Letters

We welcome letters from readers, particularly commentaries that reflect upon or take issue with material we have published. The writer's name, affiliation, address, and telephone number should be included. Because of space limitations, letters are subject to abridgment.

Repeal PUHCA and PURPA

TO THE EDITOR:

Jerry Taylor's "Electric Utility Reform: Shock Therapy or Managed Competition?" (last issue) should be mandatory reading for policymakers engaged in restructuring the electric industry and the rules that govern it. One can quibble with certain details in his analysis. It is not true, for example, that "natural gas pipelines generally are held by a multiplicity of consumers holding title to a fraction of the line's capacity," as executives at Enron, the Williams Companies, and Columbia can attest. Taylor does a great service for all of us, however, by banishing the notion that the electricity reforms being discussed on Capitol Hill and throughout the states are "deregulation." With that misnomer properly set aside, it is easier to determine whether the reforms under consideration address the real barriers to achieving a more efficient electric industry.

Debates about how various aspects of the Schaefer bill (H.R. 3790) score on this test will continue for months, and perhaps years, depending on what changes Schaefer makes to his bill before Congress convenes. It is absolutely clear, however, that H.R. 3790 fails to eliminate two real, significant barriers to a more competitive, efficient electric industry: the Public Utility Holding Company Act of 1935 (PUHCA) and the Public Utility Regulatory Policies Act of 1978 (PURPA). Taylor says it well, "Every day that H.R. 3790 prolongs the life of these statutes is an additional day that the industry suffers under a distorted and inefficient market structure that mitigates against the delivery of lower prices and better service to American consumers."

We cannot know for certain how much better-off consumers would be in the absence of these statutes. We do know, however, that consumers are paying billions of dollars for high-priced PURPA power, and that PURPA "entrepreneurs" continue to seek subsidies. One California utility is facing more than 1000 MW of costly PURPA power for which developers, from as far away as New Mexico, are demanding long-term purchase contracts; this in the face of California's restructuring law that will eliminate retail sales franchises by the end of 2001.

We also know that PUHCA drastically limits the number of potential investors in the industry, denying utilities and their customers the capital, innovation, and competition that less-restricted investment would provide. These costs are hard to quantify, but they will become clearer as investment bankers seek buyers for generation, divested by choice or order, and discover that willing buyers are deterred by PUHCA. This cannot be in the interest of consumers, who stand to benefit most from robust auctions for these assets.

PUHCA's burdens also will become more apparent as utilities move to transfer control of their transmission systems to independent operators. The most ardent advocates of a "restructured" electric industry want this even though, as Taylor observes, "We simply do not know enough about this industry, given how distorted it has been by government intervention, to pass judgment about whether vertical integration is or is not efficient." It is not clear, however, how transfers of transmission control would be accomplished under PUHCA. "No Action" letters from the SEC may suffice, but why require this and provide a forum for potential delay or litigation?

If Congress would do the two things that only it has the power to do—repeal PUHCA and PURPA—little additional federal legislation may be necessary, other than that required to deal with the ever-growing incompatibility of the public utilities (TVA, PMAs, rurals, and municipals) with competitive electric markets. Argentina, Australia, and many other countries are privatizing their electricity systems, but the United States apparently cannot muster the political will to do the same. Indeed, the Clinton administration's recent opening of the federal piggy bank to bail out rural electric cooperatives—more than \$1.5 billion in federal loans were written off by the Department of Agriculture in September for Soyland Power Cooperative and Deseret Generation & Transmission Cooperative—suggests that immediate congressional action is needed, lest the benefits to consumers of a more competitive electric market be wiped out by burgeoning taxpayer liabilities for rural electric white elephants.

What about customer choice? It now exists effectively at the wholesale level thanks to the Energy Policy Act of 1992 and the Federal Energy Regulatory Commission. Judging from the legislation passed by Rhode Island and California in August, and from initiatives pending in many other states, it appears the states are ready and willing to deal with choice for retail customers. Admittedly, there is some question about the legal authority of the states to order retail wheeling under the Federal Power Act; however, this question could be resolved by a simple clarification in federal legislation to repeal PUHCA and PURPA.

The demand for cheaper electricity, new technology that is making self-generation a reality for smaller customers, and competition among states for jobs and economic development are likely to bring about retail choice sooner rather than later, even without a federal mandate.

In sum, I agree with much of the "shock therapy" prescribed by Taylor. It will take time, however, for his unconventional wisdom to be digested by policymakers. In the meantime, a little laser surgery on PUHCA and PURPA would do wonders to clarify what truly needs to be done and to bring consumers the benefits of the competitive electricity generation market that is upon us—ready or not.

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Bullies in the Electric-Policy Sandbox

TO THE EDITOR:

Jerry Taylor's article (last issue) is provocative and stimulating; however, I still find myself wondering how a card-carrying member of the Cato Institute would bring about a change from, say, the British system of driving on the left to the American one of driving on the right. For reasons that may stem from my own imagination, I envision the Cato-type saying: Let each individual decide upon which side of the road to drive. If additional rules are necessary, they will follow naturally.

