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Title: Economics, Ethics, and The Long Arc of Public Utilities:  
A Paper in Honor of Professor Harry M. Trebing

JEL Codes: L5 and L9

Short Abstract

Harry Trebing has made substantial contributions to the understanding of social control of economic enterprise, and in particular the regulation of public utilities. Imbued with institutional economic ways of knowing, he sustained the construct of Progressive era public interest regulation during a period of neoclassical economic assault on regulatory institutions.

### Introduction

"Public utilities are closely associated with our conception of civilization. The public interest is manifested chiefly in connection with those functions which preserve civilized life, and prevent it from becoming, as Hobbes says, 'solitary, brutish, and nasty'.

Martin G. Glaeser<sup>1</sup>

Harry Trebing is a reform minded institutional economist of unquestioned importance. Educated at the University of Wisconsin, when it was a bastion of institutionalism, he earned a place in the highest echelon of those who established the rationales for and formats of social control of industries. Trebing has both enhanced the constructs of institutionalism and advanced the institutions of institutionalists - for which, as Allan Gruchy observed, members of AFEE should be continually grateful.<sup>2</sup>

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<sup>1</sup> Martin Glaeser, *Outlines of Public Utility Economics*, The MacMillan Company, (1929) 12.

<sup>2</sup> "The Association for Evolutionary Economics has had no more dedicated a member than (Harry Trebing). He rescued the Journal of Economic Issues from possible oblivion at one of its darkest times. He was successful in securing financial aid for the association from Michigan State University. In addition, he served as the association's eighth president and has always been willing to devote time and energy to assuring the welfare of the association and its journal. He has been especially concerned with keeping the door of the association open to younger institutionalists who will be called upon to carry the baton after we have passed on. In all matters he has gone far beyond the calls of duty and responsibility, and the members of the Association for Evolutionary Economics are greatly indebted to him." Allan G. Gruchy, "The Veblen-Commons Award - Harry Trebing," *Journal of Economic Issues*, 18, 2 (1984) 349 - 351.

An abiding concern of Trebing has been the existence, use, and abuse of market power (which, by its very nature is extortive and distortive) - especially with regards to public utilities. Following in the footsteps of Martin Glaeser, Richard T. Ely, John R. Commons, J. M. Clark, James Bonbright, and Eli Clemens, Trebing's work has reinforced an understanding of both the appropriateness and appropriate means of public utility control. He has furthered the public interest theory of regulation with its incumbent objectives of pursuing social rather than private goals and attaining the higher public efficiencies.<sup>3</sup>

Harry Trebing's work has been holistic in nature, recognizing the need for a reciprocal understanding of the whole and the parts of regulatory institutions. Adept at Veblenesk keen-edged commentary, Trebing has followed the institutionalist tradition of John R. Commons by combining theory with active participation in the institutional processes of regulation.

### The Nature of Public Utilities

The nature and need for public utility services is based on the recognition of the conjoint essential requirements of society. The guiding principles for the role and responsibilities of providers of utility services are encapsulated in the 'public utility concept', an enunciation of fundamental social and moral ethical standards for the provision of critical services essential for public wellbeing.

Public utilities are quasi-public entities that are characterized by the inherent market power of the providers and the necessity of the services provided. Their quasi-public nature exists because the essentialness of the services provided extends to the needs of society and because the services can be provided differentially on a fee for use basis.

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<sup>3</sup> See Harry Trebing, "Regulation of Industry: An Institutional Approach," *Journal of Economic Issues*, 21, 4 (1987) 1705 - 1737.

The market power of public utilities exists by virtue of other factors than the various forms of market manipulation<sup>4</sup> and state grants of authority.<sup>5</sup> Market power can exist by virtue of production and delivery technologies that have economies (such as scale, scope, diversity, and utilization) and significant costs of entry and exit sufficient to limit the number sustainable providers in a given market area. Such technologies are the basis of 'natural monopolies' and 'natural oligopolies'. Market power can also exist by virtue of control of limited sites suitable for placement of bridges, docks, wharves, canals and so forth.

