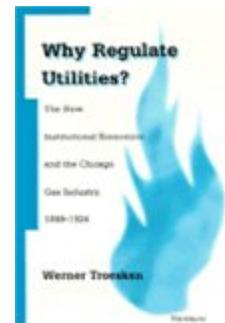


# H-Net Reviews

in the Humanities & Social Sciences

Werner Troesken. *Why Regulate Utilities? The New Institutional Economics and the Chicago Gas Industry, 1849-1924*. Ann Arbor: University of Michigan Press, 1996. xv + 132 pp. \$37.50 (cloth), ISBN 978-0-472-10739-1.

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## The City and the State

Conflicts between federal and state governments regarding legislative jurisdiction and political power are a common theme in U.S. history. A powerful federal government suggests weak state governments, and *vice versa*. What factors cause the balance of power and influence to shift? During today's era of New Deal regulatory state dismemberment, it is timely to examine the relationship of federal, state, and local regulatory authority and policy.

In *Why Regulate Utilities?*, Werner Troesken (Asst. Prof. of History and Economics at the University of Pittsburgh) takes a "case study" approach to analyze issues related to the balance of regulatory power between city and state governments. His focus is on Chicago's gas utilities between the years 1849 and 1924. Gas utilities provide a good subject for this study because they are "natural monopolies," meaning that the high capital costs and extensive pipeline distribution systems required for one system to operate discourage the construction of a duplicate, competing system. Troesken explains that "Economists have long believed that utilities provided the quintessential example of market failure ... If regulation failed to improve things in markets that were natural monopolies, it would surely fail in situations where claims of market failure were more tenuous" (p. 5). In his book, the author suggests a new perspective for evaluating regulatory behavior by examining a wider range of contract solutions available to utilities and municipalities in conflict over utility service.

The book is divided into three parts: Part I discusses the background to public utility regulation; Part II dissects in separate chapters the regulatory history of Chicago's gas utilities from 1849 through 1924; and Part III presents supporting appendices.

In Part I, Troesken explains the theoretical basis of his book. He intends to test competing theories of regulatory behavior. On one side is the "public interest" interpretation which suggests that lawmakers created state utility commissions to protect consumers against monopoly power and associated high utility rates. The "Chicago School" posits the contrary view that state regulatory policy benefited utilities and was essentially "captured" by business interests. When state legislatures began establishing state regulatory commissions, between 1907 and 1922 about thirty states did so, it appeared that one of two things happened: states acted decisively in favor of the public interest, or states acted decisively in favor of business.

As Troesken argues, neither of these regulatory models satisfactorily explains the change from municipal to state utility regulation. Instead, Troesken builds upon the "relational contracting" interpretation of regulatory behavior. This theory suggests that state and municipal regulatory policy were markedly similar. Thus, the transition from municipal regulation to state regulation "represented more of a change in the way cities and utilities contracted than a move from pure and unfettered competition to widespread state intervention" (p. 5).

The evidence supporting the book's thesis is concisely presented in Part II which is titled "History." The narrative moves through successive eras characterized by—and with chapters titled—competition (1849-97); antitrust (1888-97); monopoly (1897-1905); municipal regulation (1905-13); and state regulation (1914-24).

Troesken begins this section of the book by describing the nineteenth century gas industry. Gas lighting was a luxury until the 1870s, and even then, its availability was limited to larger urban areas. By 1899, Chicago, New York, Philadelphia and St. Louis burned about 50% of U.S. coal gas production; thus, Chicago emerges as a relevant urban era to study regarding gas usage. The Chicago Gas Light and Coke Company was the city's first gas utility, and after the Peoples Gas Light and Coke Company began operating (1862), these two gas firms dominated the city's gas service until 1880. Through a territorial agreement, they each served customers in separate parts of the city. As gas production technology improved and demand increased, new firms entered the market to challenge existing firms and, more typically, to provide service in new areas. Price competition commenced, and gas rates fell. To avoid the disastrous effects of cut-throat price competition, gas firms merged and stabilized prices. But prices rose and gas consumers, along with famed attorney Clarence Darrow, attempted (largely unsuccessfully) to lower gas rates and break-up the gas trust. Emerging from this effort was the state legislated Enabling Act (1905) which empowered the city of Chicago for the first time to regulate gas rates. Attacks on the Enabling Act by utilities threatened Chicago's rate making powers. Utility firms opposed any law giving local politicians power over rates, fearing that these politicians would trade lower gas rates for votes without regard for the gas firm's cost of service. Instead, utilities supported the creation of a state commission relatively insulated from local political pressures. The Illinois legislature created a state utility commission in 1913.

The final section of the book contains two appendices. The first is a brief but very clear description of the production processes for manufactured coal gas, standard coal gas, and water gas. These descriptions are particularly useful for readers who are not aware of the earlier gas industry which depended upon coal as the base fuel for gas production rather than natural gas reserves. The second appendix is an explication of the event study methodology and regression analysis used to generate data for the author's tables and observations.

This case study approach does succeed in presenting

a convincing argument that the imposition of state utility regulation is not necessarily an indication of a one-sided victory of either corporate policy or the public interest. Troesken's conceptualization rests upon a mechanistic view of history. For example, he writes: "Think of history as a puzzle. To complete the puzzle, we need all of the pieces—we need to know all of the relevant facts. We also need to know how all the pieces fit together—we need a theory to interpret the facts" (p. 7). If one believes that historical truth is discovered through scientific empiricism, the approach makes perfect sense. Troesken's analysis of gas prices, income statements, and stock price changes to gauge the affect of local and state regulatory decisions, for example, is well done. To some extent, however, historical context is underrepresented in the work. While the author states that historical context is important for establishing a framework for understanding the various pieces of the "puzzle," discussion of the most appropriate historical context—the progressive era—is largely absent from the study. It would also be interesting to know whether the Illinois commission remained relatively independent of utility company influence, and Samuel Insull especially, during the 1920s.

The author's historical research is well grounded in regulatory literature, relevant court cases, and contemporary newspaper accounts. Along with gas industry trade journals, Troesken relies upon Stotz and Jamison's *History of the Gas Industry* (1938) as a primary source on early gas industry development. Although that work is dated, it does remain as the most commonly cited secondary source on the nineteenth and early twentieth century gas industry.

The stated audience for this book is economists and historical economists, particularly those who are interested in regulation and institutional change. The author expresses the hope that non-economists will also be interested in the book, and some urban historians and historians of technology may well find the book to contain useful information. The book will most likely find a secure place within economic and regulatory scholarship, and scholars of urban politics should find this work provocative as well.

*Why Regulate Utilities?* is a carefully crafted, concise, and insightful analysis of the shifting locus of regulatory authority between local agency and the state commission. Using the Chicago gas industry as the subject, Werner Troesken provides a concise model of regulatory power shifts and in the process illuminates the important point that imposition of state regulatory authority alone

is not a clear indication of state intervention explicitly for, or against, the public interest. Rather, the independent state commission may well provide relatively objective and fair forum—like a court—for regulatory decision making. Interestingly, the logical extension of this theory suggests that regulation by federal commission might

also be more accurately assessed in the context of contract formation rather than governmental intrusion.

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