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## **The Defense of Monopoly as a Determinant of the Process of Transformation of State-owned Infrastructure Sectors in Poland**

by

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### ***Abstract***

This paper aims to prove that during the transformation process in Poland of the sectors of general economic interests due to specific economic characteristics of those sectors and the fact that interests of three groups participating in the decision making in this process: government, management and employees turned out being non controversial prevented loosing the monopoly status they initially enjoyed. The method used was the analysis of the stages of negotiation illustrated by subsequent documents of official strategies chosen for three sectors: railway, electricity and the final result illustrated by the structure of the market. Preventing the monopoly status permitted those groups seeking the rent, the monopoly status created or even demand that rent in the form of subsidy from the public authorities budgets by the threat of the strike which is the grave threat in the sectors delivering the service of general economic interest.

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**Classifications and key words:** infrastructure, public capital, public service obligations.

## I. Introduction

The main purpose of this paper is to prove that during the transformation process of the Polish sectors of general economic interest<sup>1</sup> a wide range of actions were undertaken by a number of interest groups in an effort to maintain their monopolistic or quasi-monopolistic positions. It will also be shown that the following two factors played a major role in this process: (1) specific economic characteristics of the sectors, and (2) the undisputed interests of three major players who shaped the transformation process.

The thesis of this article will be presented by analysing the transformation process of two selected sectors: railways and electricity. A comparison will be made between subsequent strategic plans applied by public authorities in each sector. The selection of these particular industries was intentional because, at the outset, they significantly differed in their organisational structure. This paper is intended to prove that the initial structure of the monopolistic enterprises had no influence on the outcome of the transformation process which, for both sectors, was the preservation of their monopoly status. It will be shown that the analogies in the transformation processes of these industries have brought them, step by step, to become comparable oligopolistic structures.

Initially, the electricity sector was structured to be quasi-competitive, under regulatory induced competition, while the railway industry was from the outset designed to be an unquestionable monopoly. However, to explain their transformation process, the real interests of the parties involved in it will need to be identified. To do so, this paper will present an analysis of the reasons behind the transformation steps progressively taken by public authorities, but subsequently withdrawn. This way, the degree will be shown, to which the influence of special interest groups shaped, or changed public initiatives that were unacceptable to them. Judging by the results and theoretical analyses, similar phenomena are quite likely to be occurring in other European countries. Nevertheless, the documents that are used here in an attempt to prove the paper's hypothesis, relate to Poland only.

The basic theoretical assumptions that frame the aforementioned arguments are easy to understand. A monopoly (a dominant position) allows an enterprise enjoying it to extract the so-called "monopolistic rent". In economic theory,

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<sup>1</sup> The term introduced by the ECC in: *Green Paper on Services of General Interest*, Brussels, 21.5.2003, COM (2003) 270 final.

a company is treated as a unit and is personified. That means that the enterprise “acts” in the market and “makes” its own decisions and also, that something “lies in the interest of the enterprise” and so on. However, according to the theory of organisation, in reality only people can have interests and make decisions. There are groups of people that have either the same – sometimes merely non-conflicting – or contrary interests. In this paper, a company will be considered to be an organisation. The main interest groups acting within that organisation will be analysed. The paper will consider the competence of each group to make decisions in the name of the enterprise and the power of other groups to influence such decisions.

Within a company, three interest groups can be identified: the owners, that is, the representatives of the government; the management; and the employees. This approach calls for one more party to be considered, namely, the state seen here as a law constituent and deemed to be the representative of the interest group formed by consumers of monopoly products or services. In the following discussion, the term “state” will be used when discussing its actions as a law constituent. When casting the state in the role of an owner, the term “government” will be used. If both the state and the government act as law constituents, they will be referred to as “public authorities”.

At the beginning of the transformation process, the government was the only legal owner of the two sectors in question, that is, their monopoly was guaranteed by law. A state enterprise was an organisationally independent unit, administered by an executive board. The first step in the transformation of both sectors came with the withdrawal of their legal monopoly status. This step constituted a formal change from a monopolistic, to a dominant position. That notion will be noted later in the discussion in the context of “defending the monopolistic position”.

## **II. Infrastructure as a distinct, although not distinguished, economic and legal group of sectors**

Even though services of general economic interest have a clearly defined place in the national economy<sup>2</sup>, they do not appear under a separate heading in the “services” section of the national statistics. Furthermore, services of general economic interest have been controlled and their activities regulated by various state authorities, but they have never been legally recognised as a single entity and, as such, have not held any particular place in economic theory.

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<sup>2</sup> Legally defined recently in: *Green Paper on Services of General Interest*, Brussels, 21.5.2003, COM (2003) 270 final.

In most economic papers, services of general economic interest are usually defined by itemising<sup>3</sup>, a good example of which is a division into the following broad categories: transport, energy, communication and communal utilities (water etc.).

