Introduction

Colin Robinson

The thirteenth series of the Beesley Lectures on Regulation was held in the autumn of 2003. The Lectures, arranged by the London Business School and the Institute of Economic Affairs, are named after the late Professor Michael Beesley, who originated the series in 1991 and was the main organizer until his death in September 1999. Lectures given in the 2003 series are reprinted in this volume: all have been revised by their authors for publication. Also included in this volume are the comments on the lectures made by the chairman of each session, acting in his or her capacity as discussant.

Analysis of regulation of the privatized utilities in Britain – gas, electricity, water, telecommunications and the railways – constitutes the core of the series, as it has done from the beginning. But the emphasis on experience in other countries and on international issues has increased, as was Michael Beesley's intention. In the 2003 series, in addition to papers on the British utilities, there were lectures on competition policy and trade, on US experience of deregulation, on emissions trading and on European merger control.

Chapter 1 is by Professor Frédéric Jenny, of the Conseil de la Concurrence in Paris, who has studied in great detail the debate within the World Trade Organization (WTO) on whether international trade rules should be complemented by competition rules. Jenny argues that transnational anticompetitive practices, in particular 'hardcore cartels', impose significant costs on developing countries and undermine attempts to liberalize trade. However, because there is a public good aspect to the elimination of these practices, countries negotiating in a WTO round may be unwilling to make concessions on other issues to secure the benefits of increased competition. Jenny claims that the competition agreement suggested by the European Union under the Cancun negotiations imposed too high costs on small developing countries for it to be acceptable. Nevertheless, says Jenny, although the Cancun Ministerial conference failed to deal with these issues, compromises would be possible. For example, there could be a non-binding agreement, or an agreement under which WTO members could join when

they were prepared to do so, or an agreement that allowed ‘members to choose their level of commitment to the competition issue’.

Sir Geoffrey Owen, of the London School of Economics, commenting on Jenny’s paper, describes transnational cartels as a ‘blight on the world trading system’. Bilateral agreements among national competition authorities will not do, says Owen, because they will be confined to advanced countries with well-developed competition laws. A multilateral solution is therefore essential. Rather than trying to rush developing countries into agreements, the more developed countries should try to foster a greater understanding of the benefits from action against cartels. Furthermore, multinational companies should look into their own activities to ensure they do not ‘run counter to their rhetorical commitments’ to benefit the world.

In Chapter 2, Robert Crandall and Clifford Winston, of the Brookings Institution, consider whether antitrust policy enhances consumer welfare. The paper, which was presented in the lecture series by Winston, was first published in the *Journal of Economic Perspectives*, volume 17, no. 4 and is reproduced here by permission. The authors point out that economic theory, which is very fertile in demonstrating that various actions by firms can be interpreted as either procompetitive or anticompetitive, offers little policy guidance. The empirical evidence is therefore crucial. Crandall and Winston review that evidence and conclude that US antitrust policy appears to have been ineffective: among the reasons are the excessive duration of monopolization cases, which means that issues change while cases are being pursued, and the power of the market in curbing anticompetitive practices, which leaves little for antitrust to do. In the short term, the competition authorities should concentrate on ‘the most significant and egregious violations’. More research is required into why some policies have succeeded and other have failed.

David Arculus, Chairman of the UK’s Better Regulation Task Force (BRTF), looks at some of the lessons of the failures of US antitrust policies for government departments and regulatory bodies that wish to impose regulations in Britain. He sets out the principles of good regulation and the procedures the BRTF has put in place, and stresses the importance of thinking about alternatives to regulation: the Task Force has deliberately tried to make it more difficult for government to introduce new regulations. Government should concentrate on outcomes and leave the market to find the way to achieve the desired results.

Chapter 3, about efficiencies in merger control, is written by Jrissey Motis (IDEI), Damien Neven (GIIS, Geneva) and Paul Seabright (University of Toulouse). It was presented in the Beesley Lecture series by Neven. The authors argue that a better understanding and treatment of efficiencies is essential if EU merger control is to be improved: the present EU approach

is likely to lead to significant type II errors (allowing anticompetitive mergers) as well as type I errors (prohibiting or imposing conditions on procompetitive mergers). In particular, the evaluation of synergies in mergers needs to be improved. For instance, the competition authorities could ask firms why they propose to undertake a merger rather than carrying out some alternative form of corporate reorganization. The reallocation of intangible assets may be an important source of synergies but, regardless of whether or not it is, it would be advantageous for the authorities to enquire directly into management's view of the sources of gains to shareholders and then to judge to what extent those gains can be achieved without significant costs to consumers.

Sir John Vickers, of the Office of Fair Trading (OFT), comments on the paper from the OFT's viewpoint. He argues that efficiency assessments enter into the OFT's work both when it determines whether there is likely to be a substantial lessening of competition (SLC) and also when it assesses whether, even if there is an adverse SLC verdict, there are likely to be sufficient customer benefits to offset it: the OFT must necessarily be demanding when investigating claims about prospective efficiency gains. It already asks for the business case for a merger. According to Vickers, efficiency considerations fit more easily into an SLC-based regime than if the test is based on dominance.

