COMPETITION AND REGULATION IN REGULATED SECTORS*

MAURICIO RICARDO III TORTOLERO SERRANO**

Resumen

En la mayoría de los países alrededor del mundo, los gobiernos a través de las agencias regulatorias y de la competencia trabajan en cómo introducir la competencia en sectores regulados. En este trabajo abordamos algunos aspectos actuales de procesos de liberalización y neoregulación en sectores de servicios públicos tales como la electricidad, el gas, los carburantes, las telecomunicaciones, los transportes o el correo, que tradicionalmente han funcionado en régimen de monopolio y gestión pública. La introducción de un régimen competitivo en estos sectores implica mayores opciones de elección para los consumidores, incrementos en eficiencia y mejoramiento de la calidad de vida. En este contexto, se plantea el cuestionamiento crucial y actual sobre cómo deben aplicarse las políticas de competencia en sectores que se encuentran liberalizándose y neoregulándose, y si para ello se deben aplicar los mismos criterios que para los mercados de productos como automóviles o refrescos. Así, en este trabajo tratamos de exponer que la competencia en estos sectores reviste características singulares, fundamentalmente, son mercados regulados, en transición y con tendencia a la concentración, por lo que en ellos el mecanismo para su desarrollo debe ser objeto de una nueva formulación, partiendo de las bases originarias de la doctrina de la competencia, sus objetivos y los fundamentos económicos sobre los que se basa. Por lo tanto, este trabajo se desarrolla primeramente abordando cuestiones básicas sobre nociones de competencia, algunas referencia económicas y diversos temas sobre la competencia en los sectores regulados, tales como la intervención del gobierno y la eficiencia económica, mercado y regula-

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ción, el modelo de la competencia regulada en los servicios públicos y la liberalización, entre otros, con la finalidad de contribuir en el entendimiento de este tema.

Summary

In most countries throughout the world, regulators are struggling to determine how to introduce competition into regulated sectors. This paper examines some aspects involved in the liberalization and neo—regulation processes in public utility sectors such as electricity, gas, fuel, telecommunications, transportation or postal services, which have traditionally been operated as a monopoly and with public management. The introduction of competition in these sectors can increase consumer choice and enhance efficiency, making sectors more productive and allowing consumers to increase their standard of living. In this context, crucial and current questions are raised about how to enforce competition policy in these sectors, as well as if for them we must apply the same criteria as for markets for products such as automobiles or soft drinks. This paper will try to state that competition in these sectors has particular characteristics, mainly because these are regulated markets, in transition and with a tendency to concentration. Being this so, the mechanism for the development of these sectors must be re—formulated based on the original foundations of the doctrine of competition, its objectives and economic fundaments in which this is based. Therefore, this work is developed primarily to address basic questions about notions of competition, some economic and various references in competition issues on regulated sectors such as government intervention and economic efficiency, market and regulation, the model of regulated competition in public services and liberalization, among others, in order to contribute to a better understanding of this topic.

I. Introduction

In recent years we have been living liberalization and neo—regulation worldwide processes in public utility sectors such as electricity, gas, fuel, telecommunications, transportation or postal services, which have traditionally been operated as a monopoly and with public management.

The introduction of a competitive regime in these sectors requires, as in any market, the protection of competition against practices from operators that can hamper it, especially in areas where for historical reasons, there have been an established operator, and almost always dominant.

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II. Notions and economic references on competition

The ideas involved in competition have been originally developed by the economic science, for this reason we consider relevant to start analyzing this subject with some references and ideas in this context. Competition occupies a role in economic science that it is hard to imagine the economic theory as a social discipline without this concept (Demsetz 1986).

Competition, wrote Samuel Johnson, “is the act of endeavouring to gain what another endeavours to gain at the same time.” We are all familiar with competition, from childhood games, from sporting contests, from trying to get ahead in our jobs. But our firsthand familiarity does not tell us how vitally important competition is to the study of economic life.

Competition for scarce resources is the core concept around which all modern economics is built. Adam Smith saw that competition would lead not to chaos, but to a spontaneous and productive social order. His insight gave birth to economics as a science.

Economists have spent two centuries divining the myriad ways in which competition works its influences. What John Stuart Mill said in 1848 is still true today: Only through the principle of competition has political economy any pretension to the character of a science (High 1998).

The effects of competition permeate economic life. Prices, wages, methods of production, what products are produced and in which quantities, the size and organization of business firms, the distribution of resources, and people's incomes all result from competitive processes.

a) *Market*

The economic theory says that competition[1] exists when different companies attend to the same market in order to provide their products to a set of consumers, who act independently, and constitute the demand.

Competition is an action that actors should develop in its own sphere of economic transactions, which is the market (Dromi 1999). Competition, we can say, is a market situation. In general terms, the market is the context within which it takes place the purchase and sale of goods, or where there are those who demand goods and services and who offer them.

In this respect professors Alonso Luis Calvo Caravaca and Javier Carrascosa González mention that market can be seen as a *meeting point* between offer and demand. Thanks to it the answers to the three most important economic questions can be found: what to produce, how and for whom. (Calvo and Carrascosa 2003).

The most important thing when referring to market is to keep in mind that the diverse actors that intervene in it should be so related, that every transaction affects and is affected by the others. In other words, information should be enough as to know the prices, commercialized volumes as well as the practical mechanisms to join to the market, already be selling or buying goods, as a response to such information.

A market indicates the existence of big groups of buyers and sellers from different kinds of goods or services, such as the consumer goods market, the capital market, the labour market, etc. These general market categories are useful when considering the working of the whole economy. For a more detailed analysis it is convenient to consider more specific categories, such as the automobile market, the cereal market and even the illustrated children's book market.

As it was established before, market is conceived as a context where those who demand goods and services as well as those who offer them can be found. Therefore, offer and demand are two forces that intervene in it in order to determine the price in which these are traded.

[1] It is appropriate to mention that this concept is used in Economics as well as in Law variating its sense according to the circumstances.

The word *market* frequently designates a physical space where such transactions take place, but the economic concept much more abstract: it refers to the group of human interactions that though they might have a spatial point of reference, they should not be limited to a determined space (Sabino 1991).

