# 100 Years of Government Control over Utilities

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Leslie Hannah
London School of Economics

*Outline*

My interest in the topic of regulation has taken a variety of forms: practical (as director of an economic consultancy involved *inter alia* in the UK electricity privatisation process), pedagogic (as a teacher of would-be regulators both in UK business schools and the University of Tokyo) and in research terms (as the author of books touching on the twentieth century regulation of electricity, pensions and monopolies in the UK, and more recently writing on the early twentieth century history of energy regulation in Europe and the USA). The ACCC's invitation wisely suggested I should not take you too far into the arcane details, but reflect more on some long-run lessons for today and that is what I propose to do.

*Regulation in 1900*

If we imagine ourselves transported back in time to the world of 1900, what would strike us about the late Victorian world of regulation? The overwhelming impression would be that there was, compared to today, not much of it. At the world exposition of 1900 in Paris there were several hundred professional meetings, but none were of regulatory specialists and those that came closest to discussing the issues were the meetings of railway managers and corporate securities experts. 'Welfare economics' and the notion of the state compensating for failing markets was implicit in some of the economics literature, but hardly well developed or central. To practical men, the word 'regulation' mainly meant the factory inspector monitoring child labour, or the rail safety inspector enforcing the interlocking of points (switches) and signals. That sort of thing was much more common in Europe than America, and proportionately ten times as many Americans – thousands of them annually – died by railroad in consequence.

Yet plainly, many of the problems of public interest that later drove nationalisation or regulation of natural and network monopolies were also of importance to the economies of 1900. Postal services and telegraph cables (not to speak of the more modern telephone, and the just-invented radio), gas for lighting and heating, electricity for lighting, tramways and power, Standard Oil's (as Exxon was then called) global monopoly of lighting kerosene, urban water supply, the Suez Canal, and, above all, the most pervasive and capital-hungry technology of the day, railways: all raised network and/or monopoly issues that were very similar to those we face today (and they actually accounted for a larger proportion of GDP than similar industries today).

One contemporary answer to the problem of these industries, which worked quite well in some circumstances, was to do *nothing*. Telegrams were then the preferred mode of time-critical business communication and the world-wide web of international cables was mainly in private-sector hands and essentially unregulated (though minor issues of inter-operability and language encoding, as with all communications technologies, occasionally arose). The lack of regulation probably did not matter, because competition developed to a substantial degree – there were, for example, dozens of cables on the most important route, connecting London with New York (though one wonders about how much collusion developed). Even in Asia-Pacific a little competition was developing.

In principle, there was a more serious monopoly problem with franchised local electricity and gas monopolies (competing supply of each had once been common, but by 1900 it was increasingly rare). Yet, in fact, most gas and electricity at that time was used for lighting (as was almost all Standard Oil's kerosene), so what is more properly conceived of as the market for artificial light was, in fact, quite competitive. As is the way with technological change, however, that solution soon dissipated. It is true that kerosene (where petrol for automobile use soon dominated) remained happily contestable, but when, around 1910, electricity finally beat gas hands-down for lighting, and when gas was more commonly used for heat, and electricity for power, their natural monopoly characteristics became more problematic. Many societies then intensified their (sometimes already existing, but generally toothless) regulatory bodies. You never know when technological and market change is going to make a competitive market out of a monopoly or the reverse.

Another 1900 solution was *regulation without regulators* (not one perhaps likely to appeal to many of this audience!). It was tried for a time, for example in energy utilities. The 'sliding scale' was set when awarding the franchise and allowed gas utilities to increase dividends only if they reduced the gas price, with the trade-offs being clearly stipulated and non-negotiable. In fact, however, technical progress and shareholder benefits from scale economies dictated that prices were reduced faster than dividends were raised, so the provisions became inoperative. The few that remained generally fell victim to the inflation and massive changes in relative factor prices that followed the global disasters of 1914 and 1931. The regulators amongst you can breathe a sigh of relief – regulators really are necessary. No matter how theoretically impossible it is to reset X in the RPI minus X formula (or in the not too distant version that was the sliding scale), it proved to be necessary in practice (or some alternative had to be found)!

The Suez Canal also had a mixture of sliding scales and user representation to limit its arguably unrivalled monopoly pricing power. The failure of the Panama project (which only succeeded with US government money in 1914) was a warning to users not to push capitalists too far – they, like us, had to consider the impact of regulatory actions on the future supply of capital.

