

# *"Institutional Economic Design of Governance in Competitive Utility Reforms"*

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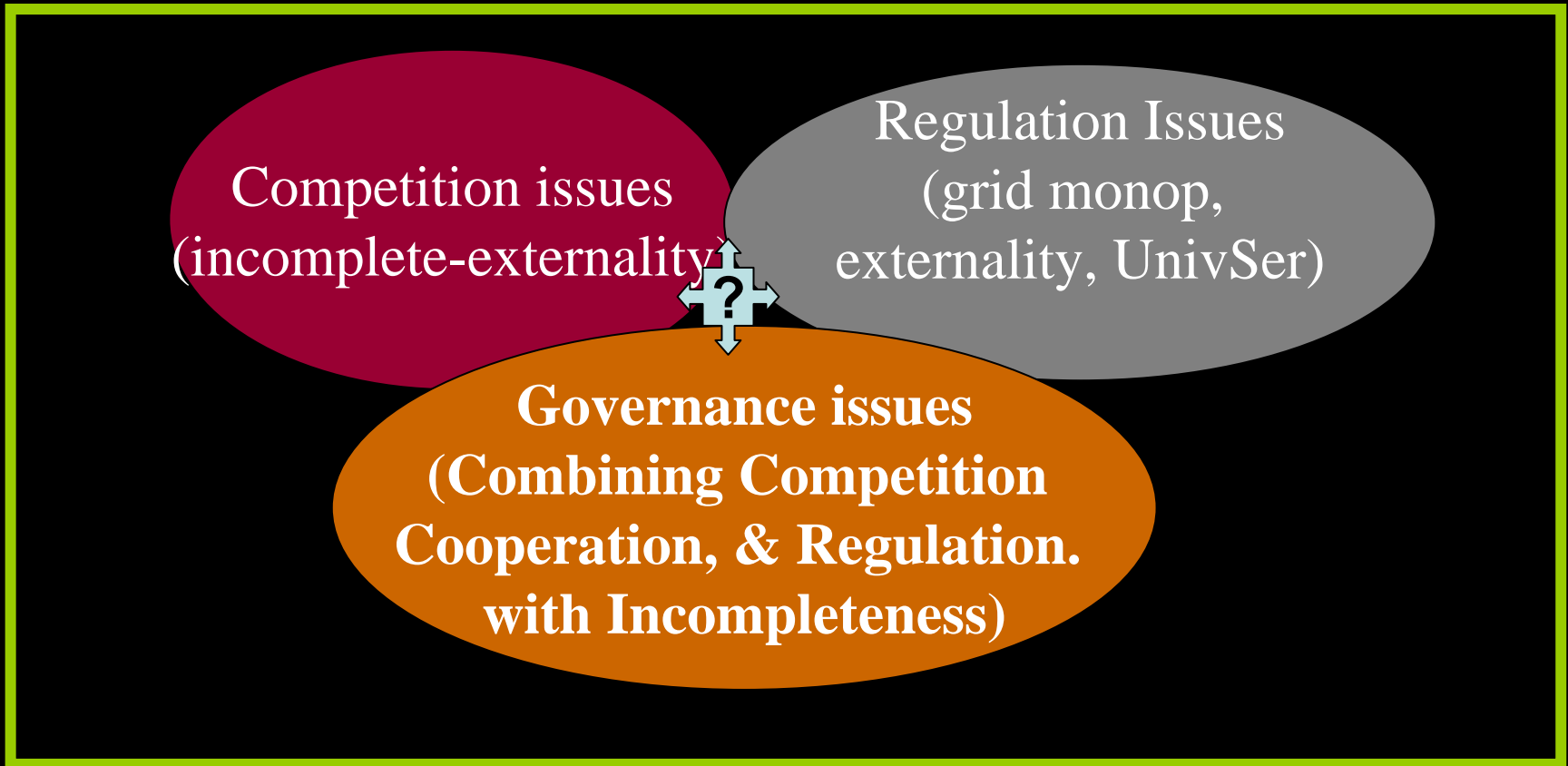
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# *Is Reflexive Governance in network industries a problem?*

