

# Unmasking the Regulators

Reviewed by Susan E. Dudley

## THE REGULATORS: Anonymous Power Brokers in American Politics

by Cindy Skrzycki

256 pp., Lanham, Md.: Rowman and Littlefield

Cindy Skrzycki's weekly *Washington Post* column "The Regulators" has captured the readers' attention for more than a decade, uncovering the power struggles, political intrigue, special interests, and legal battles that go on behind the scenes in Washington. Now, her wit and humor help make the seemingly arcane topic of regulation accessible (and even fun) for readers of her new book, *The Regulators: Anonymous Power Brokers in American Politics*. Fans of her column will be pleased to see that, like her *Post* stories, each chapter is humorously illustrated by Keith Bendis.

The book, punctuated by some of her most interesting and important columns over the years, will make absorbing reading for anyone interested in American politics and regulation. Skrzycki's goal in writing the book was to "take a complicated and sometimes inscrutable topic and make it a comprehensible, important lesson in government," and she succeeds. The six chapters give readers a sense of the ever-present hand of regulation in our daily lives, the people and entities who drive regulatory policy, and the efforts (largely unsuccessful) to reign in the "anonymous power brokers."

**A look inside** The first chapter, titled "The Long Arm of the Regulators: The Ubiquitous Regulatory State," contains anecdotes about the people and lobbying behind regulations ranging from the size of the holes in Swiss cheese to what constitutes a "serving size" for breath mints and the legal size of prunes. It also offers

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more quantitative measures of the extent of regulation, providing statistics on the growth in the number of pages in the *Federal Register* and the staffing at federal regulatory agencies as well as estimates of the costs of regulation.

It recounts the interesting history of how the *Federal Register* was created as the daily compendium of new regulatory activity. The Federal Register Act was passed in 1935 in response to a Supreme Court ruling that chastised President Franklin D. Roosevelt for failing to give adequate notice of executive orders setting petroleum quota allowances. The first

annual page count, in 1936, was a mere 2,620 pages. The book notes that it peaked in 2000 at 74,258 pages. (According to Mercatus page counts, the peak was actually during President Jimmy Carter's tenure—87,012 pages in 1980. In President Bill Clinton's last year in office, the page count hit 83,293. After a decline in 2001, the *Register* climbed again to 80,332 pages in 2002.)

The chapter also reviews the changing nature of regulation, from the economic regulation that was prevalent in the early part of the twentieth century to the social regulation promulgated by agencies that emerged in the 1970s such as the Environmental Protection Agency and the Occupational Safety and Health Administration. Using two case studies, the National Highway Traffic Safety Administration's auto safety regulations and OSHA's ergonomics rule, the book illustrates how Congress, regulators, and interest groups play a role in the development of new regulations.

Chapter Two, "The Regulators: Who Makes the Rules, and How Much Power Do They Have?" introduces readers to regulators like Food and Drug Administration employee Robert H. Dick, who spent half a century swirling imported tea on his tongue to ensure it met FDA standards of

purity and wholesomeness, or the Federal Communications Commission's Robert Ratcliffe, who monitors the airwaves for offensive material that might violate federal rules. It also highlights the power they hold over the regulated community and illustrates why the jobs are coveted through stories about the Consumer Product Safety Commission, the Department of Labor, and the Securities and Exchange Commission.

The third chapter, "Special Interests: Bending the Will of the Regulators," provides a fascinating behind-the-scenes look at the intense and coordinated lobbying effort that resulted in congressional disapproval of the controversial ergonomics rule issued during the last months of the Clinton administration. The focus of



this chapter is on special business interests, but it also discusses Congress's role as a special interest in the regulatory process, and throws in some more obscure examples of regulatory influence (such as a flap over regulations governing the color of doggie treats made from hog penises).

Chapter Four provides an overview of efforts to reform the regulatory process, from the House Republicans' "Contract with America" to the Clinton administration's "Reinventing Government Initiative." While this overview does not discuss earlier efforts at reform, it highlights some ambitious goals for making regulations and regulators more accountable, and how political realities diluted legislative efforts. It misses an opportunity to illustrate how special interests (including, perhaps especially, many non-profit, so-called "public interest," organizations) with much to lose in a more transparent and rigorous regulatory process, defeated broad proposals for reform. But one column laments (and I believe with good reason), "Americans still don't really know how much federal regulations cost and if the 'smartest' rules are always put on the books. ... And that would be useful information no matter who is running the regulatory state."