For this particular analysis we should be able to differentiate between regulated markets and free markets. The conditions in which market is achieved and in which goods as well as services are offered are developed according to this two basic models, which admit intermediate formulas. These conditions can also be rigid —not capable of any negotiation— and determined by public powers or by the offer's sector. They can also be free conditions resulting from the laws of offer and demand, a market in which one enters freely to offer or demand a good or service. The first model (*Regulation*) is usually employed in strategic sectors or of a marked social content: telecommunications, energy, transportation, sanitary services, etc. For the rest of the activities the free model (*Deregulation*) is usually followed. Though this division is clear in the theoretical plane, in practice no economical sector is completely rigid or completely free. There are sectors that tend to a directed model (Regulation), while other sectors are based in the freedom of conditions (Deregulation) (Calvo and Carrascosa 2003).

b) *Perfect competition, monopoly and imperfect competition*

At the beginning the ideas of competition were established through the perfect competition market model:[2] "market structure in which the number of participants is so big, and individual participation of each of them is so small, that the particular action of none of them will have a noticeable effect on the market's group. In perfect competition, all of the participants accept the price of the market as something in which they do not have any control" (Lancaster 2003).

This market formula is opposed to monopoly: market situation in which there is a single seller. The monopolist dominates at length the price he applies, which means, he does not consider the prices as given since he can fix them as he pleases.

If the monopoly is compared to a perfect competition situation, it will prove that the monopolist fixes much higher prices, produces less and ob-

[2] In most part, this model responds to the market's situation during the dawn of the Industrial Revolution rather than the one that prevails in modern economy, thus allowing a clearer and more general analysis of the economic phenomena. (Cabanellas 1983)

tains a benefit that is much higher than normal (sometimes qualified as a “monopoly rent”). When consumers have to pay a higher price for the acquisition of a good or a service there is a wellbeing net loss. Besides all this a transfer of the income from the consumers for the benefit of the business in situation of monopoly is produced. One must indicate that between these two structures of conflicting market, infinite intermediate conducts can be developed.

Referring to the situations that are found in practice, and that certainly move away from the perfect model, the economists are used to refer to as imperfect. This concept covers a multitude of different situations that go from the ones that approach pure competition to the ones that approach the total lack of it.

In spite of the fact that the imperfect competition results in great interest for economists, since it is a situation that can be found in real life, its study has not reported greater conclusions of interest: it is not possible to build a general theory for each of the possible situations that can be found in practice and, in most cases, the model of perfect competition or study of the monopolies offer results that can be extrapolated in some way to the intermediate situations.[3]

Inside the imperfect competition, we find a zone in which greater economic investigation dissidences exist regarding what should be considered normal, reasonable, practical or convenient.

Nonetheless it is important to mention that the perfect competition theory is no more than that, a theory, the necessary conditions for com-

[3] When many sellers, that may produce similar substitutes, exist they cannot be considered as perfect substitutes —because of the advertising differentiation as well as by small details in their final touch or presentation— we are faced by what is called monopolistic competence. In this case, though each specific product can be considered monopolized by a determined firm, the markets usually act as if there was perfect competition between them, particularly if there are no difficulties for new firms to compete between them and the differences between consumers are significant for the consumer.

When very few sellers control a market and that is possible, for each of the firms, knowing beforehand with certain estimation of the rest, we will find ourselves in face of an oligopoly, which at first will be far from perfect competition. The same happens when the market is dominated by few important buyers; this is the case is referred to as oligopoly. An oligopsony is a market form in which the number of buyers is small while the number of sellers in theory could be large. In both situations the agreements between firms that buy or sell are frequent, existing then the possibility of prices very far away from the ones that a perfect competition would provide emerging. At last, in the limit, there are situations of monopoly or monopsony, in which, depending of the case, just one offer or one demand, acts in the market (Sabino 1991).

petition to be perfect are extremely improbable.[4] The same happens with monopolies in their most pure or absolute form.[5]

Competition is perceived as a key process that forces enterprises to prove efficiency[6] and commercialize at a lower cost with a wider range of product and services. In this way they reflect the growth in the consumers' welfare. Competition also favours innovation, technological change as well as technical progress.

In general, economists consider that competition incites efficiency, multiplies the survival and success chances of companies, which also increases the probabilities of the ideal usage of the limited economical resources.

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[4] There is perfect competition when a market complies with the following five conditions (Barre 2003):

a) *Atomicity*: According to this economic system, a plurality of subjects that participate exists —in principle, unlimited— in the market, offering (*atomist industries*) or acquiring diverse goods and services, economic agents that are recognized as substantially equal legal processing. As a result of it, the price is for the business an external and objective data that is supplied by the general economic process. The business is obliged to adapt its economic behaviour to the changing situation of the market and the consumer freely can elect among several alternatives according to its preferences.

b) *Transparency*: Thanks to the circulation and accessibility of the information on the market, the businesses can adapt its behaviour as well as the consumer, elect among the goods or services offered with sufficient information for it or, at least, with the possibility to investigate it easily.

c) *Homogeneity of products*: The fungibility or sustituibility of the products offered in the market is so large that the consumer has extensive possibilities of option (*homogeneous products*). That enlarges the power as much diminishes it for the businesses. It enlarges thus the competitiveness between businesses and is stimulated them to lower prices, to improve other economic conditions or to introduce innovative products. The economic system, in general, is benefited and, particularly, the consumers, whose power grows proportionally to the decrease of the businesses offers. The economic system, in general, is benefited and, particularly, the consumers, whose power grows so much like. Nevertheless, if a business manages to differentiate a product (product differentiation), it creates its own market which subtracted of the competence of the others.

d) *Mobility of production factors*: the free mobility of the prices to the ones that come offered the goods and services in the market only is possible in a satisfactory way when the factors of production —especially, capital and work, but also land— can be diverted from a sector of economic activity to another or from a geographical place to another, permitting the business to be adapted to the changing circumstances of the market or to the apparition of new economic operators.

e) *Ease of entry*: there is not a state of free competition if the access to the market does not remain open. Artificial obstacles: legal monopolies, customs bonds or technical regulations inspired by the protectionism to the national manufactures— can impede it.

[5] Given that in practice it is common to find next replacements for the majority of the goods and services, the absolute monopolies are quite infrequent, although, the producers can exercise some degree of monopolization in the market, whether for specific characteristics of the merchandise they produce or because they are not offered in identical conditions of time and space with the ones that compete with them. Thus, the pure monopoly results an extreme case, of some comparable way to that of the perfect competence (Sabino 1991).

