

**PUBLIC UTILITY RATE MAKING
AND THE PRICE LEVEL**

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By

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PREFACE

THE GREAT DIFFICULTIES that have been experienced by public utilities commissions in regulating utility rates have to a considerable extent been due to the large fluctuations in prices throughout the greater part of the period in which the policy of administrative rate making by commissions has been in effect. In the decade prior to the World War the rise in prices was moderate and it was possible, although not without some difficulty, to make the necessary revision in utility rates. The tremendous rise in prices during and immediately after the war necessitated large and frequent revision of rates which could not be made satisfactorily in view of the general opposition of consumers. The short period of relatively stable prices in the 1920's relieved utilities commissions to some extent of the burden of frequent rate revision. However, with the sharp decline in prices during the recent great depression, difficulties were once more encountered. Consumers pressed for large reductions in rates, and utility companies faced with a decline in revenue from decreased sales resisted rate revision that would have reduced their net incomes even more.

Even the instability of prices would not have prevented effective regulation of utility rates if a satisfactory rate making method had been available. Unfortunately, the rate making rule established by the courts was too complex in its required procedure to permit the prompt and complete adjustment of utility rates in the period of rapidly changing prices. The ultimate purpose of the rule that utility rates must provide a fair rate of return on the fair value of utility property was to duplicate in the field of regulated rates the process of normal price determination in competitive society. Although it would have been desirable to regulate utility rates in a manner that would generally maintain equality of the prices of utility services with their costs of production, this was not in fact achieved under the rate making rule. With the complex, dilatory, and expensive rate making procedure

required under the rate making rule it was impossible to bring about prompt adjustment of rates with changing costs of production. Utility rates thus acquired an undesirable rigidity entirely out of harmony with the purpose of the rate making rule. The experience of the past twenty years shows conclusively the futility of attempting to regulate utility rates on the precise pattern of the price making process of competitive society.

Throughout the war and again in the great depression, commissions found it was impossible to use the rate making method and procedure required by the rate making rule. Instead, it was necessary to develop new methods of rate making that permitted the use of a simpler procedure under which rates could be adjusted more promptly to changing operating costs. The rate making methods developed during the period of unstable prices were designed to introduce greater flexibility in the rate making process, and for this reason they deserve consideration with other proposals for increasing the effectiveness of rate regulation.

It is the purpose of this study to show how the rate making rule and its procedure were developed, to consider the difficulties that were experienced under this rule, to discuss the new methods of rate making that commissions used during the period of rapid fluctuation in prices, and to offer a reasonable solution for the rate making problem.

This study of *Public Utility Rate Making and the Price Level* was undertaken at the suggestion of Professor F. W. Taussig. In his *Principles of Economics* (II, 118), Professor Taussig has commented briefly on the effect of the abrupt price advance during the war on the public utility industries. I have tried to carry the analysis into various aspects of the rate making problem during the war and postwar years and during the recent depression. The aid and advice of Professor Taussig have been invaluable in completing the study.

I should like to record my obligation to the Harvard Club of Chicago for the scholarship I held in 1927, and to the authorities of Harvard University for the Ricardo Prize Scholarship and the University Fellowship in Economics that I held in 1928.

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