State and Federal Roles in Facilitating Electricity Competition: Legal and Economic Perspectives

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Abstract

Jurisdictions have overlapping authority regarding electricity restructuring when a national authority and subnational regional governments—for example, states—both have a say. The initial sections of the paper review the division of regulatory authority over electricity markets in the United States, constitutional provisions, recent developments, and how federalist concerns have been manifested in antitrust and telecommunications. Justifications for using private markets rather than central governments suggest an efficiency approach to dividing authority, based on information, cross-border externalities, and agency, that is, the ability of a government to reflect the political preferences of its constituents. The goal is not to impose a “right” policy (e.g., promoting efficiency) through a rhetorical “back door,” but to set up rules that would best reflect constituent views. This analysis suggests that transmission and environmental regulations should be set on a regional or national level. States should retain control over when and how to open local retail markets. Uncertainty regarding the best way to organize electricity markets warrants localized experimentation. The paper concludes with brief discussions of nonefficiency ethical criteria and transnational considerations.

Key Words: electricity restructuring, federalism, regulatory policy

JEL Classification Numbers: H11, L94, L51, H77
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Opening electricity markets to competition presents familiar and complex questions: whether to do so, what sectors to deregulate, when to initiate competition, and how the process should be implemented. Along with “whether,” “what,” “when,” and “how,” is the less familiar but equally complex issue of “who” gets to answer those questions and for which sectors of the electricity industry. The “who” issue arises when jurisdictions have overlapping authority, in particular, when a national authority and a state government both could have a say regarding electricity restructuring.¹

In the United States, this issue manifests itself in disputes regarding the extent to which the federal government can impose its priorities on state legislatures and regulators that oversee pricing and other practices in the selling of electricity to end users—household, commercial, and industrial customers. Canada, with its heritage of strong provincial governments, offers another context in which these jurisdictional “who” conflicts may arise. A much more recent but also important context involves relations between the European Union and its member nations.

¹ The term “restructuring” has become a standard way to refer to the process of opening electricity markets. Primarily, this is because competition in generation requires that unaffiliated power producers have to be able to transmit energy over the incumbent’s transmission lines owned by previously self-contained incumbent electric utilities at reasonable rates and at non-discriminatory terms. This ability requires, at minimum, that incumbent utilities open up their operations to ensure that unaffiliated generators can transmit power to their customers on terms and conditions equal to those obtained by affiliated generators. Some argue that this objective can be achieved by having independent governance of transmission facilities; others suggest that effective competition requires that the incumbent utilities divest generation altogether. In either case, the incumbent utilities are “restructured” in the process of replacing end-to-end regulation with competition in the generation sector. For more, see T. Brennan, K. Palmer, and S. Martinez, Alternating Currents: Electricity Markets and Public Policy (Washington, DC: Resources for the Future, 2002) at 1, 71–80.
Allocation of authority among levels of government is not limited to these countries and regions. A recent issue of The Economist offered the following:

Electricity is a political issue the world over, but especially so in [Country X]. The debate over reform pits the central government against regional governors. Although [capital of Country X] controls wholesale electricity tariffs, the governors control retail prices. They are adamant about keeping this power so they can protect industries to which they have ties. Moreover, they are determined to maintain low electricity prices for households, which pay about $2 a month to keep their lights on, roughly the price of a cheap bottle of vodka.2

The last comparison tells us that Country X is Russia, only recently beginning to attempt to have competition in any market, much less one that has been regulated in nominally capitalist countries for about a century.

The Economist’s observations indicate that political power and self-interest are likely to determine how conflicts among levels of government will be resolved, not only in Russia but in Canada, the United States, and other places around the world with overlapping authorities. Our purpose is to shed some light on how these questions should be understood. Our hope is that adding some understanding on how authority over different sectors of the electricity industry might best be partitioned or shared might tilt the eventual outcome in all of these areas toward more sensible and beneficial consequences.

The discussion begins with a description of the division of regulatory authority over electricity markets in the United States between national institutions (e.g., the Federal Energy Regulatory Commission, or FERC) and state regulators (typically exercised through public service commissions or public utility commissions, or PUCs). It includes a review of a recent Supreme Court case3 that has legally if not conceptually clarified one dimension of the political competition among these jurisdictions, determination of the transmission charges billed to end users.

The review continues with a look at legislation considered in the 107th U.S. Congress that, if passed in some form by the 108th Congress, would affect further developments in the U.S.

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electricity industry.\textsuperscript{4} It also examines FERC’s efforts to encourage the formation of five large “regional transmission organizations” (RTOs) with standard designs for the wholesale electricity markets they would encompass.\textsuperscript{5} After looking at constitutional provisions and recent developments, the introductory sections conclude with a discussion of how federalism has played out in other contexts, primarily antitrust and telecommunications.

That background provides the basis for an examination of the division of authority among a national government and its member states from the standpoint of economic efficiency. The method will be to see what the justifications for using private markets rather than central governments to allocate goods and services offer as an analogy. Key dimensions of that comparison will involve information, cross-border externalities, and agency, that is, the ability of a government to reflect the political preferences of its constituents. In looking at allocation of authority across levels of government, the goal is not to impose a “right” policy (e.g., promoting efficiency) through a rhetorical “back door,” but to set up rules that would best reflect constituent views.

Lessons from this comparison apply to electricity restructuring, most especially to whether states or the national government should set the rules and policies for entry and competition at the wholesale level. They suggest that transmission and environmental regulations are more likely to be appropriately set on a regional interstate or national level. States and provinces should retain control over when and how to open local retail markets. In addition, uncertainty regarding the best way to organize electricity markets may warrant localized experimentation rather than risking a nationwide manifestation of California’s electricity crisis.

This paper concludes with a brief discussion of other ethical criteria unrelated to efficiency, for example, distributive justice and rights. Regardless of the degree to which such criteria apply to electricity policy in general or the federalism question in particular, they should be assessed to make our normative analysis more thorough. This analysis of state–federal relations may also pertain to issues of transnational governance, e.g., managing electricity markets that cross the U.S.–Canadian border.

\textsuperscript{4} 107th Congress, HR.4 (as passed by the Republican-controlled U.S. House of Representatives and HR.4 EAS, as amended by the Democratic-controlled Senate. Online links to these bills are available through the Web site of the House Committee on Energy and Commerce, http://energycommerce.house.gov/107/action/H.R.4.htm. A conference committee has been attempting to reconcile those bills; whether it will succeed in coming up with a compromise that both houses of the U.S. Congress will pass and President Bush will sign remains to be seen.