This theme of accountability is continued in Chapter Five, which examines the roles cost-benefit analysis and risk assessment have played in the regulatory process. It offers case studies of the recent NHTSA tire safety rule, and the roles the Bush Office of Management and Budget, auto and tire manufacturers, pro-regulation groups, and Congress played in its development.

The final chapter provides some interesting insights into what to expect for the future of regulation. It discusses the impact the September 11 terrorist attacks, the Enron scandal, and international treaties will have on the regulatory state and concludes,

After several decades of efforts to deregulate and reduce the role of federal government, the pendulum has swung back toward more government intervention and regulation in key areas such as corporate governance, accounting, and homeland security, though de-emphasizing health and environmental regulation continued apace. In short, in the space of one year there was an unprecedented expansion of the regulatory state.

All of this is interesting, important, and probably enlightening for lay readers who are not immersed in the daily politics of regulation.

**Slant?** Readers should not look to *The Regulators*, however, for an academic treatment of the theories of regulation or for details of legal or economic principles. Skrzycki does not appear to ascribe to public choice economics, which argues that people matter much less than the incentives they face. While the book does recognize that profit motives drive the business community, and getting reelected drives Congress, it is less cognizant of the business community's incentives to produce safer products, protect workers, and maintain reputation. It also makes no mention of the incentives so-called public interest groups face to expand their funding by publicizing (some might say fabricating) crises.

Instead, Skrzycki focuses on the more personal side of regulation: Who are these anonymous power brokers determining the flush mechanisms in our toilets and the color of doggie treats?

Because the book focuses not on the substance of the rules but instead on the people who make them, it rarely expresses opinions about whether particular regulations are good or bad. The author does, of course, enjoy ridiculing

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**Skrzycki's perceptive and amusing book will help bring this esoteric aspect of U.S. politics within the grasp of lay readers.**

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particularly ludicrous ones, but she is more interested in the politics of how regulations are developed than on the merits of the rules themselves. It is disappointing, therefore, that the book is not more even-handed in its treatment of the different groups involved.

My main complaint about this otherwise engaging book is its slant, which is probably unintentional, as Skrzycki takes some pains to be objective in her reporting. Nevertheless, organizations that espouse classical liberal views, believe in liberty and free enterprise, or are interested in increasing the accountability of regulators to the American public (for example, the American Enterprise Institute, the Heritage Foundation, or Citizens for a Sound Economy) are invariably slapped with a label of "conservative," "pro-business," or in the case of the National Federation of Independent Businesses, "devotedly loyal to the Republican Party." (Cato is always referred to as libertarian.) Yet, pro-regulatory groups who lobby for ever-greater state control over people's lives, such as Public Citizen, the Natural Resources Defense Council, etc., are never burdened with a corresponding adjective. In fact, while the "conservative" adjective is applied unflinchingly to organizations to the right of center, I can recall only a few uses of the word "liberal" in the book.

Of course, this is consistent with what veteran CBS News correspondent Bernard Goldberg observes in his best-selling 2001 book, *Bias*, but it is disappointing nonethe-

less in a book that attempts to present a balanced picture of the political process.

This slant is particularly evident in the third chapter on special interests. While ergonomics is certainly a noteworthy case study, the chapter is likely to give uninitiated readers the impression that "special interests" appear mainly on the side of business at the expense of consumers and average Americans. While it does talk about the counter-efforts of organized labor on the

ergonomics issue, it portrays unions to be David to the business community's "powerful, well-bankrolled" Goliath.

It also examines EPA's decision to force General Electric Corp. to dredge the Hudson River for PCBs. The focus is,

again, on GE's lobbying efforts, with much less on those of pro-dredging groups, even though the latter overwhelmed the former (and ultimately succeeded in swaying EPA policy).

Indeed, the 40-page chapter on special interests devotes only two paragraphs to the power of so-called public interest groups, and even there leaves the impression that, unlike their "business" counterparts who are "paid handsomely," nonprofits are "operating on a shoestring." The assumption seems to be that anyone who supports restrictions on the power of regulators must represent business interests and be motivated by profit. Yet, organizations that want to expand regulators' power to restrict individual freedoms are presumed unquestioningly to be motivated by altruistic public interests. This inconsistency is exemplified in a comment about the efforts of Rep. Joseph Knollenberg (R-Mich.) to eliminate the Department of Energy's regulations requiring low-flow toilets. Because toilet manufacturers supported the efficiency standards, his motives could not be attributed to business lobbying. But rather than recognize that opposition to regulation could be in the public interest, the book labels his motivations as "pure self-interest."

