

"Politics": The Public and Private Versions

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POLITICS, *n.* *Strife of interests masquerading as a contest of principles.*
— Ambrose Bierce, *The Devil's Dictionary*

In utility regulation, politics comes in two forms: *public-interest politics*—the regulator's obligation to make tradeoffs among meritorious but conflicting goals; and *private-interest politics*—the pressures regulators receive from a growing mix of benefit seekers. When applied to regulation's public-interest mission, one enhances, the other undermines. Understanding the distinction is essential to effective regulation.

This essay categorizes regulation's many political components, distinguishing between commission decisionmaking and legislative processes. The next essay discusses how effective regulators make the best of regulation's increasingly political dimension.

Public-Interest Politics

Commissions practice public-interest politics when they exercise their statutory discretion: Regulatory statutes have broad phrases: "just and reasonable," "undue discrimination," "public interest." Verbal breadth means policy discretion. The exercise of discretion is a political act: using government powers to create rights and obligations, to allocate benefits and costs, to establish expectations and consequences. This discretion comes with constraints, namely facts and logic (without which decisionmaking is "arbitrary and capricious" and thus unlawful). But within those constraints, consider the many political choices:

"Just and reasonable": For return on equity, upper or lower end of the "zone of reasonableness"? For rate design, average embedded cost, or long-run marginal cost? Scarcity prices to induce new supply and dampen load, or average prices to produce simplicity and reduce volatility?

"Undue discrimination": For commercial and industrial customers, rate discounts below embedded costs (with the difference picked up by residential customers) to keep them on the system? Discounts for low-income customers (paid for by more fortunate customers)? Energy-efficiency programs, paid for by all to benefit only some?

"Public interest": Surcharges (a technique for funding public programs without "raising taxes) to fund environmental improvements, worker retraining necessitated by merger-related job loss, or research investments in experimental technologies?

These choices are the meat and potatoes of utility regulation. They are all political choices, because they allocate among citizens their rights and responsibilities, their burdens and benefits. They reflect the tensions inherent in any policymaking: tensions between the technical and equitable, short-term and long-term, rural and urban, large customer and small customer, legacy customer and new customer, investor and consumer, shareholder and lender. Regulation's inherently political nature should cause no surprise, since commissions exercise legislative powers (although they sometimes use court-like procedures). (On regulation's legislative character, see "Commissions Are Not Courts; Regulators Are Not Judges" and "Legislatures and Commissions: How Well Do They Work Together?")

Legislatures practice public-interest politics when they define a commission's powers and determine its resources. Regulation's central public-interest question is: What performance should we require of regulated utilities, what products and services, at what standard of excellence? Answering this question, the legislature first must decide which decisions to prescribe and which to delegate: Which decisions belong with those who face the voters, and which decisions belong with those whose main tools are expertise, facts, and procedural formality?

When delegating powers to the commission, a legislature then must address three more questions: How much and what type of commission intervention is necessary to ensure excellent industry performance? What should be the commission's reward and penalty powers? What resources, and what flexibility, must the commission have to build the expertise, fact-gathering capability, and procedures necessary to service the public interest?

A legislature's broadest public-interest question is whether regulation should play any role. The legislature must ask, continuously: What industry structure most effectively will induce accountability in our infrastructural industries? Or, as Prof. Alfred Kahn memorably wrote in *The Economics of Regulation*, what is "the best possible mix of inevitably imperfect regulation and inevitably imperfect competition"? A principled selection of the "best possible mix"—for example, reducing regulation in response to effective competition, or restoring regulation as competition weakens—is "political" because it affects stakeholders. But those stakeholders' interest in the outcome need not divert the legislature's purpose from public-interest promotion to private-interest pursuit.

Private-Interest Politics

The commission's broad discretion attracts private-interest pressures. Statutory breadth is a two-edged sword. It accommodates legitimate political judgments, but also invites private interests to claim public-interest purpose. Examples: (1) A utility insists that only a 14% return on equity (a private-interest desire) will prevent debilitating bond downgrades (a public-interest concern); but then settles at 12.5% (exposing the public-interest argument as a clothesless emperor). (2) There are generation owners arguing that supramarket prices (a private-interest desire) are necessary for entry (a public-interest concern), adding that scarcity pricing induces efficient consumption (another public-interest concern), while offering no facts on elasticities of demand (facts that might show the weakness of the public-interest argument). Industrial

customers often seek discounts below fully allocated cost (a private-interest desire), arguing that without rate reductions they will depart, shifting fixed costs to other ratepayers (a public-interest argument), while offering no facts on their destination (evidence that would reveal the strength or weakness of their argument).

With these examples, I mean no broad-brush tarring of the many legitimate arguments of this type. But they are real-world examples.

In responding to private pressures, legislatures can make regulation more effective or less effective. Legislative prescriptiveness shrinks commission discretion. One state statute actually specifies the company types regulators may use as "comparables" when setting the utility's authorized return on equity. Other statutes single out specific costs for accelerated or guaranteed cost recovery. These statutes, produced by private-interest pressures, inject constraints and slants unaided by the expertise and fact-gathering techniques normally used by commissions.

By diminishing commission discretion, legislation also can reduce the accountability of sellers. Awarding ratepayer-funded "incentives" without defining seller obligations makes ratepayers pay extra for performance already inherent in the obligation to serve. Reducing regulation in the name of "competition" without facts on competition's effectiveness of competition does the double duty of increasing customer vulnerability while giving "competition" a bad name. These are not public-interest results.

Conclusion

Private and public interests are like Boolean circles with blurry boundaries: They overlap but do not coincide. Compared to the industries they regulate, commissions and legislatures are overworked and informationally disadvantaged. In this context, effectiveness requires continuous curiosity, alertness, and skepticism.