim (2004), the mark-ups in some network industries are below average compared with the OECD countries. This may, on the one hand, reflect the successful liberalization process, which has driven the Austrian price level from being one of the highest in Europe down to an average level. On the other hand, low mark-ups can also mean less profit and rationalization pressure on the owners. Overall, it would be fair to consider competition relatively effective in telecommunications, in the area of postal services already liberalized, and in air traffic (low-cost carriers). Rail traffic has not been fully opened by law yet,[11] and the energy markets – despite full statutory opening – do not (yet) show effective competition, or price reductions were offset by increases in taxes. Economic effects also depend on an effective general competition policy.

Like in other countries, some concerns with regard to negative effects of the regulatory change in Austria did not materialize either. As a case in point, the high licensing fees in telecommunications did not lead to a high price level (Knoll, 1999), and in spite of a lack of cross-subsidizing, local calls did not become more expensive. Likewise, lower energy prices did not result in increased pollution (Burger and Handler, 2001). What would have to be examined more closely, however, is whether the closing of post offices is compatible with the commitment to provide universal services throughout the country. In any case, alternative forms of service provision merit discussion (e.g. all-in-one grocery stores).

Winston (1998) uses the example of the U.S.A. to point out that companies need time to adapt to new regulatory conditions. Therefore, the effects of regulatory changes should be examined over an extended period of time. In his opinion, however, the empirical evidence appears to support the positive impact of market opening and competition.

4 Reasons for Change

How can regulatory reforms and the switch from internal to external regu-

[10] *This is confirmed by Haslauer and Gassler (2005), who identify as the main beneficiaries of the liberalization of the electricity sector large customers as well as the state by way of increased taxes.*

[11] *According to IBM and Kirchner (2004), however, Austria ranks among those countries which show a delayed opening of the rail market.*

lation as well as the liberalization of the network industries in Austria be explained? Section 4 describes the role of EU accession based on theoretical explanatory approaches and Austrian regulatory analyses and concludes by discussing alternative reasons for change.

4.1 Regulation as the Result of Competition between Interest Groups

In accordance with Viscusi et al. (2001, p. 313ff.), the theory of public interest explains regulation exclusively as a reaction to market failure, while the theory of regulatory capture postulates the other extreme, i.e. regulation as a result of lobbying and interest groups. Neither theory can sufficiently explain empirical observations such as a lack of correlation between market failure and regulation on the one hand, and regulation at the expense of companies on the other.

The economic theory of regulation regards regulation as the result of interest groups competing for political influence. In line with Olson's findings (1965), small groups with high per-capita profits from regulatory measures are at an advantage compared with large groups with low per-capita profits: Small groups (such as trade associations) can be more easily organized (than consumers), and favorable profit prospects encourage such behavior. Regulation and deregulation can thus be explained as relative changes in the influence of interest groups. Likewise, regulation in reaction to market failure can be explained by the resulting large benefit for some interest groups (Viscusi et al., 2001).

According to the historical approach of Vietor (1994), regulation patterns follow the success brought about by the various strategies of economic policy. Thus, after the Great Depression of the 1930s, unfettered market coordination was abandoned, and the state became considerably more important as a problem solver. The economic policy failures during the economic crisis of the 1970s resulted in a contrary development.[12]

4.2 Regulation in Austria prior to Accession to the EU: Signs of Inefficiency and Impact of Special Interests

After World War II, the regulatory system of the network industries in Austria was in line with the way in which Europe was dealing with its specific characteristics and the prevailing view of general market failure in these sectors. Regulatory and economic discussions in Austria, however, showed that as early as the 1980s, regulation was no longer purely a reaction to market failure and on top of that proved to be economically inefficient.[13]

4.2.1 Regulatory Discussion: Signs of Interest Groups Exerting Influence

Following Teufelsbauer (1996), one might argue that the economic theory of regulation is more applicable to the political-economic system of the U.S.A., while Austria and Central

[12] *Regulation results from dissatisfaction with the outcome of market processes, while deregulation follows from dissatisfaction with regulation (Supper, 1986, p. 768).*

