THE CONUNDRUM OF INDUSTRIAL POLICY IN A COMPETITIVE ELECTRICITY MARKET

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EXPANDING THE SCOPE OF CONFLICT:

E.E. Schattschneider in“The Semi-Sovereign People” explained that in the American system players who do not win in one arena may attempt to bring the conflict into a broader or new arena.

Forum shopping is an expected feature of political, regulatory and litigation activity.

This means that an issue may take a long time to reach resolution and may be revisited.

ENERGY IS AN ESPECIALLY TEMPTING AREA FOR CONFLICT EXPANSION

- Energy industries, while large, complex and interconnected , have relatively small number of easily regulated supply-side players.
- Many players seek government advantages.
- Inherent price volatility stimulates attention.
- Misapprehension of energy markets by public and by policy makers invites political reaction.
- Adverse results of legislative intervention tend to be delayed and accountability obscured.

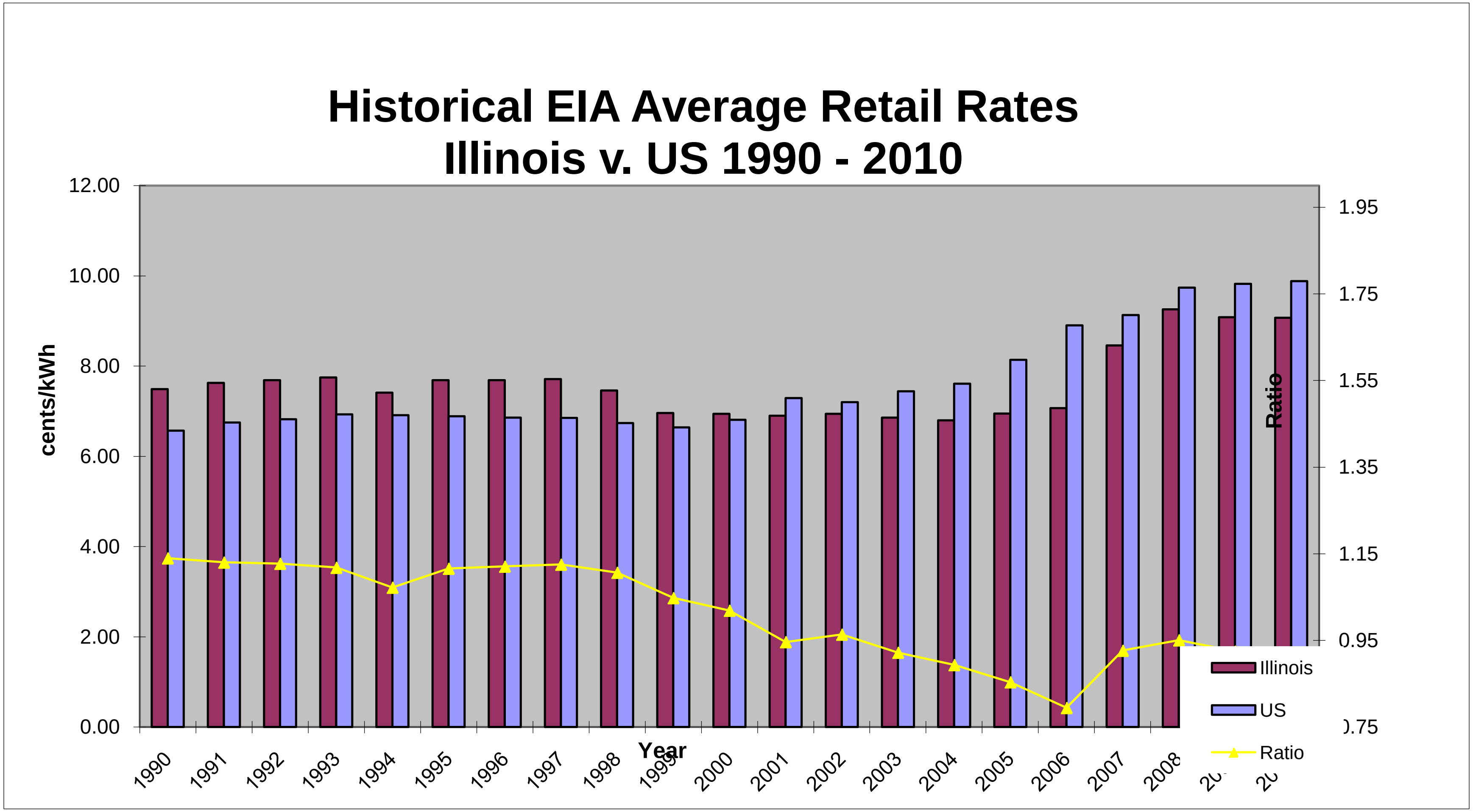
THE ILLINOIS JOURNEY TO COMPETITIVE ELECTRICITY MARKETS

- Illinois was a leader in the development of state-level utility regulation in the early 1900s.
- The political bargain that granted & regulated monopoly in accord with technical & financial realities unraveled when conditions changed:
  - Increasing cost industry in 1960s-1980s
  - Troubled nuclear construction cycle
  - Regulation & de-regulation in other sectors.
- Global advance of market philosophy created a receptive climate for regulatory reform.

ILLINOIS' 1997 RESTRUCTURING WAS NOT AN ABERRATION

- Although Illinois was an early mover, market reform has been widespread phenomenon.
- Today wholesale electricity is largely market based on in developed economies.
- Retail competition is policy and active in
  - 20 US & Canadian jurisdictions with 40% of demand
  - The rest of the English world (UK, Australia, NZ)
  - European Union & Parts of Latin America
- Illinois had already been a leader in reliance on markets in natural gas, telecom, P&C insurance.

ILLINOIS HAS IMPROVED ITS PRICE POSITION v. U.S. AVG. SINCE 1999



ILLINOIS IS IN A NEW ROUND OF INDUSTRIAL POLICY IN ELECTRICITY

- Decade-long intervention hiatus after the 1997 Law – until residential rate freeze ended.
- “Climate Change” concerns widely opened the door to a variety of renewable portfolio requirements & energy efficiency mandates.
- Such initiatives require significant subsidies due to their above-market cost/price position.
- Generally, these market interventions are not based on explicit cost-benefit analyses but are examples of expanding the scope of conflict.

