Public Utilities as Social Agencies

BY KENNETH W. COSTELLO

Public utilities regulation has expanded its domain far beyond its original mandate and what is socially optimal. The original mandate confined itself to setting “just and reasonable” rates and acting in other ways that improve the long-term welfare of utility customers. The idea was to protect customers from “monopoly” utilities setting high rates and providing poor service. Today, as regulators pursue other goals driven by escalating politics, they inevitably compromise on that original mission.

According to most state statutes, regulators must assure the public that utility rates are just and reasonable and not unduly discriminatory. Those requirements demand that consumers pay no more than necessary to give a prudent utility a reasonable opportunity to recover efficiently incurred costs, including a “fair return” on investment.

Around the early 1990s, state regulators and legislatures began requiring utilities to widen their sphere to include subsidizing low-income households. Subsequent expansions in authority included accommodating, facilitating, and even subsidizing utilities’ competitors (e.g., retail solar providers and other forms of renewable energy); investing in politically popular technologies; promoting energy efficiency; and achieving clean air/climate change targets beyond federal and local mandates. Those demands on utilities have escalated their costs, hindering their ability to operate as profitable entities providing basic services reliably and economically.

A major part of the current policy debate on utilities regulation centers on the utility business model, addressing—among other things—the extent to which utilities should broaden their activities to satisfy society’s demands driven by political forces. An expansive role for utilities has led, for example, to higher electricity prices along with the compromise of traditional regulatory objectives like cost-based rates, consumer protection, least-cost utility operations, and adequate service reliability. California is the poster child for this development, although other states have also gone down this primrose path.

Perhaps ironically, utilities themselves may be complicit in broadening their social responsibility for the purpose of goodwill/publicity that they hope will lead to favorable treatment from regulators and other governmental entities. Utilities increasingly become strong proponents of subsidized energy efficiency programs and clean-energy technologies in the absence of a rigorous demonstration that these are in the best interests of their customers.

Stakeholder capture / The growing politicization of public utilities regulation reflects, above all else, efforts by stakeholders to capture the benefits of governmental actions. This has negative repercussions for regulation as an institution. First, it means more special-interest influence with additional stakeholders having motives to co-opt the public interest.

Second, regulator emphasis shifts to short-term (i.e., myopic) or non-economic effects. The long-term welfare of consumers takes a back seat to other considerations. One outcome is the promotion of new capital projects on the basis of their non-cost attributes. With greater politicization, regulators have increasingly stressed the effects on the environment, climate, job creation, economic development, and other outcomes. This complicates regulators’ job of making the inevitable tradeoffs to advance the public interest. It also likely results in less concern for customer welfare as other objectives become integral to regulators’ decisions.

Third, politicization makes it more difficult for regulators to execute the long-standing “balancing act” of reconciling utility and consumer interests with the advancement of politically popular objectives. The increase in stakeholders has complicated the regulator’s task to achieve a balanced outcome. How do regulators sum and weigh those interests in advancing the public good? The public interest takes on more obscure interpretations when special interests become more diverse and greater in number: it is harder to define and know when it improves.

Fourth, politicization inevitably results in wasteful rent-seeking costs. Public utilities regulators are vulnerable to efforts by advocates of special interests to achieve self-serving outcomes at the expense of the general public. Either for ideological or monetary reasons, these groups want to shape the future, and the sooner the better. Their vision of the future would fill their pockets or satisfy their political agenda. The electric industry in particular has several features making it highly visible and susceptible to politics and interest-group lobbying. Among them are having a substantial environmental footprint, being a large user of energy, providing an essential service, and yielding a high social cost from service interruptions.

Fifth, politicization increases the likelihood of subsidies and the socialization of costs for new investments. Subsidies can cause substantial damage by being unfair to funding parties (namely, utility customers), economically inefficient, and unfair to competing energy sources. One bizarre yet common practice is for electric utilities to subsidize their customers to use less of their core service via energy efficiency initiatives and to subsidize their competitors under regulatory mandates and distorted ratemaking practices. Overall, subsidies almost always fail a benefit-cost test from a societal perspective.

One salient illustration of harmful politicization is the question of how much competition should be allowed in tradi-
tionally monopolistic markets. Regulators and interest groups often form an agreement with utilities to address the challenges posed by increased competition by suppressing it. Regulation itself has been a major reason for utility monopoly power because of its practice of limiting entry even when economic, technological, and market conditions would warrant opening up the market to competition.