Taylor would like to change the system, but would his changes result in a positive revolution? His scheme would reallocate many entitlements, particularly property rights. According to Taylor, reallocation is just because the entitlements were ill gotten. This is dangerous reasoning since many entitlements and types of property can be considered the ill-gotten result of forced transactions that occurred some time in the past. Both war and politics redistribute wealth and entitlements. Where do we draw the line?

It makes sense to consider the "grid" as private property only if one understands three qualifications. First, the grid is not entirely privately owned. Second, it became privately owned to a great extent via eminent domain takings. Third, customers did not choose to pay for the grid. The debate among Libertarians could focus on exactly when and where the first forced taking took place, whether paying for the grid is the equivalent of forced taxation, and how much compensation is due and to whom.

One of Taylor's arguments seems to be that ill-gotten gains become legitimate by passing through several generations; for corporations, this means generations of management. (There is a certain plausibility to this. Although many electric companies bear Edison's name, their recent behavior and legacy is Insull's.) Invoking Ronald Coase, however, is naive. Transaction-cost economics and Coase himself tell us that ex ante allocations of all possible property rights are inefficient.

As we peel, layer by layer, the onion of almost a century of eminent domain, original cost-of-service pricing, lack of real-time pricing, government directed fuel-choice decisions, and a host of other social programs, we find an elaborate system of entitlements that has served as the basis for millions of economic decisions that structure the industry. Without a well-designed transition, industry restructuring would be as disastrous as adopting the British system of driving without establishing new traffic rules.

Natural monopolies exist, but we do not need to regulate each and every one we see. Would Taylor know a natural monopoly if he saw one? Has Robert Bradley ever found evidence of a natural monopoly? The natural monopoly aspects in the electric utility industry usually come from engineering costs. ($C(A+B) < C(A)+C(B)$ for those doing the math.) Higher voltage lines, for example, have a lower average cost per-unit transmitted than lower voltage lines. Legitimate issues of natural monopoly and public goods often are leveraged to include unnatural monopolies like number of customers or generation ownership under a franchise. This is where problems arise.

Can open entry end monopoly and create competition? Anyone who believes that it is easy to string wires, even with rights-of-way access, has not paid attention to local property owners' complaints about takings. Is stringing wire adjacent to someone's property a taking if it lowers the value of that person's property? For Taylor's scheme to work, we must declare that there are no takings with regard to adjacent property.

A real danger is the merging of local gas- and electric-distribution systems without retail access. Microturbines may give customers an alternative; unfortunately, however, their precursors, gasoline generators, have not significantly penetrated the market. Could we privatize the roads and tell the public that helicopters are the competitive alternative?

There is no doubt that the electric utility industry needs reform. Utilities with stranded costs favor debating radical solutions because the debate simply prolongs the status quo—a winning strategy for the utilities. Furthermore, just giving rights-of-way access significantly slows the introduction of competition.

While Cato is eliminating PURPA, PUHCA, and FERC, is it just an oversight that they did not eliminate the FPA, state commissions, and NERC (including its unruly regional progeny)? In all, Taylor's proposals for reform suggest that one or more public bodies will be needed to deal with public rights-of-way, public hazards, privatization of publicly owned assets, violations of the Commerce Clause, takings, and antitrust issues. Pushing the issues into the courts is a copout. Judges have limited knowledge and training in the economics and engineering of electric markets, so why does Taylor find comfort in antitrust law?

Designing these institutions from scratch is a good exercise in public policy. It is fun to have Taylor and Niskanen playing in the electric-policy sandbox, but it appears they want me out of it. Rights-of-way access is not as simple as they have portrayed it, and it is not enough.

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Schaefer Bill Insupportable

TO THE EDITOR:

Jerry Taylor did a sound job of dismantling the notion that H.R. 3790 represents a significant move toward deregulation (last issue). As Taylor points out, Schaefer essentially takes the presumption of natural monopoly as the basis for regulating prices and rights-of-way access, halting the search for market-based solutions to market transaction problems.

So what's the beef if Schaefer's

bill would open up retail competition? In general, by wrongly assuming that the underlying problem is natural monopoly, the bill contains recommendations that will not respond to real industry problems. The bill plasters over market transaction issues with a barrage of regulatory fixes including nondiscriminatory access, universal service, flexible pricing, and competitively neutral regulation. Taylor correctly notes that private owners will not have any economic incentives to invest in these highly regulated assets. (The bill balances this deficiency by granting FERC the regulatory authority to expand transmission capacity.) Furthermore, regulatory decision making will proceed without the local knowledge that market participants possess, and these private parties will not have clear incentives to share information or to search for innovative solutions to real problems.

There is much to criticize in this legislation, but what I find most troubling is the assumption that natural monopoly reigns in both transmission and distribution activities. For a competitive electric power industry, the natural monopoly argument is not simply weak—it is irrelevant. This is true even if one believes that efficiency requires integration of many or all transmission and distribution assets within a region or across regions. As Taylor points out, this may not be the situation today and, clearly, may not be the case in the future.

