Introduction

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On a sunny week of June 2007, a small group of economists locked themselves in a meeting room in Nice for a workshop intended to prepare a book on regulatory issues in order to express their deep admiration for Oliver E. Williamson, his work, and the stream of research he has inspired in that area. However, in preparing the meeting as well as this book, Michel Ghertman and I did not intend to deliver a traditional festschrift. We rather wanted the authors to explore some of the avenues opened by Professor Williamson, and to introduce new ideas and perspectives. In order to make this possible, we restricted the audience to the contributors, so as to facilitate extensive discussions and exchanges. After the conference, all chapters were rewritten, submitted to referees, and revised (several of them more than once).

The strong red thread interweaving the different contributions thus prepared comes from transaction costs economics and, more generally, from new institutional economics and the powerful tools it provides for analysing public policies. Regulatory issues offer a particularly favourable ground in that respect. The deregulation movement that developed since the early 1980s, the controversies it has raised and that it continues to face, and the obstacles encountered in the reforms of public utilities that it epitomizes, can gain enormously, on both theoretical and empirical sides, in using transaction cost lenses. At the same time, diverging experiences in different countries and different sectors have substantially enriched our experience and our databases, thus providing opportunities to proceed comparatively, which is a major lesson carried by Ronald Coase, Douglass North, Oliver Williamson and others. The chapters in this book are clearly impregnated by their view, but in an active and exploratory way.

The book is organized in three parts.

Part I (‘Analytical framework’) assembles chapters that push the conceptual framework, without losing sight of the contributions of the past or neglecting the ‘real’ world to which this framework applies. Honour where honour is due, the opening chapter is from Oliver Williamson. It reassesses the basic contribution of transaction cost economics in revisiting its precursors, thus putting the theory in perspective. However, this is
not a purely historical piece. Professor Williamson emphasizes the need to take into account governance issues, with a more specific attention to the role of contracts, since this is where substantial transaction costs are embedded, determining what solutions are feasible. The ‘benign neglect’ in which too many reformers of public utilities have held these aspects might well explain why there are so many flaws and failures in deregulation experiences.

Chapter 2, by Gary Libecap, develops another key concept in new institutional economics, property rights, with a special attention to the difficulties involved in the allocation of these rights because of their distributional implications. The chapter analyses alternative allocation mechanisms (first-possesion rules, uniform-allocation rules, auction rules), exhibiting their respective strength and weaknesses. The discussion is then extended to specific areas, namely: subsurface oil and gas reservoirs, air pollution emission permits and the allocation of ITQs in fisheries, all domains in which Professor Libecap expertise is widely acknowledged.

In Chapter 3, Pablo Spiller develops the contractual approach initiated by Williamson to exhibit the differences between private and public contracting. Going further than his previous analysis of uncertainties associated to government opportunism, which plagues so many reforms, he shows the complementary uncertainties resulting from third party opportunism, that is, the influence of interest groups. His analysis demonstrates the major impact they can have on the characteristics of contracts in reforming public utilities, particularly the rigidity it introduces, and how they may push towards the implementation of modes of organization with low incentives. Empirical evidence is briefly introduced that suggests the significance of these problems.

Chapter 4, by Steve Tadelis, fits nicely in that pattern since it focuses on incentive issues faced by public procurement. Contrasting competitive bidding in the private sector with that in the public sector, Tadelis shows that the possibility the private sector has to negotiate with selected supplier(s) before a contractual arrangement is agreed upon tends to be denied in the public sector, for reasons that Spiller’s chapter helps understanding. One result is that public procurement operates within a more rigid framework, adding additional constraints for the parties, which translate into costs. Negotiated contracts may be less effective in selecting lowest costs bidders, but they might economize significantly on ex post transaction costs, thus being an important source of costs savings.

In Chapter 5, which concludes this section, Claude Ménard combines a control engineering perspective on public utilities with a transaction costs approach, exhibiting the difficulties in aligning modes of organization with technical functions in a way that maintain the integrity of the system,
which also conditions its effectiveness. He argues that beyond the general rules of the game, ‘micro-institutions’ play a central role in guaranteeing that core transactions are monitored within a coherent framework. The status of some of these micro-institutions is then examined and discussed. The analysis is supported by casual evidence, mainly based on extensive case studies of the reform of urban water systems.

Part II (‘Governance and performance’) then turns to a close examination of governance, its difficult reform in what Ménard would call ‘critical infrastructures’, and its impact on performance of substantially distinct sectors. By governance, one can understand ‘means by which to infuse order, thereby to mitigate conflict and realize mutual gain’ (Williamson, this volume, p. 12). In Chapter 6, Luis Andres, José Luis Guasch and Sebastián Lopez Azumendi explore the impact of regulatory agencies on the performance of electricity distribution. Based on an index of regulatory governance that they tested on an extensive database from reforms in the electricity sector in Latin America, they show that the existence, experience, and governance of regulatory agencies make a very significant difference in how electricity systems perform. Their chapter is also full of methodological insights on how to measure this complex relationship between regulation and performance.

Chapter 7, by Howard Shelanski, examines the controversial issue of how relationships between network owners and application providers in broadband communications should be regulated, if they should be regulated at all. Indeed, because networks are characterized by market power, since there is most of the time no more than two or three competitors in the last-mile network market, the question arises about whether free and unmediated access for any provider is the optimal solution. Having confronted and discussed the arguments of defenders of the ‘neutrality’ in the rules of access to networks, and of proponents of discrimination rights that would allow networks to impose constraints on application providers, he concludes that long-term structural problems are at stake, and that our knowledge remains quite limited for dealing with these complex issues.

