Deregulation Means Higher Rates

MARKET DESIGNS HURT COMPETITIVENESS

BY MARILYN SHOWALTER

AFTER A DECADE OF TRIALS IN ELECT-ricity restructuring and price deregulation, the jury of consumers and state officials has returned a verdict: not working.

In 2000, according to the U.S. Department of Energy, 24 states and the District of Columbia had taken steps eventually to allow markets instead of regulators to set retail prices. Since then, however, a trio of states, Nevada, New Mexico and West Virginia, repealed laws before restructuring for most consumers could take effect. Three others, Arkansas, Oklahoma, and Oregon, never pulled critical deregulatory triggers. Montana and Virginia recently re-regulated before residential consumers were forced to pay deregulated rates. Ohio and Pennsylvania continue under price caps, thus avoiding market prices. Illinois enacted company-provided credits to blunt the effect of market prices, Arizona judicially invalidated restructuring laws, and California partially suspended retail access. What drove these states to act were high prices either they or their more "evolved" restructured neighbors were suffering.

Today, 11 states and the District of Columbia subject significant portions of their population to market prices. They are California, Connecticut, Delaware, Maine, Maryland, Massachusetts, Michigan, New Hampshire, New Jersey, Rhode Island and Texas.

All of these jurisdictions also participate in organized wholesale markets, designed and operated by regional transmission organizations or a similar entity. Based on prices and price-trends in this group, one can safely predict further agitation by residential, commercial and business customers, followed by remedial action by responsive public officials.

The gap in retail electricity prices between the deregulated and regulated states continues to widen. The difference has more than doubled, from around 2 cents per kilowatt-hour in 2000 to more than 4 cents in 2007. Calculations in this article are based on federal electricity price data for the 12 months ended June 30.

The comparative economic disadvantage to consumers in the deregulated states is enormous. These states began with higher prices, which is one reason they were motivated to experiment with deregulation in the first place. Two exceptions, Maryland and Texas, began with modest rates, and they have experienced immodest increases.

In 2000, consumers in the now-deregulated states paid $26 billion more, in 2006 dollars, for electricity than they would have paid, had they had been able to purchase their power at the average rate of the regulated states. Today, consumers in the deregulated states pay $48 billion more for their power, in 2006 dollars, than they would pay if they were able to enjoy the average rate of the regulated states. The seven-year cumulative value of the gap in prices between regulated and deregulated states, if invested at a real return of at 5 percent, is $298 billion.

This is not to say that deregulation is entirely responsible for the whole gap, or that the gap can be closed. The gap does, however, reveal the significant economic disadvantage suffered by customers in the price-deregulated states, and the imperative for their states and regions – whatever their resource mix – to pursue the most effective form of economic regulation of electricity.

Restructuring enthusiasts try to discount the reality of high prices in a number of ways. First, they fault the selection of states shown as deregulated and argue that the restructured states of Illinois, Ohio, Pennsylvania and Virginia should be included with the deregulated group. But with the exception of a few months in Illinois and a small corner of Pennsylvania, retail prices in these states have been constrained by price caps. Retail prices under price caps do not reflect market prices.


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Second, these enthusiasts argue that deregulated and regulated states have experienced comparable percentage increases in rates. They would argue that the price increase in Idaho is the same as the price increase in New Hampshire because both experienced about a 20 percent increase since 2000. But no consumer would agree that New Hampshire's increase from 11.4 cents a kilowatt-hour to 13.6 cents is the same as Idaho's increase from 4 to 4.8 cents – the cheapest rates in the nation.

Moreover, while Idaho and other low-cost states may enjoy long-owned low-cost resources, they do not have an inherent advantage in acquiring new resources. As states add resources, they are all paying incremental, not percentage, amounts for them.

Some advocates claim that the higher prices in deregulated states are simply the unfortunate effect of increased natural gas prices. Actually they are a reflection of market design. The wholesale market designs that drive retail prices in the deregulated states allow the most expensive needed bid, often natural gas, to set the price for all needed resources, regardless of their underlying costs. If the price of natural gas increases, as it has, or if an even more expensive renewable resource becomes the marginal bid – a likely scenario in many regions – prices for all resources will increase as a result. By contrast, in a regulated cost-based system, a higher-cost resource will not affect the amount consumers must pay for a lower-cost resource.

Finally, some market enthusiasts say, "just wait": prices will cycle down, improvements will be made, and consumers will ultimately benefit. In the meantime, though, consumers are paying a heavy price, businesses are shutting down or moving, often to regulated states, and each fix disappoints. As the price gap continues to widen, this plea for tomorrow rings increasingly hollow.

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