\textsuperscript{5} See n. 11 and 14 \textit{infra} and accompanying text.
Institutional contexts—the U.S. electricity regulatory structure

The Feds

Primary responsibility for electricity regulation at the federal level in the United States is part of the responsibility of FERC. FERC has existed by that name since 1977, but it was originally the Federal Power Commission, created by the Federal Power Act in 1935. FERC has authority over interstate commerce in oil pipelines and wholesale markets and delivery of natural gas and electricity. Wholesale markets essentially are defined as sales for resale to end users, for example, when a generation utility sells energy to a local distribution company, which in turn sells that electricity to residential, commercial, or industrial customers.

FERC’s most consequential efforts in electricity restructuring have sprung from its authority over interstate transmission facilities. Following mandates in the 1992 Energy Policy Act, FERC issued “open access” Order 888. This order promoted wholesale competition by requiring that utilities that own interstate transmission grids make those facilities available on reasonable and nondiscriminatory terms so unaffiliated generators can ship electricity to their customers. Since then, FERC has taken a greater interest in how transmission grids are organized, proposing creation of and rules for large-scale RTOs in its Order 2000, issued in December 1999. These large RTOs are intended to separate operational control over the grid from utilities that also own generators, so as to reduce incentives to discriminate against independent power producers. More recently, FERC has advocated a more specific RTO approach, creating five that would span the continental United States.

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6 For more on the history and responsibilities of FERC, see its Web site at http://www.ferc.gov/about/about.htm.
8 FERC also licenses construction of hydroelectric dams.
10 Accompanying Order 888 was Order 889, mandating institution of an Open Access Same-Time Information System (OASIS), to facilitate transmission and wholesale electricity markets by providing users with up-to-the-minute reports on tariffs and availability of capacity.
FERC also sets the rules for wholesale market pricing and design. Wholesale markets, whether supplied by independent power pools or instituted by state governments, have to have their rules and procedures approved by FERC. When wholesale prices in California hit unprecedented persistent levels in the summer of 2000 and winter of 2001, FERC mandated temporary wholesale price ceilings. As part of its initiative to bring the U.S. energy market under a few RTOs, FERC has proposed “standard market design” rules encompassing transmission access, congestion management, timing and coverage of energy and ancillary service trading, and capacity requirements. FERC has also attempted to use its authority over whether generators can set market-based prices as a lever to force utilities to join RTOs.

The states

While FERC’s authority is extensive, it cannot design and institute retail competition. Under U.S. law, regulation of the retail rates paid by households, businesses, and industry for power is carried out by the states. The agencies in each state that carry this out are generally known as public service commissions or public utility commissions (PUCs). The PUCs typically regulate the retail rates and policies regarding local telephone service, natural gas delivery, and often other services within the state.

With regard to electricity, decisions whether, when, and how to offer end users choice of their energy providers are up to the states. As noted above, the states may decide to design wholesale markets and set up organizations to manage the transmission grid in their states, but final approval of these actions remains with FERC. At this writing, 18 states are actively working to open markets. Twenty-five states and the District of Columbia (like a state in this regard) have no active efforts. California, most notoriously, was the first state to institute retail

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15 The FERC “supply margin assessment” test would revoke market-based pricing authority from generators that are large enough so that other competitors cannot supply peak demand in their regions, and do not join an RTO. FERC, Order on Triennial Market Power Updates and Announcing New, Interim Generation Market Power Screen and Mitigation Policy, Nov. 20, 2001, available online at http://www.ferc.gov/calendar/commissionmeetings/Discussion_papers/11-20-01/ER962495-015.PDF.
16 The National Association of Regulatory Utility Commissioners (NARUC) provides online links to the Web sites for the various PUCs at http://www.naruc.org/resources/state.shtml.
17 For example, in my home state of Maryland, the PUC regulates some water rates, taxicab fares, and piloting ships in local harbors.
competition and the first to pull the plug on it. Since the California electricity crisis, six states that had been actively restructuring retail markets have delayed their efforts.\(^{18}\)

Some regulatory authority over the electricity sector is more diverse and, in many respects, shared by both federal and state agencies. Mergers of electric utilities require the approval of the PUCs in states where the merger would result in a transfer of control of covered facilities. FERC retains approval authority over mergers, along with the agencies normally charged with enforcing the antitrust laws, the Federal Trade Commission and the U.S. Department of Justice’s Antitrust Division.\(^{19}\) Both the federal government’s Environmental Protection Agency and state environmental departments issue rules that may affect utility emissions and power plant and transmission siting.\(^{20}\)

**The states vs. the feds**

Relationships between the states and federal government in electricity matters are not always easy. Neither level of government generally wants to cede authority to the other. One manifestation of this dispute recently was the subject of litigation that ended up before the Supreme Court, the final court of appeal in the United States. In this case, *New York v. Federal Energy Regulatory Commission*, decided on March 4, 2002, the dispute was over whether FERC had misapplied its authority in issuing Order 888.\(^{21}\)

The issue in the case was FERC’s decision in Order 888 requiring utilities to offer open access for retail electricity transmissions under a nondiscriminatory tariff if the utility (with state approval) bills retail customers separately for transmission. However, if transmission is not unbundled in retail rates, FERC decided that states would retain implicit authority over rates

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\(^{20}\) For an example of state environmental regulation that supplements federal policies, see the California South Coast Air Quality Management District Title V Permit Program, described online at [http://www.aqmd.gov/titlev/index.html](http://www.aqmd.gov/titlev/index.html).

\(^{21}\) 122 S. Ct. 1012 (2002). The following description of the case and its resolution comes from this Supreme Court opinion. The decision is available online at [http://a257.g.akamaitech.net/7/257/2422/04mar20021030/wwww.supremecourtus.gov/opinions/01pdf/00-568.pdf](http://a257.g.akamaitech.net/7/257/2422/04mar20021030/wwww.supremecourtus.gov/opinions/01pdf/00-568.pdf).
charged at retail for transmission, when they set the overall retail prices for electricity. FERC was attacked from both sides. From one side, the state of New York and other parties claimed that FERC had overstepped the limits on its authority over the industry in forcing utilities to offer nondiscriminatory access for retail power transmissions if the utility bills customers separately for transmission. From the other side, Enron (prior to its notorious demise) attached FERC for deferring to states when transmission rates remained bundled.