Utility services are essential both for individual wellbeing and for the wellbeing of society. Some necessities arise naturally from biological requirements for sustaining life, such as access to clean water and sanitation services.<sup>6</sup> Some necessities arise from the adaption to evolving facilitating technologies and delivery systems<sup>7</sup> Whether arising naturally or by means of adaption, the needs for essential utility services extends throughout society without regards to income or location.

At various times, industries seen as having public utility characteristics have included water systems, transportation, services incidental to transportation and more recently, telecommunications, electric power, and natural gas delivery. Increasingly, many view wireless service, cable, and internet connectivity as possessing public utility characteristics.

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<sup>4</sup> For example, anticompetitive practices such as price fixing, market sharing, predatory pricing, strategic mergers, monopolization, and so forth.

<sup>5</sup> For example, exclusive rights granted to either a single or limited number of entities by charter or limiting types of licensing.

<sup>6</sup> While food, housing, and clothing are biological necessities, their means of provision does not typically convey market power to the producer. Site constraints and the technology of water supply, however, can convey market power.

<sup>7</sup> These are utilities that 'though not public at inception become so overtime' referenced in *Charles Wolff Packing Co. v. Court of Industrial Relations*, 262 U.S. 522 (1923),

The provision of public utility services extend back millennia. In ancient times, such services have included water supply, sanitation, drainage, irrigation, and transportation systems.<sup>8</sup> Public wells were dug in Ancient Egypt and Mesopotamia. Romans built aqueducts to bring water to Rome and canals to dispose of all of the city's sewage and storm water into the Tiber river. Drainage systems were built in Babylon and irrigation systems were developed in Egypt. Phoenicians constructed artificial harbors and built lighthouses, and so forth. With regards to transportation, Greeks and Romans built roads and paved streets. Ferries were established to carry people and goods across rivers and transport canals were built in ancient Egypt, Rome, and by the Moors in Spain. In addition, street lights (oil lamps hung across streets by ropes) were installed in Antioch in the 4th century C.E. Though some utility services in ancient times were provided as private undertakings, most were provided by the state.

Privately provided utility services declined in the middle ages, because of a lack of security due to the instability of political entities. Private utilities began to expand in the 17th and 18th centuries. In more recent times the advent of electric power and telecommunication technologies led first to the establishment of local utility systems and then with the adoption of alternating current and signal repeaters these utility systems expanded regionally and nationally. The advent of rolled steel pipe and arc welding led to the development of a nationwide natural gas delivery system.

The combination of supply characteristics and provision of necessary services has resulted in significant public utility market power. Their power is not clearly evident at a state of equilibrium in utility markets. At equilibrium, the power of all parties has been equalized,

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<sup>8</sup> Martin Glaeser traced utilities and public function undertakings to the time of ancient Egypt and Greece. See Glaeser, *op cit*, Chapters 1, 2.

meaning that utilities have exhausted their ability to extract economic rents from its consumers. The power of utilities is seen most clearly during states of disequilibrium, which exists almost continuously, where utilities have the ability to shift adverse consequences onto consumers and others. Unchecked public utility market power results in the discretionary ability to choose price levels, discriminate among consumers, limit access to service, and choose technologies of production and the placement of production facilities. Such power can result in the perpetuation of adverse social and environmental externalities, and, as utilities extend their reach through national expansion, increase their political power leading to a potential of oligarchies of oligopolies.

#### Freedom To Extort, Ethical Standards, And The Public Utility Concept

Markets might yield reasonable social consequences, but only when there is an absence of externalities and consumers have an unfettered freedom to choose, including the freedom to choose not to purchase a product and not experience a loss in wellbeing.