TAYLORVILLE ENERGY CENTER (TEC): CASE STUDY IN MARKET INTERVENTION

- Especially interesting because, unlike RPS debates, opponents insisted on a cost/benefit review in light of existing competitive market.
- Proponents’ acknowledged costs far above market but argued that off-setting benefits justified the long-term commitment.
- The landscape was changing even as the debate was underway: demise of climate legislation, proposed USEPA emission regulations, doubling of USDoE natural gas reserves.

ACCEPTED TERMS OF THE TEC DEBATE

- TEC would be a combined-cycle gas fired generator fueled by high Btu gas made from coal and by purchased pipeline gas.
- Local job creation would be on the order of
  - 10 million construction man-hours (2500 peak)
  - 400 ongoing jobs: coal, transport & operations
  - 100s of local/in-state “multiplier” jobs
- Levelized 30-year purchase price of >21¢/kWh
- Some uncertainties about capital/operating costs

KEY ARGUMENTS IN FAVOR OF TEC

- Taylorville area, construction trades need jobs.
- Increase in Illinois electric prices due to TEC mandate would not be burdensome to residential & business.
- Full commercial development of gasification technology deserves Illinois-based support.
- Commercially competitive technology can revive the high-sulfur coal industry in Illinois.
- New USEPA regulations will force closure of many Midwest coal plants requiring replacement.
- Base load generation cannot be built in current wholesale competitive market.

KEY ARGUMENTS AGAINST TEC

- Local & project jobs are highly subsidized.
- >21¢/kWh power = 5x current market = .2¢/kWh surcharge = $286 million/y/30 years will have a large net negative job impact.
- Illinois should not fund private development, especially if Feds are already funding clean coal technology.
- Market won't support base load because there is not need for new base load in the market
- Cost of replacing plants closed by USEPA rules would be <7¢/kWh & new EIA gas estimates make TEC even more "out of the market" than do study assumptions.

THE POLICY CONUNDRUM: THE INFORMATION GAP v. MARKETS

- Under what conditions can we expect public policies that prescribe energy sources to prove superior in results to competitive markets?
- Can we expect the legislative process to cope with the volume of complex energy data?
- Can "industrial policies" be flexible enough to adapt to tech, financial, economic changes?
- Can the legislative process can be more oriented toward the future than to current conditions?
- To what extent will price signals be distorted and lead to unanticipated and adverse consequences?