

## BOOK REVIEW – 2006

**A Review of "REGULATING UTILITIES AND PROMOTING COMPETITION: LESSONS FOR THE FUTURE" by Colin Robinson (Ed), Edwards Elgar Publishing, Cheltenham, UK, 2006 ISBN 13 9781 84542 7115**

This is a nine-chapter set of papers and commentaries presented by an authoritative group of British economists, regulators and other experts at a 2004 forum of the UK Institute of Economic Affairs and the London Business School. With the main exception of a final chapter on developing economies, the subject matter is mostly relevant to the United Kingdom. The editor is Colin Robinson, Emeritus Professor of Economics, University of Surrey.

Some parts are more memorable than others but one virtue of the collection is that the reader can pick and choose what is of interest. Most chapters are followed by a commentary by an equally authoritative expert as the chapter author. International readers will be quickly drawn, as was this reviewer, to chapters 3 and 8 which deal with two topics of enormous contemporary importance. This review looks at each chapter in turn.

In chapter 1 on the UK railways, Tom Winsor places on record the "unwarranted political interference" with the independence and jurisdiction of the UK Office of Rail Regulation. Stephen Glaister commented that ministers were unwilling or unable to write down clearly in advance what they wanted. Competition never worked as a discipline on the railways, he said, because the government undermined competition at every turn. This chapter is an account of appalling regulatory design and unpredictable political intervention in utility regulation.

In chapter 2 on the gas industry, Nigel Cornwall explained the growing influence of the Continental European gas market on the market in Britain. He expressed concern about the slow transition to competitive gas markets on the Continent, arguing that European competition policy should be applied much more rigorously. The best protection for consumers will come, he said, from 'liberalised,

competitive markets for natural gas, where regulators will monitor developments and introduce or suggest necessary corrective measures'. John Michell agreed that more competition in the gas markets of other EU countries is desirable but said that Britain has been trying to achieve that for years with little success. Michell questioned whether market liberalisation is enough, given that there might be market failures. He also questioned whether the necessary degree of political will, which was evident during Britain's energy market liberalisation, could be encouraged in other EU countries.

In chapter 3 on the economics and politics of wind power, David Simpson provided a rigorous and illuminating analysis on Britain's wind power programme, explaining how it is aided by government subsidies that are funded by a 'stealth user charge'. He felt that the programme is 'an expensive and ineffectual method of carbon emissions abatement that adds little to the security of the nation's energy supplies'. He suggested that, instead of the government's 'picking winners' procedure among technologies, it would be better to employ a carbon tax or a carbon trading scheme to reduce the consumption of carbon-intensive energy: market prices would then adjust to reflect the environmental damage of emissions and the cost of achieving environmental goals would become more transparent. The government's renewables (and energy efficiency) schemes would then become largely redundant. Simpson's analysis should, in this reviewer's opinion, be required reading for energy sector policymakers and officials around the world. A similarly rigorous economic analysis of coal, natural gas, nuclear energy and solar power as competing sources of fuel for electricity generation would have been most enlightening. Perhaps a subject for a future forum?

In chapter 4, Christopher Bellamy reviewed the four roles of the UK Competition Appeal Tribunal, *viz*

1. to ensure that the system is seen to be fair;
2. to get the law right (given the "grey area");
3. to aid transparency and visibility; and
4. to produce dialogue so that the system adapts and develops.

Bellamy identified four issues for further debate: whether a 'competition culture' has really taken root in Britain; the importance of regional and local enforcement of competition policy; the benefits of a 'reasonable flow of enforcement decisions'; and the issue of increasing deterrence. George Yarrow in his commentary emphasised the importance of judicial supervision of the use of executive power, pointing out that 'many of the most important occurrences of conspiracies against consumers, of abuses of power, and of undue concentration of power are to be found within government'. He was less optimistic than Bellamy about the prospects for finding simple rules that have net beneficial effects across a range of differing market contexts.