The thesis of the chapter's section entitled "Congress is a Special Interest" is illustrated with a 1997 column on now-retired Sen. Fred Thompson's (R-Tenn.) regulatory reform initiatives, which interfered with regulators' plans. Members of Congress certainly respond to

constituents' special interests through oversight hearings and letters to agencies. However, this example appears not to appreciate the legitimacy of Congress' constitutional authority to legislate and its responsibility to guide the regulatory process through legislation.

**Conclusion** Despite those weaknesses, the book would provide a good introduction to regulation for an undergraduate political science course or a supplement to a more scholarly/academic treatment. Instructors would probably want to supplement it with background on the constitutionally determined roles of the three branches of government and on the economics of regula-

tion, but it provides a good background on the rulemaking process and the different players involved, and adds color to an otherwise dull topic.

The regulatory leviathan continues to grow, and crises like the ones discussed in the last chapter will add fuel to its expansion. While regulation may seem like an arcane topic of study, its influence can be felt in every aspect of our lives. It is important for Americans outside the Beltway to understand the scope of regulations, how they are made, and what their consequences are. Cindy Skrzycki's perceptive and amusing new book will help bring this esoteric aspect of American politics within the grasp of lay readers. **R**

growth and content of federal ethics regulation over the past four decades. (To Mackenzie's credit, those chapters are not nearly as boring as they sound). The rest of the book assesses the costs and benefits of the policies and sets out lessons learned, including a call for reform.

**Data** Mackenzie does not offer much data to assess the consequences of ethics policies. Ethics watchdogs keep thousands of financial disclosure forms on file but they throw them out after six years, which protects the privacy of individuals but denies the author and other researchers time-series data. Instead, Mackenzie measures the integrity of public officials by counting indictments and convictions by the Department of Justice. Such legal actions have increased, but the author believes the increase reflects a change in reporting requirements rather than additional corruption.

Of course, there are other measures of public trust in government. The famous time-series data collected biennially by the National Election Studies group at the University of Michigan provide a long and consistent measure of public confidence in the federal government. Mackenzie evokes but does not much exploit the Michigan data, which is a shame because the public trust measure varies—it mostly goes down with the notable exceptions of Reagan's first term and Clinton's second.

Mackenzie has data about policy inputs in ethics regulation (for example, the number of forms filed and so on). Did they affect public trust? A multivariable regression might have yielded some insights here.

One criticism that can definitely be leveled against *Scandal Proof* is that Mackenzie should be more careful about asserting causality.

Closer attention to the public trust series might have dissuaded him from baldly asserting that ethics policies have led to a steady decline in public trust in government. Indeed, public trust actually rose from 1980 to 1984 in the wake of passage of the 1978 law.

Mackenzie also asserts that the era of increased ethics regulation has seen a

## Searching for the Beneficiaries of Government Ethics Laws

Reviewed by John Samples

### SCANDAL PROOF: Do Ethics Laws Make Government Ethical?

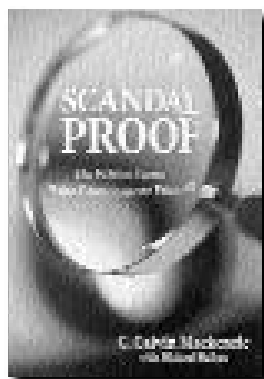
by G. Calvin Mackenzie with Michael Hafken  
196 pp., Washington, D.C.: The Brookings Institution Press, 2002.

When proposing the legislation that would later become the Ethics in Government Act of 1978, President Jimmy Carter said the measure would assure the American people that "their government is devoted exclusively to the public interest" by creating "far-reaching safeguards against conflicts of interest and abuse of the public trust by government officials." Whether that claim proved right is the subject of *Scandal Proof* by G. Calvin Mackenzie. The book examines the 1978 law and previous regulations governing the conduct of executive branch officials, and concludes that federal ethics policies have failed to realize their stated aspirations. In recounting that fail-

ure, the author adumbrates a different, more interesting story about federal ethics policies.

The book's main story about ethics regulation fits well into the genre called "public interest theory of regulation." The genre assumes that government regulation aims at solving public problems caused by market or political failures, thereby maximizing some larger public value like the general welfare. True to public interest theory, Mackenzie claims that, in passing the 1978 law, "we undertook new ethics policies to raise the level of public integrity in government and to enhance public faith and confidence in that integrity."

