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The Folklore of Deregulation (with Apologies to Thurman Arnold)

Richard D. Cudahy†

At the dawn of the new millennium, deregulation has spread like wildfire, unmindful of counsels of caution. A touching faith in competition as the universal solvent of economic ills has fostered all sorts of quaint and obscure beliefs. This Commentary traces these beliefs as they have grown and proliferated in telecommunications, the airlines, and electric power, so as to form a folklore of deregulation—a sort of mythology of the market.

This Commentary surveys the hallmarks of deregulation—peculiar phenomena like unbundling, the stranding of costs, and mergers on a gigantic scale. And it celebrates the army of middlemen sustained by the folklore of deregulation—marketers, publicists, advertisers, and the like—a new class dedicated to reinventing venerable industries as savvy competitors.

Introduction

In the early Sixties, the funnel cloud of deregulation drifted ominously out from the Chicago Midway, driving bureaucrats everywhere to the storm cellars. The time was then not far off when a regulatory agency that missed a new opportunity to promote competition in place of regulation would be promptly “sunsetted.” This was particularly true if the opportunity involved service that could be described as “innovative” or, better yet, as employing a “novel technology.” The “sunset” (rivaling the guillotine in terminal capacity) is the fate facing all regulatory agencies in the Age of Competition, sooner or later. But the sunset can be delayed, perhaps indefinitely, with the creative invocation of what I have chosen to call the folklore of deregulation. This is a set of convictions at the core of which is the love of competition for its own sake. This is the creed that honors the way of markets as the single source of progress and prosperity—not to mention virtue, wisdom, motherhood, and apple pie. Today, deregulation and competition occupy the very high ground. And they have won the invaluable prerogative of really treasured social goals: the right always to be referred to as “reforms.” Agencies embracing the folklore of deregulation will be tolerated—even loved—despite an embarrassing history of unseemly regulatory activity.

Over the centuries, “reform” has meant everything from the eight-hour workday to simplified spelling. In the very dim recesses of the past, the word “reform” was used to describe such things as the progressive income tax. Now that


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exquisitely painful exaction would never be mentioned as a reform. Instead the
flat tax is a "reform." Once public ownership was hailed as a "reform," but
certainly not lately. Now privatization has become a "reform." Years ago
planning was thought to be a "reform." Now it is merely a mark of unfaithfulness
to markets. Reform today means deregulation, competition, privatization, and the
unconstrained reign of the free market. Thus, a wonderful belief system has
emerged around the process of deregulation. This Commentary will explore the
various articles of faith that attach to the growth of competition as it expands into
the area formerly occupied by regulation. The curious origins and feverish
growth of the faith in deregulation will be examined in three very important
venues: telecommunications, airlines, and electric power. We will see that certain
endeavors—e.g., the unbundling of functions, the stranding of costs, the
passionate search for mergers, and the pervasive drumbeat of advertising—are
the indispensable ingredients of deregulation. Moreover, we will see that the
process of deregulation itself is legitimized by an army of consultants, marketers,
middlemen, and media people that give shape and meaning to the folklore of
deregulation.

I. Deregulation—History and Application

The history of deregulation, seen in perspective, is both short and
spectacular. Deregulation has spread like wildfire from the promising turf of
airlines and telecommunications to the thornier territory of electric power.

A. Long-Distance Telecommunications

More than thirty years ago, in a hearing room in Washington, the sleeping
giant of competition arose from his slumber, rubbed his eyes and roared; things
have never been the same since for what used to be called the "regulated
industries." The Washington caper involved the effort of an upstart firm,
Microwave Communications, Inc., to build a communications link between
Chicago and St. Louis.1 In order to do this, the newcomer—familiarly dubbed
MCI—had to secure the permission of a regulatory agency, the Federal
Communications Commission (FCC). In those days, the most difficult thing
about building a telephone line was certainly not stringing the wires. Rather it
was getting the authorization of the federal or state regulatory agency that
professed to have the wisdom to know how many lines there ought to be for any
particular service and who ought to build them.

In this case, the proposed line was to provide only "private line" service—
i.e., service to big companies that needed to have a line dedicated exclusively to

their use. MCI claimed that it could take care of these prime customers more cheaply and effectively than the incumbent operator, the American Telephone and Telegraph Company (AT&T). But even for this rather obscure fragment of the vast telephone network, the upstart, MCI, needed FCC approval to compete with the anointed provider of all long-distance telephone service in America, AT&T. This monster enterprise called itself the Bell System, claiming a clear line of descent from the inventor of the telephone himself. AT&T had only one major flaw: It was a monopoly. This meant that it had many enemies. Even those whom it served most faithfully could be stirred up to revile it by something as minor as a wrong number. Still, its most strident critics often called it “Ma Bell” in recognition of its warm but stifling embrace of all things telephonic. Ma Bell, though a monopolist, was once recognized for a few virtues, like not reducing its $9 dividend during the Great Depression. Now, however, in an era when many stocks no longer pay any dividends, even this has been forgotten.

