

When the lights go out

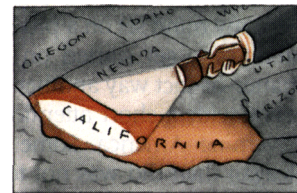
Don't blame deregulation for the chaos in California's electricity-supply industry. Blame "deregulation"

YOU cannot help but notice what a bad name deregulation has with voters—not just in the United States, where it is suffering its latest mighty embarrassment, but all over the world. Those nationalised industries and closely commanded semi-private enterprises of yesteryear were such paragons of efficiency and anxious attention to customers' needs, were they not? And their services were always such a bargain, don't forget, at a cost to taxpayers through subsidies and underwritten losses rarely adding up to more than billions of dollars. It wasn't broke, this old-fashioned way of delivering essential public services, but for some reason it had to be fixed. Along came short-sighted politicians, in the grip of the latest ideological fashion, bowing down to *laissez faire* and other such nonsense, and look what happened.

In the mid-1990s, California saw itself as the cutting-edge of utility deregulation. The old monopoly providers of electricity were radically restructured. Henceforth, suppliers and consumers would meet in a marketplace, trading electricity for transmission to consumers. That sounded a lot like capitalism. Now look at the mess.

This week, after months of turmoil and mounting fury, one of the state's biggest utilities, Southern California Edison, said it would not make payments of \$596m owed to creditors. Bankruptcies loom. A long-threatened programme of rolling blackouts, triggered as the state's reserves of power were exhausted, came into effect on January 17th. Gray Davis, California's governor, has declared a state of emergency and talks of stern remedies, including expropriation of assets and forthright re-regulation. What a shambles (see pages 55-57). Evidently, markets have their limits.

Hang on a minute. Markets do have their limits, but California's so-called deregulation of electricity has little light—if you will forgive the expression—to shed on them. The reason is that the system was not in fact deregulated. It would have been possible, as a long-term aim, simply to abolish the old monopoly protections and dismantle the command-and-control apparatus. The utilities rejected that because it would have left them with lots of uneconomic power-generating capacity acquired under the good old days of the previous regime; they wanted compensation for those "stranded assets". Organisations claiming to represent the interests of consum-



ers rejected it as well because they wanted implicit subsidies to particular groups to continue (which meant keeping the cost hidden) and because they feared the untrammelled monopoly power of the liberated suppliers.

The upshot was an overweening regulatory scheme slapped on top of a supposedly market-based system. One feature, rate freezes, is chiefly responsible for the present emergency: it has obliged suppliers (to their surprise) to sell power at a small fraction of the price they have to pay for it. Of course, the risk that costs would rise much faster than they could be passed along to consumers was foreseeable—and could perfectly well have been hedged in financial markets. That was not allowed. So much for market forces.

Unnatural acts

If electricity supply were a natural monopoly it would be right to worry that deregulation might go too far, to consumers' cost. The fact is, it is not a natural monopoly.

With the advent of micropower generation, the industry no longer has lower costs only at large scales of production. Small is feasible. The scope for local production also undercuts the natural-monopoly aspects of transmission across the grid. Consumer groups have always worried that, without regulation, the big gains from market-priced power will go to companies not individual consumers. Corporate customers will command discounts and negotiate clever cost-reducing contracts based on real-time monitoring of demand and congestion-pricing, none of this yet available to ordinary buyers. So what? If the benefits of cheaper electricity flowing from genuine deregulation go mainly to companies, fine: their costs will fall, and the savings will be passed on in the prices of their own goods and services. That is how markets work.

Sometimes, no question, genuine deregulation has gone wrong. But that is not the lesson from California. What happened there was "deregulation"—guided on one side by the utilities' desire to rig the market and on the other by a conviction that unrigged markets are out to screw consumers. The result was a partial, muddled and self-contradictory plan, leading eventually to this week's debacle. Next time, forget "deregulation" and try the real thing.