In other words, the states argued that FERC could not regulate transmission rates and require open access at retail under any circumstances; Enron argued that FERC had to regulate those rates under all circumstances; FERC chose to regulate only when the transmission rates were unbundled on consumers’ bills. The Supreme Court sided with FERC. It held that Congress gave FERC authority to regulate the terms and conditions of transmission, without restriction to the wholesale market. (FERC authority over sales of electricity, as opposed to transmission, is so restricted.) With regard to Enron’s complaint, the Court held that FERC did not deny that it had authority over transmission rates even if bundled, but that it had the authority to defer to the states.22

Many states are also resisting FERC’s initiatives regarding RTOs.23 They argue that they should retain discretion over whether to join RTOs, which RTO to join. Many believe that joining should not be necessary if a state does not open retail markets. State governments are also concerned about transmission pricing and possible energy price increases if the RTOs wholesale market does not work well. Last and not least, they want to know what roles state PUCs will have in governing these multi-state organizations.

**Possible legislation**

The late 1990s saw numerous Congressional efforts to accelerate retail electricity competition through statutory imposition of federal authority over traditionally state-controlled retail markets.24 The Clinton administration proposed legislation that would have mandated open

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22 Disenting judges Thomas, Scalia, and Kennedy disagreed with the majority of the Supreme Court on this point, arguing that FERC did not supply necessary justifications for treating retail transmission differently depending on whether it was listed separately on the end user’s bill.

23 These arguments are found in various transcripts of hearings across the United States regarding FERC’s RTO proposals. Transcripts are available online on FERC’s RTO “Commission Issuances” Web site, [http://www.ferc.gov/Electric/RTO/issuances.htm](http://www.ferc.gov/Electric/RTO/issuances.htm).

24 *Alternating Currents*, n. 1 *supra* at 32.
markets by 2003, except in states that had elected to “opt out” through some sort of formal legislative process.25 In the wake of the California crisis, such calls are absent.

Both the House and Senate passed energy bills during the 107th Congress, but they were quite different. The Republican-controlled House bill had no provisions dealing with electricity markets. The Democratic-controlled Senate version had numerous restructuring provisions. Distribution utilities would have been required to offer real-time pricing to stimulate conservation during peak use periods. States would be encouraged to adopt competition and could call on FERC for technical assistance, but no mandates remain. An interesting provision of the Senate bill, section 242(a)(7), however, states that

No electric utility may refuse to interconnect a generating facility with the distribution facilities of the electric utility if the owner or operator of the generation facility complies with technical standards adopted by the State regulatory authority and agrees to pay the costs established by such State regulatory authority.26

This provision appears effectively to mandate retail restructuring, unless the state PUC can set “technical standards” or “costs” to be prohibitively high. In any event, we are unlikely to find out what this provision might mean until the issue is revisited after the new Congress begins in January 2003. With Republican control of the House and Senate, we might expect that any legislation passed in the 108th Congress would reflect views expressed by the Bush administration to propose “comprehensive legislation that promotes competition,” although with no reference to federal mandates.27

Legal contexts

U.S. Constitution

Space does not permit more than a brief synopsis of some of the legal structures in which conflicts between states and the national government are framed, if not resolved. But any such review would begin with Article I, Section 8, of the U.S. Constitution. Article I sets out the general rules and powers of the U.S. Congress. Among those powers enumerated in Section 8 is

26 See HR.4 EAS, via links at n. 4 supra.
the power “[t]o regulate Commerce with foreign Nations, and among the several States.” The roles of the states are also addressed in amendments to the Constitution. The 10th Amendment, part of the Bill of Rights, states in its entirety, “The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people.”

The so-called “commerce clause” of Article I, Section 8, has been interpreted quite broadly since the 1940s, when the Supreme Court declared, “The power of Congress over interstate commerce is not confined to the regulation of commerce among the states. It extends to those activities intrastate which so affect interstate commerce or the exercise of the power of Congress over it …” The court went on to say, “Our conclusion is unaffected by the Tenth Amendment [which] states but a truism that all is retained which has not been surrendered.”

One commentary describes the resulting scope of the commerce clause as “the direct source of the most important powers that the Federal Government exercises in peacetime, and, except for the due process and equal protection clauses of the Fourteenth Amendment, it is the most important limitation imposed by the Constitution on the exercise of state power.” Only recently has there been a rare reversal of the trend toward expanded federal power over the states. The Supreme Court invalidated a federal law against possessing firearms within a thousand feet of a school as exceeding Congress’s power over interstate commerce.

**U.S. antitrust**

Antitrust law in the United States has exhibited a surprisingly different pattern than that of national pre-eminence exhibited by judicial interpretations of the commerce clause. In this area,

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28 The 11th Amendment precludes U.S. federal courts from exercising jurisdiction over suits brought against states by residents outside the state or in other countries. The current Supreme Court has expanded state immunity under this amendment. In *Seminole Tribe of Florida v. Florida*, 517 U.S. 44 (1996), the Supreme Court invalidated Congressional authorization of suits against states by native American tribes. In *Alden v. Maine*, 527 U.S. 706 (1999), the Supreme Court disallowed suits under federal law against states in state courts.


30 *Id.* at 90.

31 Findlaw.com, Annotations, Article 1, Section 8, Clause 3, available online at [http://caselaw.lp.findlaw.com/data/constitution/article01/28.html#1](http://caselaw.lp.findlaw.com/data/constitution/article01/28.html#1).


the boundaries were set out by the Supreme Court in its 1943 decision in *Parker v. Brown*. That case involved a suit by a California raisin grower who wanted to sell more than the quota allowed by a committee set up under the California Agriculture Prorate Act. Despite the fact that the state of California had a virtual monopoly at that time over raisin production in the United States, the Supreme Court reversed lower court decisions and found against the raisin grower.

This decision created the “state action” doctrine in U.S. antitrust law, immunizing from antitrust liability state governments or private parties following state programs. As the Supreme Court stated in a recent state action case, “Principles of federalism require that the federal antitrust laws be subject to supersession by state regulatory programs.” Subsequent Supreme Court decisions following *Parker* refined the state action doctrine but have not reversed it.

The most important qualifications were established by the Supreme Court more than three decades later in its decisions in the *Goldfarb* and *Midcal* cases. In *Goldfarb*, the Supreme Court invalidated a minimum fee schedule for title searches imposed by the Virginia State Bar, on the grounds that the price fixing was not “compelled by direction of the State acting as a sovereign.” This came to be known as the “clear articulation” test, that is, that the anticompetitive conduct had to be the result of specifically defined state policy. In *Midcal*, the Supreme Court overturned a California law that allowed an otherwise illegal resale price maintenance scheme for wine, because the state did not “actively supervise” the scheme. The requirements that a state “clearly articulate” and “actively supervise” anticompetitive conduct to obtain antitrust immunity have become important components of the state action doctrine.