These infrastructure services share many key characteristics. The most significant of them is the natural monopoly phenomenon that continues to prevail even after their legal monopoly has been withdrawn. The natural monopoly present in these sectors is closely related to a distribution network. Each network, dedicated to a specific kind of goods, is essential for connecting suppliers to consumers. An interchange of networks is technically impossible (oil or gas pipelines cannot supply electricity) while it is economically irrational to install two parallel electric (telephone, etc.) cables in one house or factory. Similarly, no person would ever consider building parallel rail tracks.

Establishing a network system always requires a substantial initial investment. Once the specific structure is in place, the cost of adding a new end-user is minimal. All networks have a similar cost structures that differs from the one adopted in micro economic theory. Its main features are: extremely high initial investments; a long wait for the return on these investments; very high maintenance costs that are irrespective of the level of exploitation which, in turn, leads to high fixed costs and low variable costs; a high risk of loss on these investments (in case of business failure, the assets are rarely transferable). As a result, new entry into a market where another enterprise is already operating involves a high level of risk. These features have caused, at a certain stage of the history of economic development, the nationalisation of these particular sectors.

At the outset of the transformation process in Poland, services of general economic interest were purposely excluded from privatisation by legislation<sup>4</sup>. The Act of 1996<sup>5</sup> repealed the Act of 1990, but created a delegation for the government to issue a regulation which should define the companies of special interest to the state and economy the privatisation of which will require government approval.

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<sup>3</sup> See K. Bobińska, "Ekonomiczna racjonalność finansowania usług użyteczności publicznej" (2005) 4 *Studia Ekonomiczne*; the article contains examples of the various approaches to itemising applied by different authors.

<sup>4</sup> See Act of 13 July 1990 on privatisation of state-owned companies (Journal of Laws No. 51, item 298). It was the first legal act that allowed transfer of public enterprises to private ownership. The Regulation of the Council of Ministers of 1991 listed the enterprises of special importance: among them, power plants, power stations, the railways, telecommunications industry, transmission networks, the water boards, gas and oil pipelines, as well as distilleries and refineries.

<sup>5</sup> The Act of 30 August 1996 on commercialisation and privatisation of state enterprises (Journal of Laws No. 118, item 561).

One of the goals of the Act of 1996 on commercialisation and privatisation of state enterprises was to introduce the relativity of the notion of ownership change. The Act of 1990 had underlined that the privatisation of public enterprises was the principal objective of the reforms and that only privatisation meant ownership change. Unlike the Act of 1990, the Act of 1996 spoke about a transformation of a state enterprises into a single state-owned shareholding company that represents another legal form of state ownership.

The Regulation of the Council of Ministers of 1997, implementing the Act of 1996, identified which entities hold special importance to the national economy. It adopted a more liberal approach to privatisation in general. However, privatisation as such is not the subject of this paper (a public monopoly can easily become a privately owned one); the issue considered here is a comprehensive de-monopolisation of the market.

The Act of 1996 on commercialisation and privatisation of state enterprises has unexpectedly proven to obstruct the process of dividing the previously monopolised sectors of general economic interest because it included a clause that entitled workers to a 15% share of the monopolist, free of charge, provided the company became a public company. The vertically integrated, huge state monopolists encompassed, however, varied elements, some of which were worth a significant amount, while some, next to nothing. Furthermore, some elements were released for quick privatisation, some were to stay public. The workers of the state monopolists wanted shares of equal value. The company could then start any operations (divisions of property), using its shares but not its assets, as it was allowed to do under the previous law. It soon became evident that before the employees agreed to divide the entity, the method of division of its shares had to be agreed on first.

Such legislative prerequisites opened the door to all sorts of pressurising by various interest groups within the company to be privatised. The manoeuvrings in the sectors of general economic interest started when the Polish government was getting ready to incorporate a series of Community directives that defined the process of liberalisation of sectors of general economic interest. The analysis of those factors that influenced the shape of those rules will be the subject of further discussion in this paper.

“If the form and realisation of political economy were based on a unidirectional influence on the systems, structures, and divisions it deals with, most decisions, with respect to production, allocation, or other values, would be favourably made (by “ I mean here “close to perfection”) (...). However, in the real world interactions exist, and economic politics is not some external element unrelated to its subjects”<sup>6</sup>. Neither the shaping nor

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<sup>6</sup> See A. Walczykowska, “Koncentracja a aktywność polityczna korporacji” [in:] M. Raczyński i inni, *W pogoni za rentą*, Warszawa 1998.

the realisation of regulatory or anti-monopolistic strategies is an activity that is free from external influences. Any analysis of the transformation process occurring within the sectors of general economic interests should bear this in mind.

### III. Tactics of interest groups during the transformation process

Niskanen (1971), one of the precursors of the approach presented in this paper, wrote: “[a]mong the several arguments that may enter the bureaucrat’s utility function are the following: salary, perquisites (...), public reputation, power, patronage, output of the bureau, ease making changes, and ease of managing the bureau. All of these variables except the last two, I contend, are a positive monotonic function of the total budget of the bureau during the bureaucrat’s tenure in office”<sup>7</sup>.