Mackenzie's story about the public interest and ethics policies has several parts. The initial chapters provide a general overview of politics and corruption prior to 1961 when President John F. Kennedy initiated the modern era of ethics regulation of federal officials. The middle two chapters examine the



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steady decline in voter turnout among adults. Yet, as Samuel Popkin and Michael MacDonald demonstrated in their 2002 *American Political Science Review* article “The Myth of the Vanishing Voter,” the turnout of eligible voters (the voting-age population less those not eligible to vote) has remained flat following a steep decline between 1972 and 1974.

*Scandal Proof* offers somewhat better evidence on the costs of ethics policy. Mackenzie believes ethics regulations have made it much harder to staff new administrations, a point supported by the testimony of several (mostly Republican) former executive branch officials. He also offers reliable numbers about the increasing delays in staffing executive branch positions.

The author draws up a balance sheet on ethics rules and concludes that we should deregulate the conduct of executive branch officials both because of the costs involved in adhering to the rules and the lack of evidence that a real problem ever existed with bureaucratic ethics. Thus ends Mackenzie’s main story about ethics regulation, a tale of policy gone wrong by accident.

**Public choice** But was there an accident, and did the ethics regulations fail to achieve their intended purpose? Mackenzie’s evidence does not really fit public interest theory of regulation no matter how many times he claims that it should. Hence, the author is forced to offer another story — one of partisan and political finagling that properly belongs in the genre of public choice theory of regulation.

To understand the public choice story in these pages, we might recall the assertion that “we undertook new ethics policies to raise the level of public integrity in government and to enhance public faith and confidence in that integrity.” In fact, “we” undertook nothing — several presidents and Congress assembled and enacted the ethics regulations. Unusually large partisan majorities controlled the 95th Congress that enacted the 1978 law: Democrats made up 60 percent of the Senate and 67 percent of the House, a fact absent from *Scandal Proof*. Of

course, those presidents and that Congress assured everyone that the new policies aimed at restoring public faith or some version of public interest.

Yet Mackenzie shows in devastating detail that the ethics policies fell most heavily on business executives who would be likely candidates to serve in Republican administrations. Those executives were the wealthiest of potential appointees and most likely to be affected by conflict-of-interest regulations —

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### The author is forced to offer a story of partisanship and political finagling that belongs in the genre of public choice.

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regardless of whether they were truly susceptible to favor-buying. Mackenzie understands the partisan purposes behind the policies: “The congressional majorities of the time were increasingly liberal and often little sympathetic to the consequences of these rules for business executives.”

When Reagan sought appointees in 1981, he found qualified people who were unwilling to be nominated. Mackenzie remarks, “These recruiting difficulties caused few tears to be shed by the Democrats who controlled the Congresses that created many of the ethics regulations that so nettled the Reagan personnel recruiters.” Even if a nominee agreed to go forward, the Reaganites found the new ethics regulations prolonged the process from weeks to months and required “significant alterations in their personal finances.” The author notes that ethics regulations are especially effective in taking away momentum from a newly elected administration.

*Scandal Proof* uncovers other facts contrary to public interest theory. If the federal government enacted ethics laws to deal with a decline in public trust, the policies should have followed the problem. Yet he shows that Kennedy and Johnson decreed important elements in federal ethics regulation even as public confidence in government hit its zenith. The 1978 law does follow more than a decade of falling confidence, but ethics regulations did not suddenly spring to

life in response to falls in public confidence. That anomaly might have suggested that ethics laws might have some purpose other than restoring public faith in government.

The book’s non-partisan perspective weakens its analysis in other ways. Mackenzie collects data about indictments and convictions of federal officials from 1970 to 1999 as a way to measure the integrity of executive branch officials. He notices that both have risen

but concludes the increase reflects a change in reporting the data. If we take that change into account, however, his chart should still be of interest for reasons that escape the author. After the change in reporting in 1983,

indictments of federal officials rose steadily, peaking in 1992 and then declining until 1999. Indictments and convictions rose during Republican administrations and fell during the Clinton era. Perhaps federal officials appointed by Republicans are more corrupt than their counterparts in the Clinton administration. An alternative conjecture is that the merit system employees in the Public Integrity section of the Department of Justice are committed liberal Democrats who try harder to indict and convict Republican officials. My guess may be wrong, but the correspondence between partisan change and rising (or falling) indictment rates should have set off alarms with a political scientist.

