

"Affordable" Utility Service: What is Regulation's Role?

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With the nation's economy stressed, politicians are pressuring regulators to make utility service "affordable." This picture has three problems.

Wealth Redistribution is Not Regulation's Department

Under embedded cost ratemaking, the regulator identifies prudent costs, computes a revenue requirement to cover those costs, then designs rates to produce the revenue requirement. Rate design makes each customer category bear the costs it causes. None of these steps—prudent cost identification, revenue requirement computation, cost allocation—involves affordability. Affordability becomes a factor only if we jiggle the numbers—if we lower rates for the unfortunate by raising rates for others. Achieving affordability through rate design means compromising cost causation to redistribute wealth. It resembles taxation of one class to benefit another, with this exception: With taxation, citizens can retire representatives whose votes offend; but with utility service, captive customers are stuck with the rates regulators set.

Instead of shifting costs between customer classes, regulators might redistribute wealth in a different way: by “taxing” shareholders, i.e., reducing shareholder returns below the otherwise appropriate level. But taxing shareholders is no more the regulator's domain than is taxing other customers. And it's likely unconstitutional: Having invested to serve the public, shareholders expect "just compensation," undiminished by a forced contribution for affordability.

Moving money among citizens is essential to a fair society. Poverty is intolerable and private charity never suffices, so government steps in. But helping the luckless should be done by political leaders, who must justify their actions to the electorate; not by professional regulators, whose focus must be industry performance.

Affordability of any product—groceries, a Lexus, or utility service—depends on one's wealth and income, and on the cost of other products. The poor could better afford utility service if we raised their income and increased their wealth. Or if we lowered their cost of housing, health care, transportation, or education. But these initiatives are outside regulators' authority. To make regulators responsible for affordability is illogical.

Cheap Energy is Cheap Politics

Politicians who argue for affordability take the easy road. To legislate economic development, greenness, reliability, energy independence, and technology leadership, all efforts that increase costs, while commanding the regulator to make service "affordable," is low-risk politics, responsibility-avoidance politics, cheap politics.

When politicians call for "lower rates," the electorate feels entitled to receive rather than encouraged to contribute. But no family, no congregation, no civil society, thrives if its key verb is "take" rather than "give." And when lower rates now lead to higher costs later, citizens become cynical. Self-doubting, also, as they question their ability to distinguish pander from policy. These are the results when politicians avoid their responsibility for affordability.

"Affordability" Undermines Regulation's Responsibility

Mathematician Carson Chow says he's found the cause of our obesity epidemic: low food prices. Studying 40 years of data, he spotted both correlation and causation between girth growth and cost declines. He traced these trends to government farm policy shifts (from paying for non-production to stimulating full production) and technology boosts (which lowered production costs). The lower the cost, the more production; the more production, the more (fast) food; the more food, the more calories available; the more calories available, the more calories consumed. See C. Dreifus, "[A Mathematical Challenge to Obesity](#)," *The New York Times* (May 14, 2012). We are both over-consuming and under-appreciating: Dr. Chow found that "Americans are wasting food at a progressively increasing rate." (Fairness point: Chow has his doubters. See Michael Moyer, "[The Mathematician's Obesity Fallacy](#)," *Scientific American* (May 15, 2012).

What does food have to do with "affordable" utility service? A regulator's job is to regulate—to establish performance standards, then align compensation with compliance. In this equation, affordability is not a variable. To make service affordable to the unlucky, the commission would have to lower the price below cost. That leads to overconsumption, to Dr. Chow's "waste." This inefficiency hurts everyone.

Economic efficiency exists when no further action can create benefits without increasing costs by more than the benefits. Conversely, economic inefficiency exists when we forego some action that, if taken, can make someone better off without making anyone worse off. To over-consume, to waste, to act inefficiently, to leave a benefit on the table, makes everyone worse off. Underpricing in the name of affordability makes someone worse off, unnecessarily. How sensible is that?

Actions for Affordability: The Right Roles for Regulators

Unless essential services are affordable, government will not be credible. Regulators, being part of government, have to help. (A commission staff chief told me 25 years ago, "Sometimes you have to put aside your principles and do what's right.") And some regulatory statutes explicitly require the regulator to make service "affordable." (As is the case, I am told, in Vanuatu, an 83-island nation in the South Pacific.) Here are 3 ways, consistent with economic efficiency, for regulators to address affordability.

Help the unlucky reduce usage. Regulators can advocate for affordability by pressing for policies that make consumption less costly, like improved housing stock, "orbs" that signal high prices, and efficient lighting and appliances. Analogy: Doctors save lives not just by treating gunshot wounds, but by advocating for gun safety. (American Academy of Pediatrics: "The absence of guns from children's homes and communities is the most reliable and effective measure to prevent firearm-related injuries....")

Interpret "affordability" as long-term affordability. Getting prices right and preventing overconsumption, even if it raises prices in the short run, reduces total costs in the long run.

Expose the dark side of under-pricing. Rather than follow politicians down the low-price, low-risk, cheap politics path, regulators, like Dr. Chow, can talk facts: about the real costs of utility service, the problem of overconsumption, the error of under-pricing. With their credibility rooted in expertise, regulators can pressure legislators to act on affordability directly by enacting income-raising policies. Better education, housing, and health care—all these lead to higher incomes, so that citizens can afford utility service priced properly.