Insight

Even During Bomb Cyclone, Don't Over-Regulate Electricity

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The timing of the "bomb cyclone" couldn't be worse for those who want their energy to be both reliable and affordable. A federal agency will soon decide whether to artificially raise prices in an effort to make financially struggling sources of energy more reliable. High electricity prices during extreme weather events like the bomb cyclone drive calls for the government to keep endangered energy sources open. The problem? The market, free of government intervention, is a far better mechanism for ensuring energy reliability at the lowest cost.

The Federal Energy Regulatory Commission (FERC) will decide on January 10th whether to implement a Department of Energy (DOE) proposal to raise electricity rates for coal and nuclear plants to support the supposed reliability of the energy these sources provide. These kinds of plants have come under increasing economic pressure as lower-cost renewable sources and natural gas have come online. Government policies have exacerbated the pressures on these more traditional sources by transferring costs from electricity bills to tax burdens, as have state government "renewable portfolio standards" mandating growth from specific energy types.

The consequence of government support for specific energy sources is that it causes the preferred sources to replace market-based decisions. The most expensive energy generators end up closing first, but before any subsidies or mandates those generators were still profitable, especially during times of abnormally high demand (like a bomb cyclone). After government preferences, it becomes more profitable to close those plants since government policies have either made the plants no longer profitable or no longer competitive, even though all a public policy does is shift the burdens to a different party.

DOE's proposed regulation would force ratepayers to pay a higher "just and reasonable" rate year-round to plants that have a 90-day on-site fuel supply. This policy would protect dispatchable sources like coal from the economic pressures created, in part, by other government policies. Thus, during extreme events, the supply of electricity would still be high enough to minimize price spikes.

While this proposal is a reaction to a problem, it does not fix the problem. During the 2014 polar vortex, which the DOE used to justify its proposal, energy shortages, and thus higher prices, were caused in part by transmission issues and, ironically, frozen coal piles and conveyer belts. Thus, what is "reliable" has seemingly little to do with on-site fuel supplies. Furthermore, the DOE's assessment of grid reliability earlier in 2017 determined that cheap natural gas—a positive market development—better explains retirements of coal and nuclear plants than government intervention.

The DOE's proposal does highlight how government intrusion into electricity markets creates myriad problems. Through subsidies, mandates, and other policies, governments have intervened significantly in how electricity is managed. Adopting the new regulation would simply introduce more distortion into the energy market. Even the Institute for Energy Research, one of the most ardent defenders of fossil fuels, has opposed the regulation for this reason. And the long-term effect of the proposal is simple: a wealth transfer from electricity ratepayers (you) to protect otherwise uncompetitive power plants.

Instead of artificially propping up one energy source, the government should allow the market to support reliable energy sources. The high prices that result during these extreme events give more reliable sources an opportunity to make more money. Suppressing that market signal, as this regulation would do, discourages cheaper and yet still reliable sources from coming online to compete with the expensive incumbents. The DOE's proposal merely decides for consumers which power sources should get paid more to stay open, rather than allowing the true test of their reliability—which ones stay open and thus keep making money during these abnormal conditions—guide electricity markets.

Unfortunately, when prices are about six times higher than normal—as in New England on January 4th—it becomes much less politically palatable to defend market principles. Nevertheless, it is vital that policymakers have the discipline to keep those high prices in place to encourage long-term reliable power sources. The effectiveness of those price signals was proven during the bomb cyclone, as even though costs were high, power remained available; a testament to the effectiveness of markets in ensuring reliability.

As the grid uses more intermittent sources of energy such as solar and wind, it is becoming harder to manage during extreme weather. However, the DOE's proposal is not the answer. Hopefully FERC will take a long view to addressing electricity pricing challenges based on what is best for the future, and not just what would have been best during the bomb cyclone.