In a monopolistic environment, rent seeking – an activity where firms are trying to achieve or secure a favourable position on their markets – has been an integral part of modern economics for a long time. The first economic theories concerning this issue were discussed by Tullock (1967)<sup>8</sup>. Early commentators showed, in various scenarios, that the social cost of legally guaranteed monopoly was much higher than an average cost of market failure because a monopoly, seen as an organisation, was able to wrest for itself more privileges.

According to Krueger (1974)<sup>9</sup>, the term “rent capture” generally means swapping market mechanisms for governmental interference in the allocation of both labour and capital resources. The result is that subjects concentrate their activities on competing for, or securing the transfer of the rent, instead of generating profits. It has often been pointed out that such actions are only possible in a specific, legally institutionalised environment that favours the distribution of wealth and profits to a select group<sup>10</sup>.

Many argue that the term “rent seeking” should only refer to activities of firms in such economies where various forms of state regulation exist

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<sup>7</sup> W.A. Niskanen, *Bureaucracy and Representative Government*, Chicago 1971, p. 38.

<sup>8</sup> G. Tullock, “The welfare costs of tariffs, monopolies, and theft” (1974) 5 *Western Economic Journal* 224–232; A.O. Krueger, “Government Failures in Development” (1990) 3 *Journal of Economic Perspectives* 4.

<sup>9</sup> A.O. Krueger, “The political economy of the rent-seeking” (1974) 91 *American Economic Review* 291–303; A.O. Krueger, “Government Failures...”.

<sup>10</sup> See M. Raczyński, “Monopol w teorii pogoni za rentą” [in:] M. Raczyński, *W pogoni...*, p. 8 and 11.

as well as protectionist foreign trade practices, direct governmental transfers, and all other forms of preferential treatment. This is the case in this analysis.

Rent seeking attracts various special-interest groups whose actions strongly influence the way in which privatisation is carried out. In this analysis, the following basic interest groups need to be identified:

- A. Three groups within each enterprise: the owners, the executive board, and the employees among whom the monopoly rent can be appropriately divided between the groups. If the state acts as an owner (sometimes merely the majority owner) its role is carried out by the government, ministers and their representatives that act in the company's supervisory board; this is why they are being placed within the enterprise.
- B. The state representing national interests, i.e., consumer interests. In this role we may see the Parliament and the Regulator.

In the first category, all three interest groups within an enterprise push for such a form of privatisation which would guarantee them sustainable gain. The game is also played for how these benefits would be shared among these three actors. Let us try to define the interests of the group within the enterprise. The first group is the government. The objectives of the government (the owner) are determined by the fact that it acts in its own short-term interest – it wishes to secure such conditions which would guarantee it peaceful reign, at least for the duration of the relevant term in office.

The most important of these conditions – not necessarily in this order, as the pattern depends on the situation – are:

- to maintain stability in the key monopolised industry sectors where labour unrest<sup>11</sup> would paralyse the country;
- to raise national revenues;
- to fill key positions in state-owned enterprises with figures “stabilising” their administration; consequently, to have influence over the decisions taken by these companies, not quite privatising the sectors<sup>12</sup>.

Furthermore, it would be hard to ignore that “the public administration, otherwise called bureaucracy – another player among the main characters performing on the economic stage”<sup>13</sup> – consisting of central, regional, and

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<sup>11</sup> A note, *Applied Economics Letters*, 2001, 8, 273–277, says “labour protection, forced through both by the management and the employees, was given as a justification for competition protection”. Strike is one of the forms of pressure, whose costs can be easily measured.

<sup>12</sup> Owning shares or company stocks (even minority) in a privatised institution, the government can subsidise other public enterprises without cutting the national budget, which the failure of these enterprises would inevitably bring.

<sup>13</sup> See L. Gilejko, “Aktorzy sfery ekonomicznej i ich strategie” [in:] *Socjologia gospodarki. Część II: Rynek i otoczenie instytucjonalne*, Warszawa 2005.



local public officials and employees in all modern societies, wields enormous power<sup>14</sup> (determined by the government's role in the economy) and pursues its own interests. Of course, not all administrators are elite, but the upper echelons make for a large segment of the elite group. The size of this segment depends on the scale and character of the government's stake in the economy. According to Raczyński, this group is an important player in the "interest game". Its involvement seriously politicises the economy which in turn fosters strong ties between several elite groups, especially between the political and economic elites<sup>15</sup>.

The second interest group whose actions affect the transformation process from within the company is the executive board. Government ownership guarantees the upholding of high office positions which, apart from other benefits, gives the executive board the freedom to hire others onto posts lower in the company's hierarchy. It also allows its members to participate in the "office shuffle", to seek promotion to a ministerial position, to the board of directors, or even presidency of the company.