[6] This term has many meanings. In the context of Industrial Organization and Competition Law and Policy, the term "efficiency" can be understood as the optimal utilization of scarce resources.

When under a monopoly, that is the absence of competition, the situation is very different.[7] The monopoly appears to have a restriction in production since there is always a bigger incentive to achieve efficiency in production through a competitive market, then competition seems to offer the consumer a greater range of election. The competition arranges society's resources in an optimal way in comparison to the monopoly's inefficiency.

c) *Workable competition*

In spite of all that has been previously discussed, when the perfect competition is unreachable and even undesired,[8] some economists have opted for the *workable competition*[9] an economical model reasonable to aspire, since it is achievable when seen from a practical point of view.

The notion of workable competition comes from the following statement: since perfect competition does not exist,[10] the theories based on it can not provide neither valid nor practical orientations for the competition policy.

The idea was first enunciated by economist J. M. Clark in 1940. He argued that the goal of policy should be to make competition "workable",

[7] The monopolist is in a position that can affect the price of the market. He is responsible of all the *output*, and since it is the added production the one that determines the price through the relation supply—demand, it has in its hands the possibility to increase the price by reducing the volume of its own production. Besides, the monopolist, when having as an objective the maximization of benefits, if he chooses not to increase production to the maximum possible. The result of all of this will be that the *output* will be inferior to what it would be in a perfect competition situation. Therefore, consumers would not be able to get goods or services that in a market situation. Occurs in this situation therefore allocative inefficiency: the resources of society are not distributed as efficiently as possible. The objections to the monopoly do not end here. The efficiency in production, will also be inferior by principle, when the monopolist is not worried by the competition forces that oblige him to reduce cost to their minimum level. Besides, he can not feel the need of innovating because he does not experiment the constant pressure of having to gain clients by offering them better and more advanced products. Being this so, it is said that the monopolist's best benefit is the easy life he can enjoy (Whish 1989).

[8] It is not true that the perfect competition is desirable if it can not be established on all the markets.

[9] Also called: effective, possible, practicable or functional.

[10] Perfect competition does not exist or has ever existed, and if the neoclassical imagined such well known equilibrium model it to try to explain how prices are formed but never to serve as a utopian model which lead to economic reality normatively. In the real world, competition is a process of rivalry between businesses that struggle to gain potential customers. In this process, employers are competing with each other using various means, price, quality, service, advertising, etc.—in order to make sales and ultimately profits. Because of this, competition cannot be seen as a mechanical optimization in the context of a known constraints, but must perceive it as an exploratory process developed over time, through which they discover and exploit opportunities for profit, under uncertain circumstances (Pascual 2003).

not necessarily perfect.[11] He proposed criteria for judging whether competition was workable, and this provoked a series of revisions and counter—proposals. The criteria put forward are wide ranging e.g. the number of firms should be at least large as economies of scale permit, promotional expenses should not be excessive and advertising should be informative. No consensus has arisen over what might constitute workable competition but all bodies which administer competition policy in effect employ some version of it.

The theory of workable competition finds theoretical difficulties when it tries to determine its consistence by establishing what must be understood by it.[12] However, it seems that from a workable competition structure as an effect a profit could be expected over the function and behaviour, thus turning into something valuable for the defence and maintenance of the same structure.

Workable competition, in other words, it is a particular model, attached to reality, changeable and integrated by competitive and monopolistic elements, in this there are other types of market structures besides of the perfect competition —the monopoly, the oligopoly, monopolistic competition— and it must be defended, within certain limits, a reduction of the competition in certain economic concentrations, destined to guarantee technical progress and an efficiency level that will derive from the optimum dimensions of the business. Economic competition could not be conceived as a wild conflict —and quite often ruinous— between all of the economic operators among themselves, but as a way of fomenting technological and economical innovations to emerge— negative aspects that classical economists link this to a monopoly. A myth has fallen —the affirmation that free competition must always constitute the rule and the monopoly the exception— and a rigorously imperative demand has imposed: no matter what the size of the enterprise is or how reduced in number, it must keep the climate of necessary economic rivalry safe enough for consumers to be able to dispose of a reasonable possibility of election between different offers. In any case, the benefits of the competition would be assured by the countervailing power of the different monopolistic groups that operate in the offer and demand sector within an hybrid market characterized by the concentration of power

[11] To establish if the competence is practicable or not, J. M. Clark proposed a series of criteria, that other authors have revised subsequently while they formulated a certain number of contrapositions. These criteria are very extensive, being the conditions required especially the following: businesses should be at least as numerous as the scale economies permit them to be; the consecrated expenses of the promotion of goods or services should not be excessive and the publicity should be of informative nature (Glosario de Economía Industrial y Derecho de la Competencia 1995).

[12] There is no consensus on the characteristics of workable competition, but the implementation of the competition policy by the responsible agencies is always based on a more or less adapted version of this notion.

in the hands of few operators concentration of sellers (oligopoly as a rule) and the product differentiation (the conflict between the homogeneity of the goods and services, or the creation of submarkets) (Calvo and Carrascosa 2003).

Competition is the essence of the market economy, so much that it can be said that both terms are, in reality, inseparable: there is no market economy without competition and the existence of competition produces as a result a type of economy that is of market, or that approaches to it. In a market economy, where there exist a great variety of offering possibilities, a scarcely competitive business has few possibilities to survive. This acts simultaneously as stimulus for a greater efficiency and also like a control of the price level (Korah 1988).

The underlying principle of a market economy is that it should be the competition and not the state control or the private monopolies, the best system to obtain a better efficiency, a growing innovation and some lower prices, of which an optimum allocation of resources will result at the same time, some growing living standards, and at least at a long—term a protection of the employment. To produce such desirable results a market economy should maintain a structure of effective competition. Of another way, is said, will turn out to be costly, inefficient and incapable to satisfy the needs of the consumers to the prices that they be willing to pay. In another way, it is said, it will turn out to be costly, inefficient and incapable to satisfy the needs of the consumers to the prices that they are willing to pay (Bellamy and Child 1992).

III. Competition in regulated sectors

Public utilities such as fuel, electricity, postal services, telephones or transportation, have been sectors that for a long time have been organized based on regulation[13] or public regulation and hardly watched by the authorities, alien to the free competition.