The typical explanation of natural monopoly ignores market transaction issues. A basic economics textbook, for example, will show that natural monopoly occurs when an increase in output by one producer leads to lower long run unit costs for that output. Such a text also will show that this situation increases the potential for one firm to control the market; but, this explanation is incomplete. In an unregulated marketplace, potential users will expend resources to find an effective means to deal with the opportunism presented when one party controls an asset whose services are difficult to bypass. This "hold-up" problem in transmission and distribution is a normal transaction issue that all participants must deal with to be successful. In other words, transaction costs are real, and market players would not permit a market structure to evolve that neglected obvious hold-up problems.

Knowing that a competitive marketplace can produce greater aggregate wealth than a monopoly can, it is simply a matter of efficiency to avoid single ownership of integrated transmission and distribution systems. Put another way, transmission and distribution assets will be of greater value to those who can effectively manage the hold-up problem by owning the assets and privately resolving governance issues concerning access and pricing. We should expect that competitive bidding for these assets will reflect these differences—a monopoly owner would not be the highest bidder. The Schaefer bill not only ignores this logic, it eliminates incentives for participants to search for more efficient market structures.

With this understanding of the market, I will suggest an outline for properly deregulating the industry. First, restructuring transmission and distribution ownership is a move in the right direction. I have written (*Regulation*, 1992 No. 1) that the current configuration of ownership is highly inefficient, and joint ownership of transmission and distribution by major system users should be vigorously encouraged by law. Taylor indicates that other industries in which hold-up problems exist apply joint-user ownership to deal with asset hold-ups; but, he also argues that the precise nature of market-based solutions in the power industry are by no means clear and market participants should be able to discover the most efficient remedies. Thus, he is less enthusiastic to script a direct breakout policy than I am. I agree that market discovery might eventually achieve such solutions, but it seems unlikely that massive restructuring will proceed without substantial legislative inducement, because participants might fear that the government will retract any seeming openness to private solutions.

Second, I agree with Taylor that electricity deregulation legislation should be federal, overriding state and local regulations. As Taylor notes, this would be a wonderful time to rediscover an appropriate use of the Commerce Clause. A well-reasoned opposition to H.R. 3790 does not rest upon states' rights, as many conservative groups now argue. A competitive power industry, including retail sales, involves interstate and international trade, thus its regulation should be a matter of federal policy. While some state governments admirably have pushed the deregulation issue faster than the federal government, the dismantling of state regulations is part of bona fide deregulation.

Moreover, Schaefer is not questioning the ongoing jurisdiction of state regulators. Mindful of testy state-federal jurisdictional issues, he believes the bill represents the views of state regulators. Many state regulators, however, remain distressed about the bill's codification of divisions in regulatory turf that already are outlined in FERC Order 888. The fact that the bill causes strong dispute among politicians and regulators supports the view that it is not about pushing deregulation, but rather about making, as Taylor wrote, "a tactical withdrawal to a more defensible regulatory position that will prove more difficult for free marketeers to breach."

Third, we should not try to solve pricing, service reliability, and access issues up front. No regulator can possibly know what these solutions will look like in a dynamic industry. The best answers will change through time, which points to the value of setting up deregulation so that it is tractable as a private, collective, governance effort of industry participants. Unlike regulators, industry participants have the appropriate local knowledge and the incentives to use that knowledge effectively. But what if this theorizing about the value of private governance is incorrect and a monopoly asserts itself? While I share Taylor's hesitancy to add more regulations, the application of antitrust laws probably would be a sensible safeguard that could deflect more intrusive regulations.

Fourth, along the way to developing a competitive power market by privatizing state utilities, we should do as much for our federal utilities—the PMAs and the TVA—and eliminate subsidies to all public power utilities and cooperatives. Instead, H.R. 3790 seeks to halt the resale of subsidized power by such utilities, presumably to keep the playing field level. Taylor believes this is a sensible restriction, but I think he is mistaken. If public power subsidization continues (as the bill allows), then encouraging resale of those entitlements would allocate energy resources to the highest-valued uses. From a political perspective, the outrage caused by such naked transfers of wealth can only encourage the privatization of these New Deal relics. Last, we have to get past the "stranded cost" problems as soon as possible; there is no economic basis for keeping this issue alive in a competitive marketplace. Such uncashed claims will chill aggressive market behavior in the future. Let's set lump-sum payoffs and end the debate.

To succeed with deregulation, the first step cannot be average—we must hurdle a heap of bad ideas, especially the natural monopoly myth. As Taylor points out, the debate is mired in the childlike fantasy that true competition conforms to the model of perfect competition. One can only wonder if this ignorance of Austrian and modern neoclassic economics is not rational ignorance, for it is the perpetuation of the fantasy of natural monopoly that underpins the drive for ongoing regulation with all its rent-gathering potential. If we are sincerely interested in deregulation and market choices, this bill is insupportable.