Chapter 4 is a description and analysis of the UK and EU emissions trading regimes by Sir Charles Nicholson of BP plc. Nicholson explains the two main types of trading systems (allowance trading and baseline and credit trading) and points out that such markets are in their infancy as means of reducing carbon dioxide emissions. The UK's system, a voluntary regime starting in 2002, in Nicholson's view had a successful first year. The EU scheme, which begins in 2005, will be far-reaching and mandatory: about 95 per cent of allowances to emit carbon dioxide will be allocated free of charge. The trend towards trading systems applies not just to the developed world – seven regions of China are adopting market-based emissions trading schemes. Nicholson points out some of the uncertainties in how the EU scheme will work – for example, whether some accession states will opt out and whether allocations will be challenged in the courts. But, he says, it offers a chance to meet Kyoto targets.

Colin Robinson (University of Surrey) comments on some of the implicit assumptions underlying emissions trading schemes. For example, it is assumed that a global warming trend has been established, whereas the evidence is unclear. Second, the assumption that any warming is due to carbon emissions is open to question. Third, the assumption that collective action is required has not been established. Fourth, the option to let people adapt receives little consideration. Emissions trading schemes are better

than centralized interventionist measures, says Robinson, but people should be sceptical of the argument that there is a 'massive and looming global problem' that requires urgent action.

Chapter 5 is an analysis by Annegret Groebel, of the German Regulatory Authority for Telecommunications and Post, of 'convergence' in telecommunications and broadcasting markets and its impact on regulation. In Britain, a decision was made to create one 'converged' regulator (Ofcom) from five existing regulators, to regulate all electronic communications markets. The British regime is different from that in the rest of the EU in that Ofcom is a content regulator, possibly leading, Groebel argues, to diseconomies of scope. Groebel contrasts Ofcom with its German counterpart, RegTP, in terms of both scope and organizational structures, noting that RegTP (responsible for energy as well as telecoms) has three times the staff of Ofcom even though it does not deal with content regulation. Groebel concludes that, while there may be benefits in having content and conduit regulation in one organization, there may also be conflicts of interest because conduit regulation is market-driven whereas content regulation has a significant 'public interest' aspect.

Colin Robinson, commenting on Groebel's paper, agrees with her that it is uncertain whether the merging of previously separate regulators in Ofcom will be successful: the outcome might be managerial diseconomies. Content regulation is a difficult issue, especially when it is centralized. There might be advantages in decentralizing it, as in Germany where it is a responsibility of the states. Other aspects of the German system seem less worth emulating: for example, the very wide scope of RegTP, which includes energy and post as well as electronic communications, may well lead to diseconomies. Nevertheless, inter-country comparisons of the kind used by Groebel are fruitful sources of ideas about how to improve regulatory systems.

Eileen Marshall, formerly of Ofgem, considers energy regulation in Chapter 6. A White Paper of February 2003 gave priority to two policy goals – control of carbon dioxide emissions and maintenance of security of energy supply – but the way the government is pursuing these goals is likely to lead to serious problems, she argues. The government's method of setting many different targets and using many policy instruments will politicize environmental policy, leaving it open to lobbying by pressure groups. Moreover, by specifying the amount of energy saving which should occur and the quantities of some energy sources (such as renewables) which should be used, the government is likely to dampen competition, creating a managed market. There may also be an adverse impact on security of supply as government intervention on both the supply and demand sides restricts the ability of markets to provide security. A change in the government's approach to policy is required, says Marshall, to avoid compromising

independent economic regulation and competition. Instead of targeting particular fuels and activities, the government should leave it to a carbon trading scheme to achieve its environmental goals.

Stephen Littlechild, University of Cambridge and former electricity regulator, is in general agreement with Marshall's view. In particular, he agrees that adoption of a carbon trading scheme would be the most efficient way to achieve the government's environmental objectives, though he has doubts whether market participants would regard commitments to these objectives as credible. He is sceptical also about the underlying issue of climate change, asking whether it is rational 'to impose high costs on customers today to deal with a possible eventuality a century or two in the future, of which we presently know very little?' He concludes by asking whether it is prudent to commit to carbon dioxide reduction goals at present.

Chris Bolt, at the time of the lecture the PPP (Public-Private Partnership) Arbiter but now the Rail Regulator, considers the supervisory regime for London Underground Limited (LUL) in Chapter 7. The PPP arrangements for LUL are different from those in other infrastructure sectors, he says, and the role of the Arbiter is different from those of the utility regulators. The Arbiter has a restricted remit, compared with traditional regulators, not covering specification and enforcement of delivery; he is reactive, giving guidance or directions only when requested by the parties; and he can be given 'narrow' terms of reference even at the time of a Periodic Review. According to Bolt, compared with the national rail network, there are some favourable aspects of the PPP arrangements for LUL – for example the smaller number of direct contractual relationships and the clear customer focus. He is optimistic about the prospects for the PPP and the Arbiter, principally because the structure of the PPP arrangements seems more robust than that for the national rail network and the system for modifying contracts offers some useful alternatives to the licensing approach.