Balancing objectives / Regulators should ask themselves whether utilities customers are getting the short end of the stick. Are customers funding the advancement of political objectives through inflated rates without compensatory benefits? The term “turkey stuffing” aptly describes the situation where utilities keep fastening surcharges to a typical customer’s bill to fund investments and other activities, the benefits of which often largely accrue to others, including fringe interests with some form of political leverage.

Regulators face the challenge of balancing the objectives of keeping prudent utilities financially healthy while fostering a broader social agenda. One could rightly ask whether utilities more closely resemble public agencies than private entities driven to serve only their shareholders and customers. One could also question whether funding political mandates through utility rates best serves customers. Regulators should stand back and conduct a reality check when thinking about the proper role for utilities in a society that highly values affordable and reliable utility services.

To be fair, regulators are not the sole culprit for the extreme politicization that is threatening the interests of utility customers. Legislative actions set the framework for regulatory actions that often restrict the ability of regulators to serve the public interest. Politics typically propels these actions, with special interests unduly influencing the legislation. We have seen utilities, environmentalists, new market players, and other special interests going to state legislatures for favors after failing with regulators. Their intent is to promote their agenda, not society’s interest.

Population in the developing world / However, Malthus and Malthusians missed the dramatic demographic change that has occurred in some developed countries and threatens to occur in many others. Total population is declining in Russia, Japan, and Italy. Russia’s decline began in the 1990s, Japan has been declining for the last eight years, and Italy has been declining for the last four. The negative effect of low fertility on Italian population growth has been exacerbated by net emigration of younger Italians. Economic growth in those three countries has been slow because of reduction in their labor force and productivity. Japan has had two decades of near zero economic growth; Italy’s gross domestic product per capita, adjusted for inflation, was lower in 2018 than it was in 2000.

In many other developed countries, population would have declined in recent years were it not for immigration. Fertility rates in most rich countries have been below the replacement level of 2.1 for some time. In 2017, the average fertility rate for the rich countries of the Organization for Economic Cooperation and Development was 1.7. In the European Union it was 1.6 and the United States was 1.7. Fertility rates in the prosperous countries of Asia have also fallen below replacement level, including 1.4 for Japan, 1.4 for South Korea, 1.2 for Singapore, and 1.6 for China.

Migration / Fertility rates nearly three times as high in developing countries than developed countries have persisted for some time, with the result that populations in rich countries are much older. The percentage of the population over age 65 in 2017 was six times as great in developed countries than in developing countries. In 2017, Japan had the oldest population, with 28% over age 65 compared to the world average of 9%. Italy was next highest at 23%. The United States was at 16% and rising.

Migration from poor to rich countries has been stimulated by Great Divergences in fertility rates and ages of populations. Emigration from poor countries has also

The Great Divergence that Malthus Missed

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been magnified by violence in failed states such as Libya, Nigeria, and Guatemala.

The massive migration from the developing world to the developed world has resulted in organized opposition in receiving countries and the rise of populist or economic nationalist movements and political leaders such as Donald Trump in the United States, Brexit supporters in Great Britain, Victor Orban in Hungary, and the Law and Justice Party in Poland. Opponents of immigration in Germany have punished Angela Merkel’s Christian Democratic Union for its liberal policies on immigration. The proposed border wall on the U.S.–Mexican border is a graphic symbol of opposition to immigration.

Immigrants are a convenient scapegoat employed by populist politicians, but technology and trade shocks explain much of the labor displacement in the receiving countries. In some countries, natives may not oppose all immigrants, but rather those who are “culturally different.” For example, the Polish government has strongly opposed European Commission encouragement for member nations to accept Muslim immigrants, but Poland has accepted large numbers of neighboring Ukrainians.

Not all countries have resisted immigration. Prior to 1973, Australia was known for its restrictive “White Australia” policy that limited immigration to people of European origin. Major reform has transformed Australia from a country largely closed to immigrants to a country with one of the highest percentages of foreign-born residents (29%) in the world. Australian immigration policy has favored skilled immigrants and foreign students, and the result has been rapid economic growth.

Demographic developments in distant parts of the world can have powerful economic and political effects in other countries. Most receiving countries have reacted by raising barriers to immigration, but Australia has demonstrated that encouraging selective immigration can be used to avoid possible negative effects of population decline. Malthus has warned us about the dangers of too many people. Can there also be too few?

**Regulatory Agencies Get Guidance on ‘Guidance’**

**BY JOHN J. COHRSSEN AND HENRY I. MILLER**

A persistent criticism of government is that it unfairly imposes obscure requirements on individuals, organizations, and companies that can lead to inappropriate prosecution and penalties. Last October, the Trump administration issued two executive orders (EOs) intended to prevent that from happening.

