

The origin and strange history of regulation in the UK: three case studies in search of a theory

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Abstract

Theories of regulation have not been applied very extensively to the UK, although the UK has the earliest history of regulation for (what would now be seen as) defensible reasons of economic or social policy. In this tentative paper, I take three snapshots of regulation in the UK and ask what (if anything) we can learn from them for the performance of the three main theories of regulation.

The three snapshots are of:

- the origin of railway regulation from 1825 to 1844;
- regulatory failure in the Aberfan disaster (1966);
- the tardy development of a new pattern of regulation after 1979.

The evidence shows that all three theories are viable but that none contains the whole truth.

The origin and strange history of regulation in the UK: three case studies in search of a theory¹

Introduction

Regulation has existed for as long as governments have interfered in private actions: that is, for ever. To make the subject tractable, therefore, I first restrict 'regulation' to mean *regulation for defensible reasons of economic or social policy*. Expropriation of citizens and distribution of the spoils to the king's (general's, president's) favourites is by fiat not regarded as regulation and not discussed further in this paper.

Even this restriction is not enough to make the subject tractable. Many examples of regulation in pre-19th century politics (and indeed since) may have originated in what seemed to be good ideas at the time rather than (or in addition to) naked expropriation of one group in favour of another.

Taking British examples more or less at random:

- Medieval charters to towns allowing them to hold fairs and exempting them from feudal jurisdiction. These enabled islands of capitalism to develop in a feudal sea, to the long-term benefit of marine life.
- The Test and Corporation Acts of the 1670s, which closed the English universities and corporate bodies to all who were not members of the official state church, for what seemed at the time to be good reasons of social control - reasons which the attempt to restore Catholicism under James II shortly afterwards seemed to justify.

Therefore I further restrict the field of study to *regulation for (what would now be seen as) defensible reasons of economic or social policy*. In so doing I consciously break the historian's first rule, 'The past is another country; they do things differently there'. I have no excuse except that of making the subject tractable. It enables me to start in the early 19th century.

The main part of this paper therefore comprises three case studies. The cases are:

- the origin of railway regulation from 1825 to 1844;
- regulatory failure in the Aberfan disaster (1966)
- the tardy development of a new pattern of regulation after 1979.

I claim no scientific basis for the case selection. The first two cases draw on my previously published work; the third deals with the obvious puzzle of why political agents after 1979 were so slow to realise that extensive privatisation would entail extensive re-regulation. The two cases on which I have previously published also differ. In the first, regulation was the focus from the outset. In the second, the compelling evidence of regulatory failure only emerged as we worked through papers newly released under the 30-years rule.²

For this audience there is no need to set out, nor to analyse, the principal theories of regulation. I look mainly at economic theories, which I characterise as

- public-interest
- regulatory capture
- median voter.

The *public interest* theory states that regulation is the solution to certain sorts of market failure, especially market failure due to natural monopoly (cf esp. Foster 1992). A normative version states that given such failure, regulation *ought* to occur. A positive version (that no scholar known to me is brave or foolhardy enough to espouse) would state that given such market failure, regulation *does* occur.

Regulatory capture is a product of the public choice movement (Virginia branch). It is both positive and normative. In a strong positive version, it predicts that regulation comes into existence to serve the interest of the regulated. A weaker positive version would hold that, once

regulation has come into existence (for whatever, perhaps exogenous, reason), it is captured by the interest being regulated. A normative implication, much favoured by UK governments since 1979, is that self-regulation is A Bad Thing (except, curiously, for lawyers - but then Lady Thatcher is a lawyer).

The *median voter* theory in this context emanates principally from the public choice movement (Chicago branch). It is held to be an implication of the more general median voter theory (Black 1958). The more general theory implies that, providing that politics in the relevant arena has only one issue dimension, then in any defensible voting system the outcome will be the favourite issue position of the median voter in that dimension. In its Chicagoan application to any economic policy arena such as trade policy or optimal regulation, it implies that policy in each dimension sits stably at the (possibly weighted) median point of the interests concerned. In relation to regulation, the Chicago position might be characterised as Virginia without attitude. Yes, regulators may be captured, in any given policy area, by the regulated industry. That simply shows, ex post, that the regulated industry was more intense, or better informed, than those who would have gained from a different pattern of regulation. All is for the best in the best of all possible worlds. As the old economist said to the young economist who said 'Look! there's a \$100 bill on the sidewalk!', 'There can't be. If there had been, somebody would have picked it up' (Compare Wittman 1995 with Olson 2000).

Case 1. W.E. Gladstone and the Regulation of Railways Act 1844.

Government regulation of the railways in the United Kingdom dates back to the 1840s.

Inspectors of Railways were first appointed under an Act of 1840. Because the Act stipulated that the inspectors must not have a connection with any railway company, they were drawn from

the Royal Engineers and their reports always stated their military rank. Although this ban was repealed in 1844, these features have remained unaltered. Their first report in 1841 demanded that their powers of regulation be strengthened, a demand partly met in 1842. The companies set up short-lived trade associations in 1839 and 1841, but in 1844 the directors of the Liverpool & Manchester Railway could still deplore the lack of 'a *professional advocate* in the House of Commons, as was the practice with the West India Interest, the Canadian Interest, &C' (Alderman 1973 pp 16, 273). A stable Railway Companies' Association, run through the Railway Clearing House, did not emerge until 1861.

The Regulation of Railways Act 1844 (7 & 8 Vict. c85) was pushed through Parliament by W.E. Gladstone, President of the Board of Trade, despite fierce opposition from the railway companies. Section 1 of the Act gave Parliament the power, from 21 years after its passage, to cap the rates of any new line which was earning more than 10% a year on the value of its paid-up stock. Section 2 empowered Parliament, after the same period of time, to nationalise any new railway company which was making over 10% annual profits. Section 6 was the famous 'parliamentary train' clause, which was to apply to any company, old or new, whenever it sought new parliamentary powers. It required every company to run at least one train each way every weekday which stopped at every station and carried third-class passengers in covered accommodation with seats at an average speed (including stops) of not less than 12 mph and a fare of not more than 1d a mile. There were provisions for children and baggage. Other sections obliged companies to carry the mail (at any safe speed not over 27 mph); to carry troops or police; to allow public telegraph lines to be erected along their rights-of-way; and to open their own telegraph systems to public use.

