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Rate-of-Return Regulation and Two-Part Tariffs

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Roger Sherman, Michael Visscher

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Abstract

In choosing a two-part tariff, a monopoly subject to rate-of-return regulation will rely more on demand elasticities and less on marginal costs than would a welfare-maximizing firm. The rate-of-return regulated firm also will reduce its access fee or its marginal usage fee more, depending on whether adding consumers or increasing output requires marginally the most capital. In the typical case these effects will favor declining-block rate structures, which helps to explain their widespread use by rate-of-return regulated firms.

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