

# NOW WHAT?

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# The Current Situation

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- ❑ Widespread skepticism toward electricity-industry restructuring
  - ❑ Rapid and radical reforms have been found to be extremely risky and may lead to disastrous outcomes
  - ❑ Retail choice for small customers not working well
  - ❑ A gamble for policymakers/politicians to support restructuring
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# The Current Situation --

*continued*

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- ❑ Still grappling over identifying “best practice” institutions underlying restructuring
  - ❑ “Bad things” don’t seem to correct themselves
  - ❑ It will take longer to get where we want to go than was expected
  - ❑ Debate over finding the right balance between markets and governmental intervention
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# The Current Situation --

*continued*

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- ❑ No guarantee of short-term benefits from restructuring
  - ❑ Electricity industry poses special problems and greater challenges for restructuring than other industries
  - ❑ Getting restructuring to work in accordance with economic theory has become difficult
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# Why Haven't Things Gone As Planned?

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- Underestimated transitional problems and difficulties in attaining the necessary conditions for successful restructuring – little tolerance for error
    - The “little things” do matter
  - Deficient understanding of institutions and incentives
  - Discounted the essential role of regulation in making competition work, creating the right incentives, and securing a positive environment for industry investments
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# Why Haven't Things Gone As Planned? -- *continued*

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- External shocks – California, Enron, corporate malfeasance, stagnant economy
  - Some problems haven't worked themselves out – one would hope for natural market forces to right most wrongs after a short adjustment period
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# Restructuring When All the Pieces Aren't in Place?

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- ❑ Transmission siting obstacles
  - ❑ Tight capital market
  - ❑ Absence of real-time pricing
  - ❑ Entry barriers in retail markets
  - ❑ Incorrect price signals
  - ❑ Local market power in generation
  - ❑ Inadequate incentives for transmission expansion
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# Restructuring When All the Pieces Aren't in Place? -- continued

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- ❑ Incumbent “advantages” over rival competitors
  - ❑ Absence of well-informed small retail customers
  - ❑ Lack of effective regulatory oversight
  - ❑ Lack of incentives/opportunities for hedging and other risk-management activities
  - ❑ Limited FERC authority over electric coops and public power
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# Can What Is Needed be Done?

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- Economists and other analysts have done a good job of listing things to be done and to avoid
  - While it is hard to disagree with them – although they need to have some empirical basis for determining which are more important than others – I question whether they can be done, at least in the short run in light of the *prevailing political environment*
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# Can What Is Needed be Done?

-- *continued*

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- If they cannot, then I question how we should move forward with restructuring and encounter the real possibility of adverse outcomes – is this the right time to charge ahead?
  - Need to walk a tightrope between having too little governmental intervention and too much (i.e., *laissez faire* and micromanagement)– either way, the outcome could be disastrous
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# Can What Is Needed be Done?

-- *continued*

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- I pose the following question:

*Should we take a chance with restructuring, even with all of the long-run promises, when the reality is that politics will dominate how it is carried out? That is, will politics produce pseudo-restructuring driven by interest-group politics and a mistrust of markets that prevails today? (Real-world restructuring diverging radically from textbook restructuring)*

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# Pertinent Questions At This Juncture

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- ❑ Why have we underestimated the difficulties of restructuring?
  - ❑ Why hasn't restructuring "worked well" in several places?
  - ❑ Can we be confident that FERC will get it right?
  - ❑ Can we be assured that the states would look beyond their parochial interests?
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# Pertinent Questions At This Juncture -- *continued*

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- ❑ Should we make sure that “all the pieces are in place” before moving forward?
  - ❑ Are the political constraints too binding in achieving the necessary conditions for successful restructuring?
  - ❑ What have been the social benefits, in kind and in size, from restructuring where it has seem to work?
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# Different Perspectives on Where to Go from Here

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- Pull the plug
- Pause or time out
- Move forward at an incremental pace\**
- Fast forward or flash-cut

\* For what it is worth, my preference

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# Some Final Thoughts

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- Don't turn back – we can and will make this work; the idea/concept of deregulation and restructuring in the electricity industry is as sound as ever before
  - Move ahead deliberately – we still need to study the unresolved issues
  - Need to take into account the political aspect of restructuring -- otherwise, we can get stuck with something that is worse than traditional regulation
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# Some Final Thoughts-- *continued*

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- ❑ Need more empirical evidence of positive outcomes from restructuring
  - ❑ Policymakers/politicians/regulators must accept the reality that restructuring may not make things better in the short run, and actually may make things worse; to have a policy of “assuring ” that things aren’t worse in the short run, say, for consumers may jeopardize the long-run success of restructuring
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# Some Final Thoughts-- *continued*

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- Restructuring requires more than an ideological foundation; it needs a plan of development as well as of implementation
  - It is one thing to identify the necessary conditions for successful restructuring; it is another to implement them because of political and other real-world factors; this is a lesson that the U.S. has clearly learned in its restructuring experience
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# Some Final Thoughts-- *continued*

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- Finally, at this time, as argued by some industry observers, a rational policy might be to “suspend play” or move ahead cautiously until we have a better handle on what it will take to make restructuring a success and to assure no or minimal negative outcomes
    - Analysts have not yet resolved the issue of identifying those institutional arrangements that would provide, for example, the correct incentives for transmission capacity expansion, achieve low transaction costs, and create efficient risk allocations
    - It could be argued that policymakers, politicians, regulators are playing Russian roulette if they move ahead with restructuring, especially at other than an incremental pace
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