Deregulate the Utilities

by Howard Baetjer Jr.

Government regulates utilities by granting them monopoly privileges, and then controlling their prices. I contend that such government intervention is wrong. It is unnecessary, inefficient, and in the final analysis, immoral. Utilities should be completely deregulated.

In particular, government should remove all its monopoly privileges and allow anyone to try to compete with existing utilities, in any market or location. Government should repeal the privileges it has conferred on various gas and electric companies, cable television companies, water companies, and so on. Let established firms try to expand into one another's territory; let new companies try to develop in any area.

At the same time, government should deregulate the pricing of utility goods and services. Presently, the rates or prices charged by most utilities are set by the political process, via public utility commissions. This practice should be abandoned. Utilities and their customers should be allowed to determine prices by voluntary agreement. Government should stop guaranteeing rates of return to the utilities, with no regard as to whether the companies are efficient or serve their customers well.

The first reason I offer for total deregulation is that utility regulation is unnecessary. It is based on the theory that utilities are "natural monopolies"—the sorts of industries in which monopolies naturally develop.

The theory holds that a natural monopoly will develop when, in a given market, there are great economies of scale. That is, fixed costs for machinery and equipment are very high—such as the cost of an electrical generating plant. At the same time, the marginal cost—the additional cost of producing one more unit—is very low. For more electricity, just turn up the generators a little. This means, according to the natural monopoly theory, that it is uneconomical for more than one firm to operate in a given market. Competition sooner or later will drive out all but one firm, leaving the consumer at its mercy.

The public policy response to this idea has been to establish monopolies by law, since they are inevitable anyway, and then regulate them "in the public interest." But natural monopoly theory is wrong. Hence the regulation based on it is just extra baggage burdening the economy.

Natural monopoly theory breaks down because it treats the world as fixed, unchanging, and mechanical. It assumes "a given market," isolated from other markets. But there are no isolated markets in the real world. All markets overlap and interact. At present, markets for electrical power in North America are expanding, despite regulation, with power being "wheeled" or transmitted over long distances. San Diego Gas and Electric Co., for example, has long term contracts to wheel in power from as far away as Oregon.[1]

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Another problem with natural monopoly theory is that it doesn't allow for changes in technology. In assuming that there are fixed costs for machinery and equipment, which any competitor will have to purchase, it fails to account for the development of new technology which will allow newcomers to compete successfully. High-voltage, direct current technology is revolutionizing electrical transmission, especially between separate operating systems. Some companies now generate competitively priced electricity using biomass, wood waste, and even garbage as fuel.[2] A rapidly increasing amount of electric power is produced not by utilities at all, but by private industries which generate power for their own use, and sell a surplus to other users. This process is known as cogeneration. As the technology develops, large-scale electrical utilities might possibly become obsolete, if regulation does not stifle the competitive process.

Economies of Scale?

Natural monopoly theory is also flawed in overstating the importance of economies of scale. There is no doubt that large industries, with scale economies and lower unit costs, can operate more efficiently than small ones, if other factors are equal. But there are many other factors, and they are rarely equal. An important factor is the efficiency that is spurred by the very existence of competition. University of Illinois professor Walter Primeaux has done extensive studies of the electrical power industry. He reasons that where competition exists, it "could lead to lower costs than a monopoly in any business by improving incentives to operate efficiently. Moreover, to the extent that inefficiency exists in a monopoly electric utility firm, the inefficiency may be so large as to overcome or offset any economies of scale gained from monopoly."[3]

According to a recent survey, there are 32 communities in the United States that have competing electrical utility companies.[4] Professor Primeaux compared 23 of these communities with others of similar size in the same states served by monopoly electrical utilities. The results are striking. Notwithstanding economy of scale advantages of the monopolies, communities with competing electric companies had average prices for residential sales that were 33 per cent lower.[5] Residents of towns served by two companies, such as Lubbock, Texas, consistently favor the better service resulting from competition. Though state regulatory commissions are usually hostile to competition, "residents who have a choice always vote for competition."[6]

The second reason for deregulating utilities is that deregulation fosters competition, which keeps prices down and quality up. The central problem is the restraint on entry—the granting of monopoly status, by law, to some politically favored businesses, keeping everybody else out. Regulated industries typically gain control of the rate-setting process and thus can award themselves "profits" regardless of their performance. Their customers, legally prevented from turning to other providers, must endure or do without. Thus the process of government regulation gets abused. The only dependable regulator for the public interest is the competitive market process.

