

The Deregulation Trap in Today's Energy Markets

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Abstract

The deregulation of the energy industry has long been a contentious issue. Opponents claim that it can lead to higher pricing, poorer dependability, and market manipulation, while supporters claim that it results in increased competition, cheaper prices, and improved efficiency. Overall, energy market deregulation can have both positive and negative effects, depending on the specific circumstances of each market. While deregulation can lead to greater competition, efficiency, and choice, it can also create greater volatility and risk if not properly managed. Therefore, policymakers and regulators need to carefully consider the potential benefits and drawbacks of deregulation before implementing any changes to the market structure. This research essay looks at the historical background and justification for the deregulation of the energy market, the effects it has on consumers, and the opportunity for regulatory control to lessen any unfavorable effects.

Keywords

Energy markets, deregulation, development, sustainability

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Introduction

From the beginning of the 20th century, the regulation of energy markets has played a significant role in the American economy (Stigler, Friedland, 1962). To guarantee that customers have access to reasonably priced and dependable energy supply, governments have historically controlled the energy markets. Nonetheless, there has been an increasing tendency toward deregulation in recent years, and several states have adopted regulations that for greater competition in the energy sector (Zajicek, 1999). Deregulation proponents assert that it can result in cheaper costs, higher effectiveness, and more innovation, while deregulation opponents caution about the possibility of market manipulation and less reliability.

Energy market deregulation refers to the process of removing government regulations and controls on the energy market, allowing for more competition and greater flexibility in pricing and supply (Bodislav, 2013). The impact of energy market deregulation can vary depending on the specific circumstances of each market, but in general, there are several potential results that may occur:

- Increased competition: Energy market deregulation can lead to increased competition among suppliers, resulting in lower prices for consumers. With more suppliers competing for customers, companies may be forced to offer more attractive pricing and incentives to win business.
- Improved efficiency: Deregulation can also lead to greater efficiency in the energy market. Suppliers may be more motivated to invest in new technologies and infrastructure to improve their competitiveness, and this can lead to more efficient use of energy resources.
- Greater choice: Deregulation can provide consumers with greater choice in terms of their energy supplier, the types of energy sources available, and the pricing plans offered. This can help to create a more dynamic and responsive market that is better suited to the needs of individual customers.

- **Market volatility:** Energy market deregulation can lead to greater market volatility and price fluctuations. This can occur if there are sudden changes in supply or demand, or if suppliers are subject to unexpected external factors such as changes in government policy or fluctuations in commodity prices.
- **Risk of market manipulation:** With increased competition and greater market complexity, there is also a risk of market manipulation by unscrupulous suppliers or other market actors. Regulators may need to be vigilant in monitoring the market to prevent anti-competitive behavior or other forms of market abuse.

Literature Review on Energy Market Deregulation

Energy market deregulation has its roots in the 1970s, when the US saw a jump in energy costs and shortages as a result of the OPEC oil embargo. In response, the government put in place a series of measures designed to cut energy use and boost local output. The Public Utilities Regulatory Policy Act of 1978 was one of the most important of these laws, requiring utilities to buy electricity from independent power producers at prices determined by regulators.

Although PURPA was designed to promote competition in the energy industry, it eventually resulted in the growth of small-scale power producers that were able to sell their electricity at exorbitant costs. As a result, in the 1990s, several states started to experiment with deregulating their energy markets. A handful of jurisdictions have fully deregulated their energy markets by the early 2000s, allowing customers to select their own energy suppliers and fostering more competition.

Deregulation of the energy market refers to the process of reducing governmental oversight and restrictions on the industry. In this process, the pricing of energy commodities like electricity, natural gas, and oil are determined by market forces. The goal of deregulating the energy market is to boost competition in the industry, boost productivity, and ultimately bring down consumer costs (Rădulescu, Angheluta et al., 2022). Deregulation of the energy market has its roots in the early 1900s, when the government started to regulate monopolies to stop them from taking advantage of customers.

The production, delivery, and cost of energy commodities were all subject to government regulation prior to the energy market's deregulation. The utilities, which were in charge of providing energy to customers, were likewise under the jurisdiction of the government (Profiroiu et al., 2020). The utilities were governed to prevent them from abusing their monopolistic position and to guarantee that they delivered electricity at fair and acceptable pricing (Radulescu et al., 2020).

Due to the energy crisis in the 1970s, the government implemented regulations to encourage energy conservation and efficiency. The government started looking at the notion of deregulating the energy industry as a method to enhance competition and bring down energy prices, but these measures had only modest results.

The government started putting deregulation measures into place for the energy industry in the 1980s. Natural gas was the first industry to be deregulated, followed by oil and electricity. The goal of deregulating the energy sector was to encourage competition, which would result in lower consumer costs, more efficiency, and innovative thinking (Jianu et al., 2019). The government thought that deregulation would spur further competition by encouraging new market entrants.