At the FCC hearing, AT&T protested bitterly that the entry of MCI would disrupt the whole nurturing system of communications with which it had blanketed the country. Under AT&T’s benevolent regime, profitable service like private line offerings to big, rich companies had helped to subsidize expensive service to places like isolated Wyoming ranches or islands in the Great Lakes. All this was in pursuit of AT&T’s sacred public utility obligation to serve all who demanded service. If MCI, unburdened as it was with ranchers or islanders, could force rates lower for the private line customers, the unsubsidized Wyoming spreads could be impoverished by outrageous telephone bills or forced to rely on smoke signals or carrier pigeons for message service.

This would be a flagrant example of a particularly heinous regulatory offense—“cream skimming.” Cream skimming can occur when a new competitor is permitted to enter a market formerly served by a regulated monopoly like AT&T and to compete for the most profitable business. Without competition, AT&T could in its infinite wisdom charge all its customers what it thought they could afford to pay—and no more. AT&T was the Robin Hood of telephony, robbing the rich to give to the poor and leveling the playing field on which all communicated. And AT&T feared that MCI, the Sheriff of Nottingham as it were, would change all that. AT&T also felt that competition was wasteful and fostered that dread economic infirmity, the duplication of facilities—two lines where one would do. Further, AT&T feared that competition threatened to impair a rare and precious accomplishment of the Bell System—reliable service.

Little did AT&T know at the time that its defeat in the MCI proceeding would prove to be so crushing that within a few years all the arguments that it used against MCI would be banished from informed discourse and would in fact be an embarrassment to anyone claiming economic literacy. It would become
unfashionable for anyone to claim that the introduction of competition to an established regulated monopoly was anything short of wonderful and inspiring.  

In the MCI case, a majority of the FCC, having a bit of foresight, spurned the embrace of Ma Bell and gave MCI the right to build its competitive line from Chicago to St. Louis. Commissioner Nicholas Johnson, a progressive fellow and in the majority, said that he was looking "for ways to add a little salt and pepper of competition to the rather tasteless stew of regulatory protection that this Commission and Bell have cooked up." But the FCC dissenters did not go quietly. Chairman Hyde—true to first principles—declared in dissent that:

The decision of the majority is diametrically opposed to sound economics and regulatory principles. It likewise is designed to cost the average American ratepayer money to the immediate benefit of a few with special interests. . . . [T]he law is equally clear that the public interest is the test—that the agency should not authorize new service simply because it constitutes "competition."

Today, this embarrassing bit of outmoded thinking almost places Chairman Hyde in a class with exponents of alchemy or the divine right of kings.

While the FCC was pondering MCI's impertinence, it also addressed the application of a Mr. Carter to sell a "Carterphone," a neat sort of telephone receiver permitting direct communication over a two-way radio. The Carterphone was what the Bell people disdainfully called a "foreign attachment." This was a gadget not of Bell System manufacture which some intermeddler wanted to affix to the telephone network. These sinister attachments had been condemned without trial for many years on the grounds that their use might damage the network. Very conveniently, only devices made by Bell were thought to be compatible with the Bell network, so Bell's manufacturing subsidiary had the huge Bell market to itself. But in the case of the Carterphone, the FCC swallowed hard, approved the device, and opened the floodgates; in came waves of flimsy stuff built to be junked soon and quickly replaced with a new model, flushing out the old stuff that had been leased to customers by AT&T and built to be fully depreciated. Deregulation and competition embrace the true culture of

2. Back in 1973, I heard John deButts, then Chairman of the old AT&T, make a speech at a convention of state regulators in Seattle. See John D. deButts, The Time Is Now for the Communications Industry: Address Before the Eighty-Fifth Annual Convention of the National Association of Regulatory Utility Commissioners, 1973 NAT'L ASS'N REG. UTIL. COMMISSIONERS PROC. 285. To an audience packed with AT&T vice presidents, he declared that his company had fought to retain its monopoly status, but, now that competition had been ordained, AT&T was going to compete with the best of them. See id. at 287. Judging by its role as a defendant in a pack of antitrust suits, AT&T did compete in a muscular way and without excessive restraint until it mutated from regulated monopoly to telephonic free spirit.

