



Does Energy Deregulation Work?

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Has deregulation of electricity markets failed? That perception is apparently -- and wrongly -- becoming the common wisdom from California to New England. There are myriad reasons for this perceived failure: Enron and California; rising natural gas (and consequently) electric prices; overlapping federal, state, and local regulations; and regulatory uncertainty, to name a few. The momentum that once propelled deregulation has slipped away and opponents of free markets seem to have the upper hand.

It's debatable whether deregulation was actually tried in most states or if it has really failed, but regardless of those questions, it is clear that at least one state, Texas, successfully transitioned to a real electricity market. As a result, Texas has what may be the most robust and mature electricity market in the world. Unfortunately, Texas state legislators are prepared to call this success a failure and are seeking to undermine this success.

Texas -- or more accurately the Electric Reliability Council of Texas (ERCOT) -- succeeded where others had failed largely because it did not "design" a market so much as set the ground rules for competition. The market responded with capital investment to provide much needed generation for the growing region and a sophisticated network of retail electric providers.

Today 68% of commercial and industrial load has switched suppliers. Despite a "Price to Beat" mechanism that distorted residential prices until it expired at the end of 2006, there are a wide variety of choices for residential consumers across the state. Consumers have access to as many as 18 different suppliers and 50 or more rate plans.

Neither consumers nor politicians are happy with electric prices, but this has more to do with the cost of natural gas and severe weather than with deregulation. Texas is heavily dependent on natural gas as a source of fuel for electricity. And yet, while the cost of natural gas has increased almost 200%, the average cost of electricity in Texas has increased only 23% from the regulated rates of 2001. In fact, some consumers can purchase electricity at rates that are nearly equal -- in real dollars -- to the old regulated rates.

In a [new report](#) by the Texas Public Policy Foundation, Dr. Robert J. Michaels outlines the success of the Texas market. He found that "Texas is competitive electricity's greatest success story in the United States, if not the world." So why are policy makers seeking to undermine what has become a model for the world?" Simple: a misperception of free markets and short-term, high-volume political pressure.

One of the contributing factors to the negative perception of electricity deregulation has been the practice of policymakers to sell market reforms with the promise of lower prices. While lower electric prices would have certainly been the outcome had natural gas prices not skyrocketed, this was not to be. So the focus on prices instead of on how markets effectively allocate resources and allow for innovation and investment has led to a distorted view of success and failure. If prices go down the market is working. If prices go up, the market has failed. This is exactly how the debate has played out across the country. The main difference in Texas is that the debate is taking place after deregulation was completed.

A package of bills is moving through the Legislature that will undo the success of deregulation in Texas. The legislation is apparently based mostly on the misperception of the workings of the market. And it will destroy the free market Texas has created.

The legislation will mandate the organizational structure of companies in the market, dictate market share at both the wholesale and retail level, and allow for the disapproval of ownership changes of utility companies. It also seeks to give the Public Utility Commission of Texas (PUCT) the ability to impose price caps, potentially force customers to a different supplier, and mandate that certain companies market their competitors' products.

These changes not only violate the most basic of free market principles, but they undermine the structure that helped make the Texas market so successful. As Dr. Michaels noted, Texas succeeded where others failed by avoiding complex market design and focusing on basic rules. This allowed the participants in the market, rather than regulators, to decide how best to compete for customers. The result was a robust system that is attracting capital investment, providing consumer choice, and keeping prices lower than they would have been.

The package of bills has passed the Texas House and Senate and now heads to conference for reconciliation.

This attack on the Texas market will have ramifications beyond the state. If the most successful example of free market reform is seen as a "failure," this could ruin the chances that future reforms can be implemented in Texas or elsewhere. Supporters of the free market and limited government are fighting against the tide in these difficult times, and if we are to regain the momentum, we need to hold the line in Texas. A step back there will be a step back for free markets everywhere.

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