Of course, a public choice analysis of ethics regulations focusing on partisanship would have to answer some difficult questions. If Democrats enacted ethics regulations to wound incoming Republican presidents, why are George W. Bush and the new Republican Senate and House not trying to repeal those rules? Perhaps they have not had enough time. Perhaps they are not willing to pay the price of ending the regulations. More likely, the Republicans wish to use ethics regulations against the next Democratic president.

Given all this, it makes little sense for Mackenzie to call for regulatory reform in ethics regulation. As Sam Peltzman has long argued, deregulation comes about only when technological or other changes

exhaust the rents created by a regulation. We have little or no evidence that the rents associated with ethics regulation are anywhere near exhausted. To the contrary, the political benefits of ethics regulation may have increased if the Republicans now see the value of such laws in harassing the next Democratic president.

**Conclusion** *Scandal Proof* is well written and admirably free of obscurity. Most readers will welcome the author's generally sober tone on a topic that often evokes more heat than light. That said, Mackenzie sometimes falls short of his own standards. Although he believes we have no "common definition of corruption," he nonetheless attaches the adjective "corrupt" to legal campaign contributions and a "faith in free enterprise." (The millions of Americans who share that faith will be surprised to find they are corrupt). Worst of all, he indulges in a two-page rant about the "ethics sewer" created by the "fetid campaign finance system" that permits "legal bribery." Mackenzie adds nothing to our understanding of campaign finance regulation and apparently knows little about the vast literature on the question of the influence of campaign contributions (and other questions whose answers he takes for granted). Those two pages are embarrassing for the author but fortunately relatively rare in this book.

I take the following lessons from the evidence adduced in *Scandal Proof*. First, Americans should be skeptical of any regulation seeking to improve the ethics of anyone, not least of which are laws purporting to improve public confidence in government. They will have little to do with ethics and much to do with the political advantage of the lawmakers who pass them. Second, it makes little sense to write as if a law is aimed at the public interest when evidence clearly shows it sought narrow partisan goals. Why not self-consciously tell the whole story of ethics regulation? Yes, the writers of ethics regulation evoked public trust in government when they unveiled their creations, but the laws themselves served private agendas. Why not simply say what this book demonstrates: Ethics regulations are mostly corrupt efforts to end political corruption **R**

# Taming the Environment

Reviewed by Richard L. Gordon

## POLICY INSTRUMENTS FOR ENVIRONMENTAL AND NATURAL RESOURCE MANAGEMENT

By Thomas Sterner.

504 pp., Washington D. C.: Resources for the Future, 2003

Books and papers on the environment largely fall into a few standard patterns — typically theorizing or explaining whether science, cost-benefit analysis, or aesthetic concerns favor a certain policy alternative. However, Thomas Sterner's new book *Policy Instruments for Environmental and Natural Resource Management* departs from more familiar modes to deal systematically and broadly with the theory and practice of controlling pollution and natural-resource problems. The study seeks to guide policymakers in designing the implementation of environmental policy.

Environmental economists almost universally agree that, as the economic theory of politics warns, adoption of optimal solutions is unlikely to occur. The great divide arises over the urgency of action. Many lawmakers and regulators see so great an exigency that they support action despite the drawbacks. Others warn of the perils of overreaction. Sterner's book is a joint venture of Resources for the Future, the World Bank, and the Swedish International Development Cooperation Agency; as might be expected from this sponsorship, Sterner stresses acting.

The exposition is split fairly evenly between review of concepts of efficient resource utilization control and reviews of implementation practice. His treatment is further divided into seven parts. The three conceptual sections treat reasons for inter-

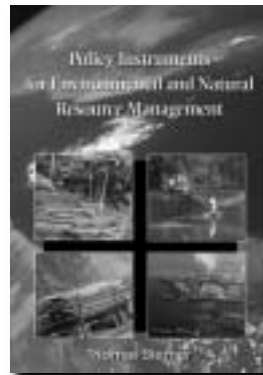
vention, the theoretic basis for alternative control methods, and the problems of selecting policies. The practice sections deal with examples in three areas — transportation, industry, and natural resources and ecosystems. Natural resources, in turn, consist of water, waste, fisheries, agriculture, and forestry. The final section tries to tie the material together.

The background section nicely summarizes much of the relevant material such as economic theories about market failure and the problems of correction, the need for property rights, the implications for environmental policies, and economic theories of fisheries, forestry, and exhaustible resources. Sterner's choices are sound and the presentation nicely conveys the essentials. My sole

complaint is that he leaves tacit a key Coase proposition about social costs: It is not their existence but their widespread impact, technically known as comprising a public good, that is relevant. Sterner separates his discussion of social costs and public goods and, in the latter, makes suggestions of the connection that seem too vague.