[13] *Especially in the post-war period, regulation in the network industries was designed in a way as to not only correct market failure, but also more or less explicitly to pursue general economic and social goals, e.g. electrification of households, cheap electricity for industry, building of new networks, regional policy, a neutral state striving for autarky, promotion of the domestic capital goods industry, as well as business cycle policy.*

Europe are characterized rather by a tradition of public administration and politics serving the common good. However, there are signs of the influence of interest groups or the general possibility of exerting influence on the regulatory process: Teufelsbauer (1986, p. 715) considered regulation in Austria the outcome of an opaque bargaining process in a club situation, the result of mutual interdependences of political bodies, large regulated economic entities, and nontransparent and closed circles of experts and civil servants. Müller (1983) mentions a draft regulation which was intended to define polite behavior for taxi and bus drivers. In response to his question why there was a need for legal regulation, he was informed that this was exactly the kind of thing demanded by business representatives. Korinek (1991) writes about the demands of trade associations and the public, the desire to get noticed, and other political factors that would lead to a regulation of economic behavior.

According to Szopo (1986), Keynesianism brought about the view that the state was the guardian of macroeconomic interests. As a rule, political processes in western democracies probably work exactly the other way round: A large number of diverse groups try to use the very tool of government interventions and sanctions to enforce their own interests at the expense of other groups; they make use of both parliamentary channels and – more commonly and more importantly – direct interventions with the administrative authorities (Szopo, 1986, p. 47). Mantl (1995b) points out that the economic analysis of law and the new political economy have found their way into the Austrian discussion, which refers to a more differentiated view of the state which included the possibility not only of market failure but also of regulatory failure.

Thus, some regulation or missing regulatory reform has probably resulted not only from market failure but also because of certain activities by interest groups as well as generally applied economic policy approaches.

4.2.2 Economic Discussion: Findings of Cost and Price Disadvantages and a General "Dislike of Competition"

Also in Austria, the purely economic discussion on regulation started long before it joined the EU. Economic analyses suggested that regulation in some network industries was not effected with the common good in mind.

A location survey of the Austrian Institute of Economic Research (WIFO) (Aiginger and Peneder, 1997) showed that Austrian companies felt particularly affected by the lack of efficiency of government regulation as reflected by high energy and telecommunications costs. According to Kramer (2002), the hard currency policy was not able to prevent an increasingly uneven burden on the liberalized sector in favor of the protected one. He argues that the social partnership had a positive impact on the former sector, while the latter managed to effect a redistribution of resources in its favor. In the longer run, this would have endangered the competitive chances of the national economy: Austrian companies not only had to bear higher initial costs for input purchased from the protected sector, but the quality of the services provided was far from first-rate, to boot. Indicators were overcapacities in personnel and labor costs which, due to internal company rules often were the source of envy when compared with the costs prevalent in the exposed sector (Kramer, 2002, p. 216). Szopo (1986) supports this analysis of the growing gap between exposed and protected sectors, which was also becoming apparent in income distribution. The location study of the Beirat für Wirtschafts- und Sozialfragen (advisory board for economic and social issues; 1994) also dealt with the issue of regulation.[14]

As for competition policy, it was stated that the demand for selective reduction of certain regulations in Austria was to be regarded mainly in connection with hostility toward competition widespread in large parts of the Austrian economy. The negative consequences of economic competition were thus exaggerated while the positive impact was overlooked. In Austria, legislation on safeguarding competition is generally of less significance than that on offering protection from competition (Kaufer and Smekal, 1983, p. 98, quoted in Szopo, 1986, p. 50).

All that shows quite clearly that there was an awareness of the need for regulatory reform even on a *national* basis well in advance of EU accession. How then was it possible to implement these findings in the face of opposing special interests?[15]

4.3 EU Accession Paves the Way for New Regulation

Reforms in network industries are faced with the classic Olson problem. Big advantages for small and well-organized groups that result from maintaining the status quo even after the original reason for regulation (market failure) is no longer relevant contrast with unclear and minor benefits for the large and unorganized majority derived from change.[16] In this situation, accession to the EU caused a significant shift in the power of interest groups, as the four fundamental freedoms of the Single Market had to be implemented. EU accession can thus be seen as a classic political economic reform strategy. With external forces requiring a comprehensive package and the necessary approval of the very package that comes both with advantages (market access) and with disadvantages (need for regulatory reform in certain sectors), special interests are pushed to the back.