3. Applications of Microwave Communications, Inc., 18 F.C.C.2d at 978.

4. Id. at 971.
consumerism—goods briefly used, quickly trashed, and promptly replaced. Innovation and waste are the two sides of the competitive coin.

In any event, out of a lowly foreign attachment and the MCI line to St. Louis came the destruction of the Bell System and its replacement by a new generation of communications behemoths, all frantically competing—when they weren’t merging.

B. Airlines

While telecommunications was only easing into deregulation one toe at a time, another industry, the airlines, jumped in with a great splash. Economic regulation of the airlines was always a bit suspect since it was originally undertaken for the frank benefit of the industry. In fact, there was not much of an industry in existence before 1938, when regulation began. Profitable operation before then had been very sporadic. The thought was that regulation could manage competition so as to keep the competitors out of bankruptcy. It was no coincidence that virtually the same line-up of airlines existed after forty years of regulation as at the beginning. Economists, who have a hard time with the concept that there can be such a thing as too much competition, thought that the record of airline regulation was deplorable. Economists generally believed that regulated airline service was overpriced and inefficient. Perhaps it was, but regulation took an infant industry and grew it into a strapping youth.

For the airline regulators, though, the sun really set. The Civil Aeronautics Board, the former controller of the airlines, was sunsetted in 1984. This became a matter of honor with Alfred Kahn and others who advocated the sunset. The idea of these people was that economic regulation had to be exterminated and its grave sewn with salt lest it come creeping back to strangle free competition in its crib. There was a thought that an industry could not live “half slave and half free,” half regulated and half not. Regulation was like a weed with deep roots; unless thoroughly uprooted, it would grow back more noxious than ever. The airlines went from being a government-managed cartel to being just a cartel, or at least that is what some people thought. Right after deregulation, some innovative low-cost airlines, like People Express and Midway, tried to break into the business and were doing quite well for a while. But eventually they folded or were absorbed amid squawks about predatory pricing, and the Big Three—United, American, and Delta⁶—came to dominate the industry. At first, these and others had a terribly difficult time making money. At one time the losses all around equaled all the profits in the industry since the beginning of commercial aviation. But, eventually, the airlines got the hang of things and were making a

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6. Now apparently to be joined by a fourth—a Northwest-Continental combination.
pot full of money. If airlines continue to make this kind of money, there may be suspicions about the reality and purity of competition, and the Department of Justice may come poking around.

Possibly the most vulnerable aspect of airline operation today is what would be, by traditional standards, blatant price discrimination. After deregulation, airlines began to price flights for maximum "yield"—i.e., revenue. Comparable seats on a flight could carry any number of prices depending on the characteristics of the customer. Elasticity of demand was a key consideration. This is a polite way of saying that the aim was to charge what the traffic would bear. So far this has evoked only mild complaints, except from business travelers, whose fares are sky high. One kind of discrimination today takes the form of offering discounts to big customers, with the biggest discounts of all going to employees of the federal government.

Ironically, discounts to big customers of the railroads were what inspired the creation of the Interstate Commerce Commission. For instance, the Rockefeller interests, which dominated the oil business, paid much lower haulage rates than their rivals. With this background, the avoidance of discrimination has understandably been a central theme in almost all schemes of transportation regulation. Yet frank discrimination is the hallmark of the deregulated airlines. Perhaps this state of affairs has not brought a high degree of protest because discretionary travel, which is paid for out of personal funds, is the beneficiary of discounts, while business travel, funded by expense accounts, generally is not.

Another point of sulfurous irritation with airline deregulation is the large disparity between big cities and small towns in terms of the availability and cost of air travel. The Los Angeles-Chicago-New York axis attracts the most intense competition and is favored with the most competitive fares. Service to Appleton, Wisconsin, or Bloomington, Illinois, on the other hand, is much less abundant and considerably more expensive. This is a version of the Ramsey principle, which states that the highest prices on a per-mile basis apply to the least competitive services. But gone is obeisance to the idea of universal service—that everyone, wherever located, should get adequate service at a fair price. This would be achievable only under regulation, of course. With competition, the megalopolis is frequently and cheaply served while the small city may have fewer flights than the space shuttle but at comparable prices.

Other complaints have been brought against the airlines. Passengers sometimes protest such traditional horrors as sardine-like seating and unsavory victuals. One large airline supplies "food" in little bags deceptively labeled "Bistro." Economists, however, are not impressed. To them, travelers provided with the elusive treasure of "choice" have opted for cheap seats shorn of amenities. Consumer choice is, after all, the polestar of deregulation and in the folklore makes up for almost any extreme of inadequate service. Most
passengers, however, do not regard safety as an amenity and firmly reject the
thought that the cheaper fares of cut-rate airlines may show up as lower spending
on maintenance with a consequent uptick in crashes. No one wants to entertain
the thought that he or she bargained for a crash when buying a super-cheap ticket.
Yet the idea that one gets what one pays for in safety as in other things seems to
be pure economic logic. So even economists may have to agree.