Formal, external, public regulatory bodies were rare, but they were developing in a few localities in gas and electricity and even more hesitantly in telephones. In 1900 both America and Britain had competitive telephone services; in most other countries telephones were nationalised and monopolised. Regulatory bodies were most developed for railways: where a variety of judicial processes, elected boards, stakeholder representation and professionally appointed civil-service regulators were tried in various countries, many involved in fixing price schedules in great detail and preventing discriminatory rates. There was a heavy political demand for regulating railways, from coalitions of business and farm users. Even though there was considerably more competition between rail systems than in some unregulated industries, political pressure had been effective, so that was where most experimentation occurred. One striking feature of the academic literature of the time is, however, that there was little discussion of alternative regulatory methods (though perhaps rather more in German and French than in English) and that also meant there was little mutual learning internationally. Regulators generally ploughed their own furrow.

That was not true of the other major response to these industries' perceived problems – nationalisation or municipalisation. This did not come naturally to *laissez faire* societies (even central banks were then investor-owned utilities!), but from the middle of the nineteenth century it was increasingly seen as the right technocratic solution. Initially municipalisation had been favoured by many practical business people, but the debate on what was tellingly relabelled 'municipal socialism' by 1900, had become increasingly politicised (and attracted academic writers in their droves). Nationalisation was already the option chosen by Germany, Belgium, Russia, Italy and Australia for railways, Japan was soon to follow, France did so in the 1930s and Britain in the 1940s. For railways – and much else – nationalisation was to become the dominant mode of monopoly control, in all major countries except America, as the twentieth century progressed.

*A 1900 Perspective on 2009*

Let me now turn the historical telescope round, and ask what one of these putative regulators of 1900, magically transported to Surfers Paradise in 2009, would have found odd about us. While some of our jargon would puzzle him and issues like interconnection fees would appear arcane, he would, after a pause for thought, recognise the basic economic issues and the way technology has remodelled so much of what we do, from simple extrapolation from his own experience. What would perhaps puzzle him most is the number of Americans here and the way that American models dominate much of the intellectual debate. What I want to suggest to you is that if we understand why that is the case we will have understood a lot about why ideas about regulation evolved as they did in the twentieth century.

In part, of course, American dominance is simply a reflection of general American intellectual leadership of the post-war world. You only have to look at Nobel prizes: early in the twentieth century Europeans had a virtual monopoly on them, now Americans do. In regulation, too, the same has happened. However, this is not a case of Americans having started off with better economic ideas. In fact, it is a matter of historical record (though present members prefer to forget it), that the American Economic Association was founded to combat the pernicious English doctrines of free trade and free markets! What was special about the United States in the first seven decades of the century was that monopolies were regulated via antitrust law and regulatory bodies like the FTC, ICC and FCC, while Europeans and others generally nationalised. This created a much larger market in ideas about regulation in the United States. Tom McCraw has shown in his book, *Prophets of Regulation*,[1] that that produced massively varied and creative responses. But it also spawned a tradition of evidence-based assessment of the relevant issues by empirical economists, unmatched in the rest of the world, and frequently aided by the fact that American federalism meant not one experiment in regulation but often 50, greatly facilitating comparative empirical analysis in some areas.

[1] President and Fellows of Harvard College, United States of America, 1984.

As John Braithwaite and Peter Drahos have shown in their masterly analysis of *Global Business Regulation*,[2] Americans not only led in the generation of ideas but those ideas easily filtered down to the rest of the world, partly through processes of physical embodiment (we follow American airline safety regulations because we buy Boeings), partly by force of weighty example, and partly by negotiation. American ideas also dominated when deregulation and privatisation became fashionable again, though Thatcher's Brits also had a walk-on part. Many would-be emulators found that native traditions of discussion of these issues had often simply died out. American economists and lawyers specialising in regulatory issues eagerly responded to their interest and themselves became more cosmopolitan proselytizers of the regulatory faith.

There is, of course, danger in intellectual hegemony and there were some regrettable consequences in this case too. The mess that is global airline regulation owes a lot to the fact that the basic ideas of the post-war era were crafted by a nation that, in the nineteenth century, stupidly refused to let foreign ships have cabotage rights, while the rest of the world (largely) had open ports. These American protectionist policies were disastrous at the time for everybody (they raised American prices for their customers and permitted the American seagoing fleet to decline from 20 per cent to 3 per cent of the world total by the early twentieth century), but that did not convince Americans of their demerits.

It was thus the same doctrine that shaped post-war international negotiations and, even after general deregulation, similarly prevented a European airline operating within the USA or a Singapore airline operating within Australia. In consequence, we are still bogged down in an arid America-Europe dispute, while the airline industry burns, though it should not have been rocket science to work out that what Alfred Kahn did domestically would work even better with international competition. In general, however, American intellectual hegemony has been relatively benign and open-minded. There are many worse worlds to live in than one dominated by American intellectual ideas.

[2] Press Syndicate of the University of Cambridge, Cambridge, 2000.