As might be expected, the trains mandated by section 6 tended to leave their starting-points around 6 am, and companies complied with the section as minimally as possible. ('The idiot who,

in railway carriages,/ Scribbles on window-panes, / We only suffer / to ride on a buffer / of
Parliamentary trains! - W.S. Gilbert, *The Mikado*). This pattern of service was still visible in the
timetable of British Railways in 1962 (see e.g. *British Railways - Scottish Region Timetable*
September 1961-June 1962, Tables 20, 23, and 28).

Gladstone's Bill set the pattern for regulation of natural monopolies not only in Britain but
elsewhere: it shaped the US 1887 Interstate Commerce Act, which itself shaped subsequent
regulation in the USA (Breyer 1982 pp 6, 199; McCraw 1984 p.13). There has been far more
interest in regulation in the USA than in the UK, among practitioners and academics alike.
Americans have mostly developed the theory of regulation on American data; here it can be
tested on an event of founding importance for regulation on both sides of the Atlantic.

Almost every railway historian assumes that the 1844 Act was important and beneficial; almost
every economic historian has argued that it was misconceived but, fortunately, unimportant
because it was emasculated in Parliament (compare eg Ellis 1954 pp.128-31 with Clapham 1926
pp 417-21; Alderman 1973 p.17; and Lubenow 1971 pp. 114-6, 182). Railway historians are
usually amateurs; economic historians usually professionals, who can be witheringly sarcastic
about the quality of evidence and argument used by the first (Hawke 1970 pp. 93-9). However,
we shall argue that in this case the railway historians are right and the economic historians wrong.
Furthermore, the third reading of Gladstone's Act was unopposed even by the 'railway interest'.
And the ideology of classical economics, in which the bureaucrats of the Board of Trade were
soaked and to which Peel and Gladstone were both converted, (Brown 1958 pp. 20-33, 214-31;
Feuchtwanger 1989, p.43; Shannon 1982, pp. 117-20) strongly favoured free trade, but not
regulation. Thus, the case poses stiff challenges to orthodox political economy.

Gladstone's achievement was long-lasting. The 1844 Act was supplemented but not abandoned; its basic pattern of price and quantity regulation was not abolished until the Transport Act 1960. The safety regulation survives to this day, and railway accidents were until recently still investigated by retired officers of the Royal Engineers. Between 1844 and 1923 there were further highly charged, and highly publicised, attempts to tighten the regulation of railway safety and/or rates. Victorians knew very well that there was a 'railway interest' comprising MPs and peers who were directors of railway companies, who led the opposition to further regulation. *Bradshaw's Railway Almanack* published a list of them every year from 1847 until 1923. Victorian regulation remains under-researched (but see Alderman 1973, Foster 1992, Gourvish 1972, Kostal 1989, Lubenow 1971, Parris 1965, Williams 1952, Schapiro forthcoming).

Every railway that wished to open to the public had first to obtain a private Act of Parliament. Parliament gave the company the right to purchase land and operate across public highways; in return it laid down maximum toll rates which the company must not exceed. Railway Acts were modelled on earlier acts authorising turnpike roads. To begin with, parliamentarians assumed that the railways would, like turnpike roads, provide the track, on which others would run goods and passenger vehicles. The railways' tolls for track use were regulated, but the charges for carriage were not. Some of the first railways, such as the Stockton & Darlington (1825), did indeed work somewhat like turnpikes. But even it was its own freight carrier, and only for passengers did it levy tolls. Soon after the first trunk line, the Liverpool & Manchester Railway, opened in 1830, it became clear that the turnpike model was impracticable both technically and economically. Technically, because increasing speeds and long braking distances meant that some one body had to be responsible for deciding when a train could enter a section of track. Economically, because any entrepreneur who tried to put a private locomotive on the track would be at the mercy of the railway company as soon as he ran out of water. The Officers of the Railway Department argued in 1841

1. That Railway Companies using locomotive power possess a practical monopoly for the conveyance of passengers ..., and that under existing circumstances this monopoly is inseparable from the nature of these establishments, and from the conduct of their business with due regard to the safety of the public.
2. That this monopoly is the result of circumstances contemplated neither by the Legislature nor by the Companies themselves, the extensive powers contained in their Acts of incorporation having been obtained under the impression that the interests of the public were sufficiently secured by fixing a maximum rate of tolls, and providing for free competition in the supply of locomotive power and other means of conveyance.
3. That, under these circumstances, the Legislature is bound to provide that the public interests shall not suffer from the mistaken view taken in the infancy of the science of locomotion, and that for this purpose the powerful monopolies, in whose hands a large and increasing portion of the internal communication of the country is placed, should be subjected to the supervision and control of the Board of Trade....
4. That, with a view to the protection of the public against any abuse of their irresponsible powers on the part of these monopolies, the Board of Trade should have the power of ascertaining precisely what the system [sic] is which is enforced towards the public on every railway, and of disallowing any part of it which appears obviously arbitrary or objectionable....(*Parliamentary Papers, House of Commons, 1841 First Session, vol. XXV.*) Hereafter cited as *P.P.* <year> <vol.>

The Railway Department comprised just three professional staff - a statistician, an engineer, and a lawyer (Parris 1965 pp. 31-5). It was semi-detached from the Board of Trade proper, and its economic views were evidently less rigorously classical. However, they struck a chord with Gladstone, their minister. Gladstone's classical and mathematical education did not expose him to

economics. He entered politics not as a free-trader or as a Liberal, but as a Tory determined to protect and enhance the role of the Church of England as a state church. This dominated his life from his entry to Parliament in 1832 until he resigned from Sir Robert Peel's cabinet over a grant to the Catholic seminary in Maynooth in 1845. Peel picked him out as an able administrator and gave him a junior government job in the short administration of 1834-5. In 1841, the Tories won a clear General Election victory. Peel offered Gladstone the Vice-Presidency of the Board of Trade. This disappointed Gladstone, who had hoped to govern Ireland: 'the science of politics deals with the government of men, but I am set to govern packages' (Feuchtwanger 1989 p.41). His education in free trade, regulation and lobbying continued intensively through his four years in office. Sir James Graham, Peel's Home Secretary, said 'Gladstone could do in four hours what it took any other man sixteen to do, and he worked sixteen hours a day' (Shannon 1982 pp. 115-6).

