

Regulation and Public Enterprise

ECO 6142 (43.533)

Fall 2002

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This course deals with the economics of regulation. It is concerned with how the government can correct market failures, which can be due, among other factors, to entry barriers and externalities. However, as the literature on the new regulatory economics shows, asymmetric information constraints regulators seriously in their interventions. Hence the need for regulators to devise incentive compatible rules and regulations. In many sectors traditional cost and rate of return regulation are gradually replaced by complete or partial deregulation and, where regulation is maintained, by price caps.

The first part of the course focuses on the traditional approaches to regulation, covering topics such as cost-based pricing, second-best pricing, price discrimination, rate of return regulation, externalities, and contestability. In the second part, the more recent analysis related to asymmetric information, opportunism, and incentives is emphasized. Topics covered in this second part include pricing, quality regulation, auctions, the dynamics of regulation, regulatory capture, privatization, and access pricing. The emphasis will be on the theoretical models of regulation and their implications for public policy.

Manuals

The two following books will be used extensively:

Laffont, J. J., and Tirole, J., 1993, *A Theory of Incentives in Procurement and Regulation*, The MIT Press.

Spulber, D., 1989, *Regulation and Markets*, The MIT Press.

In addition to journal articles, selected chapters from the following books will also be used:

Laffont, J. J., and Tirole, J., 2000, *Competition in Telecommunications*, The MIT Press.

Baumol, W. J., Panzar, J.C., and Willig, R.D., 1982 & 1988, *Contestable Markets and the Theory of Industry Structure*, Harcourt Brace Jovanovich Publishers.

Kahn, A. E., 1988, *The Economics of Regulation: Principles and Institutions*, The MIT Press.

Viscusi, W. K, Vernon, J. M., and Harrington, J.E., 1995, *Economics of Regulation and Antitrust*, The MIT Press.

Schmalensee, R., 1988, *Handbook of Industrial Organization*, Vol. II.

Schmalensee, R., 1979, *The Control of Natural Monopolies*, Lexington Books.

Richardson, J. J., 1990, *Privatisation and Deregulation in Canada and Britain*.

OECD, 1999, *Implementing domestic tradable permits for environmental protection*. Organisation for Economic Co-operation and Development, OECD Proceedings. Paris and Washington, D.C..

Evaluation

Final	50%
Paper	50%

Lectures

Overview of regulation

Spulber, Ch.1.

Viscusi, Vernon and Harrington, Ch. 10, pp. 307-22.

Roman, A. J., “Regulation, Deregulation, Competition and Privatisation: The Canadian Experience”, in Richardson, 1990, pp. 229-44.

Kahn, Alfred E. The Deregulatory Tar Baby: The Precarious Balance Between Regulation and Deregulation, 1970-2000 and Henceforward. *Journal of Regulatory Economics*. Vol. 21 (1). pp 35-56. January 2002.

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Cost-based pricing

Spulber, Ch. 3.

Klein, Christopher C. A Comparison of Cost-Based Pricing Rules for Natural Gas Distribution Utilities. *Energy Economics*. Vol. 15 (3). p 176-82. July 1993.

Braeutigam, R. R., 1980, "An analysis of fully distributed cost pricing in regulated industries", *Bell Journal of Economics*, 182-96.

Second-best pricing

Spulber, Ch. 5, pp. 159-70.

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Sheehan, Michael. Why Ramsey Pricing Is Wrong: The Case of Telecommunications Regulation. *Journal of Economic Issues*. Vol. 25 (1). p 21-32. March 1991.

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- * Ted Bergstrom & Jeffrey K. MacKie-Mason, 1991. "Some Simple Analytics of Peak-Load Pricing", RAND Journal of Economics, 241-249 Vol. 22 (2) pp. 241-249.
- * Crew, Michael A; Fernando, Chitru S; Kleindorfer, Paul R. The Theory of Peak-Load Pricing: A Survey. Journal of Regulatory Economics. Vol. 8 (3). p 215-48. November 1995.
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Rate regulation: The Averch-Johnson model

Spulber, Ch. 10, pp. 267-93.

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Externalities

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Ch. 13, pp. 350-69.

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Introduction to the New Regulatory Economics

Laffont and Tirole 1993, Introduction, pp. 1-19, 35-40.

* Pricing and regulatory innovations under increasing competition. Crew, Michael A., ed., Topics in Regulatory Economics and Policy Series. Boston; Dordrecht and London: Kluwer Academic. p 1-19. 1996.

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The basic model

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Pricing

Laffont and Tirole 1993, Ch. 2, pp. 129-37, 155-8.
Ch. 3, pp. 165-73, 178-9, 206.

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Dynamics without commitment - The Ratchet effect

Laffont and Tirole 1993, Ch. 9, pp. 375-82, 409-11.

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Dynamics with commitment and renegotiation

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The regulation of quality

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Privatization

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Second-best price discrimination

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