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How Politics Influences the Energy Pricing Decisions of Elected Public Utilities Commissioners

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ABSTRACT

An argument of those supporting the direct election of regulators is that election allows voter preferences to be translated easily into policy outcomes. However, a danger of this approach is that the low salience of regulatory issues among the median voter could allow for regulatory capture, where regulated firms use their influence to extract favorable outcomes. Although the role that institutional design plays in influencing capture has been evaluated by comparing appointed and elected regulators, evidence of the capture of elected regulators remains scant, and we know little about the conditions that may mitigate such capture. Here, we study electricity rate-making by Arizona's elected public utilities commission to determine how the economy, citizen complaints, and industry and interest group lobbying affect rate decisions. Leveraging original quantitative and interview data, we find that commissioners respond to voters and set pro-consumer electricity prices when inflation rises and when citizen complaints increase. We do not find that industry and interest group lobbying influence rate-making. We argue that commissioners are pro-behavior because prices are salient, and commissioners desire reelection. The result suggests that the electoral mechanism reduces chances of regulatory capture, although the matter of electoral pandering remains unresolved.

1. Introduction

Proponents of electing regulators directly have long argued that doing so allows for voter preferences to more easily be translated into policy outcomes. A number of scholars, including Bawn (1995); Brehm and Gates (1999); Epstein and O'halloran (1999); Huber and Shipan (2002) and Gormley and Balla (2012), have outlined the possibility that giving voters the ability to directly reward or punish regulators can lead to more voter-centric policy outcomes than would be the case if voters were only the indirect principals of regulators. Indeed, the desire for creating the imprimatur of democratic accountability in policy-making historically led to the direct election of U.S. senators (West and Stone, 2013), the direct election of utilities commissioners in several states (Berman, 2016), and has led to repeated attempts to increase the number of elected judicial positions (Shugerman, 2012).

Despite the view that direct election leads to more representative public policy outcomes, however, there is good reason to believe that electing policy-makers will not translate into policy that more concretely maps onto voter preferences. Specifically, in areas of regulatory policy, where the median voter may not care about or even follow regulatory changes, small organized interests could conceivably dominate policy-making and extract concessions from regulators even if those regulators are elected (Dal Bó, 2006; Gormley, 1983, and Besley and Coate, 2003). In particular, the entities regulated by a regulatory body can "capture" that regulatory body and push policy outcomes away from the preferences of the median voter who put members of that regulatory body into office (Stigler, 1971 and Peltzman, 1976).

We are thus faced with two opposing messages about the wisdom of electing regulators. On one hand, election should lead to more accountable regulators and consequently more voter-centric policy. On the other hand, the complexity of many regulatory issues (Mullin, 2008) and the generally low salience of regulatory policy-making among voters (Besley and Coate, 2003) opens the door for regulated entities to capture elected regulators and extract less voter-centric policy. And yet, to quote Dal Bo, "the empirical evidence on the causes and consequences of regulatory capture is scarce" (2006: 220). Moreover, the evidence is especially scarce with respect to detecting variation in regulatory capture among elected regulators: what does regulatory capture look like, and what factors motivate elected regulators to pursue voter-centric rather than firm-centric decisions and vice versa?

In this paper, we take up this important and timely matter and

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evaluate how economic and interest group factors influence the regulatory behavior of elected regulators. We specifically analyze how these factors influence the electricity rate setting behavior of Arizona's elected utility regulatory commission, the Arizona Corporation Commission, and we measure regulatory capture as the difference between the electricity rate that the Commission sets for a regulated utility and the electricity rate that a regulated utility requests in its application to the Commission for a rate increase.[1] We focus on the rate-setting behavior of elected public utilities commissioners because this represents one of the best examples of a regulatory policy area where the capture of elected regulators could occur: the median voter typically does not care about electricity regulation but regulated utilities very much do, opening the door to the potential for the capture of elected regulators by regulated utilities.

We focus on policy-making in Arizona for several reasons: first, unlike many other states and especially those states with elected utilities regulators, Arizona is extremely transparent in terms of sharing Commission records and makes the entire Commission rate decision-making process, including utility proposals and complaints from industry, interest groups, and ordinary consumers, available to the public, meaning that we can analyze how involvement by various groups in the rate-making process influences the final rate decision. We also focus on Arizona because the state has elected its public utilities commissioners since the creation of the Arizona Corporation Commission in 1912 (Berman, 2016). The long history of regulation by elected commissioners matters because it suggests that longstanding relationships between regulators and regulated utilities have formed and cemented, meaning that enough time has passed for us to detect regulatory capture, should it exist.