Tom Winsor, at the time of the lecture the Rail Regulator, comments that the PPP Arbiter's hands are rather closely tied compared with the Rail Regulator's. Furthermore, Winsor argues that a licence, as in the utility regulation regimes, is different from a regulatory contract under the PPP. A change mechanism is inherent in a licence, so the regulator can modify a licence at any time, whereas under the PPP arrangements the main contract change mechanism is only every seven-and-a-half years. Winsor also criticizes the idea of 'partnership' or 'public interest' directors (the 'spy on the board'). In the case of the national rail network, the appointment of a Public Interest Director to Railtrack at the behest of government scared the markets because it looked like political intervention in the affairs of a private company and in a regulatory settlement.

In Chapter 8, Colin Mayer of the Saïd Business School, University of Oxford, argues that water has been one of the most successful British

privatizations. A sound regulatory regime for assessing the cost of capital, valuing assets and making efficiency comparisons has been established and there has been a big increase in investment. In recent times, however, water firms have become more highly leveraged than at the time of privatization, partly because of the financing requirements of large investment programmes but partly also because of the tightening of the regulatory contract at the time of the last price review. The creation of low-cost corporate vehicles, argues Mayer, has caused an increasing divergence between private and social costs and changed the nature of the regulatory relation. Ideally, long-term commitments by both firms and regulators are required for the regime to move forward, though better control systems by regulators may also be required. In the long run, the equity model is a more suitable basis for firm–regulator relations so the regulator should try to sustain rates of return consistent with that model.

Philip Fletcher, the water regulator, commenting on Mayer's paper, points to the 'continuing appetite for new investment' in the water industry. He disagrees with Mayer in that he believes there is already a high degree of commitment in the industry: the regulator is committed to enabling the companies to finance their activities and to having a clear, consistent and objective regulatory system. Moreover, though regulators cannot 'commit' by binding their successors, they create precedents which are difficult to overturn. Fletcher does not see his ability to regulate constrained by high levels of gearing and indeed welcomes the operation of the market, which has led to the mergers, acquisitions and restructuring that have characterized the water industry.

The final chapter is by Jacques Steenbergen of Allen and Overy and Leonard Waverman of London Business School. They consider how well European merger control has worked, whether it might be replaced by *ex post* action to control any abuse that occurs as a result of a merger, and whether control could be exercised by national governments alone. Steenbergen and Waverman point out that, both in the USA and the EU, merger law became part of competition policy long after laws that prevent anti-competitive agreements and abuse of a dominant position. Fundamental differences among these various parts of competition policy are that anticompetitive agreements or monopoly abuses cannot be welfare-increasing activities so there is a clear case for laws to ban them; however, merger law concerns mergers, which *could* increase dominance. According to Steenbergen and Waverman, recent studies cast great doubt on the ability of competition authorities to ban only those mergers that are anticompetitive. They argue, therefore, that in general the European competition authorities should only prohibit mergers where *ex post* remedies would clearly be ineffective. Otherwise, they should wait until evidence of welfare losses appears.

Sir Derek Morris, at the time of the lecture the Chairman of the UK Competition Commission, disagrees with Steenbergen and Waverman about the advantages of *ex post* actions. In his view, most of the potential dangers of a merger could never be addressed *ex post* by an Article 82 case. The purpose of a merger regime is to prevent a substantial lessening of competition. Acquisition of a new entrant, for instance, may lessen competition because it reduces the flow of new ideas and threatens diversity, neither of which would provide the basis for an Article 82 case. So there is a good case for a powerful merger policy separate from the use of Article 82. Morris also urges caution in using financial data to determine whether or not competition authorities have made the right decisions in merger cases.

It is clear that there are now sufficient differences among countries in their approaches to competition policy, utility regulation and market liberalization for analysis of those differences to be fruitful. Sometimes there may be good reasons for differences because they are rooted in local circumstances, but international comparisons can be helpful in challenging assumptions about existing practices.

There are also now a number of issues that cut across international boundaries and that will undoubtedly be discussed further in future Beesley series. One, for example, is to what extent the trend towards liberalizing utility markets will continue. In Britain, except for the railways and water, there has been a significant injection of competition in recent years, principally because of procompetitive actions by utility regulators and the competition authorities. Other countries have tended to follow the same path, if less wholeheartedly. Now, however, in the energy utilities, where liberalization has gone furthest, governments are once more introducing specific measures to promote particular energy sources and to reduce energy demand, even though an EU carbon trading scheme is about to come into operation. These measures are, it is claimed, necessary because markets will fail to protect against climate change. It will be some time before it becomes clear to what extent competitive markets will survive this new interventionism that relies mainly on environmental arguments.

Another issue that emerges from this book and that will be prominent in economic policy debate in the next few years is the effectiveness of anti-monopoly policies. Attempts to promote and sustain competition are inevitably difficult, for instance because of the problem of distinguishing between entrepreneurial activity and attempts to stifle competition. Governments and competition authorities, faced with academic research that shows apparently poor results from antitrust action and, in particular, from attempts to control mergers, may need to reappraise existing laws that attempt to promote competition and to outlaw anticompetitive practices.