Gladstone became converted to free trade while negotiating the tariff reductions of 1842. This confronted him with aggrieved producer-groups who stood to lose their monopoly rents:

B of Trade and House 12³/₄ - 6³/₄ and 9¹/₄ - 1¹/₂ [ie 12.45 to 18.45 and 21.15 to 01.30]. Dined at Abp of Yorks. Copper, Tin, Zinc, Salmon, Timber, Oil, Saltmeat, all are to be ruined, and all in arms. (Diary for 15.3.1842 in Foot and Matthew 1974, p.187.

Hereafter cited as Gladstone, diary, <date>)

Gladstone's father, a West India trader in Liverpool, had earlier drawn him into embarrassed lobbying on behalf of the slaveowning sugar traders of the West Indies. These experiences seem to have made him scorn lobbyists. In 1844, when the railway companies lobbied Peel against Gladstone's bill, Gladstone published a sharp exchange of letters with them, in which he had forced them to admit that the delegation had not been authorised by the Boards of the

railways represented (*Copies of any Memorial to Sir Robert Peel, by certain Directors and others connected with Railway Companies, against the Railways Bill now before this House; and of any Correspondence thereupon between the Board of Trade and the aforesaid Memorialists* P.P. 1844 XLI.)

Gladstone's bill of 1844 was 'a personal rather than a departmental measure' and he persevered with it despite the 'indifference to hostility' of the rest of the Cabinet (Parris 1965 pp. 55-6). He argued that the need for regulation arose 'owing to the great and almost unparalleled extent of capital unemployed' in Britain. Early railways had seemed to be dubious investments. By 1844 they had proved themselves technically and economically and were earning large dividends. Therefore there was a sudden rush to promote new schemes, and the Private Bill Office had more railway bills in hand than ever before. Gladstone did not think that the entry of new railway companies would bring the railway business into competitive equilibrium. Rather, if Parliament were to allow competing routes between the same towns, 'it would afford facilities to exaction ... an increase of the evil, ... a mere multiplication of monopoly' (*Hansard* 3rd series vol. 72, cols 232-6. Hereafter cited as *H.* <vol.> <cols>). Hence Gladstone proposed:

- a power to cap the rates of new railways after a period of years, to a level such that their dividends would be held at 10% of the value of their issued capital;
- a power to nationalise any such lines after the same period of time;
- a change in Private Bill procedure to enable the Board of Trade to scrutinise all railway bills affecting the same part of the country together, and to decide which route it was most in the public interest to permit;
- to improve the standard of third-class travel. He stated that there was 'very strong feeling on this subject, both within the House, and out of doors', and added that third-class passengers could see all too plainly the difference between their carriages and those for first- and second-

class passengers. (They still can, by going to the National Railway Museum, York, and comparing the third-class open trucks of the Bodmin & Wadebridge Railway with contemporary first- and second-class carriages).

Gladstone's economic reasoning was sophisticated (Foster 1992), especially for a self-taught politician writing before Cournot's work on oligopoly was known in the English-speaking world. Most companies were discriminating monopolists. They charged fares which guaranteed a substantial operating profit, but which just undercut stagecoach fares. They were reluctant to put third-class coaches on first- and second-class trains for fear that passengers would leak on to the cheaper coaches. They negotiated exclusive deals with some road carriers to take passengers and goods to places not on the railway, and excluded others from station yards or refused to carry their goods (*Fifth Report of the Select Committee on Railways, Minutes of Evidence*, P.P. 1844, XI.; Hawke 1970, p.360; Gourvish 1972 pp. 34-44, 71; Kostal 1989 ch.5). Gladstone perceived that it was difficult or impossible to enforce competitive behaviour by direct regulation. It was also unrealistic to expect competition between companies to do the job. A promise by a new company to provide effective competition should be treated with suspicion because such companies' Acts might be

improperly used as efficient instruments of extortion against the subsisting Companies, to whom might be offered only the alternative of losing their traffic or of buying off opposition.

Even if a rival company were to construct its line rather than let itself be bought off, Gladstone cannot conceive that two bodies, or even three, acting by compact executive Boards, and secure against the entrance of any other party into the field, will fail to combine together.

George Hudson, the 'Railway King' and leader of the lobby against Gladstone's Bill, cheerfully admitted to Gladstone's Select Committee that he had offered the rival Leeds & Selby Railway a

sum of money to 'shut up their line', which they had accepted (*Fifth Report...*, Report p. xii, Minutes of Evidence p.333, q.4395. P.P. 1844, XI).

Thus Gladstone concluded that the railway market was bound to fail. There were two games to consider: the game between an existing (natural monopolist) company and the Government, and the game between an existing company and a new entrant. In the first game, the company was likely to be able to fend off attempts to regulate its rates directly because of information asymmetry. The company knew its full schedule of rates and the Government did not; therefore attempts to regulate rates simply led to the company reformulating them in a slightly different form, so that would-be regulators or plaintiffs would have to start all over again. As to the second game, Gladstone saw further than Cournot. Companies would not simply adjust their production in response to each other's activities. Rather, they could be expected to collude and share monopoly rent: as they were 'acting by compact executive Boards' they could be expected to arrive at the cooperative (collusive) equilibrium in their prisoners' dilemma game. Gladstone therefore asserted

the undoubted right and power of the State to promote the construction of new and competing Lines of Railway, as a means of protection to the Public against the consequences of the virtual monopoly which former Acts have called into existence (*Fifth Report...* p. xii).

He appointed a fifteen-member Select Committee on Railways, including his Whig predecessor, Henry Labouchere, (who sided with Gladstone whenever he spoke) and two railway directors (who did not) (*H. 72*; 232-55, 286-95, 471). Between March and June 1844, the Select Committee produced six reports and took minutes of evidence which occupy 682 pages of the large-format *Parliamentary Papers*. Gladstone dominated the enquiry from start to finish. According to one of the two railway-interest members, Gladstone came to it with a "'hypothetical outline", which he fully intended to cram down their throats'. This was a draft agreement between the Government

and the railway companies which, Gladstone claimed, offered some advantage for both sides. He then 'dressed his fly very skilfully', and persuaded some of the company chairmen who appeared before the Committee to agree to it. But when two of them refused, 'it was then found to be no more than an Indian-rubber body with gauze wings'. When Hudson refused to rise, 'the hypothetical outline was quite blown' (Thomas Gisborne, MP. *H.* 76:663).

