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OUTSIDE VIEW: ENRON'S POLICY IMPACT

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WASHINGTON, Feb. 16 (UPI) – As the media continue to report, the collapsed energy trading giant Enron understood far better than most that when you are dealing with regulated industries, you have to play in the political arena to succeed.

In light of all of the accusations about Enron's accounting practices and influence peddling, it is also appropriate to focus also on the specific impact Enron's business practices had on the public policies regulating its core businesses: energy and, to a lesser extent, broadband.

Of course, we really should not be so shocked by Enron's efforts to play in the political arena on its face, as such conduct is widespread in the energy and telecoms industry. Indeed, the now-bankrupt Global Crossing gave out more money in 2000 than Enron.

What we should understand, however, is exactly what Enron's core policy message was, and how well they sold this story to politicians – and the market as well – to advance their corporate goals.

At bottom, Enron's message was simple: To break up monopoly network industries, politicians should turn the products created in these industries into mere "commodities" that could be bought and sold in a free market.

While this message may sound great in concept, however, the economics of network industries are complex and not homogenous. So this kind of

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pedantic "cookie-cutter" approach to business and public policy – without regard to overall industry structure – is fraught with peril.

To be fair, when Enron first brought this message to the natural gas industry where it had its corporate roots, Enron actually understood the business. As such, Enron was right, and gas trading has done much to maximize consumer welfare.

However, what is important to understand is that natural gas – just like oil, wheat, pork bellies, and frozen concentrated orange juice – has all of the characteristics of a "commodity" product. You can transport it but, more importantly, you can also store it at the "city gates" for an indefinite period of time.

Where Enron first turned a good idea into snake oil was when it convinced the Clinton administration's Federal Energy Regulatory Commission to apply its gas model on the electric utility industry in a relatively cookie-cutter fashion.

Because Enron had significant generation capacity that ran on cheap natural gas, it was in the corporation's interest to have the FERC force once-vertically integrated utilities to open up their transmission grids to permit competition among competing source of suppliers.

Competition in the electric utility industry is an important public policy goal, but competition among generation suppliers means nothing without adequate transmission capacity to get that electricity to market.

Enron's solution – which the Clinton administration bought hook, line and sinker – was that transmission must be priced as cheaply as possible, and that vertically integrated electric utilities should not be permitted to own and operate their own transmission assets; instead these assets must be operated by an "Independent System Operator," "Regional Transmission Operator," "Transco" or something else along this line (FERC has yet to provide any definitive guidance about exactly what this type of entity should look like).

Enron's idea sounds good in theory, but the Clinton administration took it up so zealously that it failed to undertake the requisite intellectual heavy lifting to push through the required restructuring of the energy industry necessary to make it work.

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Unlike natural gas, electricity cannot be stored or stopped at a "city gate." Instead, the electrons flow according to the laws of physics, and in order to balance the grid, a tremendous amount of balancing must occur by having firms ramp up and ramp down depending on ever-fluctuating demand and supply considerations.

The FERC attempted to commoditize and assign property rights to electrons without taking into account long-term industry structure or developing analytically sound transmission grid dispatching mechanisms and pricing policies. Therefore, the electric utility industry is now in financial shambles. That is why Democratic Governor Gray Davis had to have the state of California take over and run the transmission assets in the recent energy crisis there.

According to recent Phoenix Center research, as a direct result of the Clinton administration's analytically flawed electric utility policies, new U.S. bulk transmission capacity over the past seven years increased by only a paltry 0.05 percent, despite the huge increase in demand over that period. Therefore to blame the Bush administration for this energy debacle because of its common Texas roots with Enron simply is not fair.

Fortunately, when it came to broadband – again, hardly an industry that one would characterize as a traditional "commodity" – Enron had little impact on telecoms policy. Yet, it nonetheless successfully sold its snake oil to Wall Street, thereby indirectly affecting the policy debate.

Instead of making a true "last-mile" play – which is exactly where new capacity is needed most – Enron attempted to create some sort of "bandwidth" exchange where you could buy and sell capacity on their long-haul network on an as-needed basis.

But there is a huge amount of excess long-haul capacity currently available from numerous wholesale "carriers' carriers." Therefore, a wholesale market for "spot" bandwidth never materialized because it is far easier – and generally more efficient – for firms to purchase inexpensive, long-term capacity instead. Indeed, barring such national emergencies as September 11, demand spikes simply do not occur in the telephone business.

Given such naiveté, it is no surprise that Enron's broadband division lost over $350 million in 2001 alone, thus further contributing to the financial collapse of the U.S. telecoms industry.

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In sum, Enron's behavior is reminiscent of Ivan Boesky's philosophy that you can trade anything so long as it is not nailed down. While this may be true in the abstract, we are now once again paying the price for having policy-makers believe that rent reallocation is the same as meaningful competition.