



PUBLIC INTEREST ADVOCACY CENTRE
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A proceeding commenced by the Ontario Energy Board on its own motion to consider the values of the inflation factors to be used in rate adjustment applications for rates effective in 2022

EB-2021-0212

Submission of the
Vulnerable Energy Consumers Coalition
(VECC)

October 1, 2021

Vulnerable Energy Consumers Coalition

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Introduction

In the proceeding EB-2021-0212 the Ontario Energy Board (OEB or Board) is seeking input on how to establish inflation factors for utilities applying incentive rate plans in 2022. A fact sheet prepared by Board staff was circulated prior to an (untranscribed) stakeholder conference on September 16, 2021.

These are the submissions of VECC.

The Problem

The Board relies on a two-factor inflation estimator to adjust rates for electricity distributor's enrolled in incentive rate plans. The inflation factor is composed of GDP-IPI (FDD) and the Average Weekly Earnings (AWE) indices. The pandemic has impacted all such indices mostly in the measure of change, but also for some indices by the veracity of the measure.

For the Consumer Price Index (CPI) the impact is measured against a fixed basket of goods. Unlike the CPI the GDP-IPI measure is not fixed and reflects changes in the output proportions, as for example between residential structure and non-residential structures, machinery and equipment¹. Similarly, the AWE measures both changes in wages and changes in the proportionate types of labour. That is, it measures both the change in wages and the change in the firms that pay those wages. In normal times these proportionate factors change only moderately and arguably are a reflection of the natural change in how labour is employed. For example, the employment of more unskilled labour as industries become more capital intensive.²

A problem arises however if there is a large and systemic change in the economy. This is what has occurred during the pandemic. For the GDP-IPI index the impacts of the pandemic are muted and for two reasons. One reason is that while output will change due to exceptional circumstances any single change is unlikely to form a large part of what is measured. For example, the pandemic may have impacted both residential and non-residential construction and while it is possible one sector may be more impacted by the pandemic than the other the difference between the two is unlikely to be large and neither measure alone makes up an overwhelming portion of the metric. Said another way, the GDP-IPI (FDD) index has a large

¹ The Implicit price indices can be seen for example at <https://www150.statcan.gc.ca/t1/tbl1/en/tv.action?pid=3610010601>

² The CPI reflects similar changes in consumption trends by periodic adjustments by Statistics Canada to the basket of goods being measured.

number of things which are measured and so changes to any single component will have only moderate impact.

These characteristics of GDP-IPI (FDD) do not hold true with respect the AWE metric. The pandemic has disproportionately impacted the low-wage sector of the economy. Statistics Canada has made this observation³:

In June 2021, payroll employment in arts, entertainment and recreation, where average earnings were \$729 per week, was 38.8% below its February 2020 level. In accommodation and food services (\$457 per week), employment was 28.2% below its pre-COVID-19 level. In contrast, two of the sectors with the highest average weekly earnings had surpassed their pre-pandemic employment levels. Employment in professional, scientific and technical services (\$1,523 per week) was 5.8% higher in June 2021 compared with February 2020, and employment in finance and insurance (\$1,453 per week) was 1.6% higher.

That is, the disproportionate loss of employment in lower-paying sectors has the effect of increasing overall average earnings both because the sample has become skewed and because the now overrepresented sectors are seeing higher employment demand. Paradoxically, as employment in low wage sectors recover the opposite effect is expected as noted by Statistics Canada in their August 2021 report⁴

Average weekly earnings decreased 1.0% to \$1,125 from May to June, partly because the employment gains were concentrated in lower-paying sectors. The largest employment gains in June were in the two sectors with the lowest average weekly earnings: accommodation and food services (\$457 per week) and retail trade (\$643 per week).

The phenomenon of changes to the population characteristic which impact the sample output is known in economics and statistics as a “composition effect.” The pandemic has resulted in large composition effects. The Board should also consider how its inflation measures are impacted by what are called “base effects” caused by the pandemic⁵.