Gladstone's Hypothetical Outline asked the railways to guarantee 'a means of communication for the poorer classes, in carriages protected from the weather, at a moderate charge'. These rules need only apply to one train a day, and railways could carry other third-class traffic (if any) by whatever arrangements they liked. His main offer in return to the companies was 'The principle that competing lines, as such, and without a legitimate traffic of their own, ought not to be encouraged when better arrangements can be made' (Hypothetical Outline of Considerations which may be given to, and asked from, Railway Companies, as equivalents in an amicable Agreement. Appendix to *Fifth Report...*, P.P. 1844 XI). The company chairmen who appeared before the Committee mistrusted, or failed to understand, this early corporatist bargain. Hudson was delighted that existing companies might be protected from competition - 'it will be a great boon to railway property' - but appeared unprepared to accept that any interests other than those of existing lines required protection. His eye was fixed exclusively on stopping what was to become the East Coast Main Line from King's Cross to York, which would eventually take the traffic away from his old roundabout route to York. He did not appear to understand the deal which Gladstone was offering (*Fifth Report...*, Minutes of Evidence, pp. 320-33, qq. 4203-4395. Quotation from q. 4203. P.P. 1844, XI).

When his fish failed to rise to the Hypothetical Outline, Gladstone decided to use a trawl-net instead. He forced the Third Report of the Select Committee over the objections of the railway-director members. This stated that the railways' monopoly 'is ... regarded, even at the present day,

with considerable jealousy by the Public at large', jealousy which could be expected to grow 'if the profits of Railways generally should be augmented in any very great degree'. Therefore it proposed nationalisation and rate-capping. It is not clear whether at this stage Gladstone's strategy was to bargain with the companies or to defy them. He held two cards in his hand. One was that the railways needed an Act to reverse a recent rating (property tax) decision hostile to them. The other was the discovery that many railways had been issuing illegal and unsecured 'loan notes' over and above the debt they were allowed by their Acts to issue. The companies needed, and Gladstone proposed, clauses in the regulatory bill to legalise the notes that had been already issued. Gladstone used these cards to get the Parliamentary Train clause applied to all companies, old and new, without incurring the accusation of retrospective legislation

as it rests upon the principle that the Companies affected by it are voluntary Suitors for the aid of the Legislature, to enable them, in some instances, to legalise transactions which they have conducted without the sanction of the law; in others to extend and enlarge, for their own benefit, the concerns in which they are engaged; and that it is open to those Companies to accept the aid, with the conditions attached to it, or to decline both the one and the other (*Fifth Report...* P.P. 1844, XI).

The Bill which he introduced was much more hostile to the railway interest than the Hypothetical Outline. Its terms for nationalisation and rate-capping gave wide executive powers to the Board of Trade. For instance, it was to have the power to deduct money otherwise due to rate-capped or purchased railways if it considered that their assets had been badly managed, and the power to make

such regulations ... as shall appear to [it] to be required for the public convenience, and necessary for securing to the public the full benefit of such revised scale of tolls, fares and charges (A Bill to attach certain conditions to the construction of future Railways ...

and for other purposes in relation to Railways. Quoted at cl. 6; see also cl. 2, 9, 10, 11. *P.P.* 1844, IV, pp.415-35.).

After an unsuccessful attempt by his two principal opponents on the Committee to have the Bill rejected without discussion, Gladstone introduced it aggressively. He complained that in discriminating against some road carriers 'the Railroad had gone among individual traders very much like a triton among the minnows'. He evoked the spectacle of a sinister interest combining railway directors and the 'deeper power in the opposition, and he might as well use plain language, ... Parliamentary agents and solicitors'. He ridiculed the claims of the railway interest that the Bill was 'a shock' to property and pointed out that railway shares had continued to rise since the Third Report announced Gladstone's intention to legislate and even since the companies' petition to Peel to withdraw the bill had been rejected. He concluded:

I shrunk from a contest with Railway Companies ... but being persuaded that justice is not with them, but against them ... I do not shrink from the contest. I say that although Railway Companies are powerful, I do not think they have mounted so high, or that Parliament has yet sunk so low, that at their bidding you shall refuse your sanction to this bill.... (Loud cheering). (*H.* 76, 489, 502, 508-9).

The Second Reading was carried by 186 to 98 - 'a satisfactory division' (diary, 11.7.1844). However, Gladstone was forced to enter a further round of discussions with Hudson, in order to preserve the bill's chances of passing in the 1844 session (Lambert 1964 pp. 106-7; Hyde 1934 pp. 159-77). In Committee, Gladstone withdrew the clauses giving the Board of Trade executive power over nationalised and rate-capped companies, and the Bill passed without a division. The rate regulation and state purchase powers remained in a weaker form. By comparison with his Bill, Gladstone had certainly suffered a defeat, which has led economic historians to conclude that the Act was a dead letter. The sophisticated proposals of the Bill might have enabled the

government to enforce regulation despite the companies' information advantages; the version enacted did not. Even so, the knowledge that the state control plans remained must have influenced rational railway investors and managers. One sure way of avoiding nationalisation would be to ensure that your rate of return remained below 10%; a way to ensure that in turn was to build unprofitable branch-lines, as conspicuously happened in late Victorian times, and avoid regulation by over-capitalisation. British railways from 1844 to 1923 may therefore be evidence for the hypothesis that regulated industries evade the effects of regulation by over-capitalisation (Averch and Johnson 1962). Furthermore, by comparison with his starting position, the Hypothetical Outline, Gladstone had gained more regulation. The rate revision power was in the Hypothetical Outline, but the state purchase power was not. The powers relating to the telegraph, also not in the Hypothetical Outline, passed unchallenged, perhaps because there was no distributional coalition of telegraph manufacturers and operators.

In 1864, when the opportunity to purchase or rate-cap railways under the 1844 Act was becoming imminent, Gladstone was Chancellor of the Exchequer in a Liberal government. He was no more hostile to state purchase in principle than in 1844, and he drew up a scheme for implementing his own legislation. But the government did not pursue it after a Royal Commission on Railways recommended against doing so (Matthew 1986, p.119).