These sectors have been organized for a long time as exceptions to the normal rules of competition valid in other sectors, being subjective to strong levels of State intervention. Public powers, political parties and administration in general have fundamented and defended regulational systems which are far away of the principles of free market whose justification has been based on terms of protection to the consumers and to the

[13] Technically by *regulation* it is understood “the rules or incentives based on the market destined to control the decisions of the companies related to prices, sales or production” or, simply, “laws or governmental procedure destined to control the behaviour of the companies” (Calvo and Blanco—Morales 2000).

businesses, as well as to the safeguard of the interest of the company. In most cases, experience has shown that this type of policy has not achieved its objectives, or has done it at the cost of generating other problems.

These public utilities have been economic sectors in which the policies of deregulation and progressive introduction of private participation that have gone applying gradually have impacted with greater force.

In the United States and in the European Union important different programmes of reform in regulated sectors have been introduced for the purpose of doing of the competition the main principle of each one of them.[14]

Although each of the regulated services has its own particularities with respect to the reform in which competition can be promoted among them, one of the most decisive factors is the existing relationship between the services and the complementary infrastructures.[15] This relationship with infrastructures, which is often attributed almost always the character of natural monopoly,[16] has marked the processes of liberalization in recent decades.

[14] Besides the introduction of competition, the reforms have pursued other complementary objectives, that are reached at the same time with this: reduction of the public deficit associated to the subsidies to public businesses, improvement of the productive efficiency in those sectors, search of private participation for the necessary investments in infrastructure, among others.

[15] E.g., in the case of the transportation, air companies must necessarily use airports to provide services, shipping lines serving the ports for loading and unloading goods and passengers, the carriers of passengers by road using stations, shops and warehouses, and railroads, in addition to these elements, also depend on a railway that determines their journeys.

[16] There is a natural monopoly when the existing conditions in the market are so that only one enterprise can exploit this market better than two or more enterprises would. The natural monopoly is owed to the characteristics of the production technology, to which very often are added to the demand, and not to the action of the public powers or the competing enterprises. The natural monopoly can be essentially differenced by a curve strongly decreasing of the medium costs in a long term as well as the marginal costs, this is so that only this enterprise can find itself in a situation of taking full advantage of economies of scale and supply the market. The natural monopoly is explained by economies of scale and important range economies with respect to market demand. It is considered that there are natural monopolies in certain segments of sectors such as electricity, railways, natural gas and telecommunications. By requiring the production efficiency of the presence of a single company, the natural monopoly is often regulated by governments, particularly in terms of price, quality and/or market access (Glosario de Economía Industrial y Derecho de la Competencia 1995). When the competition is not feasible or desirable we find the natural monopoly situation where it is cheaper to meet the demand with a single company rather than with two or more. However, even in this situation there is no reason to completely rule out the competition (Herce and De Rus 1996).

a) *Government intervention and economic efficiency (Economic aspects)*

Around the world, public utilities such as hydrocarbons, energy, postal services, telecommunications and transportation, have been subject to regulations that affect competition in these markets. The used institutions have been State enterprises or State regulatory commissions, which have also restricted the entry to give some monopoly power degree to the offerers.

The arguments that have been exposed rest in the fact that competition produces in many cases socially undesirable results, being the following the most quoted: instability of the services, product of the precariousness in which businesses should have to unfold, excess of capacity, deterioration of the quality of the services, increase of the uncertainty and loss of security. To these reasons one must add the existence of natural monopolies in some regular industries (e.g., in the transportation sector such as the railroad) where a single company (at least in which infrastructures are referred to) can produce in a lower medium price to which two or more would do it (De Rus 1992).

Economist resort to two interpretations by what the public intervention in the markets is produced. One of them is the theory of the public interest associated to the failures of the market and its necessary correction through the intervention of the State.[17] Set against this interpretation, the positive theory of regulation (Stigler 1971) maintains that the limitations of the competition are born and designed for the benefit of the own industries, thanks to the power and to the pressure that these exercise and to the own interest of the regulators with far away private objectives of the simple maximization of a function of welfare.

Inside the economic philosophy of the public interest there are at least three reasons to justify the state intervention (Kay and Vickers 1988):

i) Sometimes there are no competitive solutions, as is the case of natural monopolies or when the irretrievable high costs exist. In both

[17] The government intervention in the economy has essentially stems from two reasons: market failure and redistribution of income and wealth. The fact that the market is unable to resolve, in some situations, problems such as: achieve an efficient allocation of resources, produce goods and services, externalities, imperfect markets, as well as reasons of inequity and injustice in the sharing and distribution of wealth, among other reasons justify state interference in economic activity. Economic theories of government behaviour can be analyzed as a "public interest theory" for which its intervention is based on the need to address inefficient allocation of resources, proceeding as an agent able to act in the social interest and a "public choice theory" acting on the basis of policy decisions and the various pressure groups (voters, bureaucrats, political parties, etc.) as the result of the operation of a political market with the mutual interactions of all components. The traditional view of regulation is the theory of interest groups based in the assumption that the government intervention can solve or eliminate a lower cost than private organizations imperfections arising in the market (Ordoñez 2002).

cases the competition can be destructive and to conduct to a waste of considerable resources.

ii) Although competitive solutions are possible, they might be unattainable, since the established businesses dissuade the entrance of the potential competitors by means of barriers of diverse kind.

iii) It might happen that though competitive solutions exist and are reachable, they might not be socially desirable. This is the case of industries with strong externalities, existing differences in information that economic agents have, or simply when the obtained results are rejected for equity reasons.

For its part, empirical literature on the effects of the economic regulation allows to emphasize some common characteristics (Joskow and Rose 1989):

i) In contrast with the theories of the public interest, the economic regulation produces effects that do not favour the attainment of efficient results.

ii) In regulated monopolies, the structure of prices and the distribution of income among groups of consumers reflects political and distribution goals instead of efficiency goals. In addition, the regular prices are not necessarily lower than the ones that correspond to a structure of market with several companies and free entry.

iii) In this market structure, the effects of the regulation are more complex. There are industries (like the air transportation) in which regulation seems to have been designed to protect to the established companies, so competition has developed in other ways, different than price fixing and revenues distribution. In others, where the regulation of the prices has been in use for the benefit of the consumers, reduction of the quality has been favoured as well as the level of service.

iv) Economic regulation has direct and indirect important effects on the costs of production and the quality of the service. The technical and productive efficiency as well as the quality and variety of the services will be affected by competition not prices.

v) Regulation produces complex and variable impacts on the income distribution. Transfers of consumers to producers are one of the possibilities. Another one is the distribution of revenues with the factor I work, supported by the force of the unions when the prices and the entry are regulated.

vi) The regulatory structures are insensitive enough to the changes in the economic exogenous forces. They only answer to deep changes in the economic and political environment.