³ <https://www150.statcan.gc.ca/n1/daily-quotidien/210826/dq210826a-eng.htm>

⁴ Ibid

⁵ The pandemic has raised concerns in value measurements in both composition and base effects. These phenomena are well explained in recent U.S. Whitehouse blog: [The Pandemic’s Effect on Measured Wage Growth: https://www.whitehouse.gov/cea/blog/2021/04/19/the-pandemics-effect-on-measured-wage-growth](https://www.whitehouse.gov/cea/blog/2021/04/19/the-pandemics-effect-on-measured-wage-growth)

The Solution

This proceeding arises from the understanding of these effects and the questions it raises as to how to calculate an inflation component in electricity distribution incentive rate plans. The OEB's Notice outlined the three options for dealing with the problem:

1. Continue to apply the existing methodology and formula (including the existing inflation indices) to the 2022 rate adjustments
2. Extend the approved values for 2021 inflation rates for 2022 rate adjustments
3. Update the 2022 inflation rates under the existing methodology using a suitable sub-index of Average Weekly Earnings or a related statistic, Average Hourly Earnings, that is more representative of labour inflation expected to be experienced by distribution and transmission Utilities in 2022.

These are not, of course the only options. As noted by Staff there are other measures of inflation, including the CPI and its various iterations which could be used in replacement of the current inflation measure.

In our view the option with the least appeal is a search for a wage sub-index that may (or may not) be less affected by composition effects. It is questionable whether any wage index can be abstracted from the labour market disruptions occurring during the pandemic. In any event, as VECC has argued in a number of proceedings, the difference between CPI, GDP-IPI and other inflation indices compounded are in some sense meaningless. Overtime all these indices will trend toward a mean. And all indices present technical problems of measurement error, composition and base effects.

Our view is that some parties attribute spurious accuracy to any particular inflation estimator. It is clear that there is no "correct" estimator⁶. The Board implicitly acknowledges this itself by the fact that it applies different forms of inflation estimators to the gas utilities, electricity transmitters and electricity distributors and without and particular why there should be differences. More fundamentally there is no clear articulation as to what the inflation estimator is attempting to achieve as part of the rate plan. Is its purpose to forecast future costs changes that the utility may have to bear? Or is purpose to allow for price changes similar to what consumers (ratepayers) face with their other purchases? Or something else?

⁶ For example, BCUC the British Columbia regulator uses a hybrid of CPI and AWE. The Board might also wish to consider how the same question of the appropriateness of using AWE was examined by that Regulator in the case of the 2010 and 2021 rates for FortisBC Inc. in its Decision and Order G-42-21, page 11 of 35.

VECC has often argued that for distribution utilities the most appropriate estimator would be the CPI in one of its variant forms. This is based on the premise that the objective of an inflator to rates is to maintain rate increases in line with the basket of other goods purchased by consumers. Others may disagree and the basis for that disagreement might rest on technical measurement issues or, more importantly, on the question as to what is the objective of an inflation factor applied to a rate. Whatever the merits of the positions one might take we do not think this is the time to have that debate.

In the same way we do not believe this an appropriate time or forum in which to consider the more esoteric arguments around the value of using AWE and AHE or any other sub-labour indices. In our view, in this difficult time the Board should strive for continuity and coherence within both the gas and electricity distribution sector. It should do so in light of planning to revisit the entire question of inflation factors at some later point and once the long-term impacts of the pandemic become clearer.

Therefore, our approach is to simplify and unify as much as possible. Our suggestion would be to simply use GDP-IPI (FDD). We think this the best approach for three reasons:

1. It is already employed for use by the largest gas distributor in the province (country);
2. The composition effect is much less than for labour indices;
3. It does not require one to opine as to the merit of various labour sub-indices or in fact appropriateness of labour measures during the pandemic.

We would also note, as pointed out by Staff, that between 2007 and 2013 the Board relied solely on the GDP-IPI to estimate inflation. As such it has already been demonstrated to be a reasonable way to adjust electricity distribution rates.

Reasonably Incurred Costs

We conclude by thanking the Board for the opportunity to comment on this important issue and to Board Staff who prepared an overview of the matter.

VECC submits that it has acted responsibly and efficiently during the course of this proceeding and requests that it be allowed to recover 100% of its reasonably incurred costs.

ALL OF WHICH IS RESPECTFULLY SUBMITTED

OCTOBER 1, 2021