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Schaefer Bill Better than Nothing

TO THE EDITOR:

Jerry Taylor has written a thought provoking piece on the importance of getting electricity deregulation right (last issue). We agree that the stakes are high and care is critical. But, we are faced with the age-old conundrum: Is half a loaf better than none? Taylor's response apparently would be, "No, not in the case of electricity deregulation." We disagree.

First, Taylor correctly notes that H.R. 3790 looks a little like sausage: bits and pieces of deregulatory reform mixed with the fat of the old system. But, it is probably a dream that the government will completely abandon regulation of the electricity market.

How do Taylor's ideas on restructuring compare to the results of our CSE Foundation study on consumer choice? Our study shows that price rigidities in the current regulatory regime create considerable excess capacity in general, and particularly at night and during off-peak periods. Unleashing this capacity would put at least 13 percent more power on the market, probably about 25 percent, and possibly more. Under open access, prices would fall nearly 25 percent as the power producers would compete to put this power on the grid. If the short-run price is inelastic, the price decreases could be even more than 25 percent. Critics, including the utility lobby and the Edison Electric Institute, have been unable to refute these findings.

The fundamental question raised by Taylor is: Will deregulation release this capacity? And, if it does, will deregulation restructure the market so that consumers have access to the power without being inordinately taxed via exit fees, fees to repay so-called stranded costs, or other schemes designed to redistribute income to existing power companies? In other words, will consumers get a whole loaf of deregulation, or just a slice?

While we agree with virtually all of Taylor's points on the economic, constitutional, and ethical virtues of not taking electric power company assets, no one has proposed a taking. Deregulation, as it is currently discussed, is not a taking. The ownership of the poles, towers, meters, and lines remains with the current entities, whoever they may be. A grid is not a whole thing; it is like a car pool wherein each car is privately owned. The car pool, like the grid, consists of free-will contracts, not rights.

Under the current regulatory regime, power companies are obliged to build generators, transmission lines, and distribution networks to serve their customers. In return, they are supposed to cover their expenses and make a fair rate of return on their investment. Under the regulatory regimes in consideration, power companies would be subject to rate-of-return regulation on their transmission and distribution systems. There would not be a change in transmission or distribution regimes, therefore, there can be no taking!

While everyone seems comfortable with the idea that generation is not a natural monopoly, Taylor extends the argument by claiming that transmission and distribution are not either. We certainly agree that competition is a powerful force and that there are few natural monopolies in the world, but the system for a competitive, efficient structure for transmission and distribution markets has yet to be carefully designed. While it might be true that there are no components of natural monopoly in transmission and distribution, there are components of system integration and control. While government regulation may not be necessary to ensure efficient operation of the grid, some collective meeting of the minds is important. We don't think Taylor would suggest that Duke Power could efficiently put 50 cycle current on the grid, indeed, some private or public method for standardization is vital to the overall success of the market.

This point both bolsters and contradicts Taylor's argument about the need for regulation based on natural monopoly. We all hope that the forms that competition may take will rein in the threat of monopoly. Consider, for instance, the natural gas pipeline system. The market forces of cheap gas and self-generated power are a competitive constraint on monopoly in the supply of electricity. However, the organizing role that NERC plays cannot be dismissed. We do not see how, under this regime, rate regulation on system controls is inefficient.

The real problem is, as Taylor writes, that rate regulation of the grid "may sabotage economic gains that otherwise are within our grasp." We too are scared that cross-subsidies and the like can distort the efficiency of the market, but if competition from other markets is the appropriate check on the cost of transmission, why worry?

Let's agree, at least for the purposes of debate, that "markets are better at operating networks than regulators." How can this possibly mean that partial deregulation of the system makes the economy worse? If total deregulation is good, how can partial deregulation be bad?

Taylor tries to dismiss this argument with the proper admonition that the purpose of regulation is to redistribute rents. So be it.

However, we still believe that half a loaf is better than none. While it might be true that we all wish the IRS could be disbanded, should we oppose a 20 percent tax cut because the IRS remains intact?

A legitimate fear voiced by Taylor is that redefining regulation in transmission will recreate the problems that we are experiencing in deregulating generation. In response to this concern, we suggest structuring rate regulation in transmission in a way that will not prohibit or discourage competition on the fringes. Reregulating the transmission and distribution grids should not prohibit the construction of alternative systems. There is nothing in the theory of rate regulation that mandates closure of the market to fringe competition—this has been the case only because of practice.

Taylor's closing proposals are not entirely satisfying. Careful examination of the peculiar way that electricity moves from point to point does not leave us satisfied that simple property rights to lines alone will be efficient. More study is required here. Taylor's proposal to remove the requirement that state PUCs submit a competition plan to FERC by a certain date is, oddly enough, the mantra of most regulated utilities. They are in a panic to slow the onset of deregulation. Setting a date, and the sooner the better, seems appropriate. We agree that PURPA and PUHCA are bad laws that should be repealed; however, whether the purchase power contracts currently in force under these laws should be declared null and void is another question. Eliminating the prohibition against cross-subsidies is appropriate only if we get full and total deregulation. If we are left with regulated rates only on transmission or distribution, then cross-subsidies will be inefficient.