Gilejko suggests that in post-socialist countries, the struggle for power in the economic arena has not ceased. It mostly occurs in the relationships between the state (government, state bureaucracy) and other participants in the game (like the management of state enterprises which supports bureaucracy in the struggle for rent). This situation is not exclusive to post-socialist nations, but it is here where it is most noticeable. Various options based on monopolisation create favourable conditions for the alliance between the government and various interest groups. Gilejko suggests that bureaucracy, acting in its own interest, strengthens the short-term benefits of the government. It is also in the interest of the executive board to maintain the monopolistic position of their enterprise. Moreover, the board favours limited owner interference in the actual administration of the company with prospects of easy access to public subsidies. In other words, it would prefer its enterprise to be state-owned but with a corporate structure or, ideally, the structure of a holding company. If, however, privatisation was to occur, the most attractive option for the executive team would be to sell the company's minority shares, preferably on a stock exchange.

Surprisingly, the workers unions support the position of the management. Although most analyses suggest that the interests of the unions stand in direct

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<sup>14</sup> Ibidem.

<sup>15</sup> "In most capitalist countries, over 40% of workforce in public administration and nationalized industries are employed directly by the government". A. Giddens, *Socjologia*, Poznań 1998, p. 83 (cited after L. Gilejko, "Aktorzy sfery..."). The situation has changed since then.

opposition to those of the management<sup>16</sup>, in the case of rent-seeking, says Strumme, or to retain a monopoly *status quo*, the situation appears to be totally different. Both interest groups share the same objective, some of the forms of behaviour (in the process of realisation of these interests) turned out to be uniform<sup>17</sup>.

Concerning the legal conditions of the monopolised industry sectors in the Polish economy, job security is clearly a prime objective for all employees. But the workers also want to preserve the financial benefits (such as the legally guaranteed 15% share in the company's stock) gained during the process of the commercialisation and privatisation of state-owned enterprises. There are other benefits such as the fact that salaries and promotions are not determined by work output or efficiency. As a result, employees support privatisation but to a very limited extent. In consequence, only a minority stake in the company is sold on the stock market – as long as the state remains the company's main owner, employees can maintain their privileges. The government's symbolic sale of one share of the company not only guarantees employee *status quo*, but also brings them a financial reward in the form of a "privatisation bonus". At the same time, the price of the employee-owned shares (usually sold on soon after they have been obtained) depends on the extent to which the monopoly can be preserved.

Accordingly, the interests of the workforce coincide (or, at least, they are not in conflict) with those of the management, as the welfare of the management greatly depends on the extent of the "contentment" of its employees. Only the workers can go on strike. They can successfully block any changes that would limit a monopoly status of their firm with threats of industrial action that could cause stoppages in the delivery of products or services in the entire country – a major fear of public officials. Although strikes are usually initiated at the grass-roots, they are often encouraged at the top. This happens when the management decides it is also in their interest to demand from the owner – the government – some concessions.

There is little research in Poland that deals with specific (different to other sectors) configuration of interests occurring in the sectors of general economic interests. For this reason, it is all the more important to refer to the work of Gadowska<sup>18</sup> on "clientelism" and activities of interest groups within the coal-mining industry, a sector whose basic features resemble services of general economic interest and which, in Poland at least, up to now had never been

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<sup>16</sup> See O. R. Straume, "Rent-seeking in a unionized monopoly" (2002) 3 *Economics of Governance* 117–134.

<sup>17</sup> See S.N. Eisenstadt and L. Roniger [in:] *Patrons, Clients and Friends*, p. 28 (cited after L. Gilejko, "Aktorzy sfery...").

<sup>18</sup> See K. Gadowska, *Zjawisko klientelizmu polityczno-ekonomicznego*, Kraków 2002, p. 19.

earmarked for privatisation. She writes: “(...) the goal of a system analysis of the network interactions in the coal-mining industry, and its influence on the sector’s restructuring, is to shed light on the way politics infiltrates economic life at the expense of public interest and the common good of the society”.

According to this author, no clear distinction has been made in the post-communist countries between their economic and political system. Therefore, on the one hand, today’s difficulties to separate them have their roots in the past; on the other, the change from a centralised economy to the free-market, often requires political involvement. Any decisions directly affecting the economy are made at the political level. This is particularly true in the case of actions taken by state-owned commercial units because the course of the restructuring of their sectors is controlled by government bodies.

Long before the post-socialist transformation, Rowley<sup>19</sup> wrote that rent-seeking is not really an action initiated by individual players for their own sake – as it is often portrayed in economic models – but rather, an action taken by large companies operating under the management of executive boards<sup>20</sup>. Because of the principal–agent conflict in these cases (managers use the company’s money instead of their own in rent-seeking activities), there is a tendency to take higher risks which, in turn, lead to excessive costs associated with the pursuit of the monopolistic rent<sup>21</sup>.

#### **IV. The analysis of transformations occurring within the chosen sectors**

Since Poland signed the EU Accession Treaty in 1994, all of its existing legislation had to comply with European law in general and, in the context of the two infrastructure sectors analysed in this paper, to sector-specific directives in particular. The liberalisation of the energy field started first. “In 1992, the European Commission’s proposed the directive liberalising the sector that would gradually lead to the formation of a single European energy market”. The key objectives of the proposed directive were: to increase competition in the generation of energy; to foster third-party

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<sup>19</sup> Ch. Rowley (ed.), *The Political Economy of Rent-Seeking. Introduction*, London 1989.

