

UTILITIES, POLITICS, AND CONSUMER WELL-BEING

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Consumers are increasingly concerned and confused about utility rate regulation. Increases in electric power rates, the breakup of AT&T, and so on, have given rise to a new wave of political activity by consumers and, subsequently, their political leaders. Indeed, this previously mundane matter of utility rate regulation has moved into the political limelight, for better or worse.

Although there is currently much discussion about fighting utility rate increases, the key consumer issue revolves around the ability of utilities to provide efficient (low-cost) service over the long-run. This paper shall briefly review some of the issues regarding electric power rates and the AT&T divestiture in light of the long-run interest of consumers; particular attention will be given to Illinois.

THE CONSUMER'S INTEREST

In a competitive market, prices tend to reflect the marginal cost of production. This implies that consumer well-being is maximized since the last dollar that consumers are willing to spend on a product equals the last dollar producers expend in producing the product. Thus, the demands of consumers are met by producers at the most economical cost (and price).

In a monopolistic market, prices may exceed marginal cost. Thus, producers may earn above-normal profits and consumers pay a price above production costs. For this reason, monopolies such as the OPEC oil cartel are adverse to the well-being of consumers.

In the case of utilities, prices are regulated by the government. It is in the consumer's interest that the regulated utility price reflects the marginal cost of production as in a competitive market. If utility rates are above the incremental cost of production, they will not reflect consumer demands. Thus, as in the case of a monopoly, the utility will earn excess profits and consumer well-being will be reduced.

The well-being of consumers will also not be served by rates that are below costs. In this case, shortages will eventually occur because an adequate incentive is not provided to meet consumer demands.

Although efficient prices (based on marginal production costs)

generally serve the consumer's interest, they may not ensure that low-income consumers have access to the product. Similarly, competitive prices for cars and foreign vacations are usually prohibitive for the poor.

To the extent that society wishes to ensure that low-income consumers have access to electric power, and telephone service there are several alternatives. The most efficient means of helping the poor is simply by redistributing income to them. Thus, they would have the ability to purchase the products of utilities if they choose to do so. Similarly, income could be transferred to the poor for the particular purpose of paying utility bills.

A less efficient means of helping the poor is to charge them rates below the marginal cost of production. This means that other utility users have to pay rates that exceed the marginal cost of production. To the extent that the tax on non-poor consumers is minimal, this may not be a problem. However, as the level of redistribution increases, the economic well-being of non-poor consumers will decline since they will be taxed to subsidize the poor. In addition, the subsequent higher utility rates will be adverse to industrial development, since business will generally be taxed as well. Also, if the rates to the poor are at very low levels, this will encourage waste.

CURRENT ISSUES

Two of the most important issues, at the present, in the utility arena are the AT&T breakup and power rate increases. The AT&T divestiture is the product of a suit brought against them in 1974 by the Department of Justice for restricting competition. In 1982, an agreement was reached between AT&T and the Department of Justice to divest AT&T of its 22 local Bell operating companies.

One of the economic reasons for the AT&T divestiture was that AT&T had been taxing long-distance users to subsidize local calls. It has been estimated that long-distance rates were 60 percent above the marginal cost of long-distance calls [3]. Thus, the concept of efficient pricing was being grossly violated.

With competition in the long-distance market, rates thus stand to fall quite a bit. However, consumers will pay an increased cost of making local calls. Consumers will have to pay for the demands they make on the system just as consumers pay for the demands they make on grocery stores, car dealers, and so on. Thus, the breakup of

AT&T is in the consumer's interest, since the end product will be more efficient prices.

Although the average consumer should gain from the AT&T breakup, consumers who infrequently make long-distance calls may be less well off, since they will have to pay more for local service. To a large extent, this is how it should be since there is little justification for redistributing from long-distance users to local users. In fact, data indicate that long-distance users are not necessarily richer than local users [3]. Thus, taxing long-distance users cannot be justified on the basis that they are economically better off.