As for the rest of Taylor's agenda—privatizing the PMAs and the TVA, eliminating federal subsidies and tax incentives, opening nondiscriminatory access to all federal public rights-of-way for transmission, and removing the prohibitions faced by any party providing electricity services—we agree.

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Taylor Electrifies Debate

TO THE EDITOR:

Citizens—to say nothing of those hands participating in what the *National Journal* called the "lobbying bonanza over electricity deregulation"—should thank Jerry Taylor for his insightful article (last issue). Taylor's refreshing prescriptions for genuine electricity deregulation have significant merit.

Deregulation, in contrast to the *reregulation* proposed in the Schaefer bill, will almost certainly startle the regulators, lawmakers, lobbyists, industry mavens, lawyers, environmentalists, and associated hangers-on whose control of energy policy has been virtually unchallenged since 1973, and probably since the New Deal. Such persons inhabit an "energy policy playground" and must be satisfied before electricity laws can change. Before dismissing Taylor as a knave, fool, or utopian, playground players should heed the advice he quotes: "The experience with energy policy over the last two decades suggests that politicians often do not know what they can legislate . . . Advisors should . . . suggest what is right and persuade politicians to convince people that changes are desirable."

Whether changes are desirable, especially in light of Taylor's critique of the Schaefer bill, is not yet clear. Nevertheless, Taylor argues persuasively for freeing electricity markets. If Taylor's proposals could be granted comprehensively (or even if they could be argued with the force he brings to bear), they would win support from many unlikely quarters including, perhaps, utilities that are fighting change in the form of H.R. 3790.

"Competition," conveniently undefined, has been the hopscotch anthem of many on the energy playground since President Carter's 1978 electricity bill, PURPA. However, no consensus exists, on or off the playground, for letting true competition deliver.

By taking the most vigorous proponents of competition at their word, Taylor has provided the basis for consensus necessary to slay both the old dragon of regulation and the new serpent of managed competition. Without ideas such as Taylor's, the opportunity for historic improvement in electricity law likely will be squandered. The debate suffers, as Taylor says of the electricity grid, "from the lack of informational oxygen [necessary] for intelligent direction."

Taylor's cogent presentation of sources not heard often on the energy playground, one hopes, signals the start of an effort by the Cato Institute, other free-market institutes, and thoughtful policymakers on and off the playground, to enrich the stale air of the electricity debate with new ideas about deregulation. The terrain on which energy-policy battles currently are fought favors, to an alarming degree, "Ira Magaziner over Milton Friedman." One need only review the record of the FERC's recent "technical conferences" or the October, Santa Fe conference sponsored by state regulators and the Department of Energy to see that the impulse to regulate is as strong or stronger than ever. Only today, the potentially "stranded regulators" justify that impulse on the basis of "promoting competition." I hope that Taylor's article one day is seen as having marked the turning point on the way to less regulation for industry participants and true competition for electricity customers.

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Shocking the Opponents

TAYLOR replies:

Professors Maloney and McCormick argue that "half a loaf" is better than none (this issue). Who could disagree? I simply suggest that we can do better than the meager meal proposed by the open-access crowd and that their "half a loaf" is made of something other than the "bread" of deregulation.

They resist getting the government out of the grid-management business because "the system for a competitive, efficient structure for transmission and distribution markets has yet to be carefully designed." True, but efficient market structures are created best by the spontaneous workings of market actors, not by the politically distorted plans of government agents. Neither FERC, the fifty state PUCs, nor the best-intentioned economists at Clemson are capable of designing efficient market structures, especially for an electric industry that has been heavily distorted by eighty years of government intervention. Nobel Laureate Friedrich Hayek called that hubris the "pretense of knowledge."

The organizing role that government plays has been carried out routinely by various private agents when markets have been left to their own devices. I am certain that companies will manage to find a way to synchronize currents and grid loads without government force.

My primary concern is that the price of mandatory open access will be increased regulation of the grid. The question for Maloney and McCormick is whether the gains of mandatory retail wheeling offset the losses from what is dangerously close to de facto nationalization of the grid. Maloney and McCormick think they do; I am not so sure. Either way, open access is not a "slice" of deregulation—it is an alternative regulatory regime.

This brings us to the matter of takings. Sure, utilities would still own the poles, towers, meters, and lines under mandatory open access; they would simply lose the right to control access to them. How is this not a taking? If one can no longer control how one's property is used or by whom, how "private" is it? Rate-of-return regulation no more compensates utilities for lost property rights than paying for the cost of my door would compensate me for the inability to determine who can enter my house.

I do not seek to reallocate entitlements as Richard O'Neill suggests (this issue); I seek to end them. Likewise, I do not advocate reallocating property rights; I advocate strengthening them where they do exist and creating them where they do not. Mandatory open access accomplishes neither of the above, thus, the reason for my concern.

O'Neill's call for a "well-designed transition" is well heeded. But a transition to what? A free market, or some SimCity model of what O'Neill thinks the industry ought to look like? I argue for the former, and O'Neill (and Maloney and McCormick for that matter) apparently argue for the latter.

