

The Effective Regulator: Purposefulness

Scott Hempling
September 2007

The hedgehog is a thinker or leader who 'relates everything to a central vision ... a single, universal, organizing principle,' ... while the fox 'pursue[s] many ends, often unrelated and even contradictory.' ... In this sense, Abraham Lincoln can be considered one of the foremost hedgehogs in American history.

— James M. McPherson, “The Hedgehog and the Foxes,” in *Abraham Lincoln and the Second American Revolution* (1991) at pp. 113-14 (quoting British philosopher Isaiah Berlin’s essay on Leo Tolstoy, which essay, in turn, interprets this sentence from the Greek poet Archilochus: “The fox knows many things, but the hedgehog knows one big thing.”)

* * *

The purposeful regulator articulates her purpose. Regulatory statutes require regulators to make decisions "consistent with the public interest." These statutes presume that private behavior, unregulated, will diverge from the public interest. The purposeful regulator seeks to align private behavior with the public interest. To do so, she must (1) define the public interest, (2) identify the private interests, (3) articulate how each private interest, unregulated, might diverge from the public interest, and then (4) design regulatory inducements to achieve alignment.

What is "the public interest"? The phrase has multiple meanings. Its breadth invites flexibility, but flexibility requires accountability. Accountability comes from articulation. The effective regulator—the purposeful regulator—crafts her own definition, and articulates it publicly.

My definition of "public interest"—hardly the only possible definition—is a composite of economic efficiency, sympathetic gradualism, and political accountability:

Economic efficiency means “biggest bang for the buck”—the best feasible benefit-cost ratio. Elementary economics tells us that if an outcome is inefficient, someone has foregone some benefit attainable without cost to others. That is not a public-interest outcome.

Sympathetic gradualism means smoothing economic efficiency's hard edges. Strict benefit-cost calculation does not sympathize with citizens' short-term situations. Sympathetic gradualism means moderating efficiency's short-term pain to preserve the public acceptability necessary to long-term gain.

Political accountability requires the regulator to create political acceptance of decisions that implement economic efficiency and sympathetic gradualism. Political accountability does not mean caving in to interest groups. It means educating and explaining—adjusting and explaining the angle of change without compromising the direction of change.

Derived from three components, the public interest is both a composite and a compromise: a compromise not among private interests, but among components of the public interest. Understanding this difference is a prerequisite for purposefulness.

Caution: A public-interest purpose does invite regulators to solve all public-interest problems. Their actions are bounded by statutory purpose, to the subject matter of utility regulation, as specified by legislative intent. Compare *Gulf States Utilities Company v. Federal Power Commission*, 411 U.S. 747 (1973) (the “public interest,” as that phrase is used in Section 204 of the Federal Power Act, requires Commission to take into account antitrust law policies) with *NAACP v. Federal Power Commission* 425 U.S. 662 (1976) (the “public interest” does not authorize Commission to prohibit racial discrimination by utilities).

How might private interests diverge from the public interest? Once the regulator has defined the public interest, she must determine how private parties’ aims and actions might deviate from that public interest. For typical participants in regulatory proceeds, consider these multiple interests:

1. Utility corporation (profit maximization, market share maintenance, market share growth, solid community reputation)
2. Utility shareholders (growth in company value, share price growth, financial stability, dividends)
3. Utility CEO (all of the above, plus high salary, career enhancement, job satisfaction)
4. Nonutility competitors (market entry, market share, access to bottlenecks)
5. Consumers (low prices, reliable service, responsive customer relations)
6. Bondholders (cash flow, interest coverages, non-delinquency)

The public interest can accommodate all these private interests—in their legitimate form. No consumer legitimately expects power for free; no CEO legitimately expects compensation exceeding his peers’. But private interests can press for illegitimate ends—a consumer’s desire for below-cost power prices with above-average reliability, an investor’s desire for above-market returns with below-average risks, management’s desires for market domination. The purposeful regulator must establish boundaries, to align these interests with the public interest. We want to get to work on time, so we seek to speed; but that private interest meets the public speed limit.

So how does “public interest” relate to regulatory purpose? The purposeful regulator does not seek "compromise" or "balance" among private interests appearing before her. The effective regulator instead establishes a centrifugal force, one that disciplines private expectations and hems in private behavior. That centrifugal force is the public interest.

Recommendations for Regulators

Regulators seeking effectiveness might ask these questions:

- 1. Do I have a definition of “public interest”? Have I made my definition transparent by articulating it to my fellow commissioners and the parties? Is my definition consistent with my fellow commissioners’ definitions?*
- 2. Have I identified the private interests appearing before my commission? Do I understand—analytically, not judgmentally—how those private interests might diverge from the public interest, now or in the future?*
- 3. Have I signaled to those interests the need to align their behavior with the public interest?*
- 4. Have I determined whether my state’s regulatory mechanisms are sufficient to achieve alignment, and are no more than sufficient? (Unnecessary regulation is just as troublesome as insufficient regulation.)*