Similarly, his policy-measure section nicely summarizes the options. He starts with a general comparison between charges and performance standards and then moves to tradable permits, taxes, subsidies, policies involving abatement refunds, the role of better property-right assignment and legal liability in solving problems, voluntary compliance, and information dissemination. This nicely indicates the variety of options available. However, this scope is more familiar than Sterner indicates.

The effort to treat choice among instruments covers much territory and bravely tries to overcome insurmountable difficulties. The author begins with the classic case for market-based controls and moves on to the difficulties of dealing with differences in the pollution from various sources. He turns to analy-



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sis derived from the classic advanced environmental theory text by William Baumol and Wallace Oates. This shows which policy is preferable given the most likely type of information deficiency. As did the original work, Sterner's presentation fails to add that multiple knowledge defects may occur and the policy-makers may not even know exactly what the errors are.

The author turns to numerous more straightforward issues. These include what underlying conditions determine the mix between abatement and reduced activity, the limitation of claims that pollution taxes displace less desirable taxes, the problem of pollution by monopolies, the sharing of costs between "polluters and society," income-distribution effects, reflections on the effect of political influences on policy choice, and the problems of international policymaking. Cramping so much material into the allotted space necessarily can only produce a start at recognizing the problems; however, it is a very good beginning.

Despite the radical differences in their scope, the applications sections are similar in length and thus differ drastically in depth. The transportation section focuses on control of general pollution impacts but also has a treatment of the elimination of lead from gasoline. This is fuller coverage than possible for the other areas. The industrial section is divided between industrialized and developing countries. Both the industrial country chapter and the developing countries chapter treat a variety of programs in various countries.

The natural resource and ecosystem section is still more diffuse. Sterner presents a single chapter on each of the six complex areas treated. The results necessarily are problematic. The discussions, except for fisheries, jump among pollution, the effects of inadequate assignment of property rights, and problems of managing common resources. In short, by broadening the scope without a parallel increase in length, Sterner produces radically different degrees of coverage.

**Broad overview** Throughout, the author tries to attain simplicity. Sterner does

present calculus-based derivations of major results, but with a few exceptions relegates those to sidebars. He relies on geometry to convey his main points. Thus, the book is reasonably accessible to those comfortable with basic economic principles and even to those without much background.

In any event, he has fully surveyed the economics of environmental pollution control and given a broad sample of applications. As suggested at the outset, this provides a viewpoint absent from the literature. Sterner has well traced why to regulate, the regulatory options available, their merits and defects, and the issues of implementation. Given the vast area covered, he only samples practice. This is a valuable guide to the problems of imple-

menting environmental policy.

As previously suggested, two problems with the book arise. The first is inherent: The topics included are germane but cannot all be adequately covered in the allotted space of almost 450 pages of exposition. To be sure, full treatment probably would be as long as an *Encyclopedia Britannica*.

The second problem is a lack of concern about the wisdom of various policies. Another cost of the scope is neglect of criticisms of various initiatives. To be sure, the wisdom of the controls is not Sterner's concern. However, his choice of examples at times ignores the controversies about objectives. In the worst example, his treatment of Superfund ignores concerns that the dangers of toxic wastes were exaggerated. **R**

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## California's Energy Blight

*Reviewed by Richard L. Gordon*

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### THE CALIFORNIA ELECTRICITY CRISIS

by James L. Sweeney

292 pp., Stanford, Calif.: The Hoover Institution, 2002

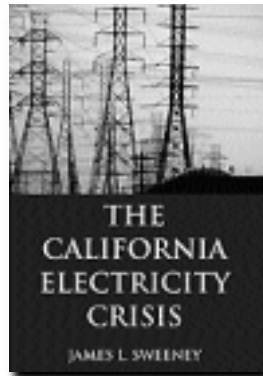
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**I**n *The California Electricity Crisis*, author James L. Sweeney has produced the most comprehensive study to date of the headline-grabbing event of the winter of 2000-2001. Sweeney is a Stanford professor who has long headed its program in energy economics; hence, he is well qualified to write the study. The results do not disappoint.

The heart of the book consists of three chapters extensively describing the various phases of the crisis. First is a critical review of California's restructuring of its electricity market earlier in the decade. The next chapter analyzes the emergence of the crisis. The third chapter examines the resulting crisis of electricity problems. A chapter follows on the consequences, especially the debts incurred by the state. Sweeney

then concludes with his proposals for improved market regulation.