Federal agencies must develop rules to implement congressional mandates. The Administrative Procedure Act (APA) requires agencies to follow a precise regulatory roadmap with notice to the public and an opportunity to comment—“notice and comment”—before rules become final. The APA process can be cumbersome and take years to complete, especially if political influences intervene.

To simplify and expedite such government intervention, agencies often use less formal, non-binding “guidance documents,” which describe an agency’s policies, procedures, and requirements in the absence of formal rules. Guidance documents can be variously designated “proposed,” “draft,” or “final.” Policies can also be established via announcements, speeches, various government documents, and the like.

Guidance documents can be a boon to regulated entities that wish to understand the current thinking of regulators, and they can provide much greater flexibility for agencies than formal rulemaking. However, they also offer the temptation for bureaucratic abuse because they can be created without an opportunity for the public to comment on them, and because they can provide the basis for enforcement actions.

**Trump EOs** / A pair of EOs issued October 9, 2019 by the Trump administration police the policy content of guidance documents and rein in opportunities for their abuse in enforcement. The EOs very broadly define a “guidance document” to include all regulation-related documents and communications that are “intended to have future effect on the behavior of regulated parties,” with several exceptions.

The EOs strengthen the oversight of executive branch agencies by the White House Office of Management and Budget while providing the OMB discretion to waive various requirements. They also direct the OMB to issue memoranda and even regulations in order to implement the EOs. And they require that issued guidance documents subject to OMB review to include not only those with electoral dates and the president’s priorities, including those with novel legal or policy issues arising out of legal mandates and the president’s priorities,

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The second set of requirements is for the promulgation of agency guidance documents:

- Each agency must have final regulations establishing processes and procedures for issuing guidance documents.
- Each guidance document must state that it does not bind the regulated entities.
- Agencies must establish procedures for the public to petition for the withdrawal or modification of a guidance document.
- “Significant” guidance documents (unless exempt) require notice and public comment as well as a public response by the agency to concerns raised in the comments.

The second EO, “Promoting the Rule of Law through Transparency and Fairness in Civil Administrative Enforcement and Adjudication,” establishes specific requirements for these actions:

- It prohibits enforcement actions that rely solely on guidance documents instead of a statute or regulation.
- When taking administrative actions, an agency may apply only those standards of conduct that have been publicly stated.
- Any agency decision or document relied upon by the agency to assert a new or expanded jurisdiction must be published and available on the agency’s website.
- Before an agency takes any action that has legal consequences for a regulated person, such as a no-action letter or notice of noncompliance, the agency must give the person an opportunity to be heard regarding the agency’s legal and factual determinations except when protecting against serious threat to health and safety, or other emergency, or otherwise authorized by statute.
- Agencies can offer reductions or waiver of civil penalties when regulated parties voluntarily report regulatory violations.

The OMB may take several months to complete implementing requirements for the EOs, after which agencies will have 10 months to complete or update their procedures for issuing guidance documents. Agencies must also review their existing guidance documents for consistency with the law and create or update their online databases with information about them.

The EOs are designed to combat regulatory agencies’ potential excesses because of the additional authority granted to the OMB and the reduced discretion available to the agencies to generate guidance documents and to rely on them for enforcement. It is difficult, however, to predict their ultimate effect, and no statistical baseline offers a way to compare the “before” and “after” effects of the EOs.

The Trump EOs would not have been necessary if the OMB had had success with its 2007 effort to exert control over guidance documents, which followed a couple of years of public and agency discussion. That effort established policies and procedures for the development, issuance, and use of significant guidance documents by executive branch departments and agencies. Like the EOs, the 2007 initiative was intended to improve the quality and transparency of agency guidance practices.

The OMB may find that its resources are too limited to aggressively monitor all guidance documents; delving into such minutiae is a formidable task.

Regulated parties are going to try to follow the agency’s wishes regardless of the format in which those wishes are expressed, or the formality with which they’re expressed. If officials issue draft guidance for public comment, but then don’t have the time or resources to process the comments and write a response, the guidance may remain in “draft” for a really long time, and regulated parties may nonetheless treat it as gospel because they expect the agency (if only implicitly) to follow the sentiments in the draft guidance in individual proceedings that decide licenses, grants, etc.

We are skeptical that the EOs alone will effect significant change in the long term. Only continuing vigilance by Congress, the White House, astute regulators, the regulated community, and the general public will prevent regulatory excesses.