The idea that government regulation was producing inefficiencies in the energy industry was one of the main drivers for the deregulation of the energy market (Angheluta et al., 2019). The government argued that because regulated monopolies were guaranteed a fixed amount of profit, they had no motivation to innovate or cut expenses. The government hoped that by liberalizing the energy sector, it would level the playing field for all businesses, fostering more efficiency and innovation (Bodislav et al., 2020).

Deregulation, according to the administration, would boost energy sector investment. Energy distribution was monopolized by utilities before deregulation, which meant that they were in charge of all sector investments. Yet, the introduction of competition allowed for the entry of new businesses, increasing investment in the industry (Bodislav et al., 2020).

Deregulation of the energy sector was also justified on the grounds that customers would pay less for their energy (Anderson, 1994). The government assumed that since businesses would have to compete on price to draw customers, competition would result in reduced pricing (Profiroiu, Radulescu & Burlacu, 2020). Deregulation, according to the government, would increase efficiency, which would reduce expenses and, ultimately, cut prices for customers.

Notwithstanding the potential advantages of deregulating the energy sector, there have also been worries about its effects. Deregulation might result in market failures, especially in the case of natural monopolies,

which is one of the key worries. In sectors with natural monopolies, one business can offer the service more effectively than others. Without regulation, there is concern that natural monopolies can take advantage of their market dominance to harm consumers (Bodislav et al., 2021).

Concerns have also been raised regarding how deregulation may affect the environment. While businesses would no longer be subject to government limits on emissions, critics claim that deregulation might increase pollution and greenhouse gas emissions (Bran et al., 2020).

Because it aids in achieving distribution efficiency, a higher employment rate, and the growth of the entire economy, the public sector—or state-owned enterprises—is viewed as an effective tool in European nations, particularly in emerging ones. To this, one can add the development of corporate behavior, which includes promoting exports and imitating state governance through corporate governance. The Japanese and American visions, which emphasize little engagement in national execution in the public sector, are in opposition to the European perspective (Brackman et al, 2009). Globally, the biggest number of privatizations occurred in the 1990s, which was highlighted by reduced government confidence in state-owned enterprises and increased budgetary costs. Large-scale privatization took place in Europe in the 1990s; it began with France and the United Kingdom in 1986, then moved on to Italy, Spain, and Germany in 1993. Europe's economic outlook between 1979 and 1999 was altered by privatization since it created a strong private sector and simplified the residual state-owned enterprises. These shifts in perspective were also in line with political and ideological trends of the day, such as "Thatcherism" and "Reaganism," but the crises of 1987 and 2007 were delayed by unresolved problems the private sector had with the public sector, which were further compounded by technological advancements that eliminated some monopoly positions from the market.

The development of telecommunications and the production and distribution of energy might be added to the list of technical advancements (Burlacu, Negescu et al., 2021). By improving allocation efficiency, information technology aids in neutralizing natural monopoly or even streamlining some oligopolistic positions. One example of a current monopoly case study is the nationalization of a business, comparable to TARP in 2009. (US). In the instance of oligopoly, we have the evolution of a market by new entrants reproducing existing oligopolies of businesses due to technical advancement. A monopoly that was broken up into smaller companies in 1984 to cut expenses and improve the economy is AT&T. In both situations (monopoly and oligopoly), we have a state-owned corporation that shouldn't have profits as its major goal since it may also experience losses (High, 1991). These losses shouldn't be seen negatively because they are related to the public company's primary goal. The business should operate on the assumption that prices are equal to marginal costs and that fixed expenses are marked losses that are compensated by the public budget, improving the efficiency of resource allocation.

Regulation versus Market Deregulation – Methodological Research

Adam Smith, the father of modern economics, introduced the concept of regulation in "Wealth of Nations," based on the premise that a seller has some benefits, but at a cost that is passed on to the broader audience.

In the 1970s, Stigler came to understand that regulations had two main effects: they redistribute income and increase economic waste costs. Interest groups ask the government for laws and work to achieve a goal on behalf of the general welfare, but they also strive to get the government to regulate the market in order to benefit themselves (Stigler, 1971). According to Stigler, when an industry is given governmental authority, its benefits would decline and its losses will increase for the entire branch. Instead of reducing market flaws brought on by natural monopolies or reducing social inequality, politicians adopt legislation in response to requests from interest groups that might provide them with supplementary advantages, such as boosting their chances of being reelected (financial support, moral support, etc.). The rationale and objectives behind action regulation reveal the motivations of those in a position to sway political decision-makers. Regulation was depicted by Stigler as an organization that seeks profits by controlling its influences for the benefit of the interest group it represents.

Since they all began as man-made monopolies, the rise of electric energy and telecommunications at the beginning of the 20th century was comparable to the emergence of real monopolies towards the end of the 20th and the beginning of the 21st centuries. Since they wanted to eventually securitize their market share, companies like Chicago Commonwealth Edison and AT&T requested the US government to monitor and control their sectors (Bodislav, 2013). These businesses helped industries, markets, and geographic penetration establish regulatory bodies. Stigler emphasized how mercantilism, another kind of modern economic regulation, shares the same poor faith attitude toward the public interest.