<sup>20</sup> R.L. Faith, R.S. Higgins, R.D. Tollison, *Managerial Rents and Outside Recruitment in the Coasian Firm, The Political Economy of Rent-Seeking* in: Ch. Rowley (ed.), *The Political Economy...*

<sup>21</sup> In Poland, a significant increase in costs occurred during the mutual exchange of posts between ministries and large industry corporations.

access (TPA) to networks; and, to separate the internal concentration of the generation, transmission, distribution, and supply of energy. Although many interest groups met the proposed reforms with suspicion<sup>22</sup>, the draft was not rejected outright. In view of the reform process occurring in the, broadly understood, energy sector, it is useful to consider its market structure. Are energy generation and supply functions competitive? Are distribution networks of the primary energy resources the only natural monopoly? One of the hypotheses is that since energy cannot be transmitted to consumers without a network, the whole chain becomes a natural monopoly. During the transformation process, the interested parties have been pressing towards such a market structure; what was achieved is a market structure where a few big companies hold power stations and distribution networks. The third-party access (TPA) rule is the method to introduce competition to an oligopolistic market structure.

Several Member States were in conflict with the Commission, wanting to support the monopoly status of their energy enterprises<sup>23</sup>. That fact only confirmed how widely popular the phenomenon of state monopoly protection was – together with its numerous prerogatives – considering the short-term interest of public officials. As a result, the Commission submitted a new proposal suggesting an even more gradual process for the formation of a single energy market within the European Union. The 96/93/EC Directive was the final document regulating electricity markets. To conform to the EU directive, the Polish government prepared the Energy Act of 1997, which regulated open-market procedures, price policies, and the energy tariff system. The changes in the organisational structure of the energy sector to which this Act refers were introduced<sup>24</sup> at the beginning of the 1990s and were based, in most part, on the British model<sup>25</sup>. However, not one decision on privatisation was made at that time<sup>26</sup>. In other words, no competition existed because the government, as a single owner, could not compete with itself. As the owner, the government was unlikely to act contrary to its own interests even if the state (as a law

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<sup>22</sup> P. Jasiński, “Światowe trendy w przemyśle energetycznym” [in:] A. Szablewski (ed.), *Mechanizmy rynkowe w energetyce i telekomunikacji. Monografie, No. 8*, INE PAN, Warszawa 1996.

<sup>23</sup> It is worth noting that the question of common energy policy had not been raised until 2007, mainly under pressure from Poland.

<sup>24</sup> The Act of 5 February 1993 on ownership restructuring certain state-owned enterprises of special importance for the national economy (Journal of Laws No. 16 item 69).

<sup>25</sup> See J. Popczyk, “Od monopolu do rynku” [in:] P. Jasiński, T. Skoczny (eds.), *Elektroenergetyka*, Warszawa, 1996.

<sup>26</sup> A. Lipowski, “Procesy restrukturyzacji w przedsiębiorstwach przemysłowych okresu transformacji systemowej (wprowadzenie do problematyki)” [in:] E. Mączyńska (ed.), *Restrukturyzacja przedsiębiorstw w procesie transformacji gospodarki polskiej*, Warszawa 2001.

constituent) tried to create favourable conditions for competition within the sector. It appeared, however, that the legislators had ignored one obvious principle of the free market: that in order to compete, more than one market player is needed.

The legislation also established a chronology of transmission rights granted to each consumer group and gradually lowered the threshold enabling access to the market so that by 2007 all consumers, large and small, would be free to choose their electricity supplier from a range of functioning businesses.

However, enterprises were strongly motivated to include distribution units, which are natural monopolies, within their wider organisational structure and the law did not exactly disallow grass-roots consolidation activities (initiated by the management of small enterprises not by the government). They rightly assumed that the bigger the corporation and fewer the choices, the greater the possibility of price control and the lesser the chance for the end user to change a supplier. The energy distribution networks were the first to start consolidating; for example, the creation of the Southern Electric Power Corporation, ENEA or BOT was decided by the executive boards of each of the participating companies. Accordingly, seven large distribution and three mixed (with both generation and distribution) corporations were created as a result of grass-roots actions. The energy generation segment of the sector, which included several dozen electric-power stations and heat and power plants, was not included in the original consolidation efforts.

The government's approach to Polish energy markets was not coherent after 1996. It was unclear which concentrations should take place before, and which after the privatisation of the subjects in question. No general strategic plans existed and no rules concerning vertical integration within the process of privatisation were defined, not even in relation to international investors who already had such links.

The 2006 government "Programme for the Electricity Industry"<sup>27</sup> revealed a conflict of interests by including goals that were inconsistent in their principles (they excluded each other). For instance, one of the main objectives of the programme was to reduce the costs of electric-power generation, transmission, and distribution by increasing productivity through effective management of network activities and improving efficiency in electricity generation companies. These objectives were in direct conflict with the very principle of the programme which aimed to divide the market among a few consolidated, powerful corporations with the ability to dictate terms to consumers and to block any new market entry. Such corporations would have

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<sup>27</sup> Program dla Elektroenergetyki, Ministerstwo Gospodarki, March 2006.

enough leveraging power to remain ineffectively managed and not to induce economic efficiency.

