



## Electricity Deregulation: Michigan Policy More Enlightened Than California's

by Lawrence W. Reed

### Summary

Many observers have blamed California's energy woes on "deregulation," but the shortages are actually the result of too much government involvement in that state's electricity market. Fortunately for Michiganders, lawmakers here were more responsible when crafting Michigan's electricity deregulation plan.

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Years ago, California state Sen. Bill Richardson wrote an instructive little book about politicians with the charming title, "What Makes You Think We Read the Bills?" The electricity debacle in the Golden State makes me think there's a need for an updated version. The title could be, "What Makes You Think We Read Anything at All?"

California's troubles are the result of an entirely homegrown and inexcusably poor policy. Saying so is also bipartisan: Every legislator of both parties (except for two who voted to abstain) endorsed the 1996 legislation that bore its fruit in recent months in the form of random blackouts and soaring prices.

The geographic boundaries of the crisis are revealing. Drive one mile across the California border in any direction and there's no significant power problem, in spite of federal orders that neighboring states send some of their electricity to California's rescue. This is not a crisis of "deregulation" or of the free market. It is a *political* crisis, a disaster made law by public officials.

It is not deregulation when government fixes retail prices, forces

companies to sell their power plants and bans them from buying power through long-term contracts, creates a state-run power broker, and stifles additional supply while demand soars. California accomplished all this alleged deregulation with a law the size of a city phone book. True deregulation would have actually freed markets to operate according to supply and demand, removing rules and barriers instead of creating a mass of new ones.

Prices are the signals of the marketplace. They tell us more than even the most capable government planner could ever know—things like what people want, how badly they want it, where and when they want it, and what they're willing to pay for it. Prices also direct production: They tell

### Regulations Keep California's Electricity Supply Low While Demand Soars

Year	Net Capacity Added (in megawatts)	Growth of Peak Demand (in megawatts)
1996	462	2,376
1997	153	2,005
1998	6	2,464
1999	5	-1,323
Total	672	5,522

*Sources:* California Energy Commission, Investor's Business Daily

California's harsh regulations make it difficult to build new power plants, while price controls cause utilities to lose money providing electricity to the state's growing number of consumers.

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suppliers to create more of something or create less and switch instead to other, more valued lines of work in concert with conditions of supply and demand. We know that when prices are fixed by government decree, they can't do any of these miraculous things effectively. If mankind has learned anything from hundreds of years of research, study, and exposition in economics, surely that's it.

But not California legislators. They fixed retail prices of electrical power, perhaps because they thought they were immune to the laws of the marketplace. Stripped of the power plants the law required them to sell, Golden State utilities had to buy power in a government-managed wholesale market where prices were rising—rising in part because of a harsh winter, an excessive and state-mandated reliance on natural gas-fired power plants, a strong economy, and a regulatory environment that prevented any new power plants from being built for over a decade.

One of the edicts of the 1996 law prevented utilities from making long-term contracts for electricity. All the juice they purchased had to be bought in the spot market, where prices are agreed to according to conditions at the current moment and delivery is immediate. Long-term contracts historically allowed utilities to lock in their power costs and thereby give them some protection against high and erratic spot market prices.

Meanwhile, real deregulation efforts in other states have resulted in new power plants being constructed to meet growing demands. But that's been almost impossible in California because of the most cumbersome, time-consuming, and costly regulations in the nation. Texas power companies have added 5,700 megawatts of generating capacity over the past five years—nine times what California has added.

Here in Michigan, deregulation efforts are not without flaws, but state legislators didn't commit the colossal errors that California officials did. They didn't require utilities to sell their power plants or forbid them from engaging in long-term contracts. They didn't make it impossible to add to capacity (two major new power plants are being built and more are likely to be approved). And Michigan legislators never tried to force utilities to move to natural gas. As a result, Michigan utilities are powered largely by cheaper and more price-stable coal. These positive factors should overcome the negative effects of short-term electricity rate controls that Michigan foolishly adopted in 2000 and that thankfully will expire in three years.

The California power meltdown has one source and one source only: state government policy. The politicians who thought they could “plan” the state's electrical future in defiance of the laws of economics should rid the books of their disastrous restructuring schemes and give real deregulation a try.

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(Lawrence W. Reed is president of the Mackinac Center for Public Policy, a research and educational institute headquartered in Midland, Michigan. Permission to reprint in whole or in part is hereby granted, provided the author and his affiliation are cited. More information on economics and deregulation is available at [www.mackinac.org](http://www.mackinac.org).)

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