

The 35th Annual National Conference of Regulatory Attorneys

Why Regulation Matters IV

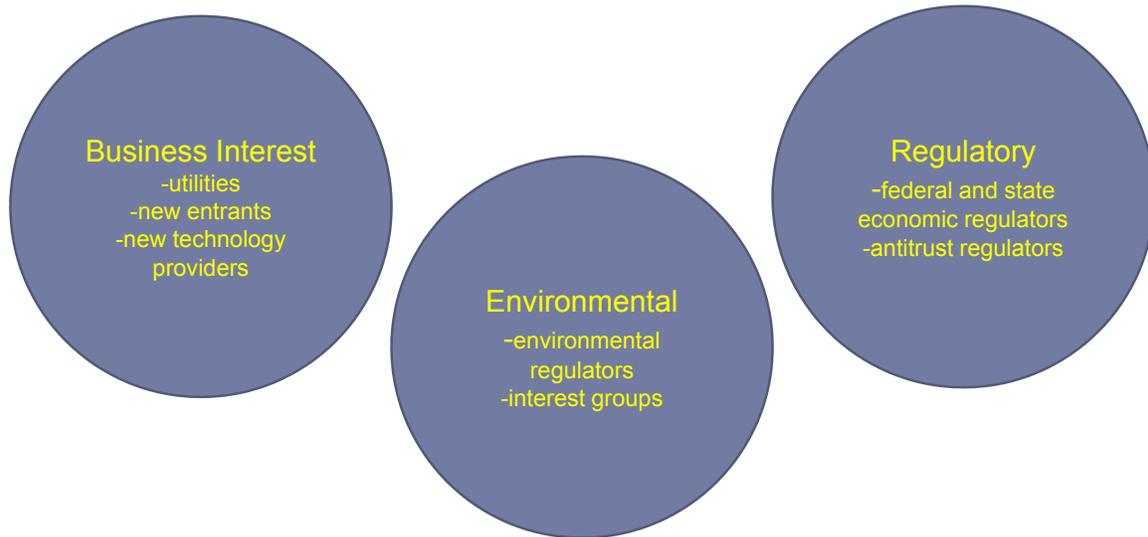
(and how to improve it)

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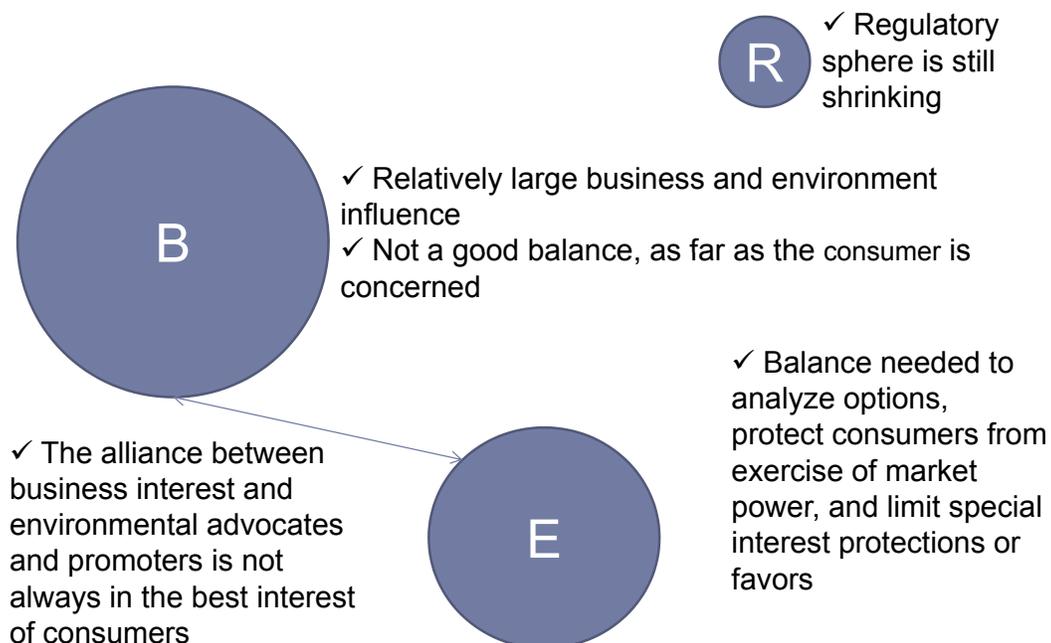
May 21, 2012
Indianapolis, Indiana