The Programme for the Electricity Industry created favourable conditions for the emergence of large energy conglomerates. A dominant position in the market was attained by Polskie Sieci Energetyczne [Polish Electricity Grid] S.A. (PSE), a former transmission system operator, that, through the acquisition of several electric-power stations, formed the Polska Grupa Energetyczna [Polish Energy Group] S.A. (PGE) structured as a holding company. The next biggest market players were the Southern Energy Group TAURON, as well as the ENEA and ENERGA distribution companies.

The birth of these powerful energy groups, with vertically integrated holding structures, formed a so-called oligopolistic competition. Thus, the implementation of the government 2006 programme was nothing but an expansion of the monopolistic system. This trend was foreseen by Popczyk<sup>28</sup> who pointed out the danger of establishing an unhealthy market structure in the Polish electricity industry that can hinder competition. In addition, large power plants (the dominant segment of the consolidated holding companies) get direct access to consumers via the distribution units (with which they now form one enterprise) and thus can dictate the price without being afraid that other power stations will offer lower price. Using this method to prove their credit solvency, power plants are able to secure new loans for “old-fashioned investments”. It is important to note that no money changed hands during the acquisition process. The acquisition of distributors occurred merely through a shuffle of government ownership. J. Popczyk also noted that a transformation process where “a political-corporate system changes into a corporate-only system”, gives corporations so much influence that it renders the government powerless. In 2008, one of the largest quasi-monopolies, ENEA, abandoned an earlier plan to sell the majority of its shares to a strategic investor, and instead decided to use the stock exchange to privatise (despite falling stock indices) its minority stock. With the privatisation on the stock market concluded, the government continues to retain the majority of its shares and thus remains its “decisive” owner. That means that the *status quo* is preserved according to the best interests of all interested parties.

The railway industry, which is the second example of services of general interest sector discussed in this paper, has only two segments: (1) the rail-track network that forms a natural monopoly, and (2) the passenger and freight transportation systems which is completely ready to be de-monopolised and opened for competition. The natural monopoly structure of rail-tracks differs,

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<sup>28</sup> J. Popczyk, “Elektroenergetyka – prywatyzacja po polsku” [in:] K. Bobińska, *Prywatyzacja infrastruktury*, *Zeszyty TEP*, No. 9, May 2005.

however, from the electricity sector as it has long been exposed to inter-modal<sup>29</sup> competition.

The EU has taken a long time to formulate guidelines for the liberalisation of railways<sup>30</sup>. The 2001/12/EU directive on the European rail system replaced Directive 91/440/EEC which only mandated the financial separation of networks. The 2001 Directive set out the dates for the liberalisation of each type of transportation.

The discussions on restructuring of the Polskie Koleje Państwowe [Polish National Railways] (PKP) started in 1998 and followed the EU legislation which was already under discussion for several years. The 2001/12/EU Directive that was finally issued demanded financial independence for rail-tracks as well as a total separation of passenger lines from freight. The first Polish transformation plan was to divide PKP into several independent entities. However, the suggested structural changes met with firm opposition from its workforce leading to a general strike<sup>31</sup>. The Act on the Commercialisation, Restructuring, and Privatisation of PKP, based on different principles, was finally passed more than a year later (on 1<sup>st</sup> January 2001).

As a result, PKP was divided into about a dozen interdependent companies<sup>32</sup> organised under the umbrella of a holding company. Each firm was headed by a president, executive officers and a supervisory board. The parent company, PKP S.A., became the owner of all assets of the transformed enterprises and a major shareholder in each of its subsidiaries. The most important companies in the group include: PKP Polskie Linie Kolejowe [Polish Rail Lines] S.A. which manages the rail-track infrastructure; the PKP Cargo S.A. which operates freight lines; and two passenger lines – PKP Intercity and PKP Regionalne Linie Kolejowe [Regional Rail Lines] S.A. The subsidiaries do not compete with each other seeing as each has a defined area of operation while their size and economic power allow them to maintain their monopoly status.

The transformation of the railway sector into a single holding company has created multiple opportunities for various forms of covert activities including cross-subsidies and guarantees of equal employee participation in receiving shares the value of which has been based on all assets of the holding. The functionality of the structural set up and sole state ownership eliminates the possibility of competition and, *eo ipso*, does not demand increased

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<sup>29</sup> Such as other transportation systems: ground (car, bus) and air (airplane).

<sup>30</sup> Liberalisation process at the European Union level began in early 1990s (with the 91/440 Directive on the common rail development).

<sup>31</sup> Which ended with the resignation of the minister.

<sup>32</sup> All PKP services were organised into separate businesses, e.g., PKP Telecommunications, PKP Energy etc.

productivity. The only method of improving profitability introduced by the new management was to reduce the number of operating rail lines. This action was presented by PKP as part of its reorganisation plan<sup>33</sup> and diligently executed ever since.

