

**A Briefing Note on the Cyclical Nature Regulation:  
The Effects of Regulatory Restructuring on the Energy Sector and  
the Airline Industry and its Effects on Consumer Welfare**

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## **BRIEFING NOTE:**

### **AN ANALYSIS OF THE TRENDS IN REGULATORY RESTRUCTURING IN THE ENERGY SECTOR AND IN THE AIRLINE INDUSTRY AND ITS EFFECTS ON CONSUMER WELFARE**

#### **PURPOSE**

The purpose of this briefing note is to describe the cycle from regulation to deregulation in the energy sector and in the airline industry, and to elaborate on the outcomes of this regulatory restructuring. The advantages and disadvantages of regulation and deregulation, and its effects on consumer welfare will also be discussed.

#### **BACKGROUND**

The state of regulation in democratic and capitalist societies is a dynamic one, where there have been fluctuating cycles of regulation, deregulation, and reregulation<sup>1</sup>. The government establishes the legal framework to enforce regulatory controls on an industry and serves the purpose of maintaining the conditions of a “free market”, while deregulation has the effect of “freeing up the market” to the entry of new competitors<sup>1</sup>. Deregulation involves the reduction or elimination of government regulatory control of an industry<sup>4</sup>. The purpose of deregulation is to fuel competition by reducing or eliminating restrictive policies that prevents natural competition in the marketplace<sup>4</sup>. The trend of economic regulations saw a rapid growth in the early 1900s and into the early 1970s, but by the 1970s to the 1980s there was a move towards deregulation of several industries including the airline industry, and the energy sectors<sup>6</sup>. The airline industry was under the tight control of regulation until The National Transportation Act of 1987 was made law in Canada, and allowed deregulation that opened the door to increased competition<sup>8</sup>, thereby eliminating the natural monopoly that historically characterized this industry<sup>6</sup>. The energy sector throughout North America has also undergone a period of deregulation. In Canada, natural gas deregulation began in 1985 with the energy market following in 1998<sup>7</sup>. This has allowed newer entrants into the industry, fueling a highly competitive marketplace<sup>5</sup>.

#### **CURRENT SITUATION**

Today much of the energy industry across North America is deregulated<sup>5</sup>. Deregulated markets are driven by competition and results in lower energy prices compared with regulated markets<sup>5</sup>. This has resulted in greater consumer choices in picking an energy supplier at an optimal price point<sup>5</sup>. In addition, the competitive markets have fueled innovation by suppliers in the adoption of energy efficiency and management approaches to remain competitive in the market and to attract new customers<sup>7</sup>. Under current conditions, consumers have been able to

shape the energy market because the competitive nature of the marketplace has caused companies to create rate plans to market to consumers and serve their specific needs <sup>7</sup>. Currently, the airline industry is also characterized by deregulation, which has resulted in an influx of airlines that has allowed for price reductions and significant growth in the industry. However, COVID-19 has had a disastrous effect on airline companies with some calling for the government to either subsidize the industry or subject the industry to reregulation in order to create a policy framework to prevent any further decline <sup>8</sup>.

## KEY CONSIDERATIONS

The following considerations present the advantages and disadvantages of regulation and deregulation based on the observed results in the energy sector and airline industries. The resultant effects for the industry and/or the outcomes for consumers may be observed as follows:

- Regulation leads to transfers of wealth, where the industry spends money to capture this wealth to retain its monopoly and to force above competitive prices <sup>6</sup>. This results in monetary waste <sup>6</sup>. This also reduces consumption as in the case of market price and entry, which were regulated in the airline industry in the 1970s resulting in the average price of airfare being above costs <sup>6</sup>. This reduced consumer welfare and limited the availability of this service <sup>6</sup>.
- Deregulation is not subject to this monetary waste and has restructured the airline industry into a competitive marketplace that has resulted in both lowered prices and increase in access through greater supply <sup>6</sup>. This has been beneficial to consumer welfare <sup>6</sup>.
- Regulation does not serve public interest by resulting in a marketplace of “natural monopolies” that keep market prices high and limit consumer access to goods and services <sup>6</sup>. Government regulations in the energy sector in the United States resulted in a shortage of natural gas in the 1970s, because of differing government incentives towards gas consuming and gas producing states with respect to their entry into the retail market <sup>5</sup>. Gas producers had incentives to enter the retail market while the gas consumers did not, which caused a supply shortage <sup>5</sup>.
- Deregulation gives consumers greater autonomy and control by providing more options to compare rates and services, and contract terms for energy suppliers <sup>5</sup>. Therefore, deregulation has a greater positive effect than regulation for consumer welfare when applied to the energy sector, because it allows prices to remain low due to competition<sup>6</sup>.

- Regulation decreases incentives towards innovation due to regulatory constraints on profits that results in less available investments to fuel innovation for quality improvements, and the development of novel products and services in the industry <sup>6</sup>.
- Regulation restrains innovation by creating regulatory barriers towards entry into new markets to provide innovative services, and there may be further delays in bringing forth a new product where the regulatory framework for the provision of new technologies has not yet been formalized <sup>6</sup>.
- Deregulation resulted in an increase in innovation in the energy sector that had the effect of creating incentives for the development of new products and services to attract new customers, and to appeal to the needs of consumers <sup>7</sup>.
- Deregulation results in decreased efficiency in an industry when parts of the sector are still under regulation because it increases the cost burden to effectively conduct business <sup>3</sup>. This occurred in the energy sector in the United States, where this restructuring towards a deregulated market resulted in a decrease in the operational efficiency to accommodate the increased demand for the generation of electricity <sup>2</sup>. In California, deregulated wholesale electricity rates resulted in electric utilities having to buy their power from market suppliers through short-term contracts <sup>6</sup>. As a result, there was a significant price increase for power due to environmental conditions that reduced the supply of affordable hydroelectric power in the face of increasing demand <sup>6</sup>.

## CONCLUSIONS

Regulatory reform appears to be a trend with multiple industries that phase through this cycle of regulation or deregulation concurrently, as policy makers of a particular time adopt a uniform approach to regulatory restructuring in favour of greater control, or less stringency for entry into the marketplace <sup>6</sup>. As a result of deregulation, the airline industry has seen significant gains to consumer welfare, while decreasing the regulatory burden on the industry that has allowed its overall growth during the pre-COVID-19 era <sup>3</sup>. However, unforeseen effects of the pandemic may usher in a new phase of regulatory control to prevent the collapse of this industry, which has seen a significant economic downturn due to travel restrictions that had brought the industry into a state of virtual standstill at the height of the pandemic <sup>3</sup>. The deregulation of the energy sector has also had beneficial effects for consumer welfare by resulting in lowered costs for consumption of a required commodity <sup>6</sup>. However, the lack of congruence between the supply of energy and the demand for such, has caused issues of energy shortages that resulted due to lack of institutional framework to support the unanticipated increase in demand where portions of the sector remained regulated <sup>6</sup>. Therefore, policy makers may be required to engage in regulatory restructuring, and should be aware of the upstream and downstream effects of a partially deregulated industry's reliance on

components of the industry that remain regulated<sup>8</sup>. This will help to mitigate the effects of circumstances that may cause imbalances in supply and demand<sup>8</sup>. This cyclical nature of regulatory restructuring will remain a trend in liberal democratic societies. This is because industry and consumer protections may necessitate changes to the degree of regulation when the economic circumstances demand a favourable outcome for the free market and for consumers. Overall, deregulation has been beneficial for consumer welfare and has allowed consumers to exercise greater autonomy in decision making when a competitive market provides greater options for the consumer. Deregulation has caused industries to be geared towards tailoring their products and services to fit consumer needs, thereby serving the public interest.

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