

Course title: **Economic Regulation**

No of credits: **4**; No. of lecture hours: **42 (approx.)**

Type of course: **Optional**; Course scheduling: **Monsoon Semester**

Evaluation: **Mid-semester exam: 35%; End-semester exam: 40%; Term paper/ presentation: 25%.**

Course Instructor: **Meeta K. Mehra**

Course outline:

The course introduces students to regulatory environment and institutions, including rationale for economic regulation, regulatory instruments and incentive schemes, and an overview of the regulatory processes. It covers the traditional theories of regulation of natural monopolies under full information. This is followed up with new incentive-based approaches to regulation under asymmetric information. Pricing in a competitive environment, access pricing, dynamic regulation and politics of regulation are additional topics covered by the course.

Modules

- 1. Introduction to Economics of Regulation:** Rationale for economic regulation, common regulatory instruments and incentive schemes, and overview of regulatory processes.(1 lectures, 1.5 hours)
Kahn, A. (1988). The Economics of Regulation, Chapter 1
Viscusi, K, Vernon, J. and Harrington, J. (1992). Economics of Regulation and Antitrust, Chapters 1 and 10.
- 2. Theory and Regulation of Natural Monopoly:** Conventional theory of regulation covering optimal policies for natural monopolies, problems of natural monopoly and policy solutions. (2 lectures, 3 hours)
Viscusi, K, Vernon, J. and Harrington, J. (1992). Economics of Regulation and Antitrust: Chapters 11 and 12.
Laffont, J-J. and Tirole, J. (1993). A Theory of Incentives in Procurement and Regulation. Introduction.
- 3. Rate of Return Regulation:** Regulating rate of return on capital (Averch-Johnson model and its critique and extensions by Baumol and Klevorick) (3 lectures, 4.5 hours)
Averch, H. and Johnson, L. (1962) Behaviour of the Firms under Regulatory Constraint, American Economic Review, 52, 1052-1069.
Baumol, W.J. and Klevorick, A.K. (1970). Input Choices and Rate-of-Return Regulation, Bell Journal of Economics and Management Science, 1, pp. 162-90.
- 4. Optimal Regulation under Asymmetric Information:** Pricing and incentives for a single and multi-product firm when the effort levels and technology type of the firm are not known to the regulator. Theory of yardstick competition. (8 lectures, 12 hours)
Laffont, J-J. and Tirole, J. (1993). A Theory of Incentives in Procurement and Regulation. Chapters 1-3.

Baron, D and Myerson R. (1982). Regulating a Monopolist with Unknown Cost. *Econometrica*, 50: 911-930.

Shleifer, A. (1985) "A Theory of Yardstick Competition", *RAND Journal of Economics*, 16: 319-327.

5. **Pricing and Competition:** Regulation under competition, access pricing and bypass (in the context of telecommunications and energy (power, gas) sectors (6 lectures, 8 hours)

Laffont, J.-J. and Tirole, J. (1993). *A Theory of Incentives in Procurement and Regulation*. Parts of chapters 5 and 6.

Laffont, J.-J. and Tirole, J. (1994) "Access pricing and competition", *European Economic Review*, 38: 1672-1710.

Laffont, J.-J. and Tirole, J. (1996) "Creating competition through interconnection: theory and practice", *Journal of Regulatory Economics*, 10: 227-256.

Armstrong, M., Doyle, C. and Vickers, J. (1996) "The access pricing problem: a synthesis", *The Journal of Industrial Economics*, 44: 131-150.

Vickers, J. (1997) "Regulation, Competition, and the Structure of Prices", *Oxford Review of Economic Policy*, 13, Spring: 15-26.

6. **Dynamics of Regulation** (4 lectures, 6 hours). Ratchet effect in the two-type case.

Laffont, J.-J. and Tirole, J. (1993). *A Theory of Incentives in Procurement and Regulation*. Parts of Chapter 9.

7. **Politics of Regulation and Regulatory Capture** (4 lectures, 6 hours): Revisiting the capture theory, comparison of capture-free regulation and regulation with producer protection, multiple interest groups.

Laffont, J.-J. and Tirole, J. (1993). *A Theory of Incentives in Procurement and Regulation*. Parts of Chapter 11.

Additional readings

Becker, G. (1983) "A theory of competition among pressure groups for political influence", *Quarterly Journal of Economics*, 98: 371-400.

Braeutigam, R (1989). *Optimal Policies for Natural Monopolies*. In Schamalese, R. and Willing, R. (Eds). *Handbook of Industrial Organization*. Elsevier Science Publishers.

Gasmi, F., Laffont, J.-J. and Sharkey, W. (2000) "Competition, Universal Service and Telecommunications Policy in Developing Countries", mimeo

Joskow Paul L. (ed.) (2000), "Economic Regulation", Edward Elgar Publishers.

Kofman, F. and Lawarrée, J. (1996) "On the optimality of allowing collusion", *Journal of Public Economics*, 61: 383-407.

Laffont, J.-J. and Tirole, J. (1990) "The politics of Government Decision Making: Regulatory Institutions", *Journal of Law, Economics and Organizations*, 6: 1-31.

Laffont, J.-J. and Tirole, J. (1991) "The politics of Government Decision Making: A Theory of Regulatory Capture", *Quarterly Journal of Economics*, 106: 1089-1127.

Laffont, J.-J. and Tirole, J. (1999) *Competition in Telecommunications*, MIT Press.

Loeb, M. and Magat, W (1979) A Decentralized Method for Utility Regulation. The Journal of Law and Economics, 22: 399-404.

Peltzman, S. (1976) "Toward a more general theory of regulation", The Journal of Law and Economics, 19: 211-240.

Spulber David, "Regulation and Markets". MIT Press, 1988

Stigler, G. (1971) "The Theory of Economic Regulation", Bell Journal of Economics and Management Science, 2: 3-21.