Natural monopolies might exist, but the engineering costs of modern electricity distribution do not exhibit the economies of scale necessary to establish one, as studies by Paul Ballonoff and Asghar Zardkoohi show, and as simple observation of the marketplace can establish. Nor does it follow that regulating natural monopolies is necessarily superior to leaving them alone. Again, Mr. O'Neill—read Posner and get back to me.

O'Neill is right to worry about NIMBY's ability to block grid expansions, but this is the purpose of eminent domain powers. Again, alternative grids are not a necessary precondition to competition; user-owned wires, self generation, voluntary poolco arrangements, and the like might be the logical direction of an evolving marketplace. We simply cannot know this now.

Sure, one or more public bodies are required to deal with public rights-of-way. But I do not find any comfort in antitrust law (indeed, I think antitrust theory is intellectually threadbare), and I am mortified that O'Neill interpreted my article as such. I am simply suggesting that as long as antitrust statutes are on the books, we might turn O'Neill into a specialized antitrust clerk as a sop to those paralyzed by fear of voluntary economic arrangements.

I do not want to *replace* O'Neill in the electric-policy sandbox; I want to blow it up. Given my fondness for him, however, I am advising that he leave before the explosion occurs.

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An Inside Job

TO THE EDITOR:

I read with much pleasure the provocative article "A Libertarian Inside, Looking Out" by my friend Frank Wilner (last issue). As a longtime admirer of Frank's seemingly incongruous talents as a careful chronicler of railroad regulation and an articulate champion of deregulation, I may be one of only a few who was not unduly surprised that Frank left the Association of American Railroads (AAR) to become Commissioner Gus Owen's chief of staff at the Surface Transportation Board (STB). Frank is not a stranger to clarifying issues by highlighting contrasts. Through his recent, dramatic career change, he has managed to focus attention on the importance of maintaining a responsible deregulatory momentum while discharging the regulatory duties retained by Congress.

As Frank correctly points out, if it were not for the STB, the regulatory responsibilities left in place by Congress would have been assigned to bureaucratic administrators who are not endowed with the board's expertise. Such unfamiliarity with the issues could have led to disparate interpretations by federal judges, some of whom might have felt compelled to impose unwarranted regulatory burdens while endeavoring to ascertain congressional intent. Entrusting the residual responsibilities to a well-qualified board composed of "talented people with private-sector experience," as envisioned by Commissioner Owen, was a far superior alternative.

Probably the most important justification for creating the STB is the absolute necessity of completing the awesome task of overseeing a fair and reasonable rationalization of the nation's rail system. This process will continue to evolve, as it has since 1980, through the sale or other disposition of marginal branch lines by mainline carriers to regional and shortline operators, and the market-driven consolidation of mainline carriers. The Burlington Northern-Santa Fe (BNSF) and Union Pacific-Southern Pacific (UPSP) mergers were giant steps forward in the rationalization process, but there is much more to do before the railroad industry can realize its full potential for providing efficient and time-sensitive service at a reasonable price.

Shortly after the Civil War, we finally emerged as a united country, not only as a result of the cessation of hostilities, but also because of the achievement of Abraham Lincoln's much less heralded vision—tying the nation together with a transcontinental railroad. We all know how important the golden spike was to the rapid industrialization and economic growth of the country in the post-Civil War period. We are also familiar with the declining prosperity of the railroad industry following World War II, not only because of greatly increased intermodal competition, but also because of the industry's inability to cope effectively with competition, due to stifling constraints imposed by organized labor and the ICC's regulatory process. Now that many of these constraints have been lifted to reinvigorate the industry with at least a modicum of financial vitality, railroading again has become a profitable endeavor.

This has happened just in time. As we approach the millennium, significant growth of the U.S. economy will be largely dependent, once again, on the ability of the rail network to provide efficient service, not only for bulk commodities and intermodal domestic shipments, but also for shipments to our northern and southern neighbors and across our land bridge connecting the Pacific Rim and Europe.

The STB can play a highly significant role by giving fair and appropriate attention to the oversight responsibilities involved in rationalizing our rail system. In so doing, the board can help the railroad industry meet the heavy service demands that will accompany its rebirth as America's premier surface-transportation mode for long-haul movements. Accordingly, I am one who is most thankful for the presence of competent, market-oriented individuals at the STB like Gus Owen and Frank Wilner. Hopefully, they will be successful in attracting other talented individuals with private-sector experience to come and serve as "Libertarians inside, looking out." Our future prosperity, dependent as it will be on the efficiency of our national rail network, demands nothing less.

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STB Keeps Trains on Track

TO THE EDITOR:

Thank you for the opportunity to reply to my friend Frank Wilner's thought provoking piece (last issue). I do not disagree with much of what he said, but I do disagree somewhat with his conclusion that there would be no Interstate Commerce Act in a Libertarian world. Frank also wrote that he and his intellectual allies hope to "transform capitalism from an unknown ideal into a self-evident truth." It is hard to argue with that, but Frank is silent on what captive rail shippers would do without a set of laws to govern the relationship between the captive rail shippers and the railroads. I will, therefore, make the case for partial regulation of the railroads.

