

Are the Meek Ever Blessed in Regulation? Can Moderation Be Excellence?

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CAMPUT May 2, 2007

The past several decades in utility regulation have featured decidedly better reviews for change, rather than consistency on the part of the regulator. Admittedly, this is in keeping with what has been a fairly widespread alteration of the regulatory frameworks associated with the regulation of utilities in North America, and throughout much of the developed world. Competitive market forces have been put forward as capable of creating the optimum conditions for furthering the public and consumer interests in the delivery of important public services such as telecommunications, energy, and transportation. Concurrently, performance based regulation, sometimes cited as providing a bridge to a competitive end state, and has enjoyed a surge in popularity as a preferred rate setting technique. I have no real quarrel with the consideration of such models as potential tools in the regulatory toolbox. Where more effective ways can be devised to reach the desired objectives, they should be adopted. I do, however have some reservations about the retailing of these changes in the general currency of public debate and the subsequent assessment of their effectiveness.

Many of the proponents of change have taken to describing the regulatory reform process in terms that are decidedly different that those found in most economic textbooks. Sometimes the language is more reminiscent of lines of dialogue from the old Steve Reeves Hercules and gladiator movie of the 1960s. For example, one such analyst noted recently in relation to regulation of the Internet:

The little guy in the USA needs to compete successfully in the global marketplace, unfettered by chains and shackles of regulation. Throughout history, average people made this country great -- and always will -- thanks to a principle called freedom¹

The context of the remarks were somewhat more mundane, of course - whether internet facilities providers should be compelled to give equal

¹ <http://pulverblog.pulver.com/archives/004400.html>

access to content providers competing with their own content based products. But the themes touched upon by the writer, which seek to place the non-interventionist position in industry governance on the side of the angels, or, as we heard yesterday, on the winning side of geopolitical developments, are common ones. Sometimes, this same fervor spills into the governing rules themselves. In telecommunications, we have seen a Directive on regulating issued to the CRTC, by the Cabinet this year that seems to model, in part, its imperative language on regulating (“strive to the maximum extent possible etc”) on Red Guard slogans from the Chinese Cultural Revolution of the 1960’s. The messianic lilt to the rhetoric both within and without the hearing room presents a case for choices associated with regulatory framework design that obfuscates more worldly purposes. As former US President Harry Truman was fond of saying, “If you see your neighbour praying too loudly in church, better go home and lock your smokehouse”.

In our view, regulators must resist the temptation to be uncritical apostles, when the deregulatory or reform revival tent hits town. Uneconomic regulation is, of course, a burden to both the utility and the customers. However, too many of the current efforts are faith based initiatives. There is rarely any rigor in the regulatory analysis that attempts to redesign regulatory formats by comparison to the status quo, and little attempt to quantify costs and resultant benefits.

To return to my theme that moderation is a much overlooked virtue in regulation, I would argue that effective regulation and, in particular, effective change can only come about when there is subsequent monitoring and empirical measurement of the effect of any regulatory function or change. As well, if the ability to effect remedial action has been disabled or insufficient safeguards are implemented, the intent of using new systems or frameworks to accomplish statutory goals is effectively subverted.

Remarkably in many regulated industries, airlines in Canada being a cautionary tale, the regulator becomes disinterested with the effects of the revolutionary change that has been wrought. The regulator’s phonograph needle becomes permanently stuck in a groove that repeats that as it is no longer involved with regulation, it has no ability, or interest to study consumer issues formerly determined by regulation. Boldness here looks rather more like recklessness, or at least indifference to the results that the boldness has produced.

While the airline example is admittedly relatively extreme, a kind of default to regulatory abstinence that implicitly favours the utility stakeholder frequently creeps into the language of similar "bold reform" in other regulated industries. When we hear expressions like "Imperfect competition is better than imperfect regulation", as we now hear in telecommunications, we know who will be bearing the burden of the imperfection of the competition. When we hear in performance based regulation that safeguards like earnings sharing dulls the utility appetite for efficiency, we know who will be providing the whetstone upon which the appetite may be sharpened. And when we hear that any return to previous practices of regulation that were the norm before bold reforms were commenced should be avoided at all costs to avoid upsetting the financial markets, we can guess who is supposed to be the shock absorber that insulates the utility shareholder from the bad news that their new streams of revenue are proving exorbitant.

It is true that stasis is not necessarily moderation particular where external change is occurring. But the boldness I see in regulatory reform or industry restructuring is too often accompanied by changes in the levers of regulation that provide for scrutiny and achieving fairness and reasonableness in utility operation.

Is the Regulator A Player or a Decider?

Regulators face increased pressure to determine issues that are not simply monetary disputes, but also seek to establish the conditions that will obtain for a larger group of public interest stakeholders. There is a temptation for the regulator to turn inward, and to doubt the wisdom of the truth seeking procedures historically employed to determine whether a particular utility expenditure has been prudent. It seems easier or even more practical to have the regulator act as a kind of benevolent potentate seeking the wisdom of subjects throughout his kingdom before retiring to rule on the issues with the help of trusted advisers. And sometimes it works. The most successful regulatory device of the last 10 years, the generic formula based ROE was initially imposed by fiat by the Ontario regulator the OEB, for example.

But the seductiveness of this approach as a potential standard operating procedure, gift wraps a more troublesome trap for the regulator than the alternative of refereeing contentious and seemingly interminable adversarial policy proceedings. Once the regulator has empowered itself as a kind of public interest king/sheriff of the utility fiefdom, it is difficult to regain the

mantle of adjudicator of disputes. This is particularly the case when the king/sheriff's own judgment is questioned. It sets up the unreasonable scenario where the regulator is playing multiple roles, and its reputation is staked out in support of its own actions as a policy player, litigant, adviser, advocate, judge and enforcer.

In addition, it creates much more possibility of industry capture in a policy environment where there may be few ways to gainsay the collegial interventions of the regulated industry. Informality without process usually works to the disadvantage of the least resourced players. A winnowing of the formal adjudication process inevitably means an increase in the influence of the regulated industries.

In surveying important utilities or public service industries, it is instructive to note that some of the least consumer friendly industries, transportation and financial services for example, have minimal transparency in governance, and few mechanisms to engage the public or consumer interest in policymaking.

Conclusion

While the meek don't seem to inherit the plaudits, let alone the earth, at least we don't have to clean up after them. We would also accept these clean up chores more readily if there were reliable measures in place to assess what elements of the efforts of the bold are failing to deliver on their promises. As well, we would also be happier when there is a factual squabble that the regulator is available, and neutral to the means of effecting a clean up or fix in accordance with the statutory objectives of regulation.