

Life before Economic Regulation

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Conference on The Objectives of Economic Regulation
(Honouring the research of Prof Catherine Waddams)

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The Nationalised Industries

SCL personal recollections & publications but drawing heavily on David Parker, *Official History of Privatisation* Vol 1

- 1945-51 Nationalisation of main industries
 - Guidance vague: “make available coal in qualities, quantities & prices as seem in public interest”
 - “break even taking one year with another”
 - No formal govt powers but much informal govt involvement
- Welfare economists urged marginal cost pricing
 - Hotelling 1938, Lerner 1944, Meade 1944, Vickrey 1948, Ruggles 1949-50, Lewis 1949, Houthakker 1951, Steiner 1957
- With only limited questioning (on the fringe of economics?)
 - Coase 1946, Thirlby 1946, Wiseman 1953, 1957

Marginal cost pricing ascendant

- 1950s Growing concerns about performance & finance
- 1961 White Paper – introduced financial objectives
- But MC pricing seemed more interesting
 - 1964/5 Early SCL lecture to students: peak-load pricing electricity
- 1967 White Paper – economic performance targets, test discount rate, marginal cost pricing - official policy at last
 - Turvey 1968, 1971 applications in nationalised industries
 - SCL 1970 -77 mathematical programming & game theory to characterise MC pricing with joint costs, common costs, state-dependent costs, applied to US telecoms, Bham airport charges, weather-dependent water prices
 - Catherine Waddams 1973 thesis MC pricing in the gas industry
- Marginal cost pricing was what economists could contribute

In reality

- Did nationalised industries use MC pricing?
 - Mid-1970s SCL experience at Treasury/sponsorDept mtgs
 - 1976 NEDO report: No
 - Callaghan: “as Chancellor I couldn’t care less” (Crossman)
- Real problems: poor financial performance, inefficiency
 - Problem not that $P \neq MC$, problem is that MC too high
- 1978 White Paper – confirm financial targets, required rate of return on new investment
 - And let industries work out their own prices
- But continuing deterioration in performance
 - Pryke 1981, 1982 deterioration due to poor mgt & govt policy
 - MMC 1980-3 reports “catalogue of deficiencies” (Parker)
- General feeling (Parker): “We cannot go on like this”
- Dennis Healey (1989): “Nationalisation has failed”

New economic thinking 1960s-1970s

- Austrian economics, competition as a rivalrous discovery process (Hayek via IEA, Kirzner)
- Public choice theory (Buchanan, Tullock)
- Agency theory, incentives, property rights (Manne, Alchian, de Alessi)
- Economics of regulation (Averch-Johnson, Stigler, Peltzmann, Demsetz)
- Monetarism/deregulation/free markets (Friedman)
- “Economic theory provided an important intellectual underpinning for privatisation” (Parker)
- YES, BUT this came a little later, because
 - a) these were mostly US analyses, not then perceived as relevant to UK, and b) the UK political climate was adverse

UK Political climate 1950s-1970s

- 1950s-60s all-party acceptance of “mixed economy”
- 1968 Ridley (internal Conservative report): large scale denationalisation unrealistic
- 1970 Conservative manifesto (Heath): “stop further nationalisation”
 - 1972 U-turns: “lame ducks”, more intervention, prices & incomes policy
- 1979 Conservative manifesto (Thatcher): raise productivity in nationalised industries, clearer financial discipline, less government interference
- So nationalisation was seen as a problem ...
- But privatisation was not seen as the solution
- Hence no interest in economic regulation of privatised sector
 - “little appreciation that ‘de-nationalisation’ would involve anything very different from the reversal of previous nationalization policies” (Wiseman 1978)

The academic climate even harsher?

- 1955/7 Institute of Economic Affairs established
 - “UK’s original free market think tank”
 - E.g. Wiseman “Growing without nationalisation” (1964)
 - “difficult to communicate antagonism to IEA” (Wiseman 1989)
 - “that Fascist lot” (“future Bank of England governor”)
- 1978 SCL *Fallacy of Mixed Economy* (IEA)
 - “Austrian critique of economic thinking & policy”
 - Not just Austrian: public choice, property rights, econs of regulation
 - Discussed problems of nationalised industries, competition needed, but deliberately did not mention privatisation
 - Obvious solution, given experience & recent economic thinking
 - But to mention privatisation would be professional suicide

Unlocking the debate

- 1979 Mrs Thatcher elected PM – many difficult issues in this area
 - need to raise money, asset disposals, borrowing constraints on nationalised industries, increase nationalised industry prices, “wets v dries” struggle
- 1980-Jun 1981 Govt discussions of denationalisation – purely internal
- But some disposals were public – so some denationalisation was now Govt policy
 - So at last possible to discuss denationalisation publicly & professionally
- 1981 Oct SCL “10 Steps to Denationalisation” (*J Econ Affairs*)
 - “the real task is not to control the industries but to control government itself”
 - Restructuring, competition, initially privatise about half the nationalised sector
 - MMC reference after 5 yrs to assess situation. But no mention of regulation
 - Regulation was not the solution, it was the problem (US) and/or ineffective (UK)
- 1982 Oct CPRS study: How to increase competition by privatisation or other means
 - Privatisation, remove statutory barriers to entry, regulation “different from US but independent of Govt”, appeal to MMC, periodic reviews of rates of return, restructuring to enable competition & benchmarking, regional efficiency comparisons, “competition for the field”
 - Dept of Industry planning sale of British Telecom, had similar thinking on regulation
- Parker: CPRS Study impressive, predicted economic regulation in UK. But not public
 - available since 2012 at National Archives, Kew

Economic regulation goes public

- 1982 Nov Queens Speech: privatise BT + regulate it (OfTel)
 - 1982 extensive internal Govt debate on nature of this regulation
 - Dept proposal (MRR), Alan Walters' objections (& ORPL)
- 1983 Feb SCL Report
 - Formally, decide between 2 schemes? Or 3rd? BUT it was more
- First public discussion of economic regulation in the UK
 - Attempt (with B) to provide crash course in relevant economics
 - Not marginal cost pricing, test discount rate, welfare econs etc
 - Austrian econs, pub choice, property rights, econs of regulation etc
 - Importance & feasibility of promoting competition in telecoms
 - Indicate potential case for 'no explicit constraints'
 - Could be relevant if sufficient steps to increase competition?
 - Also attempt to position debate & policy for future privatisations
- 1983 Jun B&L Privatisation: Principles, Problems & Priorities

Economic regulation since 1983

- “Until SCL Report 1983, world of regulatory economics & policy [was] a small group clustered around discussion of US regulatory system and rate of return regulation ... since 1983 a closed world opened up” (Stern 2003 “What the Littlechild report actually said”)
- Kind, but several others c 1983 (Wiseman, CPRS, Walters, Beesley)
- Tho’ was there *any* discussion of economic regulation before 1983?
- Since 1983, many have analysed and developed economic regulation
 - Including a focus on how markets & regulation actually work
- Catherine Waddams a leader here:
 - productivity changes in gas & electricity, distributional effects, incumbent & entrant response, impact on fuel poor, do consumers switch to best supplier, measures of fuel poverty, impact of non-discrimination clauses, consumer response in regulated markets, consumer inertia in energy markets, collective switching, regulating residential energy markets, fairness in retail energy markets, etc etc
- A particular interest & achievement has been the analysis of fairness & equity
- This seems one of the main issues to grapple with going forward