

## **Session 1: Where we have been and where we are going—lessons from many countries**

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### ***Professor Roger Noll***

Focusing mainly on telecommunications, Professor Noll noted that in addressing the question “where have we been” with regulation that there is enormous variation across countries in terms of the impact of reforms. He attributes this largely in each case to special circumstances and government arrangements. For instance, he considers that Australia’s geographic isolation is a special circumstance which drives a lot of the evolution of regulation in this country. Importantly, Prof Noll considers that Australia’s geographic isolation is such that the evolution of regulation in Australia has been slower than it would otherwise have been.

Nevertheless, Prof Noll considers that national special circumstances are large ex post rationalizations by governments who don’t really want to undertake reforms. He considers that in this regard it is not OK to be different in terms of regulatory policy.

Prof Noll illustrated this argument by noting that in Europe in the 1980s there were mainly state owned national champions with very little support for the notion of privatization and competition. A decade later there is minimal state involvement in infrastructure. Regulation is now seen as a last resort with competition and deregulation the priority where possible. This illustrates how fast things change.

When trying to understand how the evolution of regulatory thinking has come about it is important to understand why it happened. For instance there are still a large number of countries, including Australia where there is still not a great deal of competition. This is somewhat surprising given Prof Noll’s view that an efficiently operating infrastructure industry generates double the productivity benefits of other industries. Given the share of GDP accounted for by infrastructure industries it is clear that this sector is extremely important for economic growth. For instance, this is very clear in East Asia where some previously developing countries (e.g. South Korea) have become very wealthy due in large part to successful infrastructure regulatory reform.

The reasons that it became politically acceptable to reform state owned monopolies varies from country to country. There are however, some common themes. In Europe, the crucial event was very slow growth leading to a spirit of reform. In particular, it was recognized that there were potentially very big dividends arising from integration through the common market. Countries could benefit from their neighbours relative inefficiency by gaining a competitive advantage. To avoid losing out, countries recognized the need to reform their infrastructure sectors.

In the US, the rationale was somewhat different and was strongly influenced by the high tech sectors. For instance, reform of telecommunications was heavily influenced by the computer sector’s unhappiness with the performance of the telecommunications sector. Given the political power of the computer sector, there was strong pressure to reform. Prof Noll noted that IBM was the financial backer of the first competitor to AT&T. Although the entrant did not succeed financially, the move was a political success as it created the impetus for regulatory reform.

In the US energy sector, the impetus for reform arose from the two oil crises in the 1970s and the political response to the resulting vulnerability to Middle Eastern oil. This led to a decision to permit entry to generation to promote efficiencies and develop technologies that didn’t need oil.

In the US transport sector, the large states had well developed transport sectors and exploited their competitive advantage. This led to a shift at the national level to support deregulation and competition to help to erode those advantages.

The common theme in all of these experiences is that the impetus for reform arises because the private sector considers that there is a business opportunity that is being thwarted by inefficiencies in the infrastructure sectors. If the private sector interests are politically powerful this offsets the political power of the entrenched monopolists and allows reform to proceed.

Once the impetus for reform has arisen, what does experience tell us about the best ways to regulate. In this regard there are many failed attempts at liberalization, particularly in mid level developed countries. Key requirements for successful regulation are:

- Independent regulator so that there is stability despite the normal cycles of politics – “fly wheel effect”. This is promoted by long term appointments and intervention only when there is broad consensus for change to regulatory policies;
- Information gathering powers; and
- Transparency in decision making.

However, Prof Noll considers that the single most important impediment to successful liberalization/regulation arises from Universal Service Obligations (USOs). Most governments want a USO but are not prepared to pay for it. This leads to a series of internal subsidization within the utility for the purpose of maintaining universal access for customers. If there is liberalization these subsidies could not be sustained. Prof Noll quoted research that suggests that the comparative cost of subsidies paid directly by government to fund the USO is 20 times less the costs arising from restricting competition or through competitive bidding for the government subsidy to provide the Universal service. According to Prof Noll it is very important that the USO is taken out the regulatory system to separate equity issues from competition and efficiency ones. The objective to promote competition should be the sole responsibility of the regulator. Removing the USO from the regulatory obligation also removes the incentive for extensive political intervention in the regulatory process.