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34 317 U.S. 341 (1943).
39 *Ticor*, n. 35 supra. In that case, the Supreme Court invalidated a title search price fixing scheme in four states, finding that the mere existence of a state rate bureau nominally charged with the ability to veto rates set by private parties did not meet the “active supervision” requirement.
The electricity industry is not the only regulated sector that has seen conflicts between state and federal authority in the United States. The convoluted history of telecommunications begins with the Supreme Court’s 1930 decision in *Smith v. Illinois Bell*. In that case, the Supreme Court decided that it was appropriate to assign part of the (fixed) cost of the local telephone “loops” that run to a customer’s premises to the (variable) per-minute charges for long distance services. Over time this implicit subsidy grew, as falling costs for providing long distance service tempted regulators to increase the fraction of the costs of the line assigned to long distance carriers.

This cost reallocation was analogous to assigning part of the cost of the gasoline in one’s car to grocery stores because people drive to get food, and was enormously wasteful. The breakup of AT&T in 1984 and increased competition in markets for connecting users to long distance carriers eventually led to a substantial rationalization of these rates, reducing per-minute “access charges” and recovering loop costs through fixed monthly fees. This portion of the cost of these purely local facilities remains, however, confusingly, under Federal Communications Commission (FCC) jurisdiction.

Other cases have limited the FCC’s jurisdiction over state actions. Despite the *Smith* decision giving the FCC an interest in costs of local telephone plant, the Supreme Court ruled in 1986 that the FCC could not preempt the state of Louisiana’s schedules for depreciating telephone equipment. Four years later, the Ninth Circuit Court of Appeals ruled that the FCC could not preempt state authority to set terms and conditions under which local telephone companies could provide information services.

The 1996 Telecommunications Act, a major piece of legislation designed to, among other things, promote competition in local telecommunications markets, introduced new arenas of conflict between state and federal regulators. The Third Circuit Court of Appeals ruled that the

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41 282 U.S. 133 (1930).
Telecommunications Act did not overturn state zoning laws that denied a cellular telephone provider the right to place an antenna on top of an apartment building.\textsuperscript{45} In a more important case, the Supreme Court reversed the Eighth Circuit and found that the Telecommunications Act authorized the FCC to specify particular components used to provide local telephone service (“network elements”) and set prices and terms and conditions for their availability.\textsuperscript{46}

A final area of conflict involves cable television service in general and high-speed “broadband” Internet services. Such services are provided in some localities by cable television systems. Because localities have the authority to permit cable systems to install distribution lines under or over public rights-of-way, they have traditionally granted cable companies franchises for serving local areas. This has set up a long-standing conflict between local authorities and federal regulators, leading Congress in 1984 to strip these authorities of the ability to set rates.

Local cable authorities retain the right to choose franchisees. When some of large mergers in the cable industry took place in the late 1990s, these authorities attempted to use their right to approve franchise transfers to attempt to force these systems to allow any Internet service provider to offer broadband capability over the cable system’s lines. The cable industry wanted to reserve that capacity for its own broadband service, and the FCC initially opposed efforts by these local authorities to open the cable lines to other providers. Ironically, when America On-Line (AOL) merged with Time Warner, the FCC imposed “open access” regulations of just this sort.\textsuperscript{47} One might infer that the basis for the FCC’s opposition to the localities was not the substance of those rules, but its desire to ensure that it, not the states, got to make the relevant decisions.

\textbf{Efficiency context (1) – decentralized markets vs. central planning}

In many respects, the standard textbook microeconomic descriptions of consumers, producers, supply and demand, and markets do not explain why decentralized markets outperform central planning. Some economists argued in the 1930s that the advantages of marginal cost pricing could inform the task of a socialist economic manager as well as justify relying on a market system.\textsuperscript{48} The arguments in favor of markets do not follow from the


\textsuperscript{46} AT&T vs. Iowa Utilities Board, 525 U.S. 366 (1999).

\textsuperscript{47} FCC, In the Matter of Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorizations by Time Warner Inc. and America Online, Inc., Transferors, to AOL Time Warner Inc., Transferee, CS Docket No. 00-30, Memorandum Opinion and Order, Adopted Jan. 11, 2001, at ¶126.

theoretical analyses of the optimality of a “competitive equilibrium,” but from the practicalities of implementing systems for producing and distributing goods and services in a complex economy. 49 Three such practicalities stand out—information, incentives, and agency. These not only set out the case for markets over planning; they are also instructive in assessing when regulatory authority should be national and when it should be at the state or provincial level.

**Information**

In economic terms, the object of allocation and production decisions is to maximize the difference between benefits and costs. Ultimately, those benefits and costs are borne by those who consume goods and services and by those who supply the labor and resources used to produce them. A major virtue of markets over central planning is that they permit coordination of decisions made by those who know best the benefits and costs, that is, those who reap the former and bear the latter. Buyers can compare private information on benefit to market price, which under competition will correspond to marginal production cost. Sellers can compare their private information on cost to market price, which under competition will equal the marginal willingness to pay of consumers for the product. Markets mediate transactions so that all actors can make choices based on the information they have about costs and benefits.

For a central planner to accomplish this task, all of the information that markets process would have to be accurately transmitted to it. That planner would then have to use that information to ascertain supply and demand curves, determine prices, and distribute goods and services across the economy according to what they would have chosen at those prices. All of this would have to be done in a timely fashion, so the goods the central planner delivers at the end of the process correspond to the desires and costs reported at the beginning. With appropriate background expectations and institutions to define and enforce property rights and contractual obligations, that markets process all of this information effectively and quickly would seem miraculous were it not so routine.

Information, of course, is not perfectly created and distributed. Information is inherently a “public good,” that is, it can be “consumed” by one person without reducing the amount available for someone else. Because information is a public good, an economy may produce too little on its own or not distribute it as widely as it should be. Intellectual property protection (e.g., copyright and patent law) restores some of the incentives to produce information in some cases. Preventing unauthorized copying can enable information producers to earn a return on their efforts. But intellectual property law need not (and perhaps should not) cover all forms of information, and even where it does, charging a positive price could limit distribution of the

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information to all for whom it would be of value. For this reason, governments may have a role to play in subsidizing the production and distribution of some sorts of information, from basic scientific research to information on product quality and safety.

**Incentives**

Having the right information is a necessary but not sufficient condition for making efficient decisions. A second necessary condition is that those making the decisions have the right incentives to maximize benefits and minimize costs. An advantage of decentralized markets is that exactly those persons generally make those decisions. Buyers reap the benefits of their purchases, and bear the costs, insofar as the prices they pay reflect the marginal cost of supplying the goods they purchase. Suppliers bear the costs of production, but reap the marginal benefits of what they produce when they sell the products at a price, generally equal to marginal benefit. Consequently, each agent in a market, the buyers and sellers, has not only the information but also the incentive to make efficient decisions, that is, produce and consume up to the point where marginal benefit just equals marginal cost.

