

# COMMENTARY ON IMPROVING MICHIGAN'S ELECTRIC UTILITY INDUSTRY

Gary Wolfram, Ph.D.

## EXECUTIVE SUMMARY

The electric utility market has defining characteristics setting it apart from what one thinks of when discussing a market-based economy.

Because of the barriers to entry, monopoly electric utilities do not respond to the marketplace in the same way as competitive markets. Thus, if the incentives of regulated monopolies do not result in an efficient allocation of resources, action should be taken to improve these incentives.

The need for improvement can be readily seen by noting the high price of electricity and the relatively poor service quality across Michigan compared to surrounding competitor states.

There are several approaches that legislation and regulation may take to improve the incentives and performance of Michigan's electric power industry:

**1. Expanding retail competition** – Expanding retail choice would alter the incentives of the existing utilities as they would have to compete with new entrepreneurs and existing generators and wholesalers.

**2. Structural separation** – Because there is little incentive for a utility that generates electricity to provide access to another generator or a wholesaler to the line to their customer's home or business, one approach to change the incentives would be to structurally separate the ownership of generation from the ownership of distribution, in the same way that transmission was separated from generation.

**3. Allowing Consumers a Choice to Purchase Renewable Energy Specifically** – Just as some consumers would rather purchase organically-grown vegetables even if the cost of these vegetables is greater than those grown conventionally, there are consumers that would rather purchase energy that is produced from renewable sources.

**4. Require Purchase of Renewable, Co-Generation, and Waste-to-Energy Energy Sources** – Entrepreneurs have reduced incentives to take on the risk of innovating in the generation of electricity from renewable sources such as solar power, or other cutting-edge methods like co-generation and waste-to-energy, as they may not have access to a final consumer or the mass of consumers.

**5. Peak load pricing and Other Mechanisms to Encourage Consumer Efficiency** – Electric utility generators have little incentive to encourage their customers to reduce electricity usage from the utility or to move their consumption to times that are lower costs to produce.

The current structure of Michigan's electricity industry results in inefficient use of resources, higher prices for electricity, and reduced economic activity due to the incentives of both producers and consumers inherent in the current regulated monopoly structure.

Michigan's economy could be improved and consumers would benefit from introducing a fully competitive industry and/or through regulations that correct the improper incentives and add to incentives to innovate. Given the high price of electricity and relatively poor performance of Michigan utilities compared to its surrounding competitor states, it is the responsibility of the Legislature and Michigan Public Service Commission to fully address these issues either by creating a competitive market or creating regulatory incentives for better performance