Elsewhere (McLean and Foster 1992; McLean 1995) I have analysed this incident in the light of competing theories of political economy, including (but not restricted to) the three approaches to regulation listed above. The median voter hypothesis is supported as to safety regulation, since a succession of MPs told stories about the dreadful things the railway companies had done to their constituents. It is not supported as to price and quantity regulation, where the only relevant voters in Parliament were the plural railway directors against the singular Gladstone. But the one defeated the many. Relatedly, the regulatory capture hypothesis is not supported, and for an

interesting reason: Gladstone actually offered the companies a 'capture', that is to say a corporatist bargain, in the Hypothetical Outline. For whatever reason (the minutes of the Select Committee suggest an inability to grasp what was being offered and why it was a Paretian trade) the companies rejected the deal. So Gladstone drew up a fiercely interventionist Bill which became a moderately interventionist Act. The companies admittedly saw off the clauses they most disliked; but if regulatory capture were true, they would have been able to see off the rest as well. The public interest hypothesis stands as the most correct of those examined. Gladstone contradicts the public-choice assumption that politicians are maximisers of their re-election chances, rather than of the public interest as they see it.

Case 2: Aberfan

On 21 October 1966, a colliery waste tip slid down Merthyr Mountain into the mining village of Aberfan, in south Wales. It engulfed the village school and several houses, killing 144 people, of whom 109 were children at school. The ensuing Tribunal established that the National Coal Board, the public corporation which owned the tip, had for many years been tipping on top of springs which lubricated the tip and made it inherently unstable; that it had slipped twice before, in 1944 and 1963; that the Coal Board had given (at best) misleading answers to residents and the local authority who had complained about the danger the tip posed; and that the Board's liability for the disaster was 'incontestable and uncontested' (Davies 1967, p.131. For details, see McLean and Johnes 2000, chs 1-2).

All of this was known by 1967. Much more remained unknown until 1997, when the (early) opening of all the Aberfan papers in the Public Record Office enabled us to draw some more conclusions. One is that the Chairman of the National Coal Board, the Rt. Hon. Lord Robens of Woldingham, fought long, hard, and successfully to save his Board and himself after the

publication of the ‘devastating’³ Tribunal report. Nobody was prosecuted, sacked, or demoted. The Rt. Hon. Lord Robens and his Board remained in place. At the conclusion of his term at the Coal Board the Rt. Hon. Lord Robens was appointed to chair the official committee on health and safety at work which wrote the current UK law on that subject. The Rt. Hon. Lord Robens forced the charitable Disaster Fund to pay part of the cost of removing the remaining unsafe tips from above Aberfan. This was unlawful under charity law, yet the Charity Commission offered the Fund no protection. The amount thus taken was repaid (at par) by Ron Davies, incoming Secretary of State for Wales, at the change of government in 1997. Two regulatory bodies - the Charity Commission and HM Inspectorate of Mines and Quarries - failed grievously to protect the citizens of Aberfan, or of the UK more generally. For thirty years before the opening of the public records, I wondered *How on earth did they get away with it?* I then attempted, with my co-author, to explain why (McLean and Johnes 2000, chs 3 and 6-8). Parts of the explanation throw light on regulatory failure.

The trouble goes back to nationalisation. ‘Unfortunately, the minister mainly responsible for the nationalization statutes, Herbert Morrison, was not a Gladstone’ (Foster 1992, p.4). The Morrison template was first used for the nationalisation of London Transport in 1930 and then for the widespread nationalisations, mostly of utilities, by the Attlee Labour government between 1945 and 1951. Electricity, gas, some transport modes, and telecoms (always publicly owned since the early days of telephones) all have some characteristics of natural monopolies, although none was ever completely so. The grounds for nationalising coal and steel were different, and grounded in the history of British socialism. Morrison knew what he did not want; less clearly what he wanted. The clear negative idea derived from the defeat of syndicalism in the British Labour party before 1914. Its most powerful advocate, Noah Ablett, argued as follows in *The Miners’ Next Step*, published in 1912 just after a notable strike in Tonypandy in South Wales:

Alliances to be formed, and trades organisations fostered, with a view to steps being taken to amalgamate all workers into one National and International union, to work for the taking over of all industries, by the workmen themselves.

The Programme is very comprehensive, because it deals with immediate objects, as well as ultimate aims. We must have our desired end in view all the time, in order to test new proposals and policies, to see whether they tend in that direction or not. For example, the working class, if it is to fight effectually must be an army, not a mob. It must be classified, regimented and brigaded, along the lines indicated by the product. Thus, all miners, &c., have this in common; they delve in the earth to produce the minerals, ores, gems, salt, stone, &c., which form the basis of raw material for all other industries. Similarly the Railwaymen, Dockers, Seamen, Carters, etc., form the transport industry. Therefore, before an organised and self-disciplined working class can achieve its emancipation, it must coalesce on these lines.

Dangerfield (1936) saw the rise of syndicalism as part of the Strange Death of Liberal England. But he failed to notice that the syndicalists lost. Ablett's doctrine was so dangerous to the Labour Party and the leaders of trade unions that it was squashed without trace. Whoever was to control the mining industry, in Morrison's view, it must not be the miners. Morrison understood the danger that public ownership controlled by the producers could degenerate into a producers' cartel. Therefore the Morrison template, although it put union representatives on the board, never permitted union representation from a given industry to be put on its own board. The Rt. Hon. Lord Robens was a trade unionist - but from the shop workers' union, not any of the mining unions.

But Morrison - and the entire Labour Party - had fuzzy and unclear ideas about what the purposes of nationalisation *were*. Most prominent was a perception that private ownership of the industries in question had 'failed the nation'. This seemed to be true in the case of coal, as witnessed by Winston Churchill's remark in 1926 that he thought the miners' representatives were the stupidest people in the country until he met the coalowners. A second justification was that the industries nationalised under Attlee constituted the 'commanding heights' of the British economy. The questions 'Are they really?' and 'So what if they are?', so obvious today, were not raised then. The third justification was that public ownership enabled the British economy to be centrally planned. But the Morrison framework, in which each board was responsible for its own industry, and for making a surplus 'taking one year with another' (whatever that meant), precluded this.

The Victorian tradition of regulation had simply been forgotten. Safety regulation continued to work well in some industries - notably rail, where the independence of the Royal Engineers enthroned in Gladstone's time constituted an external check on industry managers. Aberfan proved that it did not exist in the coal industry. Price and quantity regulation was swept away by the assumptions, first that nationalisation made it irrelevant, and second that the duty of the nationalised industries was to maximise domestic output. Such mercantilism made sense in a world war, but not in 1966. Finally, lawyers worked in a hermetic world of their own.