In principle, the airlines were an obvious target of deregulatory efforts. After
all, they had engaged in managed competition since the beginning. Only during
the regulatory glory days of the 1930s was it even suggested that the airline
business was a natural monopoly. The main trouble with the airlines was that
they could not make any money, and the industry had no future without
regulation to hold competition in check. With the aid of regulation and air mail
contracts, the airlines reached the point where they could endure deregulation—at
least for a while.

C. Electric Power

What a different picture is presented by another industry that currently faces
deregulation—electric power. Electricity has traditionally been considered to be
(and may, in fact, still be) a natural monopoly. Incredibly capital-intensive, it has
abhorred competition and feared the duplication of facilities. Thus, having one
company running its poles down one side of the street while another does the
same thing on the other side has been the horrible example of what could happen
without a monopoly franchise. The airlines, of course, have had no comparable
concern about duplication and therefore no need for an exclusive right to serve.
Despite this, the impatient spirit of airline deregulation has been carried over into
the electric power industry. That spirit combines a touching faith in the market
with a demand that it be liberated immediately, if not sooner, from traditional
constraints. This impulse lies at the heart of deregulation and reasserts itself in
many disputes between the true believers and the faint of heart.

There are numerous examples of how electric power deregulation works. For
example, electricity deregulation means the deregulation of electric generation,
so that electric generators may compete for the business of electric distributors
or electric loads. Of course, nothing tangible actually moves from generators to
distributors; the generators merely deliver power at one point on the system while
the distributors take it off at another point. One of the key challenges in making
competition work is figuring out how to manage the transmission system that
links generators and distributors. For electricity, in flowing through a
transmission network, does not follow the path agreed upon by the interested
humans, but instead wanders hither and yon as the laws of physics ordain. This
may result at times in overload or other mischief on some of the lines. To deal
with these headaches of transmission, two basic approaches were proposed.
One of these, called "Poolco," provided for an independent system operator (ISO) to manage the system and establish hourly spot prices for power. The ISO is one of the mythic heroes of deregulation, beholden to no one and capable in theory of monumental feats of coordination and dispatch. He (or it) can guard against the overloading of lines and other threats to reliability. The ISO must also dispatch the power plants so that the cheapest power sources are called on first. An alternative proposal, known as "bilateral trading," called for electric customers to deal directly with generators for the sale of electricity. The bilateral traders had a firmer faith in the magic of markets than did the Poolco people. In fact, the bilateral traders accused the Poolco advocates of fabricating nonexistent transmission problems and of introducing an unnecessary ISO to engage in, of all things, regulation. The bilateral folks only wanted free trade between generators and distributors and believed that a fabulous market would automatically follow—untouched by human forethought. This is the same impatient spirit that deregulated the airlines, which had a long record of regulated competition. Electric power, on the other hand, was a virgin in matters competitive.

Belief in the magic of electric power markets is also shown by the increasing commitment to "retail wheeling" seen throughout the different deregulation plans in the various states. "Retail wheeling" means that retail (or end) users of electricity will have access to transmission, so that each user may choose its own source of power from nearby or from afar. The purchased power will then be shipped over the intervening transmission systems (at a price never quite certain) to the retail customer. If the customer's right to choose a supplier is the key to happiness, retail wheeling should usher in a new era of contentment.

In line with this way of thinking, the commitment of each state to electric deregulation is being measured by the warmth of its ardor for retail wheeling. Retail wheeling is an arrangement devoutly sought after by large industrial users of power. Whether retail wheeling would be of much practical benefit to other, presumably smaller, users is pretty much a matter of speculation, however. This, of course, does not prevent deregulation champions from heralding "choice" for everyone as a paradise of consumerism. In fact, the gurus of competition have lifted "choice" to such a level of hushed reverence that mere practical considerations seem to count for nothing. Retail wheeling may have problems such as reliability and the price of back-up power, but the folklore has it that "choice" is the alpha and omega, raising humanity from the banality of just plugging the cord into the socket to the special thrill of generation options without limit. The successful example of the airlines (and some other industries) and their rejection of the half-slave/half-free approach has much to do with the impatience in deregulating electric power. Those with an uncritical commitment to the market believe that the worst threat to their goals is any kind of slowdown.
that would allow the forces of regulation to regroup and counterattack. Perhaps this perception is correct, and retail wheeling is like the flag raised by the Marines on Iwo Jima to signal their final victory and discourage counterattacks. But symbolism aside and with a view to grim reality, the rush to judgment may be premature.