It must be mentioned that there is wide evidence in the developing countries of the differences in efficiency between private companies in competitive situations and protected companies (usually in the public sector). Equally, there is also considerable evidence that the activities of the workforce in the ministerial departments are less efficient than the competitive contractors of the private sector.[18]

b) *Competition and regulation in marketsof general interest*

One of the characteristic of the economic policies in recent years has been the transformation of the government bond in the organization of big public services, inside a process called neo—liberalism or neo—regulation. This way, public services in a country, such as hydrocarbons, electricity, gas, postal systems, telecommunications or transportation,[19] have changed the regime of monopoly and public management, in the one that traditionally they were giving, for a new model of exploitation, in the market regime and under private management.[20]

[18] In the routine maintenance of the road in Brazil, the costs across contract were 25% lower than those of the proper workforce and in Colombia 50% lower (Gwilliam 1998).

[19] Professor Santiago González—Varas Ibáñez asks whether we need a new term or legal category to designate economic sectors, such as these, which have traditionally been characterized as public services (public economic services). He mentions that once this designation has properly and adequately explained the legal regime: the assumption by the public sector activity (through *publicatio*) of direct or delegated management, the possibility of monopoly, free organization of the activity by public power system of administrative law regarding this type of organizational decisions or their control. Professor González—Varas said that today this name (utilities) can be discussed as appropriate to define these economic sectors, and by analyzing the basis of the changes they have experienced in recent times (oriented towards open markets and competition), he mentioned other conceptual options, such as: sectors, public services in competition regimes, markets, regulated markets or markets and services of general interest, noting that the latter name is regarded as the most consistent with the legal reality of today. A legal concept such as “market or general interest services” is to still fit within these sectors mainly administrative law, without ignoring the presence of private law. It is in public—private areas where the presence of administrative law is a constant. This does not mean that if one day the budgets of public service return (replacing the current market and liberalization) the name of public service will also return. Moreover, there is no reason to talk about public services or services of general economic interest, where both of their budgets combine. The decision in favour of the conceptual options mentioned, among other possible, must be made first, after a brief tour of the articles and the preambles of the laws governing. Second, we must investigate the actual legal nature of the activities or sectors, determining whether we are dealing with services or markets. The public service may appear in a particular activity (e.g. The road to permanent regular public transportation of passengers in general use). When this is so, not only the term “public services” “may” be used. It rather, “should” be used. Most commonly, however, these services also have become, —or are becoming— markets, although with a strong and decisive government regulation and public stamp, for example, establishing tariff regimes or “public service obligations” (González—Varas 2001).

[20] In this they have consisted, basically, processes of privatization prompted by some govern—ments in recent years (Spain, for example). Their essential element has not consisted of selling businesses, but of privatizing activities, before reserved to the State and, at most, offered in concession

In these sectors, the introduction of competition has not consisted only in “liberalization processes” (removing entry barriers to the exercise of the activity.) On the contrary, in these activities, the processes of privatization and liberalization have been accompanied by a new regulatory model for the competition, because given the natural monopoly characteristics present in some stage of their collusive activities and trends in these sectors, theoretical privatization and liberalization may eventually lead to natural monopolies, private, or more so inefficient that the monopoly state—owned utilities.

Two different types of “regulation” can be distinguished (López de Castro 2003): one is the external regulation, usually called “administrative police”, which refers to those conditions of security, health, protection of the environment and physical location, where economic activity develops, without entering inside it or predetermining managerial decisions. Another type of regulation is called “economic regulation” (public utilities), it is focused on the entry and exit of the activity (in many cases, through concessions) and affects economic conditions in which the activity takes place: the quantum of production, areas or markets that every company serves, the prices or fee that are perceived by it and, definitively, the business of which the activity consists by itself.[21]

Regulation, in general, always appears because of the no—existence or failures of the market. In this way, regulation —especially economic regulation— is for definition the substitute of the market. For the same thing, the characteristics that regulation must assemble are orientated to obtain the beneficial and stimulant effects that this one produces: it must define guidelines of behaviour, transmit signs and messages that facilitate the orientation of the agents and the fulfilment of desired political aims, demand quality and security standards as well as fix the prices when needed. In everything else, the suitable thing must be to open routes and channels for the managerial freedom and to create incentives, such as the ones the market does, for the more efficient management of companies.

In the classical model of regulation, which until now has presided over major public services such as transportation, the regulator, which came to replace the market, is who assume most of the decisions: the planning, conduct investment, financing, accounting regime, the prices of all types, optimization and management of the exploitation and, finally, even the smallest business decisions are determined, conditioned or simply ordered by the authority.

to individuals (for its indirect management —as indicated it their respective codes—, given that their ownership corresponded to the Administration).

[21] This second type of regulation, which traditionally presided over public services is the question at issue, not because of its existence, but as to the meaning and aims which are sought.

On the contrary, in a decentralized and opened system, as the one portrayed by recent sector liberalizing laws, regulation receives another sense (Ariño 1993): it does not have as central aim the "control" —of the system and its operators— but, on the contrary, it tries to promote competition when possible, and it limits itself to protecting the interests of the users —security, quality and price of the service— where this maintains the characteristics of a natural monopoly.[22]

The aim of regulation is not so much to control to the companies, as to protect society when executing activities that turn out to be essential for its life and welfare. Therefore, the fundamental aspects to which it has to be orientated are two: to guarantee the present and future presentation of the service, as well as establishing the accurate levels in the quality – price ratio, according to the degree of development and the priorities that every society wants to establish. Regulation will be justified according to the length in which the intervention and in the managerial decisions in this activity as necessary as indispensable.

c) *Regulated markets (Regulated competition)*

It is important to emphasize that the introduction of competition in sectors such as oil, electricity, telecommunications or transportation, does not lead to "free" markets, but "regulated" markets. The social importance of these activities, the asymmetry of positions between enterprises and users, the difficulty of creating open and transparent markets, technical limitations and other factors, demand it.