Here, too, governments are at a disadvantage relative to markets. Suppose that we could accomplish the staggering task of providing information on tastes and technology to a central planner in a reasonable time. That would not guarantee that the central planner would be inclined to use that information to produce efficient outcomes. The gains from those outcomes go to the individuals in the economy, not the government officials. The reliability of central allocations thus depends on how well the government reflects the preferences of the entire public. Unfortunately, as political scientists and economists have pointed out for decades, the proclivity of government to act on behalf of organized special interests or to benefit the bureaucracy itself suggests that the entire public’s interests will be poorly reflected at best.50

The case for markets is weaker when sellers or buyers do not bear the full costs of the goods and services they produce or purchase. If markets are not competitive, buyers or sellers will not take market prices as given and thus will not equate them with their private marginal benefits or costs, to produce the efficient outputs as described above.51 If markets for some goods are missing (e.g., because property rights necessary to facilitate mutually beneficial exchanges are impossible to define and enforce), people will not take the resulting “externalities” or effects on

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“third parties” into account. Markets may also disappear when asymmetric information (e.g., sellers knowing something about their products that buyers don’t know, or vice versa) can also lead markets to disintegrate. When markets are not competitive or missing, government action may be beneficial. Determining the point at which the benefits of improving market failures exceed the costs of government action with poor information and incentives remains frequently a matter of difficult judgment and considerable controversy.

**Agency**

A final aspect to efficiency, related to the incentives issue, is agency—do the institutions set up on a market economy to make decisions that reflect the preferences of those who instituted them? The presumption is that left to themselves, individuals will create organizations to minimize the effect of market failures relating to potential vulnerability to market power and exploitation, spillover “externality” effects, and asymmetric information, particularly relating to the costs of search. Firms are in many respects substitute mechanisms for allocating goods and services when markets may be too costly to use.

In many respects, the government could be viewed as the “big” solution to this agency problem, when problems of market power, externalities, and asymmetric information justify economy-wide solutions. For reasons noted above, centralization of control in this way may be justified. But the size of government means that the separation of decision making from those who reap the benefits and bear the costs of those decisions is maximized, with predictable consequences for inefficient decisions. Such divergence can also be found in large private institutions, for example, the corporation with a large number of stockholders. However, the organization of these firms presumably reflects an efficient balance between the benefits and costs of substituting institutional control for market forces. Ownership and participation in the organization are voluntary, and individuals are free to design, implement, and join institutions that better serve their interests.

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Efficiency context (2) – state governance vs. federal authority

The division of public responsibility between states and the national government has received considerable attention by economists. However, much of the attention has been on the effects of different levels of authority on the design of revenue-sharing programs between jurisdictions, as incentive mechanisms to foster more efficient decisions. Another perspective, related to that discussed here, examines tradeoffs between economic efficiency and political participation as separate values. The lessons of information, incentives, and agency in the individual versus planner context apply to the “state versus federal government” context, in which the state is the (perhaps imperfect) analogue to the individual.

Information

As with individuals, one might presume that smaller forms of government are closer to the governed. They are more likely to know better than the national government how their actions affect their constituents. The primary consideration on the other side is what one might call “economies of scale in expertise.” When regulatory policies involve complicated economic and technical effects, it may be wasteful to have more local governments reinvent the wheel. Moreover, information remains a public good. Each state may have too little incentive to develop good policies if other states can benefit from their expertise. In some cases, acquiring and using the information necessary to develop appropriate policy responses may be beyond the political or budgetary constraints facing a local government. It may be less costly or more efficient for the central government to undertake the analysis and policy design once for everyone, particularly when the likely “best solution” would apply equally well across the nation.

Two caveats may apply even when issues are complex and economies of scale in expertise seem apparent. The first is that being better able to develop relevant information does not imply that the national government should impose on states the policies implied by that information. The government could offer its expertise, either through ongoing consultation or finished

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58 Inman and Rubinfeld, n. 56 *supra*.
products, and the states could decide as they see fit how to make use of the information.60 A second consideration is that multiple jurisdictions undertaking different approaches to regulation and deregulation can generate information that might be missed if a single national policy were implemented. The value of being able to learn from others’ mistakes in a limited context is particularly important in electricity.

Incentives

The analogy to market failure in the federalism context is whether a decision by a state has efficiency effects that cross its boundary. Two categories are important. The first is if the state is able to exercise market power against buyers (or sellers, under monopsony) outside its borders. If so, a national government’s authority may be necessary to protect its constituents at large from those effects. By this criterion, the foremost state action case in U.S. antitrust, Parker v. Brown, was decided incorrectly—national antitrust laws should apply to protect the rest of the country from one state’s monopoly, in this case over raisins.61 This leaves a state free to decide to create monopolies that affect only its constituents; presumably that should be a matter for the states themselves to decide.62

A second spillover involves externalities. A typical example would be air pollution generated by factories in one state that wind or river currents deliver into another, with deleterious effects. The upwind or upriver jurisdiction may not consider the interests of others without policies set at the national level. However, although this may justify national regulation, it need not require it.

60 A related response applies to an oft-heard argument that nationwide standards may be necessary in order to avoid costs imposed by a “patchwork” in which each state or province sets different policies. Ultimately, the costs of not following an otherwise desirable standard policy are borne by the region that makes that decision. Its constituents will have to compensate providers for the extra costs they incur to obtain customized services. The situation is no different from a consumer who can choose between getting an inexpensive, off-the-shelf item or electing to get something tailored to suit particular preferences. As with the question of relying on information provided by the national government, states can decide for themselves whether the benefits to them of implementing nonstandard policies exceed the costs they would bear in doing so. National setting of standards does present one ironic legal problem, at least in the United States. Under the Administrative Procedure Act, 5 U.S.C. §706(2)(a), courts will overturn a regulatory agency’s decision if it is “arbitrary [or] capricious.” However, government action to set a standard will be most necessary when no single standard is obviously the best, since such a standard would likely arise out of the give and take of the market. But when no standard is best, picking a standard is inherently arbitrary, and thus vulnerable to court challenge under the APA. When we most need the government to choose a standard, it is least able to do so.

