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Summary

Deregulation is widely considered the cause of California's electricity crisis. However, California did not deregulate its power industry. An unworkable restructuring, with government imposed price caps and burdensome regulations, is at the root of the problem.

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"Far from deregulating, California passed legislation in 1996 to 're-structure' their power industry. Citizens should have known that something was terribly wrong with the deal when the legislation passed unanimously."

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Deregulation not to blame for dark days

By Angela Eckhardt

Oregon citizens and policymakers are turning a watchful eye to California where an electricity crisis has left the power-hungry state facing rolling blackouts, bankrupt utilities, and perhaps even state takeover of the power industry.

The easy scapegoat for the current situation? Deregulation.

In his recent State of the State address Governor Gray Davis expressed the prevailing opinion: "California's deregulation scheme is a colossal and dangerous failure…. We have surrendered the decisions about where electricity is sold and at what price to private companies with only one objective: Maximizing unheard of profits."

The only problem with that theory is California never deregulated its energy market.

An understanding of the public policies in California that created this mess has critical importance for our quality of life in Oregon. During this legislative session Oregon lawmakers are likely to discuss whether to move forward with deregulation plans here. Unfortunately, the grave situation of our neighbor state may give them cold feet, and prevent Oregon consumers from experiencing the benefits of choice and competition in the electricity market.

So what did happen? Far from deregulating, California passed legislation in 1996 to "restructure" their power industry. Citizens should have known that something was terribly wrong with the deal when the legislation passed unanimously.

Among the results of the 1996 legislation, retail electricity prices were set for consumers by state regulators. The government forced utilities to sell off their power plants, and then prohibited them from obtaining competitive, long-term contracts with the power generators. Instead, utilities were required to purchase electricity in a spot market through the state "Power Exchange," with bidding rules that required paying the *highest* bid price.

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With the combined effects of population and high tech economic growth, electricity demand increased substantially after the restructuring. Wholesalers could essentially name their price once supply began to dwindle. It is important to note, however, that these power generators were simply playing by the perverse rules set in place by the government's restructuring scheme.

Anyone who questions the ethics of the power generators' activities should take a look at the California municipal power companies. The municipals, which were allowed to keep their power plants and thus control their own supply, earned millions in profits by selling power to private utilities at jacked up prices. Even the federally owned, Oregon-based Bonneville Power Administration sold at a higher rate to California than to Washington state.

Sandwiched between skyrocketing wholesale costs and a low retail price cap, utilities were forced to buy electricity at rates as much as 100 times the amount they could legally charge consumers.

According to the California Public Utilities Commission, electricity demand grew by 14 percent from 1996 to 1999, while supply grew by less than 2 percent. In a free market, such an imbalance in supply and demand would push the retail price of a product up. This in turn would attract new providers to the market (increasing supply), and offer consumers an incentive to conserve (reduce demand).

However, in California, instead of raising the retail price cap for electricity, Governor Davis offered a more subtle incentive for consumer constraint. During the lighting ceremony for the official state Christmas tree, Governor Davis turned on and quickly turned off the lights in a symbolic gesture of conservation. Needless to say, this heartfelt display could not pack the same punch as a rate increase on a consumer's electric bill.

New companies did not come running to the California market either. They found price caps and regulatory bungling unappealing—hardly a surprise. Meanwhile, power supply stagnated as state regulations made building new power plants an expensive and lengthy endeavor, while other rules delayed maintenance and repairs of existing plants for months.

Economics 101 tells us that buyers and sellers in a free market must be able to voluntarily contract with one another, with prices set by supply and demand—not based on the guesses or good wishes of government officials. Producers must have control over their means of production, and the ability to contract as they see fit with wholesalers. Consumers must be able to choose between a variety of providers. California's electricity market enjoyed none of these freedoms.

Indeed, the situation in California should give Oregonians pause. And then we should move forward, having learned from others' mistakes, and enact the reforms that California should have: true deregulation of the power market.

Angela Eckhardt is program director at Cascade Policy Institute, a Portland, Oregon based think tank. For more information on deregulation and competition refer to www.cascadepolicy.org.

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