Confusing Politics and Economics in Electric Supply Decisions

Northwestern Energy’s proposal to buy back the Montana Power hydroelectric dams has run into some opposition. In Northwestern’s analysis of what a reasonable price was that their customers should be willing to pay to get those renewable electric resources back, Northwestern looked at what alternative sources of additional electric supply would cost in the future. Besides adding some additional wind electric generation, Northwestern assumed that the majority of additional supply would have to come from generators burning fossil fuels, either natural gas or coal.

In analyzing those future costs of generating from fossil fuels, Northwestern assumed that the federal government would be fairly strictly regulating the emissions of carbon from such electric generators. That did not seem like a wild stretch. EPA had already published rules governing the carbon emissions of new fossil fueled electric generators and will be releasing rules for existing electric generators this summer. In addition, most electric utilities around the United States analyze alternative sources of electric generation doing exactly what Northwestern did: They assume that generators burning fossil fuels will face a cost penalty tied to carbon emissions.

Many of Montana’s political leaders, however, are skeptical of the scientific claim that human carbon emissions are causing climate change. Not surprisingly, those political leaders also oppose any such federal regulation of carbon emissions. This makes Northwestern’s inclusion of the future cost of federal carbon regulation look like the utility is in cahoots with tree-hugging liberals to discourage the use of Montana coal
and natural gas. Northwestern appears to have raised the price it was willing to pay for the dams by hundreds of millions of dollars because the dams would help customers avoid the costs of that future regulation of carbon emissions.

As a result, Northwestern’s customers would have to start paying higher electric prices right away if the dams were purchased, even though the fight over regulating carbon emissions is far from over. To those who do not believe that carbon emissions are a problem, this is quite galling. They see political beliefs that they do not agree with being incorporated into the price that would be foisted off on customers if those hydroelectric dams were purchased.

To evaluate this debate, it may be helpful to turn Northwestern’s electric supply decision on its head. Suppose, instead of proposing to buy those hydroelectric facilities, Northwestern was proposing to the Montana Public Service Commission to build a new large coal-fired plant in Eastern Montana at a cost of a billion dollars. Assume further that Northwestern’s management was highly skeptical of the claim that human carbon emissions threatened climate stability. As a result, the new coal-fired plant was not designed to capture any of its carbon emissions.

Should the Montana Commission embrace such an electric generator, quickly approve making customers responsible for the billion dollar cost, and cheer the fact that more Montana coal would soon be mined?

One would hope that some hard-nosed, no-nonsense Montana conservative would say, “Just a minute now. If you build this plant, will you be allowed to operate it? We do not want customers to pay a billion dollars for an electric generator that cannot get the permits to operate! “ Even if this cautious conservative Montanan thought that
coal-fired electric utilities were currently over-regulated, she might still say “It doesn’t matter what I wish were the case. What matters in deciding whether to invest in this electric generator is what emission regulations are in place or will be put in place in the future. Building a coal-fired generator is not a political statement. It is an important economic decision.”

In that setting, should the Montana Public Service Commission really burden electric customers with a billion dollar engineering marvel that might not be allowed to operate unless another billion dollars was spent adapting it to meet the emission standards that will be in place when it comes on line?

It seems clear that the Montana Commission, like any regulatory commission around the nation, would reject such an imprudently designed electric generator regardless of what the individual commissioners thought about human caused climate change.

But it is important to realize that the very reason for rejecting such a new coal-fired generator is the same as the reason for putting a higher value on the Montana hydroelectric facilities that Northwestern is proposing to buy in the name of its customers. Those hydroelectric facilities are more valuable because they do not burn fossil fuels but instead rely on rain- and snow-fall and the forces of gravity. They represent an insurance policy against the costs of the future regulation of the emissions caused by the burning of fossil fuels. Electric utilities across the nation are shying away from coal-fired generation, not because they do not like it, but because it is too risky financially because of the high level of air and water emissions associated with it and the increasingly strict and costly regulation that follows from those emissions.
Electric generating resources that do not have the costly problems associated with the combustion of fossil fuels are economically more valuable because of that. That is not politics talking. It is cold hard economics. Ignoring that would be both imprudent and costly.