

# The Good, the Bad, and . . . the Monopoly?

**T**he electric power industry is mutating all over the globe. We can analyze, study, and compare, yet no single and universal model has emerged in any country. Each has developed a solution of its own.

The restructuring of the U.S. electric power industry has provoked a strong response here in Canada, but few seem to care that a U.S. solution could prove ill-advised on this side of the border. The structures of electric industries are fundamentally different in both countries. Prudence is called for.

## Unfocused Restructuring

Some segments of the Canadian electricity industry are experiencing a major shift in their production strategies. Traditional transmission and distribution policies are also being questioned as some market players seek new alternatives for electricity supply.

In Canada, the policy debate over restructuring is complicated by the dominance of a small number of publicly owned monopolies. Many people—legislators, regulators, and existing or potential producers—regard monopolies as a perverse element in the industry, a barrier to good trading practices. Since the monopolies are publicly owned, talk of privatization inevitably surfaces. But the existence of publicly owned monopolies does not prove that the Canadian industry is not competitive or cannot fully participate in a so-called competitive market. More competition could mean freer markets, rather than a proliferation of hundreds of new producers.

Conceptually, neither the destruction of existing monopolies or privatization constitute an appropriate response to restructuring pressures. People are confusing deregulation with restructuring and

privatization. Yet there is no such thing as deregulation. In the United States, the Public Utility Regulatory Policies Act and the Energy Policy Act serve as examples not of deregulation but of more responsive rules to answer industry and customer concerns. My definition of deregulation in the Canadian context would include the elimination of unjustified duplicative regulations between various levels of government. It would also include the elimination of outdated regulations that cannot be justified in a North American free-trade environment—such as energy export regulations. Unfocused and duplicative regulations are probably the most effective deterrent to entry into the electricity industry.

Rather than destroy existing structures, deregulation need only allow new players to enter and operate in the market. If they are cost-effective, these new players will contribute positively to the industry. Restructuring and privatization will follow as existing firms are forced to adapt. In my view, these three elements form a logical sequence. Deregulation of electricity markets is the necessary condition for market restructuring in Canada because it would automatically provide a propitious environment for restructuring and privatization. Other trade impediments are unlikely to be lifted without it.

Finally, what happens with provincially owned utilities is for every province to decide on its own. There will never be a single Canadian solution to this question; therefore, debating the issue in the context of restructuring is irrelevant. But if we must, the discussion needs to go beyond the theoretical monopoly rhetoric we find in any elementary economics course. The issue is complex and deserves more attention.

### **The Spirit of Privatization**

The spirit of privatization has come to North America partly in response to the experiences of other countries—in particular, the dismantling of the economic structure of the former Soviet Union and massive privatization in South America. The dynamics behind these privatizations are, however, extremely different. Although they occurred coincidentally, the points of departure are distinct and likely dissimilar to the restructuring pressures on the North American electricity markets.

In the Soviet Union, monopolies dealt with other monopolies; each took its signals from the Kremlin, leading eventually to ruin. But that collapse should not indict all monopolies. Central planning is a characteristic of an entire economic system; monopoly is merely a type of market structure. One can find monopolies at work under all forms of government and economic organization, including the purest expression of capitalism.

In other types of economic systems, the presence of monopolies should not necessarily imply the same decisionmaking process. In a market economy there exist many different market structures—monopolistic, oligopolistic, competitive, or any variation of these. Police, army, and governments are probably the best examples of existing monopolies. Fast food restaurants are usually more competitive. The oil refining industry is more oligopolistic. All interact in the same markets and with the same basic economic rules.

Privatization of state enterprises in South America is often raised as a reason for Canada to do the same. Yet every country has an economic dynamic of its own that makes it different in many respects from the rest of the world. Integration of world economies does not mean uniformity in market structures; global economy is not a synonym for uniform economic systems. Similarly, the privatization equation is not a universally applicable formula.

Argentina, for example, privatized its public utilities for one simple reason. Its foreign debt had reached an unmanageable level, leaving the country in bad need of hard currency. But although the privatization process will provide temporary relief from their debt burden, it does not guarantee any significant change in the economic system that will provide sustained economic growth. Many other factors will influence the country's ability to achieve economic development. I fail to recognize this type of privatization as any model for Canada.

