

# The Economics of Regulation: Contractual and Institutional Perspectives

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This course deals with the way the government regulates the provision of service in a market economy, either because it is a public good, or because competition could yield inefficiencies. Instead of providing exhaustive views of the different economic theories of regulation and public service, it provides insights of the main trade-offs at stake relying on institutional and organizational economics. Contract, regulation and institution theories will be alternatively relied upon to introduce the audience to the main theoretical and applied issues.

## Class 1. Why Regulate and How ?

*MONDAY MARCH 30TH, 11.00-13.00*

The aim of this class is to introduce the alternative explanations for governmental regulation, and to present the essential tradeoffs faced by regulators facing a (monopolistic) firm. The (complete) contract approach will be presented as well as a brief history of the policy evolutions for the past 30 years.

\*\* read in priority

\*\* Malin E. and Martimort D. 2000. Transaction Costs and Incentive Theory. *Revue d'Economie Industrielle*, 92, 125-148. (downloadable here : [http://www.persee.fr/web/revues/home/prescript/article/rei\\_0154-3229\\_2000\\_num\\_92\\_1\\_1043](http://www.persee.fr/web/revues/home/prescript/article/rei_0154-3229_2000_num_92_1_1043))

- Armstrong M and D. E. M. Sappington, 2007, Recent Developments in the Theory of Regulation, in M. Armstrong and R. Porter (eds.), *Handbook of Industrial Organization* (Vol. III), North Holland.
- Armstrong M and D. E. M. Sappington, 2006, Regulation, Competition, and Liberalization, *Journal of Economic Literature*, Vol. XLIV (June 2006), pp. 325–366
- Laffont, J.-J. & Martimort, D., 2002. *The Theory of Incentives: The Principal-Agent Model*, Princeton University Press.
- Joskow P. L., Regulation of Natural Monopolies, in A. Mitchell Polinsky & Steven Shavell (eds), *Handbook of Law and Economics* 2007
- Shleifer, A., 1985. A theory of yardstick competition. *RAND Journal of Economics*, 16(3), p.319–327.
- Shleifer, A. 2012. *The Failure Of Judges And The Rise Of Regulators*. MIT Press.

## **Class 2. Contracting for public good provision: transaction costs and regulation by incomplete contracts**

*MONDAY MARCH 30TH, 15.00-17.00*

The aim of this class is to discuss the complexity faced by governments when attempting to contract the provision of a public service to a firm. The franchise bidding solution was proposed Demsetz in 1968, and has been extensively discussed since then. Analyses proposed by Transaction Cost Economics (Williamson 1976) and by the Incomplete Contract Theory will be presented. Some recent empirical developments will be proposed too.

- \*\* Hart, O., Shleifer, A. & Vishny, R.W., 1997. The proper scope of government: Theory and an application to prisons. *Quarterly Journal of Economics*, 112(4), p.1127–1161.
- Bajari, P., Houghton, S. & Tadelis, S., 2011. Bidding for incomplete contracts: An empirical analysis. NBER Working Paper.
- Demsetz, H., 1968. Why regulate utilities? *Journal of Law and Economics*, 11, p.55–66.
- Guasch, J.L., Laffont, J-J. & Straub, S., 2008. Renegotiation of concession contracts in Latin America: Evidence from the water and transport sectors. *International Journal of Industrial Organization*, 26(2), p.421 - 442.
- Williamson, O.E., 1976. Franchise bidding for natural monopolies: In general and with respect to CATV. *Bell Journal of Economics*, 7(1), p.73–104.

## **Class 3: Contracting with the Government: Collusion, Lobbying, Third Party Opportunism, ...**

*TUESDAY MARCH 31ST, 11.00-13.00*

Any ‘contract’ between the Government and a firm — whether it is question of provision of public service, or regulatory constraints — raises issues because of the Government, is both one of the parties and the last resort enforcer of the mutual commitments. Moreover, the politicians and bureaucrats are subject to political and organizational constraints, which generate specific contracting risks. The issue of “governmental failures” will be introduced in this class

- \*\* Pablo T. Spiller, An Institutional Theory of Public Contracts: Regulatory Implications, NBER Working Paper No. 14152, August 2008
- Moszoro, Marian W. and Spiller, Pablo T., 2014, Political Contestability, Scrutiny, and Public Contracting, WP UC Berkeley
- Brousseau E., Saussier S. 2009, “Contracting with Governments”, in Jackson A. Nickerson and Brian S. Silverman (eds), *The Economic Institutions of Strategy, Advances in Strategic Management*, Volume 26. pp. 487-521

## **Class 4: Political Economy of Regulation and Market Institutions**

*TUESDAY MARCH 31ST, 15.00-17.00*

Markets are non-neutral complex social technologies. The organization and regulation of markets by the governments cannot be understood if ignoring the political economy of institutions. The political origin of markets explains why the political background frame the issues to be dealt with, and the feasibility of any policy or reform. This class will introduce the political economy of the manufacturing of markets.

- \*\* De Figuereido J., 2009, Integrated Political Strategy, NBER Working Paper No. 15053
- Spiller P. & Liao S. , 2008, "Buy, Lobby or Sue: Interest Groups' Participation in Policy Making – A Selective Survey," in E.Brousseau and J.-M. Glachant, (eds.) *New Institutional Economics*, Cambridge University Press, pp. 307-327
  - Wallis J.J. , 2014, "Why aren't Competitive Markets Self-Sustaining?" in E. Brousseau and J.-M. Glachant (eds), *The Manufacturing of the Markets*, Cambridge University Press, pp. 149-165
  - North D.C., Wallis J.J. & Weingast B.R., 2009, "The Conceptual Framework", chapter 1: Violence and Social Orders: A Conceptual Framework for Interpreting Recorded Human History, Cambridge University Press, pp. 1-29. (long version "A Conceptual Framework for Interpreting Recorded History." NBER Working Paper w12795, December 2006)
  - Brousseau, E., Y. Schemeil & J Sgard, 2010, "Constitutions, States and Development", *Journal of Comparative Economics*, vol. 38, pp. 253-266.

## **Class 5: Governance in Network Industries: lessons learnt from "New Institutional Economics"**

*TUESDAY 21 APRIL 21ST, 11.00-13.00*

This class will be based on the contribution of the Nobel laureates Coase (1991), North (1994), Williamson (2009) and Ostrom (2009) to highlight how the conceptual approaches they propose provide a relevant framework to analyze the essential challenges in regulating network industries.

- Coase, R.H., 1988, *The Firm, the Market and the Law*, University of Chicago Press
- North D., 1990, *Institutions, Institutional Change and Economic Performances*, Cambridge UP
- Ostrom E., 2005, *Understanding institutional diversity*. Princeton University Press
- Williamson O.E., 1985, *The Economic Institutions of Capitalism*, The Free Press