Wimmer and Mederer (1993, pp. 11 and 14) describe EU accession as a “Copernican change” and the “nucleus of a gigantic deregulation program.”[17] The basic concept of the single European market consists of the four fundamental freedoms in integrated markets, i.e. markets which are open

[14] *The Austrian regulatory debate began long before EU accession also from a legal point of view, even though the focus was not on network industries, but on production plant law, the Industrial Code, and free-lance professions (see e.g. Winner, 1996). Szopo (1986) describes the modern roots of the legal and institutional environments. Important parts of economic legislation dated back to the previous century or the interwar period.*

[15] *See Gutknecht (1993, p. 89): Nobody really denies nowadays that deregulation is necessary, but it remains unclear where the impetus for that is supposed to come from…*

[16] *Fernandez and Rodrik (1991) call this the “status quo bias” based on the certainty of disadvantages and uncertainty concerning benefits. This concept differs from that of Olson.*

[17] *However, this also refers to the effect of regulatory change resulting from possible discrimination against residents discussed at the time; this effect means that companies or employers are able to offer their services in accordance with their national regulations in other EU Member States, which might result in discrimination against residents of those countries bound by stricter national regulations. This country of origin principle (as opposed to the country of destination principle) has become an issue again in the current debate about services.*

to other EU Member States. Since EU Competition Law and Single Market Law take precedence over national law, these fundamental freedoms can generally be enforced. Given Austrians' traditional fear of competition (Kaufer and Smekal, 1983, p. 97), the external impulse on the part of the EU appears to have been of particular importance for opening the goods and services markets. Aiginger and Peneder (1998, p. 32) argue that EU accession had a material impact on Austria's regulatory system. As a result of the entry into the EU, the Austrian system has become more adjusted to the European mainstream on several counts. Kramer (1994a, p. 7) adds that Community policy lends also strong support to national governments to overcome internal resistance.

However, this market liberalization was not forced upon Austria unilaterally, but was probably used as a deliberate opening strategy by politics and interest groups. EU accession was also expected to result in a harmonization of competitive conditions in the exposed and protected sectors. While it was not directly on the agenda of the accession, it was nevertheless anticipated that competition regulations would also be expanded to sectors which had thus far enjoyed quasi-monopolistic positions in most European countries, particularly in the field of infrastructure utilities. These observations were definitely not the major motivation but did play a certain role in the economic policymakers' efforts to become fully integrated into the single European market (Kramer, 2002, pp. 216 to 217).[18]

4.4 Potential Market Opening absent EU Accession

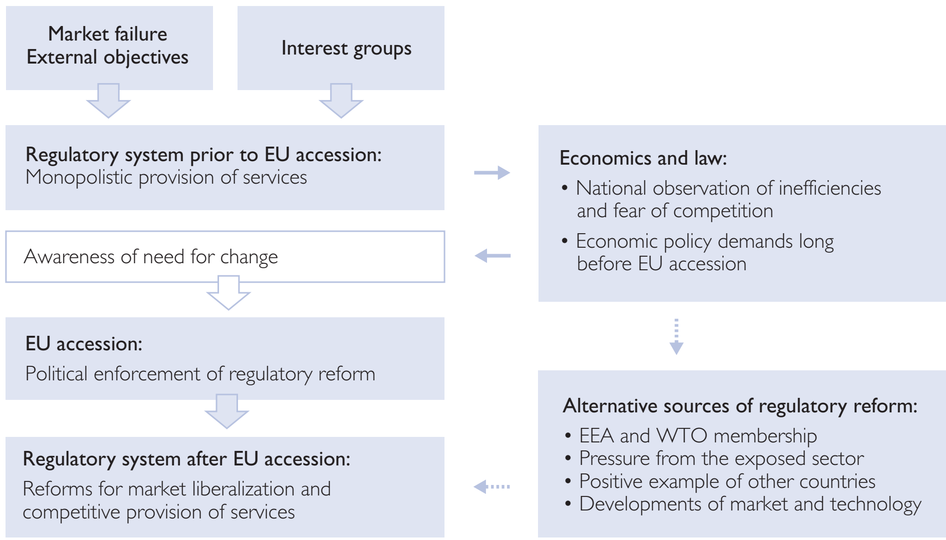
Many instances of liberalization in Austria appear to have been triggered by the EU. The European Commission with its initiatives, however, profited from the examples set by other countries. In the U.S.A., many markets were opened as early as the 1970s. Subsequently, the United Kingdom even "overtook" the U.S.A. in the 1980s and 1990s, but also Finland and Sweden proved pioneers of telecommunications and rail traffic liberalization at that time. Sweden opened its rail network in 1996, after partial liberalization had already been effected in 1992 (Mayer, 1998). Thus, Community Law was only the trigger of the liberalization of rail traffic; there are still major differences between the EU member countries, as some had already gone further than the European Commission (Segalla, 2004).