This is also one of the messages that readers can get from Chapter 8, by Magali Delmas, Michael Russo, Maria Montes-Sancho and Yesim Tokat. Comparing the performance of the deregulation of the US electric utility sector along two dimensions, productive efficiency and environmental results, they show that firms have reconfigured their assets and proceeded to significant organizational adjustments. Provisory results suggest that deregulation has been associated with a negative impact on efficiency and a positive impact on renewable energy. Thus, deregulation has complex, multidirectional effects. In order to better understand long-term
consequences, different aspects of deregulation must be disentangled, and more data collected on specific effects.

Chapter 9, by Jean-Michel Glachant and Yannick Perez, endorse a different perspective in that they proceed comparatively. Starting from problems of modularity in the reform of the electricity sector, they confront two different modes of governance implemented in the transmission system: the ‘Independent System Operator’ model adopted in the US and the ‘Transmission System Operator’ model that prevails in Europe. The main lesson they draw from this comparison is that different institutional frameworks are compatible with the governance of complex systems like transmission, and that reforms must proceed sequentially when they concern a set of interdependent and nevertheless distinct blocks. As for the impact of alternative solutions on performance, their measure remains a task ahead of us.

The last chapter of this section (Chapter 10), by Richard Geddes, is a perfect illustration that poor performance does not necessarily generate institutional reform. The US postal service, in that respect typical of most postal services worldwide, has shown a remarkable resistance to change. Notwithstanding pressures to liberalize, only some segments have been opened to competition, making the USPS an ‘organizational hybrid’. In that arrangement, worksharing rather than straightforward privatization has been the main solution adopted to introduce some competition in the system. The chapter discusses alternative explanations to this slow movement towards reform, with no simple one being fully convincing. However, in a pattern different from what Spiller explored in Chapter 3, a combination of governmental opportunism and interest group opportunism likely played a key role.

Part III (‘Adaptation and changes’) explores ambiguities of the deregulation movement and how, under some circumstances, it may even end up in reregulation. Chapter 11, by Roberta Romano, illustrates this through the saga of the Sarbanes–Oxley Act. Adopted in the context of the Enron scandal, with all the attention of the media it has crystallized, feeding political incentives to control, this law has progressively generated distortions in the running of financial markets and imposed costs hardly bearable on small firms. The question then becomes: how to go around a regulation that can hardly be changed at the legislative level because of its political dimension and the attention it could attract from the media? Romano shows the importance of the discretionary power of regulators, in this case the Securities and Exchange Commission (SEC), first in implementing, than in self-limiting the implementation of a regulation. She also illustrates, with the House bill prohibiting the SEC from expanding funds on the enforcement of section 404 against small firms, how political forces
can reach an institutional agreement to circumscribe regulations that went out of control.

At a more micro level, Chapter 12 by Adam Fremeth and Guy Holburn provides another example of the complex adaptation of regulation to changing circumstances. Looking at rate reviews that concerned two important players in the electricity sector in the US, they explore the relationship between regulator’s knowledge of regulated firms and the policy decisions they make. They exhibit the combination of mechanisms that allow regulators to reduce asymmetric information, namely: tacit knowledge based on the past experience of the regulator; codified knowledge made available through rules forcing firms to reveal information; and information provided by organized interest groups. This last point reveals the positive side of third-party opportunism. One nice thing with this chapter comes from the data that the authors were able to collect on aspects rarely measured, contrasting two stylized cases along the three mechanisms.

Chapter 13, by Dean Williamson, also looks at adaptation devices in the electricity sector, but in a different environment, that of contractual relationships between producers and marketers. Focusing on four instruments in the hands of contracting parties, duration, veto rights, risk sharing rules, and trade-off between debt and equity, he emphasizes the fact that duration, a favourite variable in many empirical studies, is only one of the four tools. Working out of a dataset of 101 marketing contracts, he exhibits the complementarity of these tools when important investments in generation capacities are at stake. Parties do combine these tools because they are aware of potential contractual hazards, due to risks of opportunism once important specific investments are made, which is very much in line with a fundamental lesson from transaction cost economics.

Jackie Krafth and Evens Saliens develop a very different perspective in Chapter 14. Focusing on retail broadband Internet markets, they argue that high switching costs for consumers may prevent competition to be effective. Their analysis is based on a discussion of the effects of the deregulation movement in the communication industries in France over the last decade. A key element of their discussion is based on the slow rate of penetration of cable connections, which they relate to switching costs. Challenging the idea that beneficial outcomes can be expected from self-regulation through competition in innovative industries, they wonder if a more active competition policy and some reregulation could be needed in order to break dominant positions that high switching costs contribute to maintain. This view might gain in being confronted to the positions expressed in Shelanski’s chapter.
The last chapter of this section and of the book, by Michel Ghertman, intends to put discussions on regulation and deregulation in an historical perspective. Chapter 15 identifies three successive conceptualization of regulation (that we could call ‘Pigovian’, ‘Stiglerian’, and ‘Williamsonian’, respectively). Ghertman argues that the empirical content of these approaches is quite weak, with a possible exception for transaction cost economics, because economists have neglected the lessons accumulated in political science about the role of politicians, interest groups and, more generally social forces. His call is therefore for a multidisciplinary approach, which is exactly what Oliver Williamson concluded in his chapter.

To sum up, the contributions of this book largely complement each other, providing a stimulating view on progress accomplished from a transaction cost perspective in the analysis of regulation, the reform of public utilities, and the complex governance, of which contracting is an important component, of network industries. Because they are deeply rooted in sector analyses, the chapters also illustrate very well a central and deep message of leading new institutional economists, among which Oliver Williamson is a key figure, which is that theory should be continuously confronted to facts, and reformed or revolutionized accordingly.