One method, among many, used to strengthen the monopolistic position of PKP, was to introduce the law on licences for railway operation. The PKP granted these licences *ex lege* and forever. Its all competitors had to reapply for them without any guarantee of renewal. It is important that the other, then PKP, companies were cargo companies with about a few percent of PKP Cargo's capacity. As these provisions were introduced retrospectively, the bias in the treatment of similar companies was all the more visible. Only pressures from two interest PKP groups – the management and the workforce – could have explained such unfair business practices.

At the same time, the deficit of the group has grown to non-repayable proportions, and it became clear that the situation would not be resolved without a heavy subsidy. The subsequent strategic plan for 2003–2006<sup>34</sup> made the government responsible for all public debts of the PKP group<sup>35</sup>. According to this plan, two types of companies could function within the national transportation system – commercial ones, and those remaining in the public domain (PKP Regional Rail Lines). The Authors of the plan hoped that the organisation of the persistently unprofitable Regional Rail Lines would be subsidised by the State budget. The government remained, however, a major shareholder of PKP Intercity and the PKP Cargo which were granted the option of being privatised. The 2003–2006 strategic plan proposed, at the same time, that the State should be responsible for the financing and development of the rail infrastructure<sup>36</sup>.

The 2003–2006 strategic plan did not succeed probably for two reasons: the likely opposition of public authorities to the scale of such flagrant subsidy; and the obvious bias in the division of the monopolised sector: the network – a government-financed natural monopoly; national rail lines – earmarked for privatisation, with the potential to remain competitive on a freed rail-transport market; and regional lines – partially subsidised by local authorities but with its ownership structure left unchanged, that is, one regional company for the whole country expected to be subsidised by all local governments without, however, giving them any influence on its behaviour. Although the strategy

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<sup>33</sup> A 2001 expert report for the Ministry of Transportation. Where it is shown that it improves only the passenger per km. efficiency but dramatically lowers the passenger per employee efficiency.

<sup>34</sup> Accepted by the government in 2003.

<sup>35</sup> And a total debt suspension or payment deferral until after 2010.

<sup>36</sup> See K. Bobińska, *Ekonomiczna racjonalność...*



was in line with EU guidelines<sup>37</sup> on the financing of public services, it limited employee benefits, usually gained in the course of privatisation, on one hand, and deprived the local governments of any control over the running of the company, on the other. Local governments wanted to own the freestanding regional lines and, consequently, refused to cooperate. In the mean time, the deficit deepened as the regional lines accounted for most of the PKP Group's external debt<sup>38</sup>.

The threat of a general strike brought about a new strategic plan for 2006–2009. While it kept the *status quo* in general, it provided for two, albeit significant, changes: it permitted a division of the PKP Regional Rail Lines, but with the agreement of both interested parties – local governments and PKP. Moreover, PKP Polish Rail Lines, responsible for rail-track infrastructure, would rejoin the parent company. This was exactly the kind of monopoly which the workers had been waiting for. The plan was, therefore, accepted and put into effect. It intentionally allowed for the rail-line operators within the holding company to be separated along the lines of their functionality to avoid internal competition. In other words, each was given monopoly in the area of its capacity<sup>39</sup>. Moreover, PKP's movable property (PKP transport sources) was deliberately divided inadequately to the needs of individual operators; for example, all PKP locomotives were reserved for the PKP Cargo, giving a purely commercial operator an unfair advantage<sup>40</sup>, and putting an unjustified financial burden on those, who might be entitled to ask for public subsidy.

The 2006–2009 strategic plan did not cut the budgetary aids, neither does it account for the loss of tax revenue from the newly created group. However, it would be prudent to assume that the authors anticipate the financial aid needed to by far exceed the level of the financial losses incurred by the PKP Group. As often stressed in the plan, the profitability of the PKP Group depends on the government's financial support which – on the other hand – should contribute to social stability. This represents an open threat to the state that, if it refuses the appropriate amount of money, the PKP will go on strike.

The size and form of the expected “support” do not follow the criteria precisely defined by the European Court of Justice<sup>41</sup> for subsidies to services of general economic interest. Such aid would be considered by the EU as

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<sup>37</sup> White Paper on services of general interest, Brussels, 12.5.2004, COM (2004) 374 final.

<sup>38</sup> It amounted to PLN 5.8 billion at the end of 2006.

<sup>39</sup> For example, Mazovia Rail Lines (Koleje Mazowieckie).

<sup>40</sup> CARGO leases out locomotives to regional lines, a public service institution financed by a local government, and, in reality, covertly subsidises CARGO.

<sup>41</sup> Judgment of 24 July 2003 in the case C–280/00 *Altmark Trans* [2003] ECR 7747.

an illegal subsidy which the government could not guarantee. Therefore, the realisation of the strategic plan for 2006–2009 is in doubt. This ambiguity could have been the reason for the creation of a new programme, published in 2007, concerning the period of time between 2007–2013.

