

Regulating Britain's Utilities

Matthew Bishop, John Kay and Colin Mayer (eds), The Regulatory Challenge, Oxford University Press, New York, 1995

Reviewed by Robert Albon

THE three editors of this volume put together a volume on privatisation and regulation nearly ten years ago, when 'privatisation was still a novel idea and Britain's new style of utility regulation was only two years old' (Preface). The extent of developments since then is reflected in the fact that in 1995 they have been unable to include all the material they wanted to in a single volume (this one has a companion dealing specifically with privatisation). Furthermore, *The Regulatory Challenge* is over 450 pages long.

The volume comprises an introduction and 18 contributions involving 27 authors. Some of the papers have been previously published and some appear to have been written for this volume. Ten of them are primarily about particular industries (express coaches, gas, the National Health Service, higher education, legal services, financial services, broadcasting, electricity, and two on telecommunications), while the remaining eight are issue-based (the European Community, law and regulation, the cost of capital, two on regulation and three on quality and standards). I found the organisation of the book rather eccentric, but would be hard-pressed to improve on the order of presentation. The introduction is useful as a discussion of the issues covered, but not as a guide to particular papers; no specific papers or authors are mentioned. Of course, the table of contents and the index can act as crude road maps for those seeking some guidance through this large and broad-ranging volume.

The editors, and some of the contributors, are not very impressed with the standard of regulation observed. In particular, it is often noted that privatisation occurred without sufficient attention to one or more of the corporate structure, degree of competition and regulatory regime to be implemented. The area which comes in for most criticism in this regard is gas. Most of the verdicts are mixed. For example, Mark Armstrong and John Vickers point, on the one hand, to 'modest progress towards a more competitive and better regulated telecommunications industry' and, on the other, to 'a decade of lost opportunities' (p.307). (Michael Beesley and Bruce Laidlaw writing on the same industry do not provide a summary verdict.)

However, the volume reports a couple of unambiguous success stories. David Thompson and Ann Whitfield are reasonably impressed with the results of deregulating express coaching and their 'assessment does not suggest a case for further policy intervention.' (p.41). Simon Domberger and Avrom Sherr are impressed with the results of reforms in the legal profession: 'Price discrimination has been

reduced, conveyancing costs have fallen in real terms, and there has been considerable improvement in customer satisfaction' (p.137).

Many authors allude to the implications of the European Commission. In their article devoted to this body, Francis McGowan and Paul Seabright provide a good review of the factors determining assignment of regulatory powers, and an interesting account of the tensions that have arisen over the clash of national and EC regulations. In conclusion the authors have a bet each way: '... uncritical enthusiasm for and an uncritical aversion to centralisation for its own sake are both dangerous attitudes ...' (p.251).

The book contains a number of more generic papers. One of these is William Baumol's paper on various aspects of regulation and contestability of natural monopoly, and on access pricing through the efficient (or optimal) component pricing rule (ECPR). The ECPR is sometimes known as the 'Baumol-Willig Rule' after its main originators. While this reviewer is a critic of aspects of the ECPR, Baumol's work in the area of policy towards natural monopoly has spanned 25 years and is of great importance and influence. This is a very useful paper.

Another of the theme papers is on price-cap regulation. The distinguished authors Ray Rees and John Vickers provide a very comprehensive and up-to-date survey of what is known in Australia as 'cpi minus x' price regulation. Rees and Vickers discuss the many difficulties with this approach to monopoly pricing regulation, and return a rather bland verdict. Their comments will be very useful in guiding those formulating such a regulatory mechanism.

Paul Grout's paper covers the intriguing issues surrounding the determination of the 'cost of capital' in regulated industries. There are many ways of valuing assets in such industries and of determining the appropriate rate of return ('cost of capital') to be applied to the asset base in particular cases. Risk considerations are important and the whole process is complicated by the interrelationship between aspects of the regulation and the values of the key variables to be determined.

Thomas Weyman-Jones's paper analyses yardstick regulation with an application to electricity distribution in the UK. There is a good account of the institutional and regulatory environment of the regional electricity companies (RECs), an analysis of yardstick and incentive regulation models, and an application of these models to the RECs. This paper will interest many readers as both Australia and New Zealand move to more competitive regulatory structures in electricity.

This volume, along with its companion volume on privatisation, will be very useful for those involved in and/or observing the extensive public utility reforms in Australia and New Zealand. Many of the contributors have been at the forefront of developing the analysis of regulatory structures in natural monopoly situations. Further, on the empirical side, the UK provides valuable lessons, both positive and negative, on how to approach policy-making for public utility industries. I have no hesitation in recommending this volume.

Robert Albon is Senior Lecturer in Economics in the Faculty of Economics and Commerce at The Australian National University.