Aberfan illustrates these three failures of regulation. The worst was the failure of HM Inspectorate of Mines and Quarries to notice that there was anything wrong with the distorted and bulging Aberfan tips. The reason was cultural. In the coal industry, power, prestige, and danger went together - underground. Underground mining was dirty and dangerous, and hundreds of lives were at stake when anything went wrong. Inspectors of Mines were drawn from the ranks. As the elite of the mining industry were underground workers, so the elite of the inspectorate were underground workers. In the graphic words of the Aberfan Tribunal,

We found that many witnesses ... had been oblivious of what lay before their eyes. It did not enter their consciousness. They were like moles being asked about the habits of birds (Davies 1967, p. 11).

Aberfan was not a reportable accident under the governing legislation, the Mines and Quarries Act 1954, because no mineworkers were injured. (When they saw the tip start to subside, the tipping gang went for a cup of tea before deciding what to do next. That action saved their lives). After the disaster, the inspectorate realised that it was vulnerable. The Minister, Richard Marsh, records being extensively briefed by the inspectorate that safety regulation was entirely a matter for them, not for him (Marsh 1978, p. 113). In the event, the Tribunal let the Inspectorate off unaccountably lightly. The reason may be purely contingent. Counsel for the Aberfan Parents' and Residents' Association, Desmond Ackner QC, was the most feared cross-examiner of his generation. He tore a sequence of Coal Board witnesses to shreds. But on the day that the Chief Inspector for South Wales was on the witness stand, Ackner was absent. His junior cross-examined the Inspector, and none of (what would surely have been) Ackner's killer questions were posed (Tribunal of Inquiry, Transcripts of Evidence, Merthyr Tydfil Public Library. Day 52: cross-examination of Cyril Leigh by Aubrey Myerson. See index at <http://www.nuff.ox.ac.uk/politics/aberfan/witalph.htm>).

Mercantilism emerged during the debate about removing the remaining spoil heaps at Aberfan. The Coal Board's legal liability to do so (leaving aside any questions about its moral responsibilities) was, as the Tribunal had recorded, incontestable and uncontested. So why was it not forced to clear up the deadly mess it had created? Partly because of the failure of the Charity Commission, discussed in the next two paragraphs. But partly because mercantilism blinded all actors to elementary economics. A weary civil servant recorded 'The cost of all the consequences ... to an NCB in deficit, must fall in the end on the Exchequer.' (J. Siberry, 06.11.67, PRO BD52/113). The most eye-opening single document in the Aberfan papers is part of a briefing

note for the Minister to use in the Commons debate on the disaster. A contractor called Ryan had claimed that he could remove the tips for one-fifth of the Coal Board's publicly stated price, if allowed to recover and sell the coal they contained. (The Coal Board knew that it could do the job for a third of its publicly stated price). If challenged on this point (in the event, he was not) the Minister was advised to explain that:

2.c. The sale of the coal is a problem:

- i) It displaces deep mined coal when the mines cannot be closed fast enough and their stockpiles are swollen
- ii) If non-NCB tips are concerned the contractor can sell the coal cheaply to the detriment of the NCB.

.... the coal recovery operation merely removes the coal to the enrichment of Mr Ryan but leaves the tip area in a shambles.... (In confidence NCB confirm that this has been Ryan's position).

The fact that someone other than the NCB could produce coal more cheaply than the Board was given as a reason for *not* doing it. Beyond that, the reader may wish to check the dictionary meaning of 'shambles' (5. transf. and fig. a. A place of carnage or wholesale slaughter; a scene of blood. Chiefly pl. const. as sing.; rarely in sing. form. *OED Online*, s.v. 'shamble').

Finally, the Charity Commission, which regulated charities including the Aberfan Disaster Fund, lived in an arcane world of its own. It made legalistic and insensitive objections to the Fund's sponsoring the memorial that stands in Aberfan cemetery, and to its making flat-rate payments. According to the Commission, the trustees ought to have reviewed each case individually to check 'whether the parents had been close to their children and were thus likely to be suffering mentally' (W.E.A. Lewis, Charity Commissioner, 08.09.67, quoted by McLean and Johnes 2000, p. 140). Though threatened with personal liability, the trustees stood firm on both issues, at the risk of making payments to parents who may not have been suffering mentally.

Having spoken when it should have remained silent, the Commission then remained silent when it should have spoken. The raid on the Disaster Fund to pay £150,000 towards the removal of the tips was unquestionably unlawful under charity law. No blame attaches to the charity trustees, whom the Rt. Hon. Lord Robens was putting under intolerable pressure by refusing to pay the full cost of removal. Substantial blame attaches to the Charity Commission for failing to protect either donors to, or beneficiaries from, the fund from this raid (McLean and Johnes 2000, ch.6).

All of the above failings except the last can be blamed on the loss of the Victorian regulatory culture. Although Morrison had tried to ensure that the miners did not run the mines for the benefit of the miners, in the arena of safety regulation they unfortunately did. There could be no clearer case of regulatory capture.

Case 3: the unaccountably slow return of regulation to the UK.

Levi-Faur (2002) has studied the ‘herding’ effects of utility liberalisation. ‘Herding’ corresponds to what others have called ‘information cascades’. One nation (or one individual) does something unprecedented, such as (Lohmann 1994) demonstrate openly against the East German regime, or (Levi-Faur 2002) liberalise telecoms. The effects that everyone predicted fail to occur. So the next least risk-averse person (nation) joins the first. Which in turn induces the next least risk-averse... and before long, the whole herd has followed its leader, ending with (respectively) the collapse of the regime and the liberalisation of telecoms in the Maldives.

These stylised stories have interesting quirks. The model cannot itself say why the first demonstrator (liberaliser) acts. That has to be explained exogenously. In the stylised story (not Levi-Faur’s) of utility liberalisation, the UK under the mould-breaking leadership of Margaret

Thatcher was the first to liberalise. Others followed in a herd upon observing the beneficial consequences. The Iron Lady is the exogenous force.

But here are two curious facts, which I did not know before reading Levi-Faur (2002). Chile liberalised telecoms before the UK; and Chile did it economically the right way round, setting a framework for regulating telecoms and liberalising afterwards. Why is the leader of the herd always taken to be the UK, not Chile? And why was the UK so slow to (re-)regulate? As to the first question, it is harder for a herd of democracies to follow a military dictatorship than another democracy. The second is more challenging. The following summary is drawn from McLean (2001).