Now then, because of the failure of traditional regulation (substitute of the market), the search of the best way to reach the objectives of the economic efficiency and the good service to the citizens is not raised as a dilemma between perfect competition, which is impossible, *versus* perfect, equally unattainable regulation. The new model of regulation for competition consists precisely of this: in introducing a major competition in those aspects or activities in which this one is possible and in checking or reforming the sense of the regulation orientating her to the re—creation of the market. This way, competition and regulation are not antithetic but complementary, as the British or North American experience has demonstrated it.[23]

[22] It has been distinguished recently the "social-regulation" (e.g., in environmental matter, security, etc.) that "does not affect to the conditions of the competition" and the "economic regulation" that though this presents two modalities. In its traditional manifestation, it is a "regulation that harms competition" to affect the level of prices and investment, while in the current deregulation process (neoregulator) is a "regulation that promotes competition" (López de Castro and Ariño 2003).

[23] Alan Jowett has discussed this dichotomy in the British case, highlighting the growing similarities of the approaches developed in the regulation of the United States and Great Britain. In his view,

The game of competition and regulation demands as inexcusable condition the transparency in the managerial functioning, which in turn claims a careful demarcation and separation of the diverse activities of which the sector consists, in such a way that the crossed subsidies cross from one to another while the correct information is provided to executives, shareholders and regulators for decision making.

d) *Regulation: means to promote competition*

In the difficult balance between market and regulation, competition is the priority aim and the regulation is the necessary instrument to promote it (or create it when it does not exist) or to replace it when its creation is impossible because of the existence of natural monopoly elements.

The market has many advantages, but in order for it to exist and work correctly, it is necessary, in many cases, that the State creates a legal and institutional framework. The fields were developed in preference to public enterprises (utilities) are not perfect markets, but on the contrary, they demand to come, major investments, supply and demand are rigid, the information is very uneven and ultimately Competition is low and easy to articulate monopolistic and oligopolistic organizations clearly harmful to society as a whole. Only when the state assumes its functions to create an institutional framework that imposes constraints and obligations to those who act in these areas.

The fields of public companies (utilities) are not perfect markets, but on the contrary, they demand, to enter, big investments, the offer and demand are rigid, the information is very unequal and, definitively, the competition is scarce and monopolistic and oligopolistic organizations that are clearly harmful for society are easy to articulate. Only when the State assumes the functions of creating an institutional framework for imposing limitations and duties to those who act in these sectors, it could cause a market, imperfect, but much more efficient than the public monopolistic management existing still now.

In this way the regulation always will be necessary but it must be only indispensable, diminishing, subsidiary and complementary of the market. The regulation promotes the market, reconstructs it when and where it is possible, it defends it, but it does not replace it.

despite the title of his article, *Competition vs. Regulation*, there is no intrinsic opposition between the two concepts for two reasons: first, because unbridled competition is not desirable; and second it, because in Britain, privatization of utilities has been accompanied by a specific regulatory framework to promote competition and to ensure public service's missions of these activities (Jowett 1994).

e) *The model of regulated competition in the public services*

The essence of the change to the model of regulated competition is reflected in the new concept and regime of these public services. It consists in going from a system of public ownership, closed concessions, exclusive rights, obligation of supply, administrative fixed prices, temporary character (with reversion/rescue in any case) and total regulation of the activity, up to the most minimal detail, to an open system, presided by the freedom of company, this is, liberate of entry (previous given authorization), with certain obligations or loads of public service (it is a question of interest of general service for the people), but with freedom of prices and modalities of service, with freedom of investment and amortization and, definitively, in regime of open competition, as any other commercial or industrial activity, in which there is a fight for the client (there are no reserved markets nor captive citizens). Of course, in this second model there is no reserve in favour of the State over this activity.

Therefore, the fundamental change is a real *despublicatio*: the new public service activities are no longer state-owned but private. However, these activities are still under state responsibility to the extent that its performance at a given level must reach all its citizens. And in the measure may be needed state funding.

f) *Public services*

The industries that we have mentioned here, as the hydrocarbons, electricity, transportation, telecommunications or postal services, among others, have been submitted to public monopolies and, therefore, removed from the game of free competition and the action of private operators: they have been "regulated sectors". In almost all the cases, the reason by which a certain sector is excluded from the competition resides in the crucial concept of "public service".

The notion of "public service" comes from the French Public Law and has been extended to the rest of continental Europe, acquiring all its height in the bosom of the welfare state arisen in the post-war. The concept of "public service" passed from including all those activities, with a major or minor economic component, considered essential for the citizens, who need a general, attainable and homogeneous service, reaching a few minimal thresholds of quality. This way, the public service started to cover basic needs of the citizens.[24]

[24] As for example, the supply of water and electricity in the homes, the access to the health and to the education, the possibility of having telephone and postal communications at attainable prices or the withdrawal of garbage in the cities or the transportation.

Traditionally, public authority (national, regional or local) took charge of these services, having been the only person in charge of its service to the citizen: that explains why very frequently the State had to implement public monopolies in these sectors, excluding them from free competition and from the share of private operators.

In general, the sectors that take part in the notion of "public service" present a series of principles or common basic elements, independent to the peculiarities of each one of them: the above mentioned principles are continuity, quality and equality of treatment of the citizens.

As a matter of fact, benefits included in the concept of public service can not be subject to uncertainty regarding its temporal continuity. Citizens could hardly accept such services provided themselves intermittently, or in some cases permanents. Also, users have come to services with certain levels of quality, which can cause severe social discontent.

A key element in the provision of public services is the principle of equal treatment and uniformity of rates. In this sense, the importance of benefits mean that only citizens with a certain level of purchasing power can access them, or that the respective rates vary by place of residence of users. This component is based on solidarity and redistribution inherent in the own conception of the welfare state.[25]

There are solid reasons for maintaining certain economic sectors sheltered from competition, if private operators acted freely on these sectors, the defining principles of public service would be seriously compromised.[26]

g) *Liberalization and privatizations*

The opening to free competition, in regular sectors tends to increase the productive efficiency and the final welfare of consumer or users: the introduction of competition would imply the almost immediate reduction of prices and rates, the improvement in the quality of the services and a major

[25] By this we mean that there is no usual direct relationship between the cost of service and compensation required of the citizen, we think, for example, in transportation services where their costs are lower in large cities (under the same infrastructure serves many users) in isolated rural areas. Using criteria based on pure performance, the fee would depend on the actual cost of service, which would discriminate against some citizens from others and this requires that the minimum services (the so-called "universal service", a term commonly used in telecommunications) are delivered homogeneous conditions for all users, resulting in the same time economically affordable.