- ✓ *When the industry you regulate gets into trouble, you go to conferences*
- ✓ *When you go to conferences, you listen to a lot of boring people*
- ✓ *When you listen to a lot of boring people, you get dull*
- ✓ *When you get dull, you speak in a monotone voice*
- ✓ *Don't speak in a monotone voice*
- ✓ *Be a good regulator*

From previous years: “Spheres of Influence” at play in utility regulation – and how the relative importance of each has changed over time

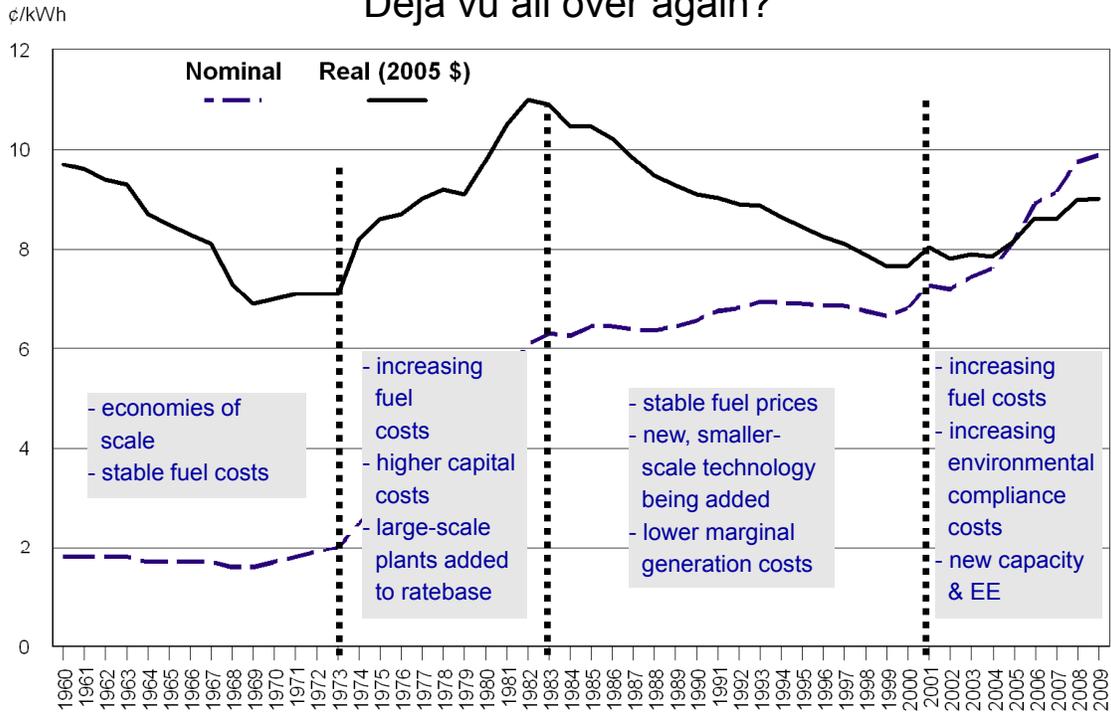


It's still not improving for consumers . . .

