

Regulating Infrastructure: Monopoly, Contracts, and Discretion. *By José A. Gómez-Ibáñez.* Cambridge, Mass.: Harvard University Press, 2003. xi + 431 pp. Tables, notes, index. Cloth, \$55. ISBN 0-674-01177-5.

Reviewed by Tony A. Freyer

José A. Gómez-Ibáñez's fine book focuses on five infrastructure industries: transportation (particularly railways, buses, and airlines), electric utilities, telecommunications (especially telephone utilities and cable television), water and sewage utilities, and gas utilities, although he also makes passing reference to industries as varied as toll roads and trash collection. Generally, each of the infrastructure industries distributed products or services through highly capitalized spatial networks requiring fixed and durable investments. Diverse motivations encouraged government intervention. First, the governments pursued control because many infrastructure networks tended to possess the "characteristics of a so-called natural monopoly, which are a combination of durable and immobile investments and strong economies of scale or traffic density. The economies of scale mean that the cheapest way to serve a community is with a single company, particularly if the local network has a relatively low density of traffic" (p. 95).

Additional motivations facilitate government intervention. Railways and roads and electric, water, and telephone utilities face difficulties in establishing consistent rights of way without government authorization of the use of eminent domain. Such power to expropriate private property is subject to abuse, however, so the state imposes conditions on its exercise. The government also acts on behalf of direct subscribers and nonsubscribers alike to preserve pure drinking water, environmentally safe sewage disposal, or safe electric lighting. In addition, the government often imposes regulation in order to achieve economic development—such as bringing electric power to isolated rural areas—and more equal opportunity, including provision for equal public access to transportation, telecommunications, or energy. More broadly still, infrastructure industries are subject to wide-ranging safety and environmental regulations in the general public interest, separate from concerns about preventing monopoly abuse.

Gómez-Ibáñez demonstrates that these diverse motivations have reflected conflicting political demands throughout time and across nations. He draws his cases primarily from the United States, Argentina, Brazil, Chile, Venezuela, Colombia, Britain, and Canada, although Sri Lanka, Mexico, Poland, Germany, Australia, and a few other countries also provide examples. In infrastructure industries, interdependent market and political demands affect pricing and service quality. A constant political danger is that the regulator will succumb to “capture.” Traditionally, Gómez-Ibáñez notes, this occurred when the regulated came to control the regulator, with the most famous example perhaps being the capture of the U.S. Interstate Commerce Commission, which became more responsive to the railroads than to the public, whose interest it was purportedly created to protect.

The stories, presented here, of the public bus system in Sri Lanka and the U.S. telephone industry reveal, however, that multiple, often contradictory, political exigencies influence the potential for capture. Thus, motivated by considerations of both economic development and equity, Sri Lankan regulators accommodated the poorest users of the public bus system. Similarly, until 1982 in the United States, federal and state regulators and Atlantic Telephone and Telegraph (AT&T) collaborated to create a complex system of cross-subsidies, one outcome of which was to guarantee phone access to the nation's least profitable rural markets.

By skillfully applying economic theories of transaction costs to the case histories, Gómez-Ibáñez lays out strategies for regulating monopoly. At different times virtually all national governments—except that of the United States—have asserted the right to supply infrastructure services through state-run enterprises. Gómez-Ibáñez considers such state expropriation, however, to be the threat or the reality that engenders the three most viable regulatory strategies: discretionary regulation, concession contracts, and private contracts. Comparing municipal franchises in the United States and Canada, the U.S. railroad and airline industries, and the British water industry, he argues that relying on concession contracts, whereby government officials represent the customers' interests in contract negotiations with the private infrastructure supplier, is preferable to the policy of government regulators setting prices and service standards for private infrastructure suppliers (discretionary regulation). Even so, Gómez-Ibáñez concludes, all else being

equal, the most efficient regulating strategy is to enable customers to enter into private contracts directly with the private infrastructure supplier.

While making a persuasive general case for private contracting, Gómez-Ibáñez recognizes the worth of maintaining policy options. The examples of the British railroad and the Argentine electric industry suggest the value of private contracting if the monopoly infrastructure—such as the railroad right of way or the electric transmission process—is “vertically unbundled” from wholesale and retail operations. As long as basic coordination problems can be resolved, the latter operations can be restructured into competing firms; imposing market competition on the core monopoly infrastructure itself, however, is probably not possible, given contemporary technological understanding. The case evidence for electricity, natural gas, water, railways, and telecommunications nonetheless also indicates that such unbundling will most likely be efficient primarily for large customers. The transaction costs to small customers seem sufficiently high, by contrast, that adequate service and effective pricing require more, rather than less, government intervention.

This book is important and timely. Gómez-Ibáñez’s rigorous empiricism and undoctinaire use of theory present a valuable contrast to the currently dominant mode of public-choice policy studies. Still, there are noteworthy slips. His treatment of California’s troubled privatization of the wholesale electricity market ignores the role of Texas companies, whose actions subsequently came under federal court indictment. Also, he is surely correct—given the trust he places in private contracting—to note the importance of strong legal institutions in ensuring that the strategy works efficiently. But the comparisons he draws between the civil law systems prevailing in most of the world and the version of the English common law systems found in the United States are too selective to be illuminating. As an example, Gómez-Ibáñez cites Steven Vogel in explaining the paradoxical policy outcome that deregulation often results in more, rather than fewer rules, governing market relations. He neglects to add, however, that the United States is distinctive in its pervasive reliance on the judicially enforced civil damage system as the regulatory device, which is in turn maintained by an unusually ubiquitous professional legal culture. Although he suggests that the constitutional ideal sustaining the U.S. regulatory order may be unique, his silence on the subject of the wider

institutional culture opens the study's larger transnational comparisons to unaddressed questions.

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