

Why the “deregulation” of electricity never could have worked

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Why deregulation causes the price of electricity to rise:

- Dismantling vertically integrated utilities is economically inefficient and endangers reliability.
- Deregulated generation faces higher cost of capital and pressure for faster depreciation (10 vs 30 yrs).
- Operating efficient wholesale markets is more expensive than power pools.
- Markets hide new sources of cost.

More reasons for higher prices:

- Market clearing prices are likely to be higher than embedded costs – particularly with natural gas prices rising. (Negative stranded costs.)
- Single price auctions – the type of markets advocated - are inefficient for both energy and capacity. They are also illegal!
- Typical regional ownership concentrations for generation make competitive markets unlikely.

Dismembering vertically integrated utilities was inefficient.

- Coordinated planning is difficult with separate distribution, transmission, and generation – and a regional transmission organization (RTO).
- Direct costs tend to rise and environmental costs are harder to take into account.
- Energy conservation investment programs were undermined, further adding to consumer costs.

Generation markets are unlikely to ever be competitive.

- Even three or four generation owners in a small region is not a competitive structure for electricity markets.
- Strategic bidding (manipulation) is easy in single-price auctions, partly because of different plant variable costs.
- Cost-effective transmission constraints make market power easy to exercise.
- Generation capacity can also be withheld to make supply and demand tight.

FERC regulation has been less effective than state PUC regulation.

- The Federal Power Act requires that rates be “just and reasonable.”
- This was not applied properly to wholesale market prices for generation. Monitoring markets for price manipulation was done improperly.
- FERC favored policies to support the ability of new generators to “compete,” even if doing so undermined state or regional least-cost planning.
- FERC never promoted cost-effective conservation or incorporating environmental externalities in planning.

Deregulation adds many layers of new costs to retail prices.

- Vertically integrated utilities with cost-of-service regulation are economically efficient. This is why that had been the US tradition.
- Distribution, transmission, and generation can be operated by one set of utility managers.
- Cost sharing through power pooling makes sense.
- Adding retail markups to cost-of-service prices drives up prices – and is a complete social waste.

CONCLUSIONS

- The so-called “deregulation” of the electric utility industry **could have been predicted** to greatly increase prices for consumers. For example, several Tellus reports prior to 2000 made this prediction.
- Moving away from cost-of-service regulation has been a **total failure**.
- There is **no way to save specific aspects** of “deregulation, nor should one want to.
- It **must be reversed** as soon as possible.