

Competition and deregulation

Recent market volatility has led to doubts that deregulation can deliver the goals of affordable and reliable power. But is deregulation at fault?

With leading states' energy markets imploding, the movement in favour of retail energy competition in the US is in disarray, says *Ken Malloy, chief executive of the Center for the Advancement of Energy Markets*. Is it time to rethink the efficacy of customer choice?

I remain unabashedly in favour of all retail customers choosing their own energy supplier. We were giddy when legislatures rushed to pass legislation to restructure electricity markets. Then California blew up. So why am I still convinced that we should embrace retail energy competition?

There are six major reasons, firstly, similar reforms have been very successful and have delivered billions in benefits and new services to consumers. Ten years after reform, prices in the airline, trucking, natural gas, railroad and telecom industries were 30 to 40 per cent lower. Interestingly, studies predicting the costs and benefits of such reforms consistently underestimated them because of the difficulty of capturing the effects of innovation in the models. A new study on natural gas deregulation rebuts some of the gibberish that passes for analysis in the wake of California. Households have experienced about \$6,000 in gas price reductions in the 15 years since reforms took place.

Secondly, regulation of the prices of local energy services has and will continue to result in horrendous distortions that harm consumers and the national economy. The history of utility regulation since the mid-1970s is littered with price distortion-induced crisis in both gas and electric industries.

Another reason for positivity is the reform of local network monopolies will result in a revolution in the delivery of goods and services. Average electricity prices on a nationwide basis will no doubt be lower than they would otherwise be under regulation. But not every consumer will have lower prices during all periods than they have today. Reform will offer consumers many new options. Some will choose price, some will choose convenience and some will choose green.

Furthermore, technology now makes reform possible, even necessary. Technology changes

everything. This is the 'Come to Jesus' part of my rationale. I don't know precisely how the internet and technology will change the demand for energy products and services and neither do you. The one thing I know is that we face an unprecedented era of change and innovation and that markets will accommodate such change.

Moreover, reform of network industries is hard. The difficulty is to keep monopoly elements regulated, but ensure that regulation does not distort service and product markets that have to use that network. The Retail Energy Deregulation Index, a biannual scorecard on the progress made on electric restructuring, only has four states and one Canadian province in even the high 60s out of 100. Progress yes, perfection no.

Finally, no important social movement has achieved anything without pain and divisiveness. If we judged social movements by the difficulties of the first blushes of change, we would have given up on the civil rights movement, the environmental movement and the consumer movement. These are important reforms to the largest sectors of our economy and we should keep our nose to the grindstone and deliver these benefits to our children. Although the end result is worthwhile, transitions are a bitch.

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For Americans in the Wild West, the summer of 2001 was free from the rolling blackouts and bankruptcy-inducing high prices, which characterised the failure of California, says *Tyson Slocum of the Public Citizen's Critical Mass Energy and Environment Programme*. While some claim that warmer weather and conservation saved the day, the federal government's imposition of round-the-clock price controls in June has provided much of the cure for dysfunctional markets.

A growing number of states which have passed some form of deregulation legislation have taken heed of the powers of re-regulation. Some have essentially repealed deregulation, others are scaling it back. With state government regulators no longer officiating wholesale electricity markets, the inherent characteristics of the electric utility industry have led to excessive market power by a handful of energy companies.

These failures are strikingly similar to other recently deregulated industries with comparable features. The Telecommunications Act of 1996 was supposed to usher in an era of competition and choice. Instead, the American economy is saddled with a dozen multi-billion dollar telecom bankruptcies, not to mention contracting revenues. Meanwhile, 91.5 per cent of phone lines continue to be controlled by the old monopolies. Since Congress relaxed regulations for the cable TV industry, consumers are paying 35 per cent more for basic cable and consolidations have resulted in six corporations presiding over 80 per cent of the market.

Just like these capital-intensive and transmission-constrained industries,

true competition in deregulated electricity markets has not materialised. Power companies, free from the oversight of state regulators, have quadrupled prices for Montana industrial consumers, doubled prices in many Northeast and New England states and driven one of California's utilities to bankruptcy. Deregulation proponents attempt to justify these failings by arguing that full deregulation – removing all retail price controls to force consumers to pay the full price – is the solution to America's ills. Not only is this 'conservation by force' option politically unacceptable, but it incorrectly assumes that high

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prices in deregulated wholesale markets are the result of a competitive market and therefore should rightfully be passed on. Prices are high because the inelasticity of supply has led to excessive scarcity rents, helping energy companies dictate prices. West Coast Power had after-tax profits of more than \$245 million in the year prices for California electricity skyrocketed. Forcing consumers to absorb price gouging of this magnitude will do nothing to make wholesale markets more competitive.

Increased transparency and swift enforcement of market rules is the only guarantee of producing markets accountable to consumers. Lawmakers, rushing to correct deregulation's failures, must exercise diligence not to make matters worse. Prescribing both broad regulatory and eminent domain authority for the federal government without addressing the utilities' monopoly control over transmission is a misdiagnosis. Non-discriminatory, reliable access to the transmission grid at affordable prices can only be provided by consumer-owned, non-profit transcos.

The flaws in the cost-based rate system pale in comparison to the damage wrought by price gouging and unreliability under market-based rates. Most states with looming deregulation deadlines have made the prudent move to re-regulate. For millions of American consumers in states exposed to deregulation, the damage has been done.

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