Margaret Thatcher was Prime Minister from 1979 until toppled by her own party on Thanksgiving Day 1990. What we now think of as Thatcherite economics was less coherent at the time than many of both Mrs Thatcher's admirers and her detractors have made it sound. It had already been spelt out, first by Enoch Powell, and then by Keith Joseph, when Mrs Thatcher became Prime Minister. Her predecessor Edward Heath had come to power in 1970 on a manifesto which promised to 'check any abuse of dominant market power or monopoly ... identify and remove obstacles that prevent effective competition and restrict initiative' (Craig 1975, p. 332). It contained no explicit promises of privatisation. As in Chile, that takes things in the order that economists prefer. But Heath failed to press ahead with it, because he (like everybody else at the time except Powell) thought that selling free-market capitalism to the electorate was impossible if unemployment soared to one million. Powell and Joseph failed because they never captured power. Thatcher succeeded. Nevertheless, that Thatcherism was not a unified ideology - or, if it was, only in retrospect - emerges most clearly from the hesitant start to her economic liberalism in office.

It is convenient to divide economic Thatcherism into three eras, defined by her three General Election victories. Thatcherism I lasted from 1979 to 1983, Thatcherism II from 1983 to 1987, and Thatcherism III from 1987 to her fall in 1990.

The Conservatives had ample room to manoeuvre in 1979. They had not won the election; Labour had lost it. Their most successful poster ('Labour isn't working') was an attack on Labour rather than a promise to do better. This was just as well, as during Thatcherism I, unemployment rose to levels last seen in the 1930s. By the second quarter of 1983 it had reached 2.9 million on seasonally adjusted figures (12.1%). Up to and including James Callaghan, all modern UK Prime Ministers had assumed that unemployment at that level was incompatible with a stable and civilised society. By experiment, Mrs Thatcher showed that it was compatible with stability. There were riots in inner-city Liverpool and London in 1981, but no general threat to public order. The unemployed were politically excluded and never became an electoral force either. Although the 1981 levels of unemployment and economic decline would certainly have led the Conservatives to defeat had the Falklands war not come along, it did. Under Thatcherism I, a government that had presided over three million unemployed was re-elected. Unemployment continued to rise until the third quarter of 1986.

Many commentators see the huge surge in unemployment as an inevitable consequence of the macro-economic policy of Thatcherism I. Mrs Thatcher and her Chancellor, Geoffrey Howe, resolutely turned their backs on Keynesian economics. They met the rise in unemployment not with an increase in public spending but with a tightening of the money supply. Some commentators accuse them of deliberately letting unemployment rip in order to kill the power of the trade unions. This is to go too quickly for conspiracy theory. It is more likely that Thatcher and Howe did not anticipate that their monetarism would take such a huge toll on employment. If

they had anticipated it, they would have known that they would have to modify it to have any hope of winning the next election.

Unlike monetary policy, union policy was prominent in the 1979 election manifesto. It was not nearly as radical as Mrs Thatcher wished, because the policy area was still controlled by James Prior, her Heathite first Secretary of State for Employment. But in monetarism, and the associated policy of controlling public spending by setting cash limits (Pliatzky 1989, p.53), the Conservatives found by experiment the means to destroy trade union power that had eluded the head-on assault of the Heath government. Controlling inflation by a consensual agreement on incomes policy had patently failed in 1979. The Conservatives could quite truthfully say to trade unions and their members that they would abandon it, and restore free collective bargaining. They did not reveal to unions and their members - because nobody asked them to - what they would do instead. In the event, allowing unemployment to let rip cowed unions in all sectors. Cash limits cowed those in the public sector, as they imposed a very direct tradeoff between pay rates and employment levels throughout the public service. And the 'winter of discontent' of 1978--9 gave the overt restrictions on union activity introduced by Thatcher the legitimacy that earlier attempts had lacked. Even so, she proceeded very cautiously, restrained by Prior until she felt strong enough to move him in 1981. Radical change to the legal position of unions came later. And in a crucial strategic retreat, the Government backed away from a confrontation with the National Union of Mineworkers (NUM) in 1981, increasing subsidies to the coal industry rather than insisting on closures or reductions of the industry's losses.

Privatisation was barely mentioned in the 1979 manifesto. The first few privatisations were mostly of profitable state holdings. They were done in order to raise money, not for any of the wider and more diverse motives that appeared under Thatcherism II and III. They realised under £500 million a year (Vickers and Yarrow 1988, ch. 6 and Table 6.1). The most significant

privatisation, which was political rather than economic, occurred almost by accident. This was the sale of council houses to their tenants at deep discounts: labelled the Right to Buy. It was a last-minute addition to the 1979 manifesto as the Conservatives discovered from their focus group research how popular the idea was (Butler and Kavanagh 1980, p.190; Garrett 1994, p. 109). It gave some voters a powerful vested interest in Conservative victory, and it broke up a concentrated electoral force with an equally powerful vested interest in Labour victory. The effect should not be exaggerated. Careful analysis (Heath and Garrett 1991; Garrett 1994) shows that council tenants who bought their homes under the Right to Buy were already more pro-Conservative than the remainder. But the effect was real. Council house buyers remained more loyal to the Conservatives as other groups slipped back in 1987 and 1992.

Privatisation took centre stage after the 1983 General Election. In this phase its objectives were political rather than economic. There were two main ones. One was the extension of popular capitalism; the other was the break-up of a united public sector interest group. The extension of popular capitalism was typified by the 'Tell Sid' advertising campaign used to sell shares in British Gas. Sid was presented as a working man, slow on the uptake, who had failed to realise what a bonanza he would join if he bought shares in British Gas. For the shares to be a bonanza they had to be underpriced. Table 1 shows the immediate gains made by share purchasers in the main privatisations of Thatcherism II.

