

3-8: Deregulation

A wave of deregulation began in the U.S. in the 1970s.

The Airline Deregulation Act of 1978 was one of the first major deregulation acts. Major impacts of deregulation of the airline industry include:

- Lower prices
- Increased industry concentration
- Adoption of efficient “hub & spoke” systems
- More congestion/delays at hubs

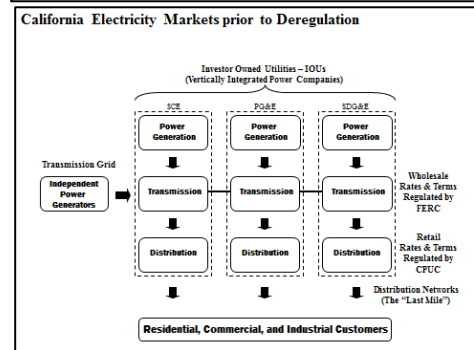
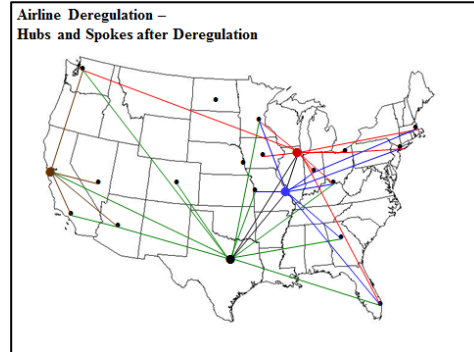
The Federal Energy Regulatory Commission (FERC) began promoting deregulation in the electricity industry in the early 1990s. California, Texas, and Pennsylvania were leaders in deregulation, but the experience in California in 2000 – 2001 highlight flaws in the deregulation process in this industry.

In general, the deregulation process in the California electricity market:

- Involved movement from vertically integrated energy companies to separation of power generation and distribution.
- Linked deregulation of retail rates to divestiture of generating assets.
- Required the establishment of a wholesale market for electricity.
- May have made the exercise of market power possible in the wholesale market.

After-the-fact evaluations of deregulation tend to highlight imperfect tradeoffs between *market failure* and *regulatory failure*.

[See additional handout on regulation.]



Deregulation

Paul Joskow, “Deregulation” (2009)

- Markets are never perfect in a textbook sense, but they are typically better than the next best alternative.
- Microeconomics offers a “sound intellectual framework” for evaluating when it makes sense to impose regulation on a market.
- Deregulation, privatization and regulatory reform initiatives (“market liberalization”) over the last three decades have generally been beneficial for the economy and for consumers.
- Market liberalization and regulatory reform initiatives have not always been successful – we should learn from both successes and failures.
- The fundamental question should be “what is the best that we can do in an imperfect world?”

The Evaluation “Framework”:

Market Failure vs. Regulatory Failure

Paul Joskow, “Deregulation” (2009)

<p>Market Imperfections</p> <ul style="list-style-type: none"> □ Market power □ Externalities □ Information costs and asymmetries 	<p>Regulatory Imperfections</p> <ul style="list-style-type: none"> □ Imperfectly informed regulators □ Bureaucratic costs □ Interest group pressures
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☞ The extent of regulation in any specific industry should reflect a careful balancing of considerations on both sides of this ledger.