The 2007–2013 strategic plan does not change any of the pre-existing principles. It does, however, put the state in the role of a coordinator of the development of the rail network leaving the actual supervision and maintenance of the national rail infrastructure<sup>42</sup> in the hands of Polish Rail Lines. It expects operational costs to be covered jointly by the national and local budgets, European Union funds, bank loans, and own resources. It leaves the entire company stock in the hands of the government. The newest plan considers the stabilisation of the financial situation of, first, PKP S.A. as the corporation's parent company, and then, of the rest of the group. To strengthen the group's overall administrative system, members of the PKP S.A. Board of Directors will serve as the presidents of the supervisory boards of its subsidiaries. As the head company, PKP S.A. is now the main party responsible for improving of the group's finances.

The problems of PKP Regional Lines have also been dealt with. By 2009, the company is expected to regain solvency<sup>43</sup>. It is to be split "equally" and handed over to the 16 Polish regional governments. In line with the strategic plan, the transition of the regional lines to the jurisdiction of local authorities will "maintain the national character of the regional rail transport, improve the quality of services, and strengthen the unity of the transportation system in the region". As a result, the unprofitable regional rail lines will no longer strain the PKP's financial health while the lucrative interregional transportation system will remain under the governance of the group. In a typical monopolistic manner, this approach will preserve high-level jobs in a separate, profitable business and limit the financial losses of the group as a whole while making the local authorities take over all of the responsibilities associated with running and maintaining of the unprofitable regional rail lines.

The government will retain its position as a major shareholder of PKP Cargo which will assume the role of "a national rail freight company" and is expected to start selling its minority stock by 2010. Similarly, the majority of shares of PKP Intercity will remain state-owned, and the PKP S.A. outstanding debt will be fully covered by the national reserves. When the ideas of restructuring PKP

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<sup>42</sup> The strategy for the rail transportation sector assumes the infrastructure maintenance to be the responsibility of the state.

<sup>43</sup> At the end of 2006, the company's deficit amounted to more than PLN 2.1 billion and exceeded the value of its assets. In 2008-2009, the company is expected to receive PLN 1,860 million in government loans.

were first formulated, public authorities refrained from openly subsidising services of general economic interest which, while allowed by European rules, demands accountability in return. The only possible solution for the government appeared to be to consolidate inefficient, but socially-needed, operators with efficient units to cover up an illegal appropriation of public funds for commercial businesses. The necessity of subsidising the public service obligations had been accepted later.

The newest strategic plan appeases the interests of the government and executive groups by keeping the organisational structure of the PKP Group in the form of a holding company creating a suitable number of executive jobs. On the other hand, the limited privatisation, included in this plan, that is, the public sale of a minority share of PKP stock, gives the employees a 15% share of the company. In addition, the position of the workforce is strengthened by the compelling, strategic principle that “the government guarantees social stability” for all firms part of the holding company, and that no persons from outside the sector will be nominated to the supervisory bodies of the PKP Group companies. There really is nothing that could be added to the latest strategic plan for the Polish rail sector that would better preserve the objectives pursued by its three interest groups.

## **V. Conclusions: The scale of the preservation monopolistic market in the sectors after the transformation**

Before the transformation, both of the analysed industries (the electricity and the railway sector) had two distinct market structures. After fifteen years of organisational reforms and property transfers from one form of state ownership to another, they both eventually adopted a comparable, though slightly different, structure of a holding company. While the energy sector encompasses several holding companies that have created an oligopolistic form of market structure, the rail industry has converted into a single holding company that incorporates one enterprise considered to be a natural monopoly as well as several others that retains dominance in each of their market segments. Inevitably, in both cases some form of monopolistic competition has developed which is, however, very difficult to monitor.

In addition, during the long legislative process when many Polish laws had to be revised to comply with European Union directives, the various interest groups within the discussed sectors managed to gain a maximum number of government guarantees: the executives had their positions secured, the employees not only escaped job cuts but also received company shares as

a result of privatisation. Such a situation can only exist in a monopolistic environment, as only then can a monopoly rent be discounted (the interested groups can profit from the monopoly rent) – no matter whether the rent is collected directly from the consumer (the energy sector) or from the state, i.e., from taxpayers (the railways).

In the course of market privatisation, the government has retained the majority of the shares in question, guaranteeing the preservation of the monopolistic *status quo* that benefits other interested groups, including private shareholders. Who, considering the initial interest groups, benefits most from privatisation? The government enjoys a short-term benefit resulting from the sale of a part of its shares while still retaining a majority stake in the companies. The corporation remains a monopoly and the government, as a majority shareholder, is interested in its profits. Therefore, it lies in the interest of the government to keep the *status quo* for as long as possible. At the same time, board members can hold on to their executives jobs, and the employees receive, a legally due, company share package as well as secured employment and the power to exert considerable pressure on the government (major share owner) and demand ever-increasing privileges.

In short, it has been to the advantage of all three interest groups to secure the monopoly status for their enterprise. As economic theory points out, only the enterprises that act on a monopolistic (or oligopolistic) market can enjoy monopoly profits which permits the pursuit of various forms of rent, the goal of all three analysed groups.

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