Table 1. Principal UK privatisations 1983--7: immediate profits

Company	Gross proceeds of sale, £m	Date of share offer	First day premium, %
British Telecom	3916	03.12.84	33
British Aerospace	550	14.05.85	12

Cable & Wireless	602	13.12.85	0.5
TSB	1360	10.10.86	35.5
British Gas	5603	08.12.86	9
British Airways	900	11.02.87	35
Rolls-Royce	1360	20.05.87	36

Source: Vickers and Yarrow 1988, Table 7.1; cases which occurred between the 1983 and 1987 General Elections and where the gross sale proceeds were £500 million or more

Having sold these shares at a huge discount, the Conservatives then put a double argument to their purchasers. 'You have made a huge gain with us - reward us. And you might make a huge loss if Labour wins the next election - protect yourself. For both reasons, vote Conservative'. The finest example of this was the letter sent in November 1986 by Norman Tebbit, then Chairman of the Conservative Party, to those who had brought British Telecom shares. He was legally able to do this despite the company's objections because the share register of a public company is a public document. The letter stated:

On Monday 8 September, Labour's industry spokesman announced his plans for your British Telecom shares.

This is what Labour has agreed to do.

If they win the next General Election, they will immediately confiscate your shareholders' rights. Then they will make you sell your shares for 130p each (which is dramatically less than the current market value)....

We, on the other hand, believe in putting these companies into real 'public ownership', by which we mean ownership, through shares, by members of the public like yourself....

The most effective way to stop Labour's attack on your savings, and your pension, is to make sure they don't get back into power. Think how much a Labour government could cost you. Then send me a donation for our Fighting Fund. (Facsimile reproduced in McLean 1989, Fig. 3.4)

In the second place, all pre-1979 attempts to control wage inflation had foundered on the rock of public sector pay bargaining. Once one group of workers had settled for a given percentage wage increase, no other organised group would settle for less. This effect was not confined to the public sector. But in the public sector, the Government was the paymaster. It would be blamed for any of the resulting strikes and disruption that followed from any attempt to impose wage restraint. That was what had happened most recently in the Winter of Discontent that made Prime Minister Thatcher possible. After privatisation, it was no longer up to the Government to set the wages of telephone, gas, or airline staff. And cash limits (see above) enabled the Government to put a stark choice to workers in the core public sector, including the civil service: 'you can have more pay and fewer jobs, or the same number of jobs and no more pay. The choice is yours'.

The influential critique by Vickers and Yarrow (1988) showed that privatisation had not promoted economic efficiency. Above all, economic efficiency implied tough regulation. Otherwise, a public monopoly might simply give way to a private monopoly. If a government aims to increase economic efficiency, privatisation as such is irrelevant; what matters is the opening of industry to competition. But the popular capitalism of Thatcherism II depended on giving Sid both a quick buck and an assurance of long-term profits. The quick buck was easy - underprice the sale. But the long-term profits depended on the company being allowed to continue to make monopoly profits. Accordingly, the Thatcher II privatisations were not accompanied by compulsory breaking-up of the companies, nor by any very determined effort to ensure that new entrants could get fair access to customers of the former state monopolist. The

privatisation of British Airports Authority (BAA), initiated in 1985 and completed just after the 1987 election, had an added twist. The value of airport terminals is hugely boosted by the duty-free concessions they can auction. But the tax anomaly that allows international travellers to avoid paying excise duty on spirits and cigarettes 'is arbitrary, and inefficient, and there is no distributional reason' for it (Vickers and Yarrow 1988, p. 360). It is a tax transfer from the poor to the rich, and from those with good health habits to those with bad health habits. By selling BAA, the Government privatised an arbitrary source of tax privilege.

The privatisations of Thatcherism III made better economic, but worse political, sense than their predecessors. In this era, each utility acquired a tough regulator who imposed the so-called RPI - X formula on prices. Each utility was allowed to increase its prices each year by no more than the average increase in the Retail Price Index, minus an amount X determined by the regulator, to ensure that the real consumer price of utilities declined. RPI - X was proposed in 1983, but the first company it was applied to, British Telecommunications (BT), was making such huge efficiency gains through technical change that it was not a binding constraint. It was not until the third Thatcher term that some privatised utilities started to find RPI - X seriously irksome.

In the third Thatcher term, electricity, rail, and coal were privatised. The electricity companies were privatised in a more pro-competitive way than British Gas or British Telecom; accordingly, prices have come down sharply, but electric Sid has made fewer windfall gains. If he held on his shares until 2002, he would by now be looking very foolish. British Rail was compulsorily broken up into small components - too small, as events since the fall of Mrs Thatcher seem to have shown. And the government finally saw off the National Union of Mineworkers (the job that Harold Macmillan had hired the Rt. Hon. Lord Robens to do) by selling most of the remaining deep-mining coal capacity to a single firm, RJB Mining, which had in turn almost vanished from the British scene by the end of the millennium.

What are we to learn from this case? I would argue that it epitomises median voter politics. A wise commentator (Samuel Brittan) has said that people always overestimated Mrs Thatcher's grasp of economics while underestimating her grasp of politics. The sequence 'Privatise first, regulate later' makes no economic sense. It makes very good political sense in a democracy. Chile, which was not a democracy, could follow an economic logic that the UK could not. Even the UK could not have followed the logic it did but for the accident of the Falklands war. But for that war, as I have argued, the new economic policies of Mrs Thatcher would have led the Conservatives to crashing defeat in the 1983 General Election. Privatisation, first suggested to Mrs Thatcher by her marketing advisers and brilliantly exploited by Mr (now Lord) Tebbit, was an excellent median-seeking device. It may have been a lousy economic device, but that should not surprise a Chicago political economist.

Conclusion

I did not plan ahead that each of these three case studies should illustrate one main economic theory of regulation. But I find that they do. That suggests to me that all three theories are viable, but that none of the three contains the whole truth. Also, that historical contingency matters. Cases #1 and #3 feature unusually strong politicians at work: Gladstone imposing what he saw as a public interest regime, and Mrs Thatcher successfully seeking a median voter in multidimensional space. Case #2 features an unusually strong industry leader, the Rt. Hon. Lord Robens, riding roughshod over weak politicians. No surprise, then, that different theories of regulation are supported in each of the three cases. There is therefore plenty of scope for plenty of conferences such as this one to work towards a more general theory of regulation.

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² The UK public records are, by default, kept closed from researchers until thirty years have elapsed from the end of the year in which a file is closed. This interpretation of '30 years' means that often somewhat over 30 years must elapse between an event and academic access to the official papers about it. On the other hand, UK departments are less terrified of early releases of documents than they once were.

³ The words of Prime Minister Harold Wilson: PRO, PREM 13/1280