The book stresses that the crux of the crisis was California Gov. Gray Davis's refusal to allow retailers to raise their electricity rates to recover the costs of a surge in wholesale prices. Futile efforts to stop the wholesale rises were followed by the state incurring massive debts to purchase electricity. The publicly financed purchases were necessary because, with unchanged rates, privately held electricity retailers could not pay for the power demanded by customers. Sweeney's conclusion is familiar to those aware of the crisis. His contribution is the fullest treatment yet of the details.



**Antecedents** The book's second chapter, which examines the state's restructuring of its electricity market, opens with a description of the organization of electricity supply in California and sketches the classic reasons for why electric utilities were vertically integrated local monopolies. The chapter then notes the



federal legislation encouraging independent generation and describes the problems — notably cost overruns on nuclear plants and extensive contracts to buy power at prices far greater than justified by actual fuel costs — that created the movement for change.

Sweeney correctly argues that the pressures to restructure were based on unrealistic expectations about how much cost reduction was feasible. He stresses the inherent cost problems faced by California utilities: high oil prices, the expensive infrastructure costs for introducing coal-fired generation, and difficulties of nuclear-plant siting.

Unfortunately, Sweeney neglects to mention the aggravating effects of public policy. The cost of California nuclear plants was made much higher by excessive solicitude towards interveners. While coal was expensive, the utilities had previously resorted to transmitting coal-fired (and nuclear) power from the Mountain states and had at least three thwarted plans to develop other plants. Intrastate coal capacity was proposed and rejected by the Energy Commission. Sweeney nicely presents an excellent treatment of the stranded-cost debate and sketches the interest in retail competition.

The remainder of the chapter describes the resulting effort by the state of California to design a restructuring process. This starts with the proposals of the California Public Utility Commission and proceeds to detailed review of the key features of the restructuring. Those features include guarantees of stranded-cost recovery, creation of a power exchange and an independent system operator, divestiture of fossil-fueled capacity within California, bans on long-term contracts for electricity, and efforts to stimulate retail competition.

Sweeney believes that the separation of the power exchange from the system operator created coordination problems and the need for arbitrageurs that could have been avoided by a unified organization. This view is presented before his valuable discussion of how the exchange and system operator worked — an arrangement that made it difficult for the operator to adapt to discrepancies between expectations and actual conditions. Sweeney also nicely

discusses the harm from a ban on contracting. His summary view is that the restructuring had potential for improving investment decision-making but was overly driven by unrealistic expectations of cost reductions.

**The crisis** Sweeney, in the third chapter, turns his attention to the emergence of the crisis during the fall of 2000. Treatment begins with the implementation of the new structure and places California in the context of Western power supply. Review of emerging trends in electricity demand and supply ensues. The initial surges in wholesale prices are then treated, and an evaluation of the causes follows. Then the effort to impose controls on wholesale prices of electricity is shown. The financial impact is reviewed and the inadequacy of policy response to wholesale price problems is observed.

All this is helpful in providing understanding, but the review of causes is the key contribution. Sweeney starts by noting that the effect of a tightening demand-supply balance is to force California to increasingly draw on high-cost plants that otherwise would have stayed idle. Retail-price rigidity aggravated the problem. Rising natural-gas prices and environmental restrictions on plant utilization added to the pressures. The author deals cautiously with charges of market manipulation, concluding that evidence is lacking of profitable opportunities to restrict output. His treatment of wholesale price controls stresses the resulting inability to compete for power with other states.

Sweeney turns to the resulting financial pressures on the utilities and the refusal of the state to provide relief. This concludes with documentation that Gov. Davis did not want a market solution to the crisis; instead, he preferred the command-and-control alternative of a price-lowering mandate from the Federal Energy Regulatory Commission.

The author distinguishes an underlying electricity crisis and the financial predicament generated by preventing a market response to the electricity crisis. The latter aggravated the former. Development begins with a sketch of the rise and fall of rates and the resulting unwill-

ingness to sell to the existing utilities. He then notes that as the Department of Water Resources became the main buyer, its monopsony power became a key influence. Sweeney turns to reasons why the outages of plants were explicable by maintenance requirements. He then reviews how new capacity and conservation measures contributed to relief. That is followed by examination of the role of blackouts, and a review of the retailers' financial plight and the state's failure to provide rate relief.

The alternative of buying by the state is the next topic. Sweeney nicely points out the economic error involved: For no good reason, debts are incurred to shelter consumers from rising energy costs, but those same consumers are liable for the debts. Whatever financing method is adopted will be more painful than absorbing the costs when consuming the electricity.