61 See n. 34 supra and accompanying text.

62 A wrinkle in the Parker case is that the plaintiff was not a raisin consumer outside California but a grower within California that wanted to grow more raisins. Were the growers the only “victims” of California’s policy, the U.S. Supreme Court’s decision would be correct on efficiency grounds—California is best placed to weigh costs and benefits of policies insofar as they affect California residents.
If the law is otherwise clear regarding the legal rights of states to impose spillovers on others, states may be able to negotiate directly with each other to resolve conflicts regarding externalities. Such negotiations, however, are unlikely to succeed if the effects cross multiple jurisdictions.

The effects need to be related to efficiency. In markets, individual decisions may have pecuniary effects on other persons or firms, for example, when they decide to purchase a product from one vendor rather than another. However, decisions with those effects do not suggest inefficiency, for example, that one could make everyone better off through some other set of transactions. In the “market versus planning” question, public policies come into play on efficiency grounds only when production or consumption decisions result from the exercise of market power or are distorted by the absence of markets reflecting costs and benefits external to the transaction. By analogy here, we would be concerned only with market power or externality spillovers resulting from decisions taken by a state. That such decisions sometimes result simply in gains or losses to firms outside the boundary would not warrant national preemption of more local authority.

**Agency**

The agency criterion plays a greater role in comparing local authority to that of the federal government. Not just one stage but both stages involve inherent limitations on the quality of the connection between consumers and the public entities making decisions on their behalf. But following the analogy from looking at the questions of “markets versus government,” the test for whether federal authority should preempt local decisions is: Did local authorities failed to act in ways reflecting the views of their constituents, and would the national government be likely to do better?

This test covers procedural integrity, not substantive outcomes. Federal authority ought not restrict local decision-making, however inefficient the outcome, absent significant effects outside the jurisdiction or impediment to providing the locality with appropriate information, regardless of what the local decision is. The analogy to “markets versus government” is useful here. The efficiency argument for deferring to individuals is not that they make decisions that are substantively “rational,” for example, eat nutritious meals instead of fast food or read great books.

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63 See Inman and Rubinfeld, n. 56 supra at 681-84 for a discussion of the feasibility of such negotiations and impediments to their resolution.

64 If markets are competitive, those decisions will have no effect on the nominal losers, since price just equals marginal cost or marginal benefit. This need not be always be true, for example, when a firm sinks cost in an inventory that may or may not end up being sold.
rather than watch television. Rather, it is that the criterion speaks only to allowing people to get what they most want, whatever that happens to be, regardless of the reasons (or lack thereof).

The post-Parker qualifications to the state action doctrine in U.S. antitrust law exemplify this principle. As that doctrine has evolved, national antitrust law can restrict actions taken under state auspices if the anticompetitive policy is clearly articulated and actively supervised. One could interpret these standards as meaning that a lack of clear articulation or active supervision indicates that the anticompetitive outcomes at issue do not reflect the policy choices of the residents within that state.

Even if provinces or states have less than perfect processes, national governments need not have decision-making procedures that are more open and less biased. In my experience in the U.S. federal government, the references to state governments I heard were usually disparaging at best. However, that experience did not indicate that the federal government did better. A compelling example was the successful effort of the cable television industry in 1984 to persuade Congress to void the franchise contracts cable operators had freely entered into with cities and counties. It suggested that there might be economies of scale in exercising special interest influence. A single big effort to get Congress to act on one’s behalf could be more effective than dozens or (in the case of cable) thousands of smaller efforts to get special benefits from local governments.

Numerous factors imply that focusing on political integrity requires judgment over many unanswered and perhaps unanswerable questions. No firm rule guarantees that decisions reflect the body politic’s preferences where voters elect only a handful of officials via plurality vote only every two to six years. Despite the inherent priority of process in ascertaining the correspondence of public choices to the public’s preferences, substance may still provide useful information, in the way that sufficiently irrational choices by individuals may lead one to question whether those choices should remain free from state interference. There may always be an argument whether, particularly in a federal system, that preemption by the national government is done with the consent of the states or provinces that constitute the nation.65

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65 The voluntary nature of state or provincial associations may also be relevant. A prominent argument in the public finance literature is that local governments’ policy choices are determined by a kind of competition for residents who can move from one jurisdiction to another [Charles Tiebout, “A Pure Theory of Local Expenditure,” *Journal of Political Economy* 64 (1956): 416–24]. The “market for residents” may be thought of as like rules chosen by universities that offer different bundles of classes and research options to attract students with different tastes. Those wanting small, teaching-oriented campuses will go to some; those wanting a large, urban experience may choose others. Whether in fact residents are sufficiently mobile to force localities to adopt efficient mixes of policies, services, and taxes remains controversial.
Efficiency context (3) – applications to electricity\textsuperscript{66}

With this framework established, we can use the dimensions of information, incentives (i.e., spillovers) and agency to look at how authority over electricity restructuring might best be divided.

\textit{Information}

Inadequate information can be a problem for a state or provincial government in two related ways—a lack of the information itself and insufficient expertise to make proper use of the information. On the first, when it comes to electricity restructuring, my guess is that in general states are not lacking in information. In the United States interested parties are generally prepared to inundate state government officials with volumes of studies and arguments designed to persuade legislators and regulators of the merits of their cause. Similar conclusions apply regarding expertise—states have experience in-house, and can hire outside experts as needed and rely on information provided by central governments to help make decisions.\textsuperscript{67}

A more telling argument in favor of leaving states with authority over electricity restructuring has to do with genuine uncertainty about how best to go about it. The list of open issues includes and is not limited to reliability assurance, auction market design, real-time pricing, ancillary service provision, consumer protection and default service practices, unbundling of regulated monopoly wires from nominally competitive generation, and stranded cost recovery.\textsuperscript{68} Had the United States moved toward opening retail markets at the national level, it quite possibly would have adopted the California model, as that state was the pioneer in giving extensive attention and support to opening retail markets. Had that happened, the problems that befell California could have happened nationwide.\textsuperscript{69}

\textsuperscript{66} This application of efficiency analysis to address the allocation of regulatory authority among levels of government draws on Chapter 12 of \textit{Alternating Currents}, n. 1 \textit{supra}.

\textsuperscript{67} Provincial governments in Canada appear to be even stronger relative to the national government compared to U.S. states. Accordingly, provincial officials would be even more likely than those in U.S. state governments to be provided as much information as is available regarding the merits of the different paths available toward or away from electricity competition. Like states, Canadian provinces can also acquire information through the use of independent experts or advice from the federal government.


One clear lesson of the U.S. experience is that having multiple states and regions trying different approaches to restructuring provides information to all. States and provinces can compete with each other on how and when to open electricity markets, using better rules to attract businesses and industries most suitable for a particular region of the country. To supplement this competition, rather than have one method prescribed from above, a better policy may be for the central government to subsidize different approaches by different states, so each can learn from the other.

