

Setting the Stage: Regulatory Challenges for Small Market Economies in Network Industries

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Introduction

- The challenge of social engineering is to devise a system that will realize synergies among regulatory tools
 - Network industries
 - unique economic features
 - “flattening the world” effect
 - How does small size affect optimal regulation, if at all?



Basic Propositions for Optimal Regulation

- Competition is the basic regulatory tool in market economies
- Market's invisible hand is the main regulatory tool
- Competition not always best regulatory mechanism
- When competition cannot achieve efficient results, more interventionary tools needed.
 - Network industries

Basic Propositions [2]

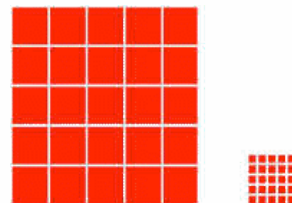
- Endemic market failure does not imply that competition has no role:
 - Competition in some parts
 - Competition *for* the market
 - Competition through interconnection
 - Changes in market conditions
- Regulation can sometimes be welfare-reducing
 - Regulatory capture
 - Slow reaction to market changes
 - Limited tolerance to instability
 - Erroneous assessment

Basic Propositions [3]

- The aim is to create synergies between the regulatory tools, including a system of "checks and balances" which maintains adequate safeguards
- Synergies should be created based on regulatory **tools** themselves, and also based on the comparative advantages of the regulatory **institutions**.
- No one-size-fits-all for the regulation/competition interface. E.g., size of market sometimes influences optimal regulation.

What makes it small?

- Definition: independent sovereign jurisdiction that can support only a small number of competitors in most of its industries, when catering to demand.
- No magic number
- Three main factors:
 - Population size
 - Population dispersion
 - Openness to trade



Why is it a “Different Class”?

- High Industrial Concentration levels
- High entry barriers
 - Minimum efficient scales
 - Supply constraints
- Sub-Optimal Levels of Production
 - Interdependence



Characteristics[2]

- Basic dilemma: Productive efficiency vs. Competitive conditions
- Limited regulatory resources in absolute terms
- Government and socio-economic elite are often intertwined




Effect on Optimal Regulation of Network Industries

- Little room for potential competitors due to limited demand. Implications:
 - High concentration levels must be taken as a given. Balance between competitive conditions and productive efficiency much more delicate.
 - Monopoly may be a natural market outcome
 - Interconnection and access extremely important for creating competitive pressures
 - Since tipping effect much faster, crucial to ensure that the situation is not abused by an inefficient firm

Second Effect

- Devise ways that will reduce legislative and regulatory capture:
 - Impose high sanctions?
 - Give regulatory roles to a body which is relatively independent from such pressures
 - Granting the competition authority standing in legislative and regulatory proceedings
 - Ensuring independence of the authority
 - Creation of a competition culture

Third Effect

- Small economies generally standard-takers.
 - Implications: Ensure that local network (generally) apply global standard
 - Increase foreign access
 - Increase access of local firms to global markets
 - Distribution effects?
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Conclusion

- Regulation as significant a variable as technology in determining the economic performance of an industry
- Crucial to ensure that the regulatory system creates checks and balances

Thank you!

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