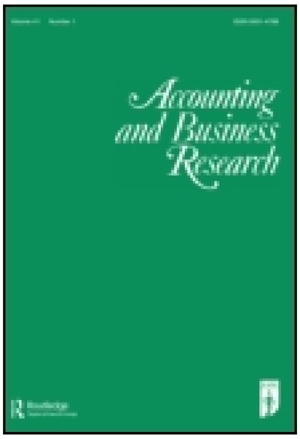

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Discussion of 'The political economy of regulation: Does it have any lessons for accounting research?'

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Discussion of 'The political economy of regulation: does it have any lessons for accounting research?'

Sir Bryan Carsberg*

It is a pleasure to be able to be the commentator on Michael Moran's interesting paper. He is a Professor of Government in the University of Manchester where I was once a Professor of Accounting, so I feel a kind of institutional allegiance, although I was rather shocked in thinking about it on the way here to realise that I left Manchester no less than 30 years ago. It is also interesting, I think, for an accountant to be challenged by thinking from another discipline, of which one perhaps has less knowledge immediately. I certainly have much less knowledge.

The interesting question arising from this paper is to think what the lessons are for the design of the institutions that we use and which are used to regulate accounting, to set accounting standards. Moran's overall conclusion, that regulation is a political affair, seems incontrovertible, and he conjures to mind an interesting picture of a kind of political market in which the currencies are partly financial but also partly other things such as political power. The players are the government, media, business, the consumer, consumer bodies and others, and one wonders whether any of the participants can truly be said to be seeking the public good as a direct objective.

There was an interesting subtext also about the business-friendliness of regulation. I shall comment a little in a minute about the probability that different kinds of institutions will be business-friendly, but I think I should say right away that to seek business-friendliness as an absolute goal for regulatory activity seems to me to be mistaken, just as one would not wish to see a total lack of friendliness. I suppose what one would hope to see as an outcome is some kind of arrangement that maximises the value of benefits over costs from a public point of view – not a very easy thing to measure, but something that suggests that probably some element of business-friendliness is desirable but not total business-friendliness.

There are, pursuing that train, several ways in which regulation can be organised. It can be carried out directly by ministerial government departments; it can be carried out by independent regulatory bodies, public bodies established by Act of Parliament with duties set by statute, and that was the position in the two regulatory bodies with which I was involved – Oftel, the first telecoms regulator, and the Office of Fair Trading. It can be left to private bodies including bodies administered by the professions. It can be left to the market but, thinking about what Michael has said and what one observes and in spite of the fact that I know there is a strong school of academic thought which believes it would be best to leave these things to the market, it seems impracticable that we should find it so. All the evidence is that leaving it to the market is not a sustainable solution because sooner or later the forces that impel politicians to act will come into play in the field of accounting, and so, whatever one may think – I have never been attracted by the argument that it should be left to the market – but whatever one thinks, it is probably a futile quest anyway.

I cannot of course avoid a little commentary on my own experience with regulation, particularly at Oftel, which, as Michael commented in his paper, turned out to be less business-friendly than perhaps people had been expecting. That was an interesting experience. I can offer you two reminiscences about that. I had responsibility at Oftel for setting British Telecom's price control. Government ministers had no power in that. Nevertheless, when I set about establishing the first price control, British Telecom's executives went to government ministers after they had received an opening broadside from me and said, 'You must call this madman Carsberg off otherwise it will be the end of Western

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civilisation as we know it' – the speech to which regulators become accustomed. Ministers did absolutely nothing. They said: 'You must go and talk to Carsberg yourself.' They sent me no messages about the meeting; in fact they did not even tell me it had taken place. I found out it had taken place by indirect means.

Then later on, when we had the benchmarking duopoly review to decide whether or not to open the basic telecoms market to wider competition than hitherto, the position changed and I did find myself under considerable government pressure. I embarked on a line that was unwelcome to government ministers at the time and they tried to dissuade me from it. I stood my ground and in the end it is fair to say – in brief summary – government ministers came around to at least accepting the track I was in.

Those experiences made me feel that there is a good deal of chance about the way these things actually turn out. I doubt very much whether one can say with any confidence whether a particular institutional arrangement is likely in general to lead to a particular outcome in terms of business-friendliness, political interference or whatever; it all depends so much on the individuals involved. One can say, I think, that a regulatory market place, if I can use that term, in which different institutions are involved at least creates a balance of forces, which may be desirable in terms of the ultimate outcome.

It is interesting to spend a minute or two on some of the *causes célèbres* in our own field of accounting on this territory. I look particularly at experience in the US where, as you all know, the law gives the Securities and Exchange Commission (SEC) the power to set accounting standards, but in practice most of the time it is left to what is now the Financial Accounting Standards Board (FASB), with occasional elements of SEC interference.

There are four major cases that came to my mind in which there was significant interference in that process. The earliest was perhaps in the last in, first out (LIFO) inventory flow assumption where the government ensured that the private sector standard-setters would not prohibit the use of LIFO.

There was the saga of oil and gas accounting where the FASB was engaged in a debate between the full cost or successful efforts accounting, and the SEC intervened in the interests of what became reserve recognition accounting, which surely provided some useful extra information.

There was the business of inflation accounting, in which I played a hand personally: I was working for FASB at the time. We were under a kind of diktat from the SEC to produce something on inflation accounting, with a strong hint that they would intervene and do something different if it was not a current cost/replacement cost-based system.

More recently there was the share-based payments fiasco where the FASB was forced to back down from what seemed a perfectly sensible and indeed highly desirable proposed accounting standard.

Some of these examples, it seems to me, are rather good, in the sense that government intervention produced an improvement. However good the reserve recognition proposals were in oil and gas, they perhaps provided some extra useful information to the market. I thought the same of inflation accounting, although we did not have that in place for long enough to find out how useful it was in practice. I thought that government intervention on LIFO and share-based payments was reprehensible and regrettable in every way one can think of. There are some good examples there and some bad examples.

More recently we have had the experience in Europe and the US of the saga of the use of fair value for financial instruments, the early stages of which again involved me when I was at IASC, as it then was, and which has continued subsequently. There again, I think one has seen perhaps rather regrettable outcomes, and outcomes certainly motivated by some European governments' wish to see a solution that was consistent with their political goals rather than something which was actually in the public interest.

Thinking about all those things it is particularly interesting to see what role the conceptual framework in accounting has. I see there is a session on that subject later in this conference. I suppose one can see a conceptual framework among other things as a device that can be used by standard-setters to strengthen their hand in political negotiations, although it is perhaps not wholly successful.

With that fairly brief canter through, I would say again as my conclusion, first, I do not think there is any set of institutional arrangements of which you can say 'This is sure to produce certain kinds of result' and therefore you cannot easily say what is the most desirable set of institutions. There is a large chance element about it. But given my scepticism about governmental motivations, shall I say, and the pleasure I get from seeing David Tweedie doing battle on fair value questions in financial instruments, I think we are much better for having independent bodies around to introduce a bit of a battle and the tension of debate into these matters.