Consider the experience of the airline industry. Under regulation, a few favored companies were protected from competition—granted legal monopolies or oligopolies on particular routes. Existing airlines influenced the Civil Aeronautics Board to maintain prices at a high level. Then came deregulation. Along came People Express, New York Air, and a rash of new services, especially in small, commuter airlines. Prices have tumbled, and the consumer has benefited.

Partial deregulation of the telecommunications utilities is having similar beneficial effects. Once AT&T's legal monopoly was ended after many decades, MCI, Sprint, Allnet and a host of other lower-cost competitors appeared. Cellular telephones, satellite communications, and fiber optics all are providing further choices with astonishing rapidity. This blessing of competition should be extended to all industries.

While these economic arguments are important, the most fundamental reason for deregulating utilities is the principle of free choice. In a good society, which prides itself on freedom, the government should protect free choice, not obstruct it. People who think they can provide electric power, telecommunications, television, gas, or any other good or service should be free to take a crack at it. What right does government have to obstruct their creative endeavors, thereby protecting the monopoly privileges of other people?

Consumers likewise should be free to reject the services of companies that are inefficient, expensive, or unresponsive to their needs, and patronize other companies that promise to serve them better. What right does government have to deny consumers a choice of utilities? Is it not absurd that such denial of choice is called regulation "in the public interest"?

Government regulation of utilities lacks a theoretical base, brings about higher costs and lower quality, and violates the principles of a free society. Government should deregulate the utilities, and let the competitive market process do the regulating, the cost-cutting, the improving of quality, and the innovating that characterize economic free choice wherever it exists. □

1. "Electrical Utilities Find Market Forces Taking More Important Role." *Wall Street Journal*, February 26, 1986.
2. Ibid.
3. Walter Primeaux, "Total Deregulation of Electrical Utilities: A Viable Policy Choice," *Unnatural Monopolies*, Robert W. Poole, ed. (Lexington Books, Lexington, Massachusetts, 1985) p. 128.
4. "Power Stations: Some Like Them Competitive," *Reason*, November, 1985, p. 18.
5. Primeaux, *op. cit.*, p. 136.
6. Jan Bellamy, "Two Utilities Are Better Than One," *Reason*, October, 1981, p. 28.

Lessons from Socialist Tanzania

by Sven Rydenfelt

Tanzania in eastern Africa became an independent nation in 1961, when it was known as Tanganyika. Its political leader Julius Nyerere, a confirmed socialist, was elected president in 1962. In his Inaugural Address to Parliament he declared:

"When we were in the midst of our struggle for independence, I promised that after we had won our freedom, we would try to achieve in ten years most of the things which our colonial rulers had failed to achieve during the whole of the time they had governed our country. Today I want to renew that promise . . . All of us have agreed that we must establish a true socialist society in Tanganyika."[1]

Of course, the President believed in his optimistic vision, and fully intended to realize it. Good intentions, however, are not enough. If you want to implement your vision, you have to start with a realistic blueprint. And, as experience later proved, Nyerere's socialist blueprint was a dream far removed from reality.

During its first years, Nyerere's government was occupied with transforming the country from a colonial area under British hegemony into a fully independent nation. Not until 1967 did the government feel strong enough to issue the Arusha Declaration, which implemented a comprehensive socialization program. All important industrial enterprises, including banks, insurance companies, export trade companies, and even most of the larger plantations, were placed under government control.

In Tanzania, however, the great majority of the population earned their livelihood as smallholders in scattered settlements. Of course, such a "primitive" agriculture had to be socialized, too. And so the Tanzanian government—following the Soviet model—decided to concentrate the multitude of small farms into large collectives called *ujamaa* villages.

President Nyerere was well aware of the importance of these small farmers. In a 1964 speech, he stated:

"Our future, in every respect, depends on our farmers more than on any other single group of citizens. They are the people responsible for using our one great national asset—our land. They constitute more than 90 per cent of our people."

Some months after the Arusha Declaration, President Nyerere published *Socialism and Rural Development,* in which he spelled out his agricultural program. Among his promises to the nation's small farmers, the following are significant:

- Respect for the individual.
- Voluntary migration into the collectives.
- The transition into collective production was to be effected gradually and quietly.
- The ultimate stage—a collective large-scale