We find ultimately that Arizona's elected regulators are accountable to the public and largely demonstrate voter-centric (or "pro-consumer") behavior when deciding electricity rates. Specifically, the regulators respond to rising inflation and, perhaps, to increases in the number of consumer complaints by setting electricity rates lower than the amount requested by utility companies. At the same time, however, we fail to find evidence that a larger number of pro-utility testimonials lead to more pro-utility electricity prices. The results, we argue, suggest that elected regulators are constrained by the electoral mechanism and work to exhibit pro-consumer behavior in areas such as electricity pricing where the desires of the median voter are likely to be clearly understood. And yet, the results also hint at the possibility that elected regulators may engage in election-related pandering rather than crafting of prudent policy decisions.

2. Elected Utilities Commissions and Pro-Consumer Behavior

In the fifty states, public utilities commissions are tasked with regulating the generation and sale of electricity and setting the rates that electric utility companies can charge consumers. In several states, public utilities commissioners are selected by voters in a general election (Coate and Besley, 2000; and Besley and Coate, 2003). The justification of electing public utilities commissioners is based on the logic of institutionalizing democratic accountability. If voters are able to directly punish and reward commissioners for the latter's regulatory choices, then commissioners will prioritize the wants of the median voter in their own regulatory decision-making and will make policy choices that are aligned closely to the preferences of the median voter (Epstein and O'halloran, 1999; Huber and Shipan, 2002 and Gormley and Balla, 2012). And indeed, both Kwoka (2002) and Besley and Coate (2003) find that electoral accountability induces pro-consumer behavior in the form of lower electricity rates compared to the rates that are observed by residents of states where regulators are appointed and therefore not subject to direct electoral oversight.

Although the stated goal of directly electing commissioners is to facilitate the transfer of the median voter's preferences into regulatory policy, it is possible that elected commissioners may actually make policies that benefit regulated utilities more than the median voter. This is because the median voter may be largely uninterested in regulatory policy and may lack the motivation and sophistication to monitor elected commissioners effectively (Kogan, Lavertu, and Peskowitz 2016) while regulated utilities possess high levels of information and motivation and can use that information and motivation to attempt to extract policy concessions from elected commissioners (Olson 1965 and Dal Bó, 2006).

Contrarily, though, it is also possible that the median voter may care deeply about electricity prices, which are directly observable every month. In this scenario, the median voter may penalize elected commissioners for increases in electricity prices, resulting in the situation where elected commissioners generally side with consumers rather than utilities. Kwoka (2002), following Primeaux and Mann (1986), argue that elected commissioners may consider themselves to be representatives of the median voter in stating that "Popularly elected commissioners, in short, may see themselves as agents of consumers" and cater to the "preferences of the dominant voting constituency, usually residential customers" (2002: 280-281). And indeed, there is anecdotal evidence that many in the general public regard direct election as an antidote to regulatory capture. A recent editorial in a Colorado newspaper advocates selecting that state's public utilities commissioners through direct election on the premise that "An elected board would answer to the people served by regulated industries" (Colorado Editorial Summit Daily 2017). However, scant empirical evidence exists about how and when elected commissioners prioritize the demands of voters over those of utilities, and we undertake this study to better understand when elected commissioners put the interests of voters above those of utilities.

While both the benefits and risks of giving regulatory responsibility to elected commissioners has been well documented, we know very little about drives pro-consumer as opposed to pro-utility behavior among elected commissioners. Part of the reason for this lack of knowledge derives from Dal Bo's comment that "One problem with the work on selection methods is that it highlights a relative difference only" (2006: 219). Essentially, much of the work on electoral accountability and regulatory capture has focused on comparing the regulatory behavior of elected and non-elected policy-makers, leading to greater understanding of how variation on the electoral/non-electoral dimension influences variation in policy setting along the pro-consumer/pro-utility dimension (Navarro, 1982; Hagerman and Ratchford, 1978; Boyes and McDowell, 1989; Smart, 1994; Kwoka, 2002, and Besley and Coate, 2003 all fit this paradigm). While the focus on comparing elected and non-elected policy-makers has been useful, we have largely not paid attention to how economic trends and variation in communication with constituents and interest groups influences decision-making among elected commissioners along the pro-consumer/pro-utility axis. Do elected commissioners pay attention to economic trends and craft ratemaking in such a way as to reduce the brunt of adverse economic shocks on voters and thus improve reelection chances? Furthermore, are commissioners responsive to signals from industry, interest groups, and ordinary voters during the rate-making process and if so, to whom are they most responsive?

We study the ratemaking of Arizona's commissioners to unlock how economic and interest group factors influence pro-consumer versus pro-utility behavior among elected regulators. Our paper proceeds as follows: we first describe the rate setting process in Arizona, deriving an observable definition of capture in this process. We then state our hypotheses, based on this definition. We test these hypotheses, finding that inflation and the complaints of ordinary consumers influence the Commission's ratemaking behavior while testimonials from businesses

[1] We discuss this further in the data section of the paper, but a larger value for (the Commission's Decided Electricity Rate—the Utility's Proposed Electricity Rate) indicates a greater possibility of capture.