The choice of 'your money or your life' provides only two choices imposed by one possessing a clearly dominant position of power. Such a choice is an extreme example of market coercion. A less extreme example of market coercion when the seller of a necessary good or service has the capability to extract revenues far in excess of the cost of the services made available. Because of the necessity of the services offered, the consumer does not have a reasonable ability to choose to not purchase the service yet not experience a loss in wellbeing. Viewing this form of market coercion as morally and ethically wrong, Saint Augustine developed the concept of 'just price' to serve as a guide for the sale of necessary services. Just price was defined as an amount equal to the cost of providing the necessary service. A just price stood in opposition to a 'natural price' which reflected the relative market power of the buyer and

seller. For providers of necessities, the natural price would always exceed the just price. The just price became the fundamental element of the public utility concept and formed a basis for the regulatory establishment of prices from that time forward. Later, Saint Thomas Aquinas refined the ethical concept of just price to include a reasonable recompense for the provider of the necessary services.

Interpretations under the common law would clarify the public utility concept as encompassing non-discrimination both in regards to access to necessary services and the relative terms of trade. In addition, interpretation of the common law led to the inclusion of the medieval concept of 'status' or reciprocal responsibility which established responsibilities for those who provide services that are of public in nature. These ethical constructs of the public utility concept are concordant with the concept of the common good. As recently reaffirmed by the Pontifical Council for Justice and Peace, the principle of the common good arises from the dignity, unity, and equality of all people and the right of persons to have access to the level of wellbeing necessary for his own development.<sup>9</sup> These ethical prescriptions lie well within the bounds of institutional economics and are elemental for the pursuit of socially responsible public utility regulation.

#### Evolution of Public Utility Regulation

While Martin Glaeser made clear that root of the public utility concept was established by Saint Augustine's development of the concept of just price, many institution economists,

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<sup>9</sup> Pontifical Council for Justice and Peace, *Compendium of The Social Doctrine of The Church*, Libreria Editrice Vaticana (2004) paragraphs 164, 165.

including Harry Trebing, trace the evolution of public utility regulation from the public calling common law prescriptions made clear by Lord Chief Justice Hale. In the in the mid-1600s, Chief Justice Hale determined in a number of cases that:

If any service rendered is of such public character as to make the agency rendering the same a public service company, then the investment in and the property of such utility becomes impressed with a public interest and ceases to be private property. Property does become clothed with public interest when used in a manner to make it of public consequence and affect the community at large. When, therefore, one devotes his property to a use in which the public have an interest in that use he must submit to be controlled by the public for the common good to the extent of the interest he has created.<sup>10</sup>

Chief Justice Hale thus established the basis for judicial regulation of public utilities and provided the basis for establishing the constitutional right for public utility regulation in the United States.<sup>11</sup>

The institutional forms of public utility regulation in the United States have evolved substantially. The various forms of public utility regulation have included regulation by charter, legislative regulation, judicial regulation, and regulation by independent administrative. Administrative regulatory agencies, the most common form of modern public utility regulation, have varied substantially in authority and forcefulness. An early agency, the Massachusetts Board of Railroad Commissioners of 1869, relied on moral suasion and appeals to the public to

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<sup>10</sup> Quoted by John S. Rilling, " Regulation of Utilities by a Regulator," *Public Service Magazine*, 23 (1917) 38-39

<sup>11</sup> See United States Supreme Court decision in *Munn v. Illinois* *Munn v. Illinois*, 94 U.S. 113 (1876) where the court relied on the common law to uphold the constitutional right of the State of Illinois to regulate grain elevator prices.

address excessive and discretionary prices set by railroads in the state. Subsequent regulatory agencies at the state and federal level engaged in direct and extensive binding control of the public utilities activities.<sup>12</sup>

Since the early 1970s, administrative regulation has faced substantial criticism and significant deregulation has occurred. The anti-regulation arguments have included claims that: regulation was established protect the regulated, regulatory agencies are captured at inception or over time, there is a market for regulation, regulation is an alternative form of taxation, regulation reflects the concentration of benefits in juxtaposition to costs of organizing opposition, unregulated monopolies are preferable to regulated utilities, there is sufficient potential and oligopolistic competition to control potential possible public utility market power abuses, and so forth.<sup>13</sup> These arguments follow earlier claims by Horace Gray that the public utility concept has passed.<sup>14</sup> Trebing has both clarified and refuted these and other arguments.<sup>15</sup>

Trebing stated in summary:

The critics of regulation represent a diverse group of academics and others who share a common belief in the supremacy of free markets over any form of regulation

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<sup>12</sup> Such control includes setting prices, universal provision of service, construction of new facilities and the abandonment of existing facilities, issuance of financial instruments, intercorporate activities, mergers and divestitures, accounting systems, etc..

