Harvard Kennedy School Energy Policy Seminar Series, Fall 2013

Twenty Years of Electricity Market Reform

Monday, September 30, 2013

Approximately twenty years after the passage of the U.S. EPAct that began the restructuring of many electricity markets in the United States, a veteran of the power industry spoke at the Harvard Kennedy School, assess in the successes and failures of electricity market reform, aimed at introducing competition and reducing the role of monopoly power production in the electricity sector.

Theresa Flaim, Principal at the firm Energy Resource Economics, traced twenty years of U.S. electricity market reform, noting that it took hold in high-cost states where "management and/or regulatory mistakes were perceived to be the problem." Part of the appeal of reform was not only the hope that it would result in cheaper electricity, but that it would punish "incompetent utility managers and misguided regulators."

Whether electricity market reform effectively punished anyone is unclear, but twenty years down the road, Flaim argued, competitive markets have successfully solved some problems that at first loomed extremely large—the issue of "stranded costs" (whether and how much to compensate utilities that had invested in plants and other infrastructure that they had invested in when they still had monopoly status) is no longer raised, and the markets themselves, after a period of experimentation and confusion which included the California electricity crisis, have settled on the basic elements of a workable market design.

A few things, however, haven't turned out as planned, Flaim noted. Hopes for dramatic short-term declines in electricity prices were not realized, nor were there great innovations in power delivery. The roll-out of retail markets, in many cases, was rushed, Flaim observed, and was sometimes undertaken before a workable framework for wholesale markets was in place. One lesson from the experience of market reform, Theresa said, was the "need to have workable wholesale markets for most customers."

Although market fundamentals have now been largely been established, Flaim pointed to two areas of "worry." First, capacity markets, used in many parts of the country to encourage adequate investment in new electricity generation, are a step away from markets and a step back toward centralized planning. Second, the potential benefits of markets have been limited by the reluctance to allow market prices to be reflected in the retail level. Citing remarks by HEPG Executive Director Ashley Brown, Flaim said, "it's ironic that we spend hundreds of millions of dollars to get all the elements of pricing for the electric industry exactly right, and then we turn around and spend more hundreds of millions of dollars to be sure no retail customer ever sees these prices."

Flaim, who has been attending meetings of the Harvard Electricity Policy Group since they began twenty years ago, praised HEPG for providing a safe haven for discussion of the "radioactive" issues around electricity restructuring and for its "relentless focus on important issues."

The Energy Policy Seminar Series is jointly sponsored by the Energy Technology Innovation Policy research group of the Belfer Center on Science and International Affairs and the Consortium for Energy Policy Research of the Mossavar-Rahmani Center for Business and Government.