[26] In fact, it should be assumed that the private enterprises would only pursue the economic profit value, which would suppose the automatic application of the criterion of the cost: thus, there would be benefits that, simply, they would not interest private investor, while in other would break the homogeneity of the rate.

possibility of election for the user since available presentations are diversified.

This not only increases the level of welfare of the consumers or users, but when stimulating the consumption of goods and services a multiplier effect is produced in the offer, which makes the economy grow as a whole.

The convenience of liberalizing becomes clearer in the sectors whose economic component is higher, as are the activities that traditionally have been regulated. As a matter of fact, these benefits easily reverb in the users by means of prices or rates applied directly to whom they subscribe: this factor can allow these sectors to receive several operators who act simultaneously in a competition regime. [27]

This way the liberalizing option on regulated sectors seems especially tempting for the State for reasons of economic efficiency. Nevertheless, the key question resides in guaranteeing a minimum of public service with the conditions and principles above-mentioned, that is why the decision to liberalize a certain regular sector and to plan the limits of the eventual liberalization concern the area of the economic sovereignty of the States.[28]

Intimately related to the eventual decision to liberalize a certain regular sector one finds the possibility of privatizing the public companies that operate in it. This way, the governments that try to undertake the liberalization of regulated sectors there must think about if it is beneficial to privatize also the public operators who remain in the sector.

In this context, there must be kept in mind that the hypothesis of the liberalization of the sector without carrying out a privatization of companies presents some risks; in effect, the introduction of competition will provoke the corresponding reduction of prices and rates, which will suppose a decrease of the financial performances of the State in relation with the income obtained by the former public monopoly.

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[27] In contrast, services such as social assistance, the education, the cleaning and urban maintenance or the public security are less translatable in economic considerations, as for its nature is less individualizable than other services, like transportations. In other words, the liberalization will be less indicated for the sectors with scarce economic component, in as much as that the private users eventually interested would find more difficulties to obtain a profit value based on the considerations of the users (Gómez-Acebo 1997).

[28] It must be said that the European Union on European law itself, which holds as one of its basic principles of free competition, allows Member States to exempt the companies responsible for the operation of services of general economic interest.

Article 106.2 of the of the Treaty on the Functioning of the European Union, literally states: "*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 the Treaties, 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 Union.*"

This implies a significant reduction of State revenues which needs to be compensated, especially in times of deficits and fiscal adjustments, and the privatization would appear as the suitable way to solve the pointed problem.

On the other hand, the option to *liberalize without privatizing* presupposes that public companies remain submitted to the same rules of competition, not being able to receive a more favourable deal; in addition, the application of the procedure of free competition will demand the full transparency of the financial relations between the State and public companies.

If on the contrary opts for *privatizing without liberalizing* the sector, will be constituted what traditionally has called the "abandonment of important incomes to private interests" (Gómez-Acebo 1997), or, more simply, the replacement of public monopolies by private monopolies. Without doubt, this decision would permit to the State to increase its incomes, although the increment of the economic efficiency and the obtaining of the benefits for the consumer would be in doubt, resulting from an opening of the market to competition.

The last possible option is that of *privatizing* and to *liberalize* at the same time. This solution supposes an ideal scenario for a regulated sector with a high economic component and, therefore, susceptible to receive the action of various operators in a regime of free competition, besides, the State monopoly should be articulated by means of a public company with patrimony and autonomous structure that can be easily alienated to private investors.

In the processes of liberalization and privatization of regulated sectors, the State should ensure the safeguarding of the public service element. Or another possibility is to open completely the market to private operators, but subject to strict legal regulations to guarantee the provision of public service under acceptable conditions for users and consumers.

IV. Conclusions

The competition, idea originally developed by economic science, has had in the last times notable development. Competition is a mechanism that contributes to the efficient functioning of markets for goods and services. It is the mechanism that permits a market economy to function. Though economic[29]

[29] To assure the efficiency of the productive system, to improve the assignment of resources between the different sectors, to distribute the wealth among the different sectors of the population, to stimulate the production, the research and the innovations.

and other non-economic[30] effects can be distinguished, like Adam Smith argued, it leads to a spontaneous social and productive order.

The development of competition is different depending on the proximity to the free or regulated market models. Because of this, the competition law and policy are necessary elements. It should be noted that competition policy is much more than the single application of competition law. In competition policy is based, among other things, the opening to competition of regulated markets. Competition policy covers aspects of liberalization, deregulation and privatization, necessary and complementary elements to achieve the efficiency of those markets. These aspects should be implemented carefully, since they can lead to anticompetitive effects, for example it can happen that a public monopoly can be transformed in to a private[31] one and that the deregulation fails to prevent anticompetitive conducts. Because of this, even when deregulation is friendly with competition, in the case of traditional regulated sectors, regulation is necessary to avoid market abuses. Therefore, a model of regulated competition is applicable in these markets, given the characteristics of natural monopoly present in some phase of its activities, its power of control in the market and the collusive tendencies that the offer presents.

As a result from the failure of traditional regulation (market's substitute), the search for a better way to achieve the objective of the economic efficiency and the good service for the citizen can not be considered as a dilemma among perfect competition, which is impossible, *versus* likewise unattainable, perfect regulation. The new model of regulation for the competition consists exactly in this: in introducing a greater competition in those

[30] Decentralization of the economic power, reduction of the field in which the private will can affect on the third party's welfare, incentivation of the individual possibilities of exercising managerial functions and the trend to structure society by means of units more limited and closer to individual worries.

[31] Privatization does not signify a mere evolutionary question, on the contrary the measure should be based on the criterion and purpose to reorganize to the public sector, to diminish or even to eradicate the expenses that these activities involve for the State and, therefore, to do them economically profitable.