<sup>13</sup> See, for example, Gabriel Kolko, *Railroads and Regulation, 1877-1919*, Princeton University Press (1965); George Stigler, "The Theory of Economic Regulation," *Bell Journal of Economics and Management Science*, 2 (Spring 1971) 3-21; Sam Peltzman, "Towards a More General Theory of Regulation," *Journal of Law and Economics* 19 (August 1976) 211 - 240; M.H. Berstein, *Regulatory Business by Independent Commission*, Princeton University Press, (1955); W.A. Jordan, "Producer Protection, Prior Market Structure and the Effects of Government Regulation," *Journal of Law and Economics* 151 (1972); R. A. Posner, "Taxation by Regulation," *Bell Journal of Economics and Management Science* 22 (1971); James Q. Wilson, *The Politics of Regulation*, Basic Books (1980);

<sup>14</sup> Horace M. Gray, "The Passing of the Public Utility Concept," *The Journal of Land and Public Utility Economics*, 1 (1940) 8-20.

<sup>15</sup> For his critique of the arguments raised by the members of the Chicago school of neoclassical economics, see: Harry Trebing, "The Chicago School versus Public Utility Regulation," *Journal of Economic Issues*, 10, 1 (1978) 97 - 126.



intervention. They draw upon revisionist theories of government and regulatory history to demonstrate the impossibility of public interest regulation. In contrast to the institutionalists, the critics of regulation share a libertarian desire to limit, constrain, or reduce the influence of government.<sup>16</sup>

With regards to the deregulation, Trebing showed through his research and writings the fallacies and failures the post 1970s wave of deregulation.<sup>17</sup>

Though Trebing recognizes that "regulation [is] an evolutionary process that must change in order to be responsive to evolving industry structures, new technologies, and new corporate strategies," he maintains there continues to be a " need for government intervention to constrain market power and assure full access to utility services for all types of consumers."

The ability to achieve the results of public utility regulation advocated by Trebing would be enhanced if there were closer adherence to the perspectives of Western ethical thought.<sup>18</sup> Such perspectives include emulating characteristics of honesty, trustworthiness, dedication, etc. in accord with the virtue ethics of Socrates, Plato, and Aristotle; maintaining right action, respect for rights, fairness, justice and duty in accord with deontological ethics; seeking good results based on a broader assessment the multiple goals of the members of public utility community in accord with teleological ethics; and pursuing community based the tenets of the Lockean Social Contract.

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<sup>16</sup> Harry Trebing, "Assessing Deregulation: the Clash between Promise and Reality," *Journal of Economic Issues*, 27, 1 (2004) pg. 2

<sup>17</sup> See for example, Harry Trebing, "Public Utility Regulation: A Case Study in the Debate over Effectiveness of Economic Regulation," *Journal of Economic Issues*, 17, 1(1984) 223 - 250. and Harry Trebing, "Assessing Deregulation: the Clash between Promise and Reality," *Journal of Economic Issues*, 27, 1 (2004) 1- 26

<sup>18</sup> see Rodney Stevenson, "An Ethical Basis for Institutional Economics," *Journal of Economic Issues*, 36, 2 (2002) 263 - 277.

## Conclusion

By his teachings, by his training programs and conferences organized Institute of Public Utilities at Michigan State University and elsewhere, and by his wealth of articles, chapters, and edited volumes, Harry Trebing has demonstrated his rightful place among the leaders of institutional economics. Though regulatory purpose and effectiveness is currently in a state of decline, the long arc of public utilities will bend towards the public interest as long as there are those like Harry Trebing who know and pass on an understanding of the ethical basis of regulation, the public utility concept.

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