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Resist the urge to 'design' the marketplace

By Elizabeth Bryan

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Most Pennsylvania residents will soon see significant increases in their electricity bills. And many state legislators are concerned about the political backlash they will receive as a result. But it is important that both residents and politicians understand how we arrived at this situation and how best to resolve it.

In 1996, Pennsylvania residents paid electricity prices about 15 percent above the national average. Legislators responded by restructuring the generation of electricity (about 60 percent of users' bills) to encourage more competition.

This reorganization of the generation component often is referred to as "deregulation," even though the generation industry is far from unregulated.

The transmission and distribution of electricity remain unchanged and regulated by the state.

In order to move from nine entrenched regional monopolies to a competitive electricity market, legislators implemented a transition period that included rate caps for consumers and recovery of "stranded costs" for providers -- ostensibly to pay for previous infrastructure investments.

Rate caps were instituted to protect customers from unpredictable price fluctuations during the transition period. In return for the loss of their monopoly status, utilities were allowed to collect a surcharge above the price of electricity, otherwise known as stranded costs.

Rate caps already have expired for six utilities across the state. The transition period will end for all state utilities in 2011 -- ending both the rate caps and the collection of stranded costs.

Some legislators support extending the rate caps in anticipation of dramatically higher prices and "corporate profits." This misses the point.

Competition forces companies to serve their customers with the best prices and service, which in turn gives consumers more control. Prior to deregulation, electricity generation prices were set by the state Public Utility Commission, which determined the amount a company should make in "reasonable profit."

This system offered little incentive for improvements in efficiency or alternative energy innovations. Only market competition provides an incentive for utility companies to lower electricity rates without lobbying for government subsidies. Pennsylvania must push onward toward a more competitive electricity market rather than going backward into re-regulation.

The goal of the recent restructuring was to lower prices. Yet many contend such a policy has failed. Instances of deregulation disasters often are cited, such as California's 2001 blackouts.

Yet, Pennsylvania's plan is drastically different from the Golden State's flawed process. In California, utilities were prohibited from procuring long-term contracts, forcing them to buy power through expensive real-time and day-ahead markets.

In Pennsylvania, utilities are required to diversify. They can buy power from generation companies through long-term contracts years in advance or do business in short-term spot markets.

We can learn many valuable lessons from the successes and mistakes of other states but one theme continues to surface: Successful transitions allow flexibility and innovation by resisting the urge to "design" the marketplace.

The experience of Texas demonstrates how competition can lead to lower prices and greater consumer choice.

Texas completed the transition to a fully restructured market on Jan. 1, 2007. Despite rising energy costs, the average rate of electricity offered today in Texas is only 2.9 percent higher than the inflation-adjusted rate in 2001. The average Texan can now choose from 28 providers, compared with only four in 2002.

Legislators will not be able to prevent all rate increases but they can take steps to minimize costs by facilitating a more competitive environment.

Lawmakers should avoid the impulse to extend rate caps. Competition in the commonwealth will not be encouraged by either mandating the installation of "smart meters" or requiring certain levels of alternative energy production.

In fact, the more mandates legislators place on electric utilities, the more expensive electricity will become.

Legislators can, however, alleviate the burden of rising rates on consumers by reducing or abolishing the state gross receipts tax on electricity, reducing the red tape in licensing new electrical generation and transmission infrastructure and repealing overly stringent, moderately beneficial environmental regulations.

Perhaps the most important thing the state can do is educate consumers on why electricity choice is important and offer tools for easily comparing and choosing among providers.

Creating an environment for a real electricity marketplace to emerge in Pennsylvania depends on consumers who can spur competition -- and reduce their own electricity bills -- by taking the time to shop for electricity and practice better energy conservation.

It will not come from politicians manipulating the marketplace and re-regulating the electricity generation industry.

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