The privatization should constitute an opportunity to obtain improvements in the operation of the businesses affected in the assembly of the economies. It should open the doors to the assembly in the markets of products and factors and in the same businesses as for productive units. The dynamics of the privatizations is double: to reduce the dimensions of the not business public sector and to enlarge its efficacy. Privatization, performed according to the appropriate methodology, substitutes the intervention of the prone, political power to depend on transparent little incentives, by the mechanism of the market in which what counts are the costs and the prices, not the political influences. It liberates the public sector of superfluous tasks, permits it to be concentrate on what constitutes its main task, the provision of goods and public utilities. After privatization the existence of an independent organ is considered important to supervise the provision of goods and services, as well as the conditions of competence. The State cannot respond of total way to privatization, therefore cannot abandon responsibilities that are its own.

aspects or activities in which this is possible and in revising or reforming the sense of the regulation oriented to the re-creation of the market. Thus, competition and regulation are not antithetic but complementary.

In the difficult equilibrium between market and regulation, competition is the priority objective and the regulation is the necessary instrument to promote that (in order to create it when it does not exist) or to substitute it when its creation is impossible because of the existence of elements of natural monopoly. The market has many advantages, but for it to exist and function correctly, in many cases is precise that the State creates an adequate legal-institutional system. The fields in which companies operate these activities are regulated markets (commonly public companies —utilities—) are not perfect markets, in order to enter into them a large investment is required, the offering and the demand are stiff, the information is very uneven and, at the end, the competition is scarce and monopolistic and oligopolistic organizations, which are clearly harmful for the assembly of the company are easy to articulate. Only when the State assumes its function of creating of an institutional framework that imposes limitations and obligations to those that act in these sectors, can a market be originated, most likely imperfect, but more efficient than the monopolistic (and generally public) management existing up to now. Regulation will always be necessary but it should be only indispensable, decreasing, subsidiary and complementary of the market. The regulation promotes the market, it reconstructs it whenever it's possible, it defends it, but it does not substitute it.

The introduction of competition can take place either *in the market* or *for the market*. The first one is the freedom of entry and exit and to decide prices and quality services by the interaction of the offering and demand, although some intervention is possible to establish quality standards, for example, without altering the essence of the competitive mechanism. The second one is to compete for the right to be the only bidder. Through public tender interested companies make their offers and the State decides, according to criteria previously established and announced. The competition is only established *ex ante*, and once awarded the tender to operate a single company in the industry, according to the contest.[32]

In the case of infrastructures it has been obviated that although there are significant advantages by having a single company (natural monopoly), there is no reason to resort necessarily to the traditional solution of eliminating competition. Before these circumstances, two models have been abundantly utilized. In first place, the vertical disintegration, this has

[32] In activities with elements of natural monopoly, which costs saving potential, proceeding from the coordination and the integration, is major than the earnings derived from the introduction of competition, it is possible to introduce competition through the market across concessions or licenses in *limited periods*.

consisted in the separation among the different activities or services of an infrastructure.[33] The second option can be the horizontal or geographical disintegration, which consists in a defragmentation by regions. The viability of these models varies according to the geographical dimension and evolution of the systems, for example of transportation of each country.

In these contexts the *essential facilities doctrine* —which originated in the American jurisprudence— occupies special importance. In order for the market to exist it is precise to recognize to all the users free access to the same market, as well as to those installations or infrastructures on which the provision of the services rests. One must recognize to the operators the right of access to the infrastructures, that is, the right of access to the market. The effectiveness of this access will determine the real competition in the provision of the services.[34] A key item of the new model of regulation for competition is the establishment of the conditions to exercise the access in non-discriminatory, objective terms, fixing a canon by its use and exact decision of the reasons that could justify an access denial.[35]

In potentially competitive activities, regulation is subordinated to the market, which is the general rule: it amuses and defends it. There is free entrance and exit in them, with an authorization of regulated character. They are completely free activities. In those activities with difficulties to be exercised in a state of free competition, for some reasons (elements of natural monopoly in networks or infrastructures) or by other (instalment of the universal service), the regulation (as well as the control in entrance, salary, prices, exit.) comes to replace the free enterprise, but should utilize mechanisms that cause smaller distortion to the market.

Competition and regulation have been conceived as the adversaries. The regulation applies better to counteract the effects of the market and not for guarantee the result that to have been obtained in a market operating efficiently. Regulation is used to counter rest the effects of the market and

[33] For example, in the railway transportation they can separate, on the one hand, railroads and stations, and on the other hand, other complementary services. This implies going from few companies or only one integrated vertically to several different, with delimited well functions: exploitation of the infrastructure, provision of load or ticket services, rent of coaches and locomotives, maintenance, etc. This was the case of the reform of the British Rail in 1984 in the United Kingdom.

[34] Because of this, the assignment of the rights of access and their conditions has to remain defined with all precision in the regulation. Some ends can be left to the initial bilateral negotiation (the toll fixing for agreement between the parts), but if the agreement does not come, clear rules as well as a rapid and executive decision that forces all must be established.

[35] An excessive canon is equivalent to a refusal. On the other hand, this model of regulation, that answers to the doctrine of the *essential facilities*, supposes a break with the traditional concept of *right of property*. In the traditional conception, the property is formed as the right of use, enjoyment and disposition in sole right. On the contrary, in this new regulation of public services, for the competition there appear to be *properties used to public use*: the property falls ill to the use of a few third parties that have right to trust in them.

not for guaranteeing as a result the most efficient. The regulatory policies are not conceived as instruments of the state to promote the economic efficiency and in this way to preserve the public interest. On the other hand, is perceived rivalry between the policies used to promote competitiveness and competition. Traditional conception, very established, is that in order to fortify the competitiveness of the economy one must create barriers of entrance. Or, one must offer subsidies or supports to the national companies so that they can face competition in the interior as well as abroad. It is also thought that companies can utilize its dominant position in the domestic market, so it can serve them as a support to compete in the international markets.[36]

In general terms it can be said that liberalization and competition in the regulated sectors are potentially an important source of increments in welfare and productivity. Important effects of the competition should be to reduce prices, improve quality and accessibility in the services. Finally, in spite of the advances, the levels of competition reached yet are not as deep as they could be, reason why the work in the promotion, development and protection of competition should continue.

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[36] Any of these options is contrary to the competition processes and policy, which aims to eliminate barriers, subsidies and grants to prevent and combat monopolies.

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