Before leaving this tale of deregulating electric power, we should consider for a moment the impact of electric deregulation on pollution. At the moment, the most prominent bugbear among environmental worries is the dreaded Greenhouse Effect. So powerful are the myths of competition that electric deregulation has actually been hailed as “the Answer” to the greenhouse problem. The belief is that the environmentally aware will exercise their precious choice to order their power from windmills and the like. In the bigger picture, however, competition is supposed to make electric power cheaper, and cheap anything is anathema to environmentalists. This is because the cheaper the power or whatever, the greater the usage, and the greater the pollution—here greenhouse gases—that is unleashed on the world.

Looked at another way, stopping greenhouse gases is expensive. An effective program would include taking external costs that are otherwise imposed on society as a whole and charging them to the buyers of electricity. Increasing costs to the buyers, however, is just the opposite of what electric competitors are looking to do. Nonetheless, despite these non sequiturs, the folklore of deregulation will probably continue to insist that black is white and that competition is wonderful for the Greenhouse Effect. The possible contradictions here are illustrated by nuclear power plants, which seem doomed by competition, but which, I confidently predict, will soon be touted as the answer to the greenhouse problem. It is uncanny how ideas in the world of energy, no matter how vehemently repudiated, rise again to fight another day. That they can is due in no small part to the folklore of deregulation.

The decisive importance of faith and folklore in energy matters is illustrated by the stark contrast between the treatment of natural gas twenty years ago and today. Twenty years ago natural gas was generally believed to be a precious resource in short supply. It was to be reserved by regulatory fiat for its highest use—home heating. It was emphatically not to be used for electric generation, for heating swimming pools, or for burning in gas logs. Now the supply of natural gas is generally believed to be inexhaustible, with no threat of inflated prices. As an environmentally friendly hydrocarbon, there can be no higher and better use for gas than for industrial applications and for electric generation. By using it in combined cycle turbine generators, we have a low-capital-cost source of power, which cancels out economies of scale in generation and voids any argument that electricity is a natural monopoly. Thus, instead of being subject to legislative extinction as a generation source, natural gas is to be elevated by free market competition to a new place of honor. There has been a radical shift in natural
gas's place in the folklore, reflecting once again the manic-depressive bent of energy thinking.

Even before the prominence of gas, there was the great turnaround on nuclear power. Once thought because of low-cost fuel to be "too cheap to meter," nuclear power actually became, in many cases, astronomically expensive. The high cost was a dominant factor in some service areas, inspiring industrial customers to yearn for cheaper power from distant generators—thereby lighting the torch of deregulation. More turnarounds in the perception of nuclear power may now be in the offing since nukes involve no carbon combustion and, as all-nuclear France illustrates, produce few greenhouse gases. Let us hope that the advocates of retail wheeling and similar measures have clearer vision than yesterday's hoarders of natural gas or the masterminds of nuclear power.

It is ironic that the legislative adoption of electric deregulation seems impossible without the inclusion of a good old regulatory chestnut—a retail rate reduction. It is, of course, the hope and expectation of the advocates of deregulation that restructuring will lead to lower rates. But that fruit of the competitive process has very little in common with a reduction in regulated rates by legislative fiat. Nonetheless, political considerations dictate that most residential customers get a regulatory sop if the large industrials are to receive their heart's desire—retail wheeling, the wonderful gift of choice, and the right to buy power from the lowest bidder.

II. The Folk of the Folklore

As we have seen, the folklore of deregulation is imbedded in all the various schemes for competition. But that folklore is perhaps most striking in the people, activities, and buzzwords that accompany these proposals. Deregulation is a magnet for middlemen and consultants, as well as for advertising people of every sort. Unbundling and stranded costs are exotic features of the process, and mergers are commonplace. All are rich ingredients of the folklore of deregulation.

