Abstract

On September 23, 1996, California became the first state to enact legislation that would restructure their electricity market with the aim of accomplishing deregulation. Now in 2002 hindsight, the legislation may have been the biggest blunder in California history. Initially, analysts argued that the state did not completely deregulate; rather, it did so halfway, imposing price caps that accelerated artificial demand and shortened supply. As time moves forward, the reasons behind this quandary become much more complicated. Observers have been led to wonder if the state succumbed to a combination of noxious market elements such as the complicated nature of electricity; faulty design issues; bad luck; or, even more implicating now, the role of market power, “gaming the system” and corruption.

Additionally, most parties recognize that market power in the electricity industry is unavoidable: electricity is inelastic, suppliers cannot store it, the product is homogenous, the industry for the most part remains vertically integrated, and the list keeps going. Therefore, it is important to note that before, during, and after the deregulation process, states and their consumers are subject to market power manipulation. This does not mean it will necessarily happen, but it can. Should your state or country tread this fine line with something as vital as electricity? As Thomas J Brennan concluded, “Perhaps electricity too, will join the list of industries in which the benefits of deregulation have proven positive. But perhaps electricity will be the sector in which markets meet their match.”

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