## Structure of the Problem



**Institutional Environment Framing**

# *Is it a Public action or market design problem?*

- Coase (1959, 1960, 1974) & Demsetz (1968) introduce alternative options than public intervention to cope with network industries : private provision, auctioning, allocating concessions in franchise bidding systems...
- **Goldberg** (1976) & **Williamson** (1976) : Regulation and Deregulation of Networks « *Pricing or Contracting problem?* »
- with quality concerns, location, time reaction... an *ex ante* solution based solely on price will be inefficient and ***ex post* interventions are needed.**

# *From Market failures to market design*

“Market Design” is generated by a sequential combination of market & non market mechanisms on several parts of the industry

As noted by Wilson (2002) and Newbery (2005) Market design Innovations are not perfect in theory & practice:

- Imperfect encapsulation of « natural monopoly & externalities » in few particular parts of the Industry Chain
- Imperfect framing of transactions by combining “ex ante” & “ex post” new competitive tools
- Market power of incumbents
- *One way is to « build more markets »*

« Market Building »  
as a remedy for  
« Market Design » failures

# ***“ Market design imperfections” & “Market building activities”***

- 3 concepts are needed for understanding « market building activity » :
  - « *Competition where possible* »
  - « *Modularity* »
  - « *Sequentiality* »

# « *Competition where possible* »

- « Competition where possible » gives us the basic boundaries of competitive and non competitive mechanisms
- Littlechild with the Electricity industry
  - Generation & Retail are competitive activities
  - Transmission & Distribution still need to be regulated in a way
- Yes but : « Where are the boundaries? »

# ***Boundaries are chosen by « modularity » decisions***

- according to Baldwin & Clark (2000) :  
***« Modularity is a particular design structure, in which parameters and tasks are interdependent within modules and independent across them***
- they add ***« but in a complex design, there are often many levels of visible and hidden information »***
- And define ***« The ideal of perfect modularity is full « plug and play » flexibility. »***
- So ***« Modularity in network industries »*** is becoming an unfinished game of ***« modules » & « interfaces »*** according to rulers decisions

# « Sequencing of decision matters »

- Newbery (2002) « *Choosing the right reform strategy is more challenging than early optimists claimed* ».
- Definitions of the reform strategy :
  - the initial reform design,
  - privatisation decision;
  - level of unbundling,
  - creation of specific regulator
  - ...
- creates new stakeholders in the regulated game with new decision rights on the network activities  
...

# ***So « market building activities » are not perfect***

- Modularity & sequentiality don't give us a perfect market solution for network industries... (externalities, market power...)
- So « how to cope with these imperfections? »
- Answer : **Try to build institutions and governance structures to deal with that kind of imperfections**

**« *Institution building* »**  
as remedy to  
« market building » failure

# Perfect *ex ante* “Governance structure” ?

- Creation of a Governance Structure is mainly defining & allocating “**rights**”.
- *So, the new rights enter within a nexus of **existing rights***
- *The creation of a perfect ex ante governance structure is then a dream, because old and new rights are being “**sequentially**” called to **intervene...***
- *... and to **interact** in a process of **sequential discovery** of limitation and evolution by their implementation (Prosser 2005).*
- *So **institutional endowment is important***

« Institution building »  
is constrained and can only be done  
within the given  
**« *Institutional Endowment* »**

# *A look on Institutional Endowment literature*

*“Existing Institutional environment makes impossible to redesign all existing rights “at the start” to begin Market Building in a perfectly designed Institutional frame of governance”.*

**Basically you can't do what you want.**

*« government strong enough to protect property rights is also strong enough to confiscate the wealth of citizens »*