In chapter 5, Robin Mason discussed the 'two big reviews' that were undertaken by the UK Office of Communications (Ofcom) – one on public service broadcasting and the other on telecommunications. On broadcasting, Mason concluded that there were no externalities that could justify the present degree of intervention, arguing that all public service broadcasting funding should be contestable. On telecoms, Mason contended that 'Ofcom needs to develop a coherent policy on conditions to mandate access to bottlenecks, and to enforce structural separation'.

In chapter 6 on the subject of market power under Article 82 of the EC Treaty, Thomas Sharpe discussed how to identify what is abuse of a dominant position in a market. The correct distinction he suggested should be between 'good economics – empirically based and robust – and bad economics – *a priori* and untested by evidence'. Dominance he felt is best expressed in terms of the possession of economic power (a wider concept than market power) giving a firm the capacity to exclude a competitor. John Vickers

agreed about the present uncertain state of the test. However, he thought what is required is to confront the 'fundamental question of what is harm to competition, and to develop practical approaches to other kinds of abuse that are similarly grounded in economic principle'.

Since the forum, debate on Article 82 has continued at EC level and elsewhere. The debate generally supports an economics-based approach, focussing on the presence of anti-competitive effects that harm consumers, rather than on the legal form that a particular business practice takes (see Report by the Economic Advisory Group for Competition Policy, "An Economic Approach to Article 82", July 2005 [www.ec.europa.eu/comm/competition/publications/studies/eagcp\\_july\\_21\\_05.pdf](http://www.ec.europa.eu/comm/competition/publications/studies/eagcp_july_21_05.pdf)). It is however possible that the approach will lead to less legal certainty.

In chapter 7, John Fingleton discussed the role of economics in merger reviews. The competition test for mergers has become the norm in many countries because of the influence of economics: 'the critical factor is the relationship between competition and productivity growth'. He emphasised the importance of solid economic foundations 'in a world where merger decisions on the same or similar transactions are taken by different institutions in different countries'. Leonard Waverman raised the question of whether a consumer surplus or a total surplus test should be used in implementing merger policy.

In chapter 8 on mergers in the UK water industry, Philip Fletcher explained why the regional water authorities were not broken up before being privatised. Quick privatisation meant that their structures could not be changed: structural reorganisation would have meant that there would have been no 'evidence or data to float these companies in the market'. Although there have been no mergers in the sector water, there have been plenty of takeovers as well as substantial restructuring. He stressed the importance of having 22 companies to compare with each other: 'comparative competition was a crucial and essential part of the regulatory tool kit'.

In chapter 9 on privatisation and regulation in developing countries, David Parker and Colin Kirkpatrick made the case that insufficient attention has been given to the design of institutional structures and regulatory instruments

in infrastructure privatisations. One problem they identified is the lack of regulatory capacity in developing countries: for example, the shortage of trained personnel, the absence of sound laws and uncertainty about law enforcement. Regulatory impact assessments (RIAs) might help to improve regulatory capacity. Another issue is whether price cap regulation is suitable in the circumstances of many developing countries – for example, serious information asymmetry, weak regulatory governance and problems in creating effective regulatory incentives. Some survey evidence suggests that there may be advantages in rate of return regulation. Parker and Kirkpatrick concluded that much uninformed transfer of regulatory systems has taken place. The editor Colin Robinson agreed on the danger of importing inappropriate regulatory systems from developed countries. He doubted, however, whether the use of RIAs would bring improvement. On price cap regulation, he said that it is not only in the developing world that price cap regulation has gone beyond what its originators intended. He sketched the circumstances in which price caps are appropriate, which normally include separation of the network from the rest of a utility. Robinson observed that regulatory systems, once entrenched, tend to grow out of control. In this reviewer's opinion, there is little argument about that.

Any set of conference proceedings will always suffer from limitations of scope and approach and this volume is no exception: There are nonetheless quite a few gems of wisdom to be found within its covers.

The main shortcoming is the lack of any attempt to draw all the threads together. The materials would have been enhanced by an analysis of how policy, industry structure, market design, regulatory regimes (including contractual regulation) as well as periodic reviews of the regulations themselves all have a part to play in promoting economic efficiency in liberalised economies. It is also a pity the publisher could not have got it into the bookstores more promptly.

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