A. Middlemen, Media, and Consultants

The folklore of deregulation is part of the powerful myth of the market, with the trader as high priest and trading as the liturgy. Again, this is perhaps best illustrated by developments in electric power. In its early years, the electric power business was dominated by engineers and scientists. The initial problems of the industry raised predominantly scientific and engineering issues—e.g.,

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7. Abundant Power from Atom Seen, N.Y. TIMES, Sept. 17, 1954, at 5 (quoting Lewis L. Strauss, Address at the Twentieth Anniversary of the National Association of Science Writers (Sept. 16, 1954)). Mr. Strauss was the chairman of the Atomic Energy Commission. See id.
whether direct or alternating current worked best. There were also early rate problems, mostly addressed by engineers. After the engineers came the lawyers, who were presumed to know how to deal with government regulation, when regulation came to be a bigger concern than which way the current flowed. If there were any cracks in the phalanx of lawyers, they were filled by the throngs of economists pouring into a land of opportunity. The economists temporarily eclipsed the lawyers by shrewdly inventing deregulation, thereby depriving the lawyers of their stock in trade.

With the advent of deregulation came a whole new breed of industry figures. This was a crowd extraordinarily comfortable in an atmosphere redolent of new angles and new dollars. These were the marketers, traders, and brokers that composed the emerging class empowered by the new regime of competition in an unregulated marketplace. In sober truth, the battle cry of deregulation was not, “Eliminate the middlemen!” Rather, middlemen—individual and corporate—were coming out of the woodwork. The pecking order of the new regime seemed to put those who arranged trades and made deals or who followed futures quotations ahead of those who merely knew how to power up a gas turbine or how to get on the good side of a utility commissioner. The less one dirtied one’s hands with wires and poles, or even rate schedules, the faster one rose, with marketers in the lead. This new prominence of the trader is a bit like a move from mere wheat farming to trading in wheat futures on the Chicago Board of Trade. How do you get them back on the farm, once they’ve seen the wheat pit? In the folklore of deregulation, the marketer and the trader are the leading players.

In the new regime, if one needs power, one merely e-mails a marketer who has gobs of electricity in his, her, or its portfolio. Everything seems ethereal because it is virtual electricity that exists only as a blip on a computer screen and will never give one a shock. One imagines that somewhere there have to be real power plants and real transmission lines and real electricity, but one doesn’t really know this for sure. All one deals with are virtual megawatts, emerging from virtual power stations onto virtual transmission lines for delivery to virtual customers, from whom payment will be received. But note this carefully: The payment is not virtual—it is in real dollars. Reality has retreated to the money part of the system.

The widespread existence of power marketers with only a computer, a fax, and a cellular telephone lends verity to the idea that electric power has joined the yen and the ringgit as a staple of exchange and speculation, and that the new elite of the electric world are traders, brokers, and marketers—middlemen. To those steeped in the culture of capitalism there is something reassuring about this. Certainly it is more modern and enlightened to entrust the fate of the nation to traders, who understand and obey the Invisible Hand, than to follow the lawyers into the snake pit of government regulation. In the folklore of deregulation, the
prime article of faith is the terminal ineptitude of government. Any government is conclusively deemed part of the problem and not part of the solution.

The better one is able to put the trading process into sophisticated garb, the better one seems to evoke the beating heart of capitalism. Thus, the development of futures and options or, better yet, options on futures for megawatts of electric power provides an exhilaration that mere megawatts cannot match. In the public relations version, these derivatives are useful for hedging and therefore contribute to the efficient management of the power system. But we sophisticates know better. We know that these vehicles occasionally prove useful, as in Orange County, to the informed speculator or even to the uninformed gambler. Also of consequence is the business that these derivatives will generate for brokerage houses and for commodity brokers, as well as for the exchanges on which they are traded. A reform and restructuring of electric power is hardly of note unless it provides new and exciting products for the trading floor—something to put pork bellies in the shade.

The deregulation of electric power has therefore generated an impressive growth of employment opportunities for brokers, traders, and marketers. This will more than make up for all the linemen, electricians, and clerks laid off in the interest of efficiency. Perhaps these unfortunates can be retrained to be useful around a trading pit. But the need for brokers, traders, and marketers is only the beginning of the employment opportunities springing from deregulation. Some of the most impressive of these opportunities are in the realm of education. No one can keep track of all the seminars, conferences, courses, colloquia, encounters, round table discussions, brown bag lunches, and après-ski discourses offered in the name of preparation for the New World of Deregulation. The revenues generated by these educational efforts seem to dwarf the combined take of all the formerly regulated industries put together. And all these industries have their own educational programs, at times with inter-industry insights, like using power lines for computer talk.