The concept that politicians "sell" regulations to the highest bidder on a market where bids are equivalent with bribes, votes, or other quantitative sources valid for decisional administrative and legislative organizations is another intriguing addition made to regulatory research by Sam Peltzman in 1976. The best regulation serves both the producers and the consumers. Niche regulation does not assist all producers or consumers, but it does make certain little subgroups more competitive. By maximizing the marginal utility of laws, regulators distribute advantages to the producer and the consumer (Schwarz, 2001). All of the political parties concerned behave in a rent-seeking manner toward the decisions made by the particular regulator.

Government regulation and economic efficiency are put under increased strain due to the competitive impact between interest groups. Becker emphasized how interest groups exert pressure on governments to get certain advantages and how barriers formed by regulations lead to economic inefficiencies. All of the recently formed competition places further pressure on public policies for long-term production growth. Both Becker and Peltzman noted that by consistently spending money on campaigning for regulatory development against deregulation, the regulatory flow may be simplified.

Here, we may see how the economy is affected by deregulation. The economic theory on sector segmenting against regulatory relaxing for getting marginal advantages and redistributing pressure on original interest groups was expanded by Becker and Peltzman. In the past, deregulatory instances could have resulted in rising marginal costs for consumers and lowered marginal benefits by regulating manufacturers. In this approach, re-regulating behavior even shifts the political balance.

The Chicago school of thought emphasized the notion of a regulative economy, built on methodological individualism and expanded on market behavior perceived as a hole, impacting the debate over the question of governments' and economic agents' incentives acting rationally. This strategy is likewise founded on Austrian economics, but the key distinction is that between the two schools, unrestricted competition exists and generates larger marginal benefits than controlled competition (Zajicek, 2001).

Limits and Discussion regarding the Inefficiency of Deregulation

The case study of the state of California's deregulation of the electricity system and energy market serves as the finest adverse illustration for comprehensive deregulation. In California, the deregulation of the energy sector resulted in unrestricted commerce between supply and demand, a phenomenon only observed in ideal markets. Because long-term agreements between producers and customers were outlawed, everyone was forced to conduct business on the spot market through the ISO, a monopoly operator (Independent System Operator). Because the deal was only carried out when a certain threshold was met, a secondary market developed within the primary market, allowing manufacturers and suppliers to manipulate pricing to their benefit. Enron and Dynegy benefited financially from the market reform, which moved the imbalance away from the energy dealers and toward the broader economy (Bodislav, 2013, 2014).

Electrical energy costs excessively increased as a result of the deregulation law. The traditional regulatory framework for the energy industry was used to establish these expenses. The law led to the formation of local monopolies and raised hurdles to entry for new energy producers, including those producing green energy. Throughout the years 1985 to 2005, this statute caused a setback for the development of electric facilities in the state of California and boosted imports from Canada to meet the state's demands. The "black swan" theory's reaffirmation in 2001 rendered this law null and void, as the year's unfavorable combination of factors—including an exceptionally hot summer, a bitterly cold winter, rising natural gas costs, and Enron's greed—led to an accelerated financial disaster (Bodislav, Constantinescu, 2014). When providers reached the consumer's maximum regulated price, they ceased providing electric energy. The law that was designed to abolish monopoly and open the energy market was a failure in this regard (Gordon, 2001). The "deregulation bill" failed due to execution issues and the way in which the regulation was seen, turning it into the most egregious example of the inefficiency produced by deregulating rather than regulating a market.

Conclusions

The charm of deregulatory reform has entranced certain nations in Central and Eastern Europe. Most politicians, businesspeople, academics, and members of the media from emerging nations support deregulation and actively engage in international lobbying because they believe that genuine regulatory actions occasionally need the development of new rules. The situation of the CEE countries is unique

because they are members of the European Union, which is a supranational organization with the most tightly regulated economy among all existing economic unions. As a result, interest groups must make significant financial investments in a potent lobbying apparatus. As the majority of these nations experienced communism, they have a vibrant economic and political elite that is aware of how to go beyond some of the EU's objectives in order to further their own interests. On this basis, a cartel is established to reorganize the laws meant to prevent the creation of monopolies (banned in the EU). Where the interest group has its headquarters and with implications for the political class that governs the European Union, independent regulators or the dominant political class determine the cartel's organizational structure.

It is necessary to reduce political influence inside public utility corporations in order to create an effective economic hybrid. The long-term answer to creating a regulated market, particularly for the energy sector and state-owned utility businesses, is to abolish government control rather than seek better regulation.

Politics has a significant impact on the type and effectiveness of regulations as well as the pace and process of regulations and deregulatory actions. Legislators' actions will determine if genuine regulatory unhappiness will result in the deregulation or re-regulation of a market and whether these changes are simply a response to certain inequalities that were seen in a prior circumstance.

We could draw the conclusion that, with a few minor exceptions, deregulation might result in lower costs, higher service quality, and the entry of new players into certain industries. However, those few minor exceptions might turn into actual black swan events if politicians and interest groups act irresponsibly or some unregulated innovations from the financial sector become systemic risks.

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