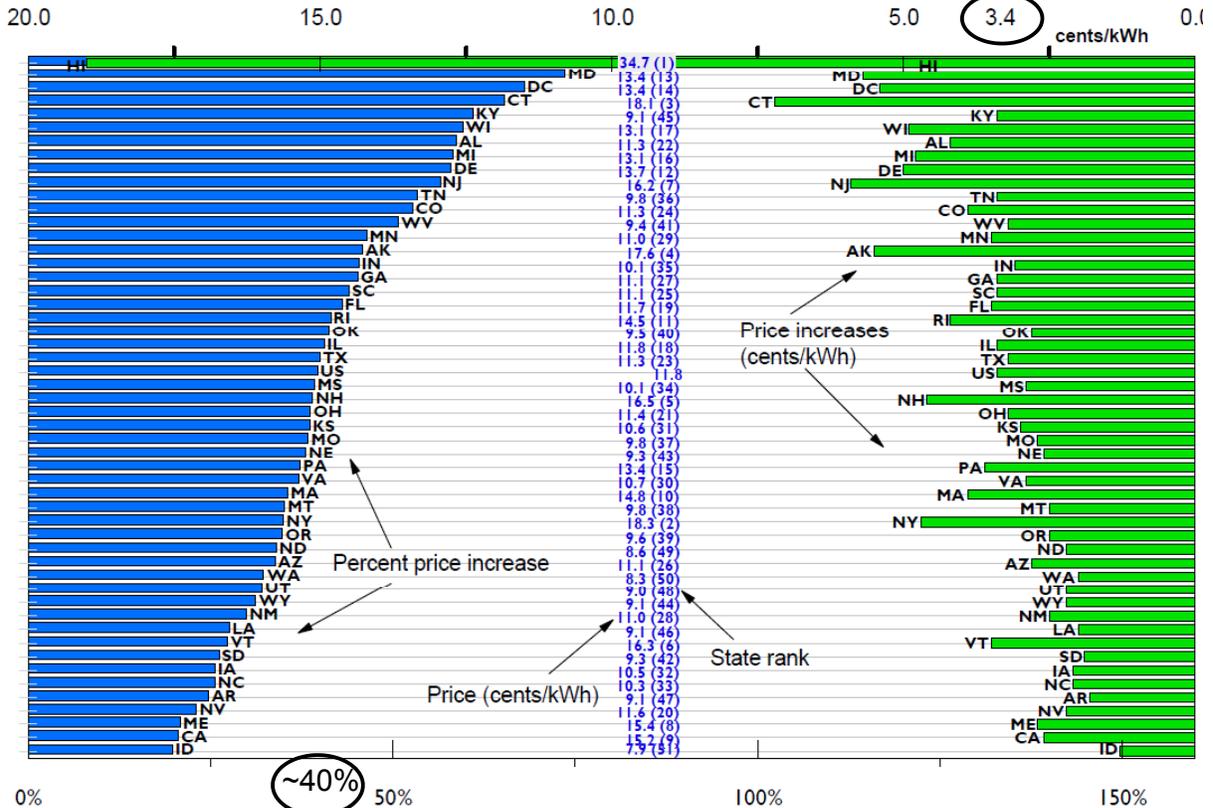


Average Retail Price of Electricity, 1960-2009

Déjà vu all over again?



State percentage price increase (left side, bottom axis), price increase (right side, top axis), and 2011 prices (center numbers, with state rank), for residential customers, from 2002 to 2011



What a public policy process should look like (but sadly, doesn't)

Set Policy Goals (what do we want to accomplish?)	Determine Means (how do we get there?)	Evaluate End Results
<ul style="list-style-type: none"> ➤ Just and reasonable price ➤ Reliable service ➤ Protect the environment ➤ Create (or preserve) jobs ➤ National security ➤ Energy independence 	<ul style="list-style-type: none"> ➤ Regulation – cost-of-service, performance-based, etc. ➤ Markets – complete deregulation or partial deregulation 	<ul style="list-style-type: none"> ➤ Determine if the means are working or not ➤ if no, try some other means or modify the current one ➤ if yes, continue to monitor or improve

▶ 7

Ken Rose NCRA 2012

LaFollette's "Scientific" Regulation

LaFollette's "Scientific" regulation – using accounting and engineering expertise to set rates, became a model for other states and is still used today (sometimes)

[picture removed]

Robert LaFollette, Sr. campaigning in 1897

▶

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Some reasons why this process can (and does) go wrong

- ▶ **Confusing Means with Ends**
 - ▶ example, thinking markets are the end result, rather than a means to an end – or seeing regulation only as an obstacle
- ▶ **Unclear goals from policymakers or the public**
 - ▶ example, no consensus on what environmental goals should be
- ▶ **Goals are too narrow, vague, or overly broad**
 - ▶ example, focusing on a technology (electric cars) rather than the cause of the problem (emissions or macroeconomic policies)
- ▶ **Lack of evaluation of the results**
 - ▶ example, ignoring bad news or shunning real analysis
- ▶ **The problem is difficult, with no clear, easy, or obvious solution**
 - ▶ example, trying to have reliable, clean, *and* affordable electricity
- ▶ **Unfortunately, we are seeing all these in recent years**