First, I should explain that even this advocate of regulation could share any number of regulation horror stories. For example, I represented the petroleum industry in its challenge of the EPA's ethanol mandate in reformulated gasoline, which was an outrageous, illegal mandate pushed by Archer Daniels Midland Company that the court of appeals properly found harmful, not helpful to the environment. I also represent Dow Jones & Company Inc. in its challenge to the Postal Rate Commission's decision that large postal customers, such as Dow Jones, must subsidize smaller postal customers. Of course there is no justification for that; we hope to persuade the court of appeals that these subsidies are illegal. I attack regulatory excesses, not defend them. But occasionally regulation is necessary in the public interest.

I will stipulate with Frank that free markets are best, but what should we do when free markets do not exist? Frank does not say. I assume that "free capitalism," as Frank used the term, includes no substantial "barriers to entry," as the economists put it. Thus, we need not regulate airline rates or motor-carrier rates because there are no significant barriers to entry in these markets. The railroads, however, are one of only two transportation modes (the other is pipelines) that are not publicly owned, and to which there are significant barriers to entry. The transportation modes owned by the public—the airways, highways, and waterways—permit access to all entrants (subject only to some safety and fitness qualifications). Regulating rates and services of these modes is unnecessary because of competition and antitrust laws. But for railroads and pipelines, rates are regulated because competition does not always exist. It does no good to speak of competition when there is none.

Yes, I am the friend of Frank who quoted Calvin Coolidge publicly about Frank's entry into the federal government. President Coolidge described something as the "most unheard of thing I ever heard of," and a Libertarian joining the government seemed a near perfect match for that quotation. Frank has explained his reasons for joining the Surface Transportation Board (STB), but he is responsible for implementing what remains of the Interstate Commerce Act. From this, I assume his ideal world includes substantial competition that does not include the railroad industry.

Having represented the electric utility industry for twenty years, let me explain that the delivered price of fuel is often more than one-half of the cost of generating electricity, and the transportation portion of the delivered price is often as much as three-quarters or four-fifths of the total delivered price. Thus, believe it or not, railroad transportation costs can represent more than one-half of the cost of generating power at coal-fired power plants. Since coal is our single largest source of electricity, this is a very important issue to every electricity consumer—which is to say, all of us.

Why do we still regulate railroads? Because certain shippers, particularly customers, are "captive" to the one railroad that serves the origin of their commodity, the destination of their plant, or the destination of their finished product. But why would anyone be captive given a number of other transportation options? Couldn't they use trucks or barges, or produce their products elsewhere? For many shippers the answer is no. Here are a few examples.

Coal is used in immense quantities by electric utilities and other industries. But under the Clean Air Act, and especially the 1990 amendments, utilities frequently must turn to low-sulfur coal that is found predominantly in the West. Some of that coal is now shipped from the West to eastern seaboard states like Georgia. There is no practical way to move that coal except by railroad. Other hazardous or bulk materials also must move by rail, either for economic or legal reasons. And, from a societal standpoint, we are collectively better-off because rails are safer than motor carriers for transporting hazardous materials. We avoid the costs of increased highway traffic when bulk commodities such as grain, phosphate rock, other ores, chemicals, and coal are moved by rail.

So railroads have a monopoly

on the movement of many bulk commodities. All of us probably agree that where competition exists, it should be preserved, and competition is a far better regulator than the government. The problem, however, is that competition often does not exist or is imperfect. Moreover, in the Union Pacific-Southern Pacific merger, the STB destroyed some competition and substituted regulation for it. So even in this day and age, we may be moving in the wrong direction.

One cannot run a competitive business without knowing what one's costs are. For years, because utilities were not in a competitive business, they could charge customers any price for railroad transportation and subsequently litigate about price setting. This is much less likely to occur in the future because of the competition faced by the electric utilities.

Meanwhile, the STB is a pale imitation of the ICC. Even the ICC had become, in recent years, a shadow of its former self. (I can hear your readers cheering!) But if your readers were captive rail shippers or customers of captive rail shippers, they would not be cheering. You see, for many reasons, it is less certain than ever that a captive rail shipper can expect relief from the government. For example, railroads have tied the ICC, and now the STB, in knots over a simple legal issue: When a shipper has competition between two railroads for part of a movement, but no competition over the remainder of the movement, can the STB compel the railroad to publish a rate on the "bottleneck segment?" Believe it or not, the ICC and the STB have been wrestling with this simple issue for two-and-a-half years! If the question is not answered soon, and in the shippers' favor, many shippers may say they no longer need the STB and will look to Congress to change the entire railroad regulatory regime.

There are other, similar issues on the STB's plate. I will not bore your readers with the details. There is, however, a very important message left. Either the STB will protect the shippers who are captives of the railroads, or captive shippers will go to Congress for other relief. Other relief could include (a) repealing the entire railroad regulatory regime, thus subjecting the railroads to antitrust laws, state laws, and the common law; (b) legislating competitive access to the railroad system with "just compensation" paid for the access; and (c) creating another solution that has yet to be devised. But be assured, captive shippers will not simply take whatever the railroads dish out. The need for reasonable railroad transportation is too important for that. And like it or not Frank, the government must, in some form and in some fashion, be part of the solution. That is why I am so glad Frank is working where he is.

