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An Industry Trapped by a Theory

by **Robert Kuttner**

In the search for the source of Thursday's blackout, the underlying cause has been all but ignored: deregulation. In principle, deregulation of the power industry was supposed to use the discipline of free markets to generate just the right amount of electricity at the right price. But electric power, it turns out, is not like ordinary commodities.

Electricity can't be stored in large quantities, and the system needs a lot of spare generating and transmission capacity for periods of peak demand like hot days in August. The power system also requires a great deal of planning and coordination, and it needs incentives for somebody to maintain and upgrade transmission lines.

Deregulation has failed on all these grounds. Yet it has few critics. Evidently, even calamities like the Enron scandal and now the most serious blackout in American history are not enough to shake faith in the theory.

Ten years ago, most public utilities were regulated monopolies. They were guaranteed a fair rate of return, based on their capital investment and costs. So the government compensated them for building spare generating capacity and maintaining transmission lines. Regulators, of course, sometimes made mistakes and the industry oversold technologies like nuclear power. Even so, in the half-century before deregulation, productivity in the electric power industry increased at about triple the rate of the economy as a whole.

However, the wave of deregulation that culminated in the late 1990's broke up the integrated utilities like Con Ed that once generated power in its own plants, transmitted it and sold it retail. It ushered in a new breed of entrepreneurial generating and trading companies. However, the prices the local utility companies could charge consumers remained partly regulated. The theory was that local utilities, no longer producing their own power, could negotiate among competing suppliers for the best price and pass the savings along to the consumer.

But deregulation hasn't worked, for three basic reasons. First, there is a fairly fixed demand for electricity and generating capacity is tight, so companies that produce it enjoy a good deal of power to manipulate prices. The Enron scandal, which soaked Californians for tens of billions of dollars, was only the most extreme example. California authorities calculated that a generating company needed to control just 3 percent of the state's supply to set a monopoly price.

Second, the idea of creating large national markets to buy and sell electricity makes more sense as economic theory than as physics, because it consumes power to transmit power. "It's only efficient to transmit electricity for a few hundred miles at most," says Dr. Richard Rosen, a physicist at the Tellus Institute, a nonprofit research group.

Third, under deregulation the local utilities no longer have an economic incentive to invest in keeping up transmission lines. Antiquated power lines are operating too close to their capacity. The more power that is shipped long distances in the new deregulated markets, the more power those lines must carry.

In addition, in the old days of regulation, a utility like Con Ed would be required to regularly submit a resource plan to a state's public service commission. The two organizations would forecast demand and decide how much money should be invested in power plants and transmission lines. Rates would be adjusted to cover costs. Under deregulation, however, nobody plays that crucial planning role.

Much of the Southeast, by contrast, has retained traditional regulation — and cheap, reliable electricity.

When the blackout hit on Thursday, many of us first thought of terrorists. What hit us may be equally dangerous. We are hostage to a delusional view of economics that allowed much of the Northeast to go dark without an enemy lifting a finger.

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