I believe that Canadian electric utilities are very efficient, whether publicly or privately owned. You

don't privatize for the sake of privatizing. If a publicly owned utility makes a reasonable profit, why shouldn't it be used by government as a means of collecting revenue? Given Canada's imperfect fiscal system and its many tax loopholes, I am not convinced that the economy would benefit from having its utilities privatized. In some cases, maybe; in others, certainly not. The ownership structure of the Canadian electric power industry should not be the prime focus of the restructuring debate; the regulatory environment is a better target.

### **The Regulator as Monopolist**

Regulations are usually put in place to correct for market failures. In the case of publicly owned monopolies, the source of market failure is obvious to the proponents of strong regulation: the potential discriminatory power of the monopoly and the overall inefficiency usually attached to the public sectors. To

**I am not convinced that the Canadian economy would benefit from privatizing publicly owned utilities.**

say that regulations will automatically solve problems caused by market failures is to say that regulators have absolute knowledge and ability to manage these situations. Permit me to doubt this.

What if regulation is not correcting market failures but building inefficiencies? Regulation tends to be monolithic, not a system that adapts to quickly evolving market situations. This inability to adapt is potentially far more damaging to competitiveness than the structure of the industry itself. It creates distortions as well as serious imbalances between different energy sources, which in turn may distort the market equilibrium.

Ironically, one of the purest forms of monopoly power is probably the one in the hands of regulators. Regulators basically operate at arm's length from governments and wield absolute power over the industries they regulate. Utilities, on the other hand, however close to monopoly they might become, will always face fuel-switching competition. Publicly owned utilities also face public and government criticism. Their activities are scrutinized regularly. They are regulated because of their potential monopoly power, yet the regulator's monopoly power threatens spectacular negative interference.

In export markets, for example, Canadian electricity is competing with electricity from various utilities as well as with natural gas and other fossil fuels used to produce electricity. Irresponsible use of regulations by third parties may cause delays in export approvals. In a highly competitive market, an exporter whose license is held up by legal challenges inevitably loses an important commercial edge. Inappropriate regulations may reallocate millions of dollars to a competing industry.

### **Economic Theory vs. Common Sense**

Economists frequently address real-life problems with complex theoretical approaches that are themselves often based on simplistic hypotheses. Yet the thread that links theory and reality may be quite tenuous. Theory taken out of context can lose all its purpose. Chemical experiments are useful in bridging

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the gap between theory and practice because they provide a controlled environment. Economic theory cannot be tested so easily.

The bottom line, then, becomes a question of faith. You can, for example, believe that markets, society, and social organizations are so perfect that shareholders and large industrials should get all the benefits of economic activity. That governments are useless because economics is running the world. That privately owned companies will never ask for financial assistance, subsidies, and other similar government interventions. That perfection rules the economy.

On the other hand, if you have long lost faith in the existence of Utopia and have your doubts about the perfection of this world, you will look at alternative ways of correcting market imperfections.

Publicly owned utilities (and monopolies) have served historically to correct certain market imperfections. They have been and still are, in some cases, the best vehicle to ensure that electricity is accessible to all potential customers within a given territory at a reasonable price. They have hooked up to the grid pockets of population that would otherwise never have been served by an electric utility. There is no reason why they should not have their place and role in the evolving marketplace.

I am not against evolution within the electric industry, but I think more attention should be paid to the process. Privatization of publicly owned utilities, combined with a dismantling of the current market structure, will soon be followed by anarchy and the collapse of dozens of enterprises. This is Darwin's Law; however, it has less to do with efficiency than with power. Financial backing and efficiency are two different concepts, and during the first phase of the restructuring process, very efficient players can be knocked out of business by financially stronger elements. In the process, the industry will waste an enormous amount of resources creating enterprises that will later require dismantling. This path will inevitably lead to higher electricity rates. Later, another restructuring will likely take place. This is the merger phase. Thus, the industry will go around in a perfect circle from an oligopoly dominated by publicly owned utilities to one characterized by privately owned utilities. I fail to see the merit of this experiment.

Canada's electricity rates are among the lowest in the world. To be worthwhile, restructuring and privatization would have to produce significant decreases in rates. But during a major shakeup in the industry, financial costs could easily outpace benefits and become a burden that will be passed along to the customer in the form of higher electricity rates.

In the Canadian context, pressures to restructure the industry cannot be justified merely on the basis of lower rates. Other forces are at play. ▼

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