**Weingast (1995)**

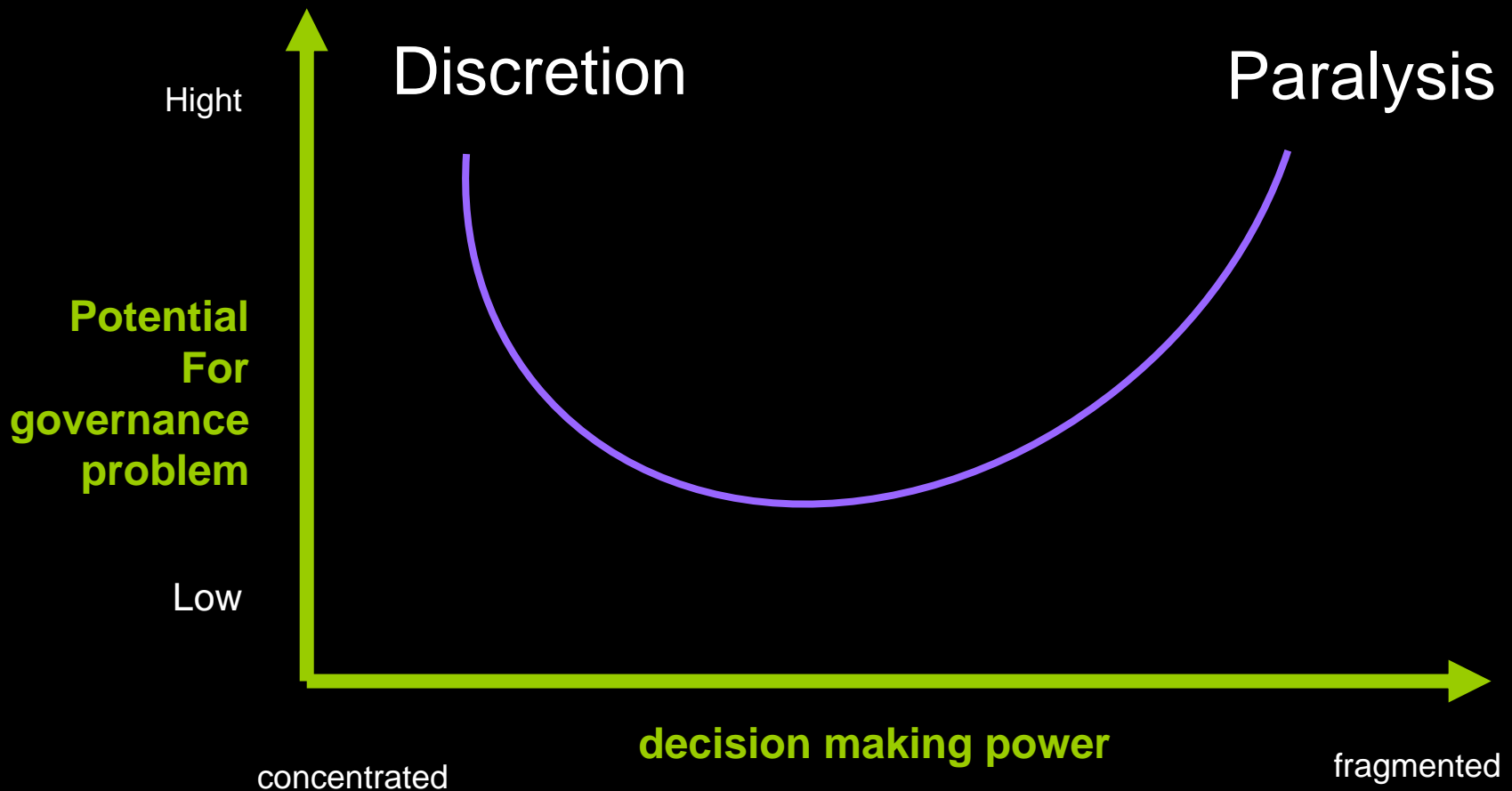
**Strong governments can change all the rules =>  
PB of discretion in regulation**

*Fragmentation and dispersal of power stemming from the interplay constitutional structure and party system leads to policy delay, gridlock, and immobilism ».*

**Tsebelis (1995, 2002)**

**Whereas weak governments can do almost nothing =>  
PB of paralysis of regulation**

# *The Mc Intyre (2003) synthesis on Veto Players impact on Institution Building*



# So is “*Institutional endowment*” a hard constraint?

**YES**

*IF numerous VETO PLAYERS CANNOT NEGOCIATE “Path reorientation” on a voluntary basis*

**NO**

*In single VETO PLAYER situation*

*or*

*IF numerous VPs CAN NEGOCIATE or “enjoy” a “Window for reform”  
à la Keller (2003)*

**As a consequence :**

*Concentred and Fragmented countries are badly equipped to converge on the same “Redesign” because of their distribution of VPs...*

# Conclusion

- Do Institutional Economics help us to better understand the reflexive governance issues in network industries?



If yes, take care of the details, gaps  
and player's rights...



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