Many of the members of the faculties of these various courses are consultants hopeful of finding work with one or more of the programs’ students, who are company managers. So there is a delightful reciprocity about things. It is generally true that brochures announcing these programs proclaim the advent of deregulation as a turning point in history roughly on a par with the discovery of America. Nonetheless, however expansive these interpretations, there is nothing to obscure the bottom line that “the ‘d’ in deregulation is for ‘dollars’.” I am still waiting to hear any suggestion that the new competitive regime might have a downside. If the advent of deregulation is like any other novelty, however, at some point there will be a reactive flood of complaints, warnings, and bomb threats demanding the immediate end of deregulatory activity and a return to what the sender will call sanity.
Rivaling the rash of educational conferences heralding the arrival of deregulation is the deluge of new newsletters, books, and periodicals dealing in hyperbolic terms with one facet or another of a deregulated industry. These publications have a seemingly inexhaustible supply of arguably newsworthy events with which to fill their pages. Now this is not news as riveting as Monica Lewinsky or Princess Di, and it may even be thin gruel for a dentist’s waiting room. But at least the definition of “newsworthy event” is far from confining. It includes, of course, every official action of every state utility commission and of every relevant federal agency. But this is only the beginning. After-dinner speeches of the commissioners may contain important clues to impending developments in state X or in the nation. This sort of interpretation calls for virtuosity on the part of the newsletter author in the art of “reading the tea leaves.” This is a talent for sensing, in an apparently unambiguous declaration, a hint that just the opposite may be in store. For example, if a regulator proclaims dramatically how ardent his or her agency has been in furthering deregulation and waves a bunch of papers to prove it, it may really be a signal that a huge batch of onerous new regulations is about to be issued.

The need for inside information is particularly pressing at a time when industries are being restructured to prepare them for competition. The reason for this is that everyone is in favor of deregulation, and it becomes increasingly important to tell those that are really for competition from those who merely fear that a negative stance will jeopardize their consulting contracts. There are few in industry, government, or academia who have gone on record as opposing deregulation. Even the managements of the highest cost and most inefficient regulated utilities declare that they are delighted to be stripped of their monopoly. They like to give the impression that their newly proclaimed desire to trash their monopolistic past and to seek entrepreneurial opportunity really was hidden in their secret hearts all along. And no politician has been rash enough to suggest that competition will be bad for the consumer and for the environment, even though his past campaigns have always been generously supported by utilities with a monopoly franchise. It is therefore important for the purveyors of inside information to be able to report not only what is said publicly but also with whom the speaker had lunch before the talk, or with whom he shot grouse in Scotland, not to mention miscellaneous pillow talk.

There is also a heart-warming rapport among, first, publications following industry news; second, conferences and seminars at which the speakers make news; and, third, consultants seeking to make a name for themselves as deregulation gurus. This combination can work beautifully, with a newsletter sponsoring a conference, at which a consultant can speak and have his views reported in the newsletter, wherein they will be read by numerous potential clients. A government official seeking lucrative employment in private industry can be a useful addition to this mix.
B. Advertising

Further, it is certainly not a revelation that deregulation has brought unimaginable prosperity to people in advertising. We will soon be listening to electricity commercials. Along this line, ads plugging as exceptionally reliable an “Old Faithful” brand of electric power (filmed in Yellowstone Park, of course) are probably not far off. We can also look forward to “green” promotions, where fly fishermen and Smokey the Bear will be featured in 30-second spots recommending current generated by windmills or flowing from a solar panel. Negative ads may showcase a mushroom cloud floating up from an errant nuclear generator.

We have as a model, of course, the virtually unintelligible television pitches of long distance telephone companies. One features ten minutes of free calling a day to American Samoa, while another explains a new procedure for making collect calls to one’s creditors. Again, these—and many more ads to come—contribute mightily to a growing economy with full employment. In theory, advertising adds enormously to the information and disinformation available to market participants; it is a colorful—if unreliable—contributor to the folklore of deregulation.

No discussion of advertising would be complete without a word on telemarketing—certainly a glorious mainstay of consumer sovereignty and soon to play a central role in connecting electric users with the generator of their dreams. The trademark of the voice on the phone is not only its butchery of all last names (including Smith and Jones) but also its hesitation before first names like “Tom,” “Dick,” and “Harry” (H-h-h-hoar-eye). At last getting beyond the name, there will be a flood of garbled talk about a unique opportunity for electricity savings from Electrosqueeze, Inc., an independent marketer. The promotion also features Koupns for Kilowatts, a business opportunity one passes up with reluctance, of course.

C. Unbundling, Stranded Costs, and Mergers

Three issues that have been the subjects of many conferences and seminars, and which arise in many deregulatory contexts, are the questions of unbundling, stranded costs, and mergers. A short word on unbundling will suffice. It is not the forced separation of lovers wrapped in intimate embrace; it is the forced separation, in the interest of competition, of utility functions and services formerly wrapped in anticompetitive embrace.