**Incentives (spillovers)**

The best case for some nationwide authority over opening electricity markets at the federal level involves those features of the industry that cross state boundaries. The primary interstate aspect of the electricity industry involves long-distance transmission. These transmission lines cross political boundaries. Moreover, because electricity takes all routes to go to a particular path, shipping electricity between two points will involve many if not all of the transmission lines connected over the entire region, not just those going between the two points.

These properties of the grid provide the cross-border effects that merit national policy to set standards and practices for the design of wholesale markets. Federal regulators should have a substantial if not exclusive role in setting tariffs, access policies, congestion management practices, and reliability policies for transmission. Because transmission is the means for shipping electricity at wholesale (from generators to distributors or “load serving entities”), wholesale markets depend on the rules by which transmission is priced, particularly when lines are congested.

A third electricity-related area in which a national government should play a role involves environmental policy. Power plant emissions of sulfur dioxide (SO$_2$) and nitrogen oxide compounds (NO$_x$) are typically borne by air currents over a wide area. A state need not be expected to take the effects of these emissions on those outside its borders when deciding where to site generation units and how intensively they should be taxed or otherwise controlled to limit the volume of pollutants they emit. Unless states can negotiate regulation and compensation schemes to control cross-boundary spillovers of pollutants, the federal government can play a useful role in setting appropriate policies.

These justifications for a national role in transmission, wholesale market design, and environmental controls do not apply to opening retail markets, that is, giving end users the ability to choose their power supplier. For the most part, the winners and losers in decisions when,
whether, and how to open retail markets are the consumers within the state.\textsuperscript{70} Those constituents are best placed to evaluate the benefits of being able to choose a supplier—lower prices, competition in providing energy services, ability to choose “green” providers. They are those best placed to decide, through their state government, whether those benefits exceed or fall short of the costs of that choice and to institute new markets and regulations to ensure that those markets work adequately and reliably.

\textit{Agency}

The final efficiency-related justification for federal preemption of state or provincial decision making would be if decisions made at the lower level of government were less connected to the preferences of their constituents than would be decisions at the higher level of government. Special interests undoubtedly play a strong role at the local level. Few of us are likely to participate in state PUC hearings to determine whether a utility’s proposed rate increase is just and reasonable. On the other hand, fewer still are likely to weigh in with decisions made even further away, in the national capital. Moreover, as California and Alberta exemplify, electricity policy decisions can and do receive substantial political attention.\textsuperscript{71}

For this reason, proposals in the United States during the late 1990s to force states to open electricity markets were not warranted by failures of the political process. Perhaps unintentionally, the Clinton administrations “opt out” proposal was a method to ensure that procedural integrity played a role in state electricity policy making. No assurance is perfect, but mandating that states open markets unless they went through some explicit legislative or regulatory policy to make an affirmative decision not to restructure would help ensure that decisions not to open markets reflected the public’s political preferences. One might argue that the burden need not have been imposed on the states to show that they did not want regulation, but an “opt out” at least leaves room for states to express their own, perhaps contrary, views.\textsuperscript{72}

\textsuperscript{70} As described above, there may be pecuniary effects outside the state, but those are inherently no different from the effects when individuals decide to purchase goods or services from one seller rather than from another.

\textsuperscript{71} California opened its electricity markets to competition in 1996 by a bill that passed the state legislature unanimously, after years of highly publicized debates on the merits of competition. It received full backing of virtually every imaginable interest group, including incumbent utilities, large industrial customers, new entrants, consumer groups, and environmentalists. That the chosen method for managing retail markets exacerbated a supply crunch and created a state crisis in the summer of 2000 testifies not to the power of special interests in market design. Rather, it speaks to the difficulty of getting it right and the merits of having multiple settings in which to identify best practices.

\textsuperscript{72} As noted above, however, since the California debacle there has been little to no movement in the U.S. Congress to force states to open retail markets.
Non-efficiency contexts

The discussion would not be complete without a look at policy norms besides efficiency and how they might apply to electricity policy decisions—here, distributive justice and moral rights.73

Distributive justice

Although efficiency is one conventional and useful criterion for looking at policy questions, other norms apply as well in judging the merits of one policy over another (including none at all).74 The first of these is distributive justice. A usual way to think about distributive justice is in the inequality of income or wealth. Underlying wealth distribution are more fundamental ethical norms. One, utilitarianism, implies that resources should be allocated to maximize the overall “utility” of people in a society. We might regard utility in a variety of ways—pleasure, happiness, or in the economist’s general framework, the ability to get more preferred bundles of goods and services.75 Combined with assumptions that (i) marginal utility of wealth falls the more one has—an assumption consistent with aversion to risk—and (ii) each individual gets the same utility from a given amount of wealth, utilitarianism suggests that more equal distributions of wealth tend to be better.

A second philosophical perspective underlying concerns with wealth distribution comes from Rawls.76 Leaving aside important nuances, Rawls’s argument begins with the viewpoint that a just society would be that which people would construct without taking their particular

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73 Other potential norms involve considerations that go beyond the individualistic orientations of efficiency, distributive justice, and rights. In some views, larger groups of persons—families, regional communities, ethnic groups, nations per se—have ethical claims apart from the interests of individual members. Other perspectives allow for ethical claims held by those other than persons—animal rights, ecosystems—apart from the values persons place upon them. I neglect these here, as they would not appear to play a significant role in electricity restructuring decisions, but they may figure into these or related policy debates.

74 Assessing the relative roles of ethical norms and political clout in the actual decision, design, and implementation of public policies is outside our purview here.


circumstances into account. If people were ignorant of their particular circumstances, but
cognizant of how social institutions (notably including markets) work, Rawls argues that persons
would organize society to maximize liberty and then distribute goods and opportunities to
maximize the well-being of the least well off person. Inequality would be tolerated if it improves
the standing of the least off persons, for example, by providing incentives to more productive
persons who generate more wealth for all.\footnote{The heart of Rawls's argument is that were persons choosing social institutions without knowing which life they would lead, they would be maximally risk averse. If individuals in the “original position” behind the “veil of ignorance,” using Rawlsian terms, were expected utility maximizers, they would choose institutions consistent with overall utilitarianism rather than focusing on the well-being of the least well off person [John Harsanyi, “Morality and the Theory of Rational Behavior,” in Amartya Sen and Bernard Williams (Eds.), \textit{Utilitarianism and Beyond} (Cambridge: Cambridge University Press, 1982): 39–62].}

Some distribution-related issues in electricity are part and parcel of efficiency concerns. If
market power at any stage leads to higher prices, holding down those prices through antitrust
enforcement or rate regulation will promote distributive objectives as well. More distinctively
distribution concerns arise because peak electricity prices may be 50 or 100 times normal prices,
even if the industry is competitive. Policy makers may want to institute some price controls to
mitigate the wealth transfer—possible at the cost of reducing peak period supplies and increasing
the likelihood of blackouts—at least until more generators come on line and reduce overall
payments from consumers.\footnote{See \textit{Alternating Currents}, n. 1 \textit{supra} at 97–98.} Opening markets, particularly wholesale markets, will tend to cause
electricity prices to “average out” across a wide area, reducing prices in previously high-cost
regions but raising prices and reducing overall consumer wealth in low-cost areas.\footnote{\textit{Id.}, 189–90.} Last, low-
income households might obtain public assistance to cover electricity purchases to ensure
minimal levels of consumption (e.g., heat in the winter) and as an indirect means of alleviating
poverty.