Since 1940, the percent of families with telephones increased from 37 percent to 92 percent. Without the subsidy to local users, the number would have been 87 percent [3]. Thus, access to phone service in the United States would be almost universal without a subsidy. However, many are worried about a severe decline in access to phone service unless it is subsidized. At most, phone service would become unaffordable for some five percent of the population. To the extent that society would like to maintain service to this five percent, alternatives to a 60 percent tax on long-distance rates are available. In California, a four percent tax on long-distance calls is levied to help the poor pay their bills. Thus, a reduction in the long-distance tax does not mean that access to service has to decline.

The case of electric power is probably more complex. During the 1950s and 1960s, there was substantial gains in productivity in this industry [1]. The productivity advances thus put downward pressure on power rates. Between 1961 and 1965, power rates actually declined in the U.S. [1]. Thus, utilities rarely had to go to regulatory commissions for rate hike requests.

Also during this period, power rates tended to be based on the value of service rather than the marginal cost of service. Thus, power was not efficiently priced since some users of power paid either more or less than its marginal cost [1]. This was the case in Illinois in the past, although this practice (called cross-subsidization) is no longer permitted.

During the 1970s, the position of power companies changed dramatically. Productivity improvements declined; the price of energy increased dramatically; prices, in general, increased substantially; the economy declined; and so on. This brought about requests for higher rates so that costs could be covered. The issue is even more complex, since higher rates have been requested to pay for what

might turn out to be bad investments by power companies. In the private sector, prices automatically increased to reflect the higher costs of oil, housing, food, and so on. But, utilities cannot increase prices without government action.

In Illinois, consumers are very well aware of higher power rates. As in the case of telephone services, the consumer's well-being will best be served if power rates reflect marginal costs and are high enough to attract adequate capital into the industry. If rates are too low, the rate of investment in power will simply decline and consumers will subsequently experience a decline in service. This point has been overlooked in most debates on power. The reality is that normal rates of return on stock in power companies typical in the 1950s and 1960s, declined to subnormal returns during the 1970s. Thus, experts predict substantial shortages of power in the future because of inadequate investment now [1].

CURRENT POLITICS

As noted at the outset, utilities have become the grist for the political mill. In Illinois, most major office holders and would-be office holders seem to have taken a position on utilities. Their position is usually quite simple: keep the rates low.

Consumer groups are increasingly active in utility matters. One important group that has been established in Illinois this past year is the Citizens Utility Board (CUB). To date, this group has over 125,000 members and is permitted to solicit members and funds via the utility rate billing process.

This past year, CUB has opposed increases in power rates and is increasingly vocal on the AT&T breakup, CUB's position is quite simple, as well: keep the rates down and let the stockholders pay for bad decisions. Another major force is industry; and it is interesting to note that even though industry is the major power user in Illinois, they have generally supported rate increases.

To a large extent, citizen groups and politicians have very little appreciation for efficient utility prices. Politicians push for lower prices to win votes and consumers push for lower prices because they perceive they will be better off. Although it may seem somewhat ironic, business groups may be the most important political promoters

of the consumer's interest, since industry has to have efficient prices to compete successfully with firms elsewhere.

The experiences of many low-income countries have proven that when prices are the product of political pressures, the consumer ultimately is hurt. This is particularly true in the case of food in the developing world. Urban consumers demand low food prices and their political leaders respond by regulating food prices below what the market would determine. The problem that evolves is that farmers do not supply enough food because of the low prices. The by-products of this are food shortages and hunger.

One position is that politicians and interest groups should ensure that the government has the capacity to regulate utilities efficiently. In Illinois, the Illinois Commerce Commission (ICC) is charged with this task. Studies indicate that they have not had the staff to do the best possible job [2]. Thus, investments in ICC are quite important if utility rate regulation is to be efficient. Once again, the long-run interest of the consumer is not necessarily in lower prices, although this may seem to be an attractive option in the short-run.

REFERENCES

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EXAMINING ATTITUDES TOWARD CONSUMER ISSUES

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Often students, administrators, and the public assume that consumer education deals only with good buymanship. However, con-