Stranded costs refer to all the most harebrained mistakes made by regulated utilities, which had duly received regulatory blessing, but which in the new order are condemned to oblivion by competition. In the electric power industry, very
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expensive nuclear plants are prominent on the list of stranded assets. The burial costs of such ill-starred undertakings are high, and there have been various plans for their payment by some category of hapless customers. Unless the customers can be forced to pay, the utilities may be driven into bankruptcy. It is therefore not surprising that many of these monopolies asked nothing of the plans stripping them of their franchises except that their stranded costs—the “funeral expenses” of their stranded assets—be somehow paid by their customers. This position is not noble, but it is surely practical. Some of the most apparently fanatical deregulators have adopted a mirror-image stance: Regulated monopoly must be destroyed root and branch, but, almost incidentally (wink and nod), the customers should pick up the tab for stranded costs. In fact, this is the new “deregulatory compact.”

Another favorite subject of conferences and of economists’ theorizing is industry concentration, mergers, and the like. As industries deregulate, their constituent companies rush into one another’s arms, forming ever more gigantic firms to compete in a much friendlier market. These surges of corporate love at first sight give rise to the aphorism (duly noted in the folklore): “Nothing is certain about deregulation except the mergers that follow.” Mergers are accomplished in the name of efficiency and perhaps (though certainly sub silentio) in the hope of some easing of competitive pressures. The efforts of the antitrust authorities to halt or slow this process are ineffectual in the face of the wild corporate lusts unleashed by deregulation. More and more, competition in the formerly regulated industries is carried on by a handful of behemoths of international dimensions. And, to complicate the picture, the competitive myth that everyone covets his neighbor’s business is being tested in, for example, the telephone industry, where the anticipated rush of long distance companies to enter local service has been notably subdued.

In the electric power industry, Herculean efforts are being made to sustain competition against merger, vertical integration, and other hazards. Power companies vertically disintegrate by selling off their power stations to eliminate cozy relations between generators and distributors in their regional market and to put rival generators on a level playing field. In line with this thinking, plants in New England are being sold to faraway California owners and, in another transaction, to an even more distant French concern. These deals are supposed to make sense competitively because the new owners have no distribution or other assets in New England with which to play footsie. As in other matters governed by the folklore of deregulation, the theoretical effectiveness of competition is the one and only factor considered. Whether the infrastructure belongs in foreign hands or even in absentee ownership is not a question any informed person would ask. Whether New England regulators will have the same leverage over distant owners is also not a permissible question. In the olden days, the only international relationships among utilities involved First World ownership of Third World facilities—and these arrangements frequently ended
unhappily for both parties to the bargain. Now, on the other hand, U.S. concerns own things in Britain (and elsewhere), and British companies own things in the U.S. (and elsewhere). So far the French electric system is not in play because it is still government-owned and, France being French, may stay that way. International cross-ownership may be put to the test if electricity demand should slacken and foreign owners seek to reduce or abandon service—pulling the infrastructure out from under, so to speak.

Conclusion

Deregulation is a wondrous process, driven by the belief that competition is all. One of the truly remarkable things about deregulation is its strong appeal to both the Right and the Left. There may be some observers in the center who do not wildly applaud deregulation, but nothing is heard from them as the plaudits come in from both ends of the political spectrum. Conservatives love deregulation because it gets rid of the government. Liberals seem to love it because it spells the end of hated monopolies. Deregulation legislation is often sponsored by a vociferous liberal in partnership with a doughty conservative. In fact, judging by the debate on deregulation, it is hard to believe that traditional regulated industries like AT&T ever had any friends. Rather, these industries seem so cowed by the volume of demands by the Right and Left that they be stripped of their monopoly, that they have accepted their fates, literally renounced their regulated past, lit a candle to deregulation and its folklore, and adopted the fanatical faith common among converts.

Competition is undoubtedly something, but whether it is all remains to be seen. It is certainly a prod to efficiency and, no doubt, to innovation; but whether it can live up to its folklore as a paradise of unlimited choice among ever-cheaper, yet always reliable, basic services may raise nagging questions. Possibly, in some circumstances, the old-fashioned obligation to serve may even be missed. The true believers would, of course, be scandalized that one could entertain such a thought. In any event, whether deregulation is a sea change or only a nudge of right rudder, it has certainly called forth a wild abundance of musings by experts and by those aspiring to be experts. They have launched a torrent of writings and speeches and regulations and orders and policy statements that rival catalogues and credit card offers as a burden on the mails. Developments in deregulation have actually appeared in front page banner headlines! That has almost succeeded in making regulated and formerly regulated industries exciting. At least that is the fragile reed on which this Commentary rests.