Example 2: on the difficult problem point (i.e., Reliable, Clean, *and* Affordable)

- ▶ **Reliable**
 - ▶ requirements for electric system stability, security and adequacy are met
 - ▶ meet or exceed NERC standards for system reliability and adequacy
- ▶ **Clean**
 - ▶ meet all existing environmental laws that pertain to electric utilities
 - ▶ also limit CO₂ emissions
- ▶ **Affordable**
 - ▶ average households and businesses are not overly burdened
 - ▶ relative burden depends on income
 - ▶ avoid sudden sharp increases in prices
- ▶ Would be nice if we could choose all three, but barring some new advanced technologies, it is not a likely possibility in the near future
- ▶ ***We need a serious discussion of this problem, not more political assault tactics***

Value of the “Dismal Science”

- George Stigler explained why economics is still called “the dismal science” more than 160 years after it was first applied
 - “Economists are messengers who so often bring bad news, and so earn the reputation of such messengers. . . . A society that does things that are inefficient or perverse in their effects ought to be told so. Doctors are obliged to warn against nostrums that do nothing to cure and may harm, and engineers are supposed to warn the legislature against perpetual motion machines. So it is with economists.”

George J. Stigler
Memoirs of an Unregulated Economist
1988
 - In short, economists are often the wet blankets that throw cold water on cherished ideas of politicians and others
 - (On the whole, economists have little value otherwise)

“Econifications”[©] -- clarification of economic terms and concepts

- ▶ The term “market” does not automatically mean “competitive”
- ▶ The term “competitive” does not always mean “perfect” or “workable”
- ▶ “Perfect” is not possible in most cases, and should not be expected
- ▶ “Competition” is a matter of degree, not *yes*, or *no*
- ▶ Most markets are imperfect to some degree, but require no intervention
 - ▶ good regulation is largely about knowing when intervention is warranted and beneficial

“Econifications”[©] (continued)

- ▶ Prices increasing (or decreasing) does not mean market failure (or success)
- ▶ Market failure does not mean there is no market, it refers to several types of market failure
- ▶ Intervention is not necessary to fix every market failure – sometimes the cure is worse than the disease – *but some market failures require governmental action to alleviate*

“Econifications”[©] (continued)

- ▶ Cost is not the same as price
 - ▶ we assume that in a *competitive market*, price is determined in the market (from supply and demand) and an individual firm is a price taker, and uses the market price to determine how much to produce
 - ▶ not so with a firm that has market power – the firm can determine a price based on market demand and its costs
- ▶ Markets are not always better than regulation
 - ▶ should compare the cost of a regulatory result with the cost of a market results
 - ▶ markets are not always self correcting, at least not always in a timeframe that is practical for humans
- ▶ A firm does not need a large market share to exercise market power, but it helps . . . a lot – especially when combined with market entry barriers and inelastic demand
 - ▶ a concentrated market is more likely to have market power, but not guaranteed – need to do good market analysis (sorely lacking in most cases)
- ▶ Do not need to be a “bad actor” to exercise market power, just be the result of profit maximizing behavior

Time for regulatory reform?

- ▶ Occasionally, the process and institutions must be revamped, reformed, or overhauled
- ▶ A start may be the process itself
 - ▶ the process favors regulated companies and interest groups over ratepayers and consumers
 - ▶ not a fair fight in terms of resources that are available to the parties
 - ▶ regulated companies have an incentive to drag out the process
 - ▶ driving up the cost for others, while their costs are mostly recovered from customers
 - ▶ Process could be less formal – lowering participants' costs, and allowing more parties to participate
 - ▶ The perception that regulatory institutions are not working in the public interest contributes to doubts about the effectiveness of government in general

- ✓ *When the industry you regulate gets into trouble, you go to conferences*
- ✓ *When you go to some conferences, you listen to a lot of really smart people*
- ✓ *When you listen to a lot of really smart people, you get smarter too*
- ✓ *When you get smarter, you speak in a way that people want to pay attention to*
- ✓ *Speak in a way that people want to pay attention to*
- ✓ *Go to and participate in the Annual National Conference of Regulatory Attorneys*