Furthermore, the initiatives of the European Commission reflected technological progress and market developments. Strong shifts in demand changed the relation between critical production mass to market volume (Peneder, 1996). From a technological point of view, it was not only the possibility of separating power generation from operating the grid which led to a restriction of the reach of natural monopolies. The natural monopoly in the generation of electricity was ended by the introduction of gas turbines. This technological development, together with the political intention of the European Commission to maintain a competitive European economy, was a primary driving force behind

[18] *This strategy of using the EU as a scapegoat can be quite dangerous if it simply serves to shift the blame for partly unpopular measures from a national level to the EU, while in turn strictly positive developments are touted as the sole result of national policies. This can only lead to an increase in EU skepticism in large parts of the population.*

Chart 3

Regulatory Reform Shown as a Result of EU Accession



Source: OeNB.

the drafting of the Electricity Directive (Wohlgemuth and Bodenhöfer, 1998, p. 374).[19]

The liberalization of many other markets had already been necessitated by Austria's accession to the European Economic Area (EEA) in 1994, such as air traffic or telecommunications (Puwein, 1994b). In addition to the EEA, Austria's membership in the WTO would have had similar consequences in terms of opening markets. Several GATT agreements aim at a similar development of international liberalization and fairness in competition as EU regulations. These adjustments would have been farther-reaching and more immediate based on EU accession, and less binding and immediate due to GATT obligations (Kramer, 1994b, p. 267).

Even without any international influence, however, Austria would very likely have opened its network sectors eventually. The well-organized representatives of the exposed sector would have demanded changes in their capacity as "consumers" in an ever more insistent manner until they would have clearly prevailed in the struggle between interest groups.

To summarize (chart 3), accession to the EU and the EEA can thus be regarded as a significant catalyst for the shift from internal to external regulation and for opening the markets in the network industries. These changes would very likely have occurred even without entry into the EU, but presumably later and not to the same extent.

5 Conclusions and Outlook

Austria's accession to the EU brought about major changes for the network industries. The inappropriate dichotomy of regulation versus deregulation

[19] *In general, the driving forces of regulatory change differ strongly between sectors. Breuss (1994) presents a table showing the sector-specific impacts of technological change and Single Market regulations.*

clouds the view of what is essential, i.e. the change from monopolistic to competitive production, from protected to open markets in the process of switching from internal to external regulation.

5.1 Characteristics and Effects of New Regulation: Favorable, but Beware of Uncritical Examination

As a rule, changes in regulations result in appropriate adjustments on the part of companies only in the medium term and require an effective competition policy for the positive repercussions of competition to take full effect. Still, even in the short time since the first network-based markets were liberalized, several positive economic effects have been observed in Austria. Conversely, possible setbacks should not be generally condemned as a weakness of the new system, but should lead to a continuous improvement of the regulatory framework with regard to the risks inherent in all change processes. Nonetheless, an economic policy paradigm must not be applied without a critical perspective and regular empirical review.