\textit{Rights}

From an ethical perspective, rights differ from both efficiency and distributive justice.
Efficiency is concerned with the absence of waste, in the sense of not forgoing opportunities to
benefit some without hurting others. Distributive justice speaks to the ability to procure goods
and services one most prefers. Rights, on the other hand, assert specific moral claims based on
important, intrinsic values that such claims protect. For example, the “right to vote” is not
warranted by either efficiency or distributive justice—it’s not a good whose benefits lie in
promoting utility or being bought and sold—but in protecting values associated with citizenship
and political participation.
Because rights constitute a moral dimension separate from efficiency or equity, they and the values they protect may warrant reducing utility as such and may “trump” such collective policy concerns. As such, their categorical nature and reliance on assertion of specific values makes them rhetorically and morally problematic; the utilitarian Jeremy Bentham famously referred to them as “nonsense on stilts.” One response to this objection is that rights, by protecting specific values, must bring with them obligations on the right holder not to alienate them, for example, that having the ability to vote by virtue of a “right” entails an obligation at least not to sell that right. Permission to alienate the right to vote would convert it into just another form of wealth.

Even if rights are a successfully defensible moral category and not merely “nonsense on stilts,” their application in electricity contexts is problematic. Some concerns with ensuring that low-income households can get electricity inexpensively may be connected to rights-based arguments. For example, one might say that obtaining electricity is necessary to have the minimal ability to communicate with others and participate as a full and autonomous member of political and cultural communities. However, the benefits of having electricity at lower prices seem primarily instrumental—allowing people to choose from among a wider range and goods and services.

**Nonefficiency norms, federalism, and electricity**

Distributive justice and rights are relevant in this discussion only to the degree to which they justify national preemption of state or provincial policy choices in electricity. A national government might justifiably intervene when states provide too little protection for moral rights, as the U.S. government has done in preventing states from discriminating against racial groups in the provision of political or civil rights. But unless one were to argue that consumers have a moral right, as opposed to an efficiency or welfare interest, in having competitive electricity markets, rights-based considerations do not seem pertinent to whether nations or subnational political units are appropriate for making particular electricity policy choices.

Distributive justice may make for a more appealing case for federal intervention to promote distributive justice. Individual states or provinces may have too little ability to redistribute wealth, as the wealthier people who pay will have some inclination to leave such jurisdictions, and the recipients of lower rates will have some inclination to move into them. If moving into

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80 Ronald Dworkin, *Taking Rights Seriously* (Cambridge, MA: Harvard University Press): xi–xiii. Dworkin’s main objective is to show how moral rights arguments properly inform judicial decisions as to what legal rights one has. But the two types of rights remain different. Legal rights may be thought of as what we can do; moral rights may be thought of as what we ought to be able to do in order to promote intrinsic values.

81 The example also illustrates Dworkin’s position (*Id.*). When rights are invoked, concerns with welfare as reflected in financial wealth seem comparatively trivial.
and out of nations is more difficult, redistribution might be more successful at the national level. That said, the wealth redistributed in electricity markets through these policies is slight. Whether it is desirable to subsidize electricity purchases by low-income households, such subsidies are not likely to have such substantial effects on either the taxpayers or the recipients to justify national preemption of state policy choices.82

Transnational contexts

Our focus has been on the legal background for federalism in electricity, including both its broad constitutional setting and specific application in other competition-policy related contexts. Economic efficiency offers a framework for allocating regulatory authority between state or provincial authorities and the national government. The key dimensions of that framework—information, incentives and cross-border spillovers, and agency issues relating to procedural integrity—explain the importance of a federal role in transmission and wholesale market design. They also provide more support than is often given toward leaving retail market questions to local governments. Not only are states or provinces best placed to assess the merits of opening retail markets from their constituents’ standpoints, but the nation gains in learning from multiple experiments in the different ways to implement electricity competition.

The analyses here do not stop at national boundaries but may justify assessing a governance role to transborder institutions, particularly when decisions in one country have substantial effects in another. The dominant subject of the Van Horne conference proceedings involved the extent to which Canadian provinces and utility companies can and should participate in regional transmission organizations largely designed in the United States but whose relevant grids and wholesale markets cross national boundaries.83 Transnational governance may facilitate efficient electricity trade and help the United States and Canada promote social objectives, but it could

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82 One may also question the extent to which states should be free to pursue their visions of good policies. The defining premise of liberal political theory is that government actions should be neutral regarding different conceptions of the “good,” leaving individuals to pursue the ends they choose. The role of the state should be limited to providing protections and, more controversially, necessary abilities to allow individuals to pursue their own ends. Continuing the theme of analogizing “provincial versus federal” to “individuals versus governments,” liberal political theory may imply similar national deference to the choices of more local forms of government.

83 The considerations are very similar to those warranting transborder organizations to deal with environmental spillovers between the United States and Canada [Secretariat, Commission for Environmental Cooperation (CEC) of North America, Environmental Challenges and Opportunities of the Evolving North American Electricity Market (Montreal: CEC, 2002): 23].
conflict with the desire for national sovereignty for either country.\textsuperscript{84} Although the analysis above could prove useful in suggesting how international electricity markets should be governed, the absence of a higher transnational governmental authority suggests that it need not determine how such markets will or will not eventually be governed.

\textsuperscript{84} Lawrence Summers recently and usefully pointed out that although it is easy to promote any two of the three goals of (i) free trade, (ii) social benefits, and (iii) sovereignty, promoting all three at the same time will inevitably lead to tensions. Lawrence Summers, “Governance and Global Markets,” Resources for the Future 50\textsuperscript{th} Anniversary Symposium (Oct., 15, 2000), available at www.rff.org/50thannivsim/Transcripts/Lawrence%20Summers%20Transcript.pdf.