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Clinton's Proregulation Record

TO THE EDITOR:

Unfortunately, Dr. William Niskanen's review of the Clinton administration's regulatory record is far too generous ("Clinton's Regulatory Record," last issue). The fact that the Clinton record is not as bad as the Bush record has more to do with the Republican-led 104th Congress than with the administration. Indeed, absent the heroic efforts of the 104th Congress to cut red tape and return common sense to regulation, the Clinton administration would have unleashed regulatory initiatives that would have made the transgressions of the Bush administration pale in comparison.

Dr. Niskanen's review of the Clinton administration's quantitative record on regulation leads him to conclude that "Clinton and Bush's deregulatory records are more similar to each other than either is to Reagan's." He also points out that these measures are limited because the "devil is in the details." It is true that the Bush and Clinton records are similar; however, the Bush administration recognized, albeit too late, that the growth of regulation was a serious burden on the economy and, during its final eighteen months, tried to reverse the trend.

Thomas Hopkins of the Rochester Institute of Technology estimated that the total cost of regulation did not increase at all between 1992 and 1993. After 1993, regulatory costs again began to grow rapidly. This pattern sharply contrasts the pattern under Clinton that was restrained by the 104th Congress, not by the administration recognizing the error of its ways.

Dr. Niskanen characterizes the administration's legislative record as inconsistent and lacking a coherent plan. In fact, however, the administration's moves were always calculated. Before the 104th Congress convened, the Clinton administration gave us the Family and Medical Leave Act, a health-care reform proposal that would have brought one-seventh of the national economy under government control, and several similar proposals that died with the 104th Congress.

Although the administration introduced little of its own regulatory legislation after the Republicans took control of Congress, it often worked to undermine the important regulatory-reform proposals introduced by the Republicans. The administration worked hard to weaken the Unfunded Mandates Reform Act (UMRA), by making it more difficult to review existing mandates. The administration also worked behind the scenes to make sure the Advisory Commission on Intergovernmental Relations would not issue a final report on existing unfunded mandates before it was scheduled to disband.

Similarly, one year after the passage of the Paperwork Reduction Act, the administration has met few of the act's goals. The act requires the Office of Management and Budget (OMB) to set a goal of at least a 10 percent reduction in the governmentwide paperwork burden for fiscal year 1996. According to a June 1996 GAO report, the OMB had not established any reduction goals, and federal agencies had reduced the overall paperwork burden by only about 1 percent over the past year. In March 1995, the Environmental Protection Agency pledged to reduce the burden of environmental paperwork 25 percent by June 30, 1996. As of that time, the administration admitted that it was only halfway to achieving its goal, because new paperwork requirements were being added faster than the old ones could be eliminated.

Most importantly, the administration worked tirelessly to undermine the efforts of the 104th Congress to enact a comprehensive reform bill that would have, among other things, improved the quality of risk assessments and required the use of benefit-cost analysis. This legislation would have helped ensure that agencies develop the "smart regulations" that Sally Katzen, administrator of the Office of Information and Regulatory Affairs (OIRA), claims the administration wants. The administration, doing the bidding of unions and environmental groups, collaborated with congressional Democrats to water down the legislation to the point where agencies essentially remained free to do as they pleased.

Despite all of this, the 104th Congress was still able to enact a number of important deregulatory reforms affecting the telecommunications and agriculture industries. Congress also improved the Safe Drinking Water Act. In the case of the Food Quality Protection Act, which replaced the Delaney Clause that banned cancer-causing chemicals from processed foods, the administration succeeded in making changes that probably will increase the price of food without providing consumers with additional benefits.

Finally, the administration's changes in OIRA's review functions should be more appropriately viewed, not as changing the "culture" of regulatory review, but rendering it completely irrelevant and ineffective. In fact, OIRA reviews only about one-third the number of rules it reviewed during the Reagan and Bush administrations. Unlike the Reagan and Bush administrations, the Clinton administration does not require federal agencies to consider the costs or benefits of all regulations. In fact, a September 1996 GAO report indicated that the administration does not require benefit-cost analyses for most of the rules it reviews. As Dr. Niskanen points out, OIRA's new role has done little to stop the expansion of agency regulatory powers. OIRA's role has always been to ensure that agencies' regulatory activities are consistent with the administration's regulatory agenda and principles. OIRA's deference to agency discretion on regulatory issues demonstrates the administration's proregulation philosophy.

The reality is that each year this country loses the equivalent of an entire new German economy because of the costs of regulation and its effects on productivity—something must be done to stop this economic hemorrhaging. The administration has both advanced costly regulatory proposals and conspired against the efforts of the 104th Congress to enact deregulatory legislation. I can only conclude that Clinton's regulatory record is, unfortunately, proregulation.

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