The decisive factor will be the performance of the new sectoral regulatory authorities in connection with general economic policy. Basically, a loss of transparency and democratic control as compared with internal regulation cannot be expected. By contrast, the obligation to justify decisions, transparency, and expertise may improve the system prior to market liberalization.

5.2 Future Regulatory Reform: Further Liberalization and European Regulatory Authorities?

As shown in table 1, further (statutory) liberalization will take place in rail traffic and postal services. The liberalization of water supply is not planned, and public local and regional transport will see a "competition for subsidies by efficient awarding procedures" (Knieps, 2000) (i.e. still monopolistic provision of services, but contracts are awarded to the best bidder in terms of price and quality). From a legal point of view, Austria's discretion in this sector will be defined by the transposition of EU Directives into national law. If the general objective of the Directive is achieved, this discretion is relatively substantial.

More far-reaching regulatory changes might result from sectoral regulatory authorities operating on a Europe-wide basis. This development might occur as a result of the heterogeneity of the regulations of services among the Member States, which Kox et al. (2004) consider to be a major obstacle to the realization of the single European market.

The free-lance professions are not part of the network industries, but changes (triggered by the EU) along the lines of the network industries can be expected. For 20 years, it has been pointed out that the regulation of these professions does not meet its intended purpose of correcting market failure (e.g. Szopo, 1986). A study of the Federal Ministry of Finance (1988, quoted by the OECD, 1989) describes the existing regulatory system as inefficient in reaching goals such as consumer protection, ensuring the quality of professional services, and the prevention of unfair competition. On the contrary, the system results in higher prices, a deceleration of structural adaptation, and a weakening of competitive strength. The European Commission (2004b) confirms this assessment. Adjustments are provided for in the Austrian reform agenda (see Cardiff Report (Federal Chancellery, 2004)). However, the long period between stating the need for change and actually effecting change again suggests the advantages of small, well-organized groups with high per-capita profits.[20] Therefore, external pressure seems necessary to bring about reform.

5.3 Role of the EU in Austria's Structural and Competition Policy: Competition as a Defining Principle

In the light of the fundamental changes in the market regulation of network industries, EU accession may well be credited with the definition and reinforcement of new focal points in Austria's structural and competition policy. Via the four fundamental freedoms of the Single Market in general and the relevant Directives of the European Commission in particular, the defining principle of competition increasingly found its way into Austria with its "historical dislike of competition." These changes are still going on, with the competition authority, for example, expanding gradually (the European Commission (2005) criticizes that the competition authority is still poorly equipped with resources).

Joining the EU may thus be viewed as the "antidote" to Olson's (1982) analysis of the economic decline in societies which had been stable for a long time. According to Olson, economic regulations would become obsolete as a result of economic, technological, and other developments, but would not be removed owing to special interests which prevent changes in regulation at the expense of the general public. At the time, the Austrian and European systems of internal regulation of network industries were a quite common reaction to the capabilities of market and technology and a means of implementing general supply objectives in the post-war period. Over time, however, the systems were hardly adapted to economic, technological and legal developments and innovations.

As for the impending major challenges of economic policy, achieving the Lisbon goals by 2010, it would be unwise to rely on help from the outside. The EU's legislative authority is limited in some Lisbon fields (education, research), which means that national politics need to assume more responsibility. In the medium term, incessantly overtaxing the EU as an agent of change would lead to a wear-out in terms of increasing EU skepticism and an unwillingness to support further integration among large parts of the population anyway. However, as was the case when joining the EU, the principle of the "comprehensive package" might again help to initiate changes. National and proactive economic policy concepts[21] can be drawn up before economic crises lead to high welfare losses and the pressure to take measures at short notice.

[20] *The statement of the Austrian Bar Association concerning the draft directive on services in the Single Market (Benn-Ibler, 2004) may serve as an example of the defensive stand and arguments based on consumer protection.*

[21] *Kok (2004) calls this Lisbon action plans, while Gnan et al. (2004) and Aiginger (2004) describe it as a national growth strategy.*

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