The remainder of the chapter reviews the patchwork of actions taken by the state and FERC to tinker with the difficulties. This begins with a review of Gov. Davis's demagogic statements, and ends with citation of what Sweeney calls "one of the most offensive statements imaginable" — the California Attorney General's indication that he hoped to put Enron chairman Kenneth Lay in a jail cell where his cellmate would rape him.

After those preliminaries, actual actions first by the state and then by FERC are reviewed. This amounts to a succession of problematic measures that failed to deal fully with the inherent problems.

Chapter Five treats the legacies of continued financial problems of Pacific Gas and Electric, the debts the state incurred, and the bad contracts with which it is stuck. On the legacy, Sweeney validly observes, "Although the electricity crisis itself was a short-term event, the policy actions — or inactions — during the challenge period and the crisis have left a continuing harmful legacy that threatens to remain for years or even decades to come."

**Proposals** To this point, Sweeney has presented a vivid picture of government failure. Given this and The Hoover Institution aegis, a scathing attack on California officials' pretenses of knowl-

edge would be a natural approach. Sweeney, however, only provides a mélange of timid “policy” proposals.

He gets off on the wrong foot by calling for more information about one of the most transparent markets extant. Sweeney neither specifies what is needed nor why. He then notes, apparently favorably, the FERC proposal for regional transmission organizations.

After endorsing Harvard professor William Hogan’s principles of organization, he critically reviews the California independent system operator’s proposals. Sweeney then turns to proposing better pricing, including continuous variation of prices at least to large customers (real-time pricing). In between, he advocates more gas pipelines, electricity transmission lines, and terrorism countermeasures. Removal of disincentives to capacity addition is proposed. He turns to the virtues and limits of private con-

tracts, and then ends with his strongest point: California must develop a sounder approach to dealing with the debts that it incurred in the 2000-2001 crisis.

Sweeney’s concluding chapter strongly stresses that defective regulation rather than deregulation was the culprit in the California crisis. However, he argues that it was the execution rather than the concept of forced restructuring that was the problem. He mentions success elsewhere. Reason exists to characterize those successes as limited. In short, Sweeney is overly timid in implementing his recognition of the pernicious effect of regulation. I have argued since 1980 that only massive deregulation will work. In my 2001 *Cato Journal* paper “Don’t Restructure Electricity: Deregulate,” which was drafted while the California restructuring was under discussion but not published until the crisis emerged, I noted that the inher-

ent defects of regulation guaranteed inefficient restructuring.

Sweeney also neglects my further warning that renegotiation is the standard response to bad contracts. Jerry Taylor and Peter VanDoren’s *Cato Policy Analysis* “California’s Electricity Crisis: What’s Going On, Who’s to Blame, and What to Do” applied such an argument to California. Sweeney ignores renegotiation in his treatment of the contract legacy and, in his policy proposals, treats the benefits of contracts also without recognizing the pressures to renegotiate.

However, the book attains its goal of clearly and completely conveying the California energy crisis. This is the book to read to understand what happened and why. Moreover, the Sweeney study is an Internet-age product; the book, a draft version, and five papers by other participants in a 2001 conference on the draft are all downloadable at [www.hoover.org](http://www.hoover.org). **R**

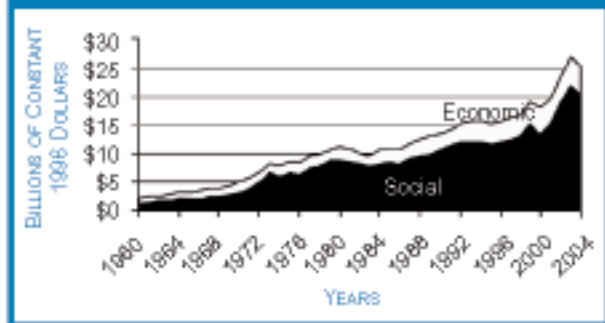
## REGULATORY SPENDING SOARS:

AN ANALYSIS OF THE U.S. BUDGET FOR 2003 AND 2004

By the end of FY 2003, over \$30 billion of your tax dollars will be spent to write, administer, and enforce the regulations of the U.S. government. Federal spending on regulatory activities is at an all-time high, and reflects a more than 13 percent increase over FY 2002. The bureaucracy required to maintain this regulatory machine will reach over 195,000 full-time people in 2003, an almost 50 percent increase over 2002.

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Costs of Administering Federal Regulation



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