

Regulation of the Network  
Industries  
A Political Science Perspective

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# Old regime

- Production and distribution of politically salient goods and services
- Formerly state function
- In order to generate public goods
- Because markets fail to produce public goods
- to guarantee accessibility, security, continuity and affordability

- Economic reasons:
- Natural monopoly justified by high start-up costs through investment in technical network
- whose long-run average cost of production decline only as output increases (Berg and Tschirhart 1988)
- Therefore...sheltered from competition,
- provider tempted to use monopoly price for services unless prevented by price regulation

- From political perspective:
- redistribution, national defense, social cohesion ...
- ...legitimizing use of public monopolies
- Fixed network and provision of services considered as public good

- Railways long considered natural monopoly – high fixed sunk costs for network and rolling stock
- Consequently dominated by single public enterprise owning infrastructure *and* providing services
- As such subject to state intervention
- With limited room for management autonomy
- Subject to political goal of public services provision
- (Henry 1997; Bauby and Boual 1993)

- Public service aspect warranted direct subsidization,
- or cross-subsidization of some services by others (Armstrong, Cowan and Vickers 1994)

# Deregulation and privatization

- Since mid 1970s
- State monopolies criticized for lack of efficiency, consumer friendliness and service innovation
- ...Privatization and deregulation of network services
- Under impact of economic internationalization
- UK and US spearheading privatization and deregulation

- Export industry pressure in other countries to follow suit because of competitive disadvantage
- Single Market programme EC pressed for liberalization of network based services
- Therefore, since mid-1980s increasingly, „contested markets“ concept applied to natural monopolies



- Privatization, deregulation ensued
- To spur competition also
- Breaking up market into regional (private) monopolies
- and introducing yardstick competition
- In public tender of licenses and franchises for provision of services in regional markets
- ..introducing competition „for“ the market
- Allows for price comparison in regional markets

However, when functions transferred to market

- Market performance still concern of public policy
- Because privatization and deregulation
- by itself no guarantee for efficient markets
  
- ...need of
  - a) market access regulation
  - b) market correcting/performance regulation

- a) *Market making regulation*:
- Abolishes restrictions on market access
- Creates rules of competition
  
- Once created, markets need to be protected from anti-competitive behaviour
- ....Competition authorities

- b) *Market correcting regulation*
- Specific outcomes of market processes are considered to be politically undesirable
- Political consensus: utilities should measure up to public interest goals
- At least minimum service provision
- Users of network services = virtually 'entire voting population of a country' (Levy and Spiller 1996:3)

- Crucial question:
- How can efficiency enhancing aspects of privatization and market-creating regulatory activity
- be reconciled with market-correcting goals of regulation?
- Interlinking of economic and political logics

- Railways:
- While infrastructure in many countries still regarded as public (or private) monopoly
- Market creation : Service operation handed over to markets
- Operators restrictions to network access abolished
- State ownership of network industries transformed into stock companies with government holding some or no shares (Levy and Spiller 1996)

- Additionally reregulation
- Service quality
- Continuity
- Safety
- Affordability
- Regulator depends on provider for information to set ,right‘ performance standards

- Conceived of as principal - agent relationship
- Regulator /principal forms contract with provider/agent/regulatee
- For both contract implies risks and uncertainties
- Information asymmetry



- *Regulator*
- Regulatory flexibility allows for adjustment to balance market efficiency and public-interest goals
- But also needs to provide incentives for investment
- Low information
- *Service Provider*
- Must satisfy consumers and shareholders
- Uncertainty of changing regulations
- High information

- *Regulator*
- Ex ante and ex post controls
- Multiple regulators
- *Regulatee*
- Shirking?
- Regulatory venue shopping?