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# LIMR

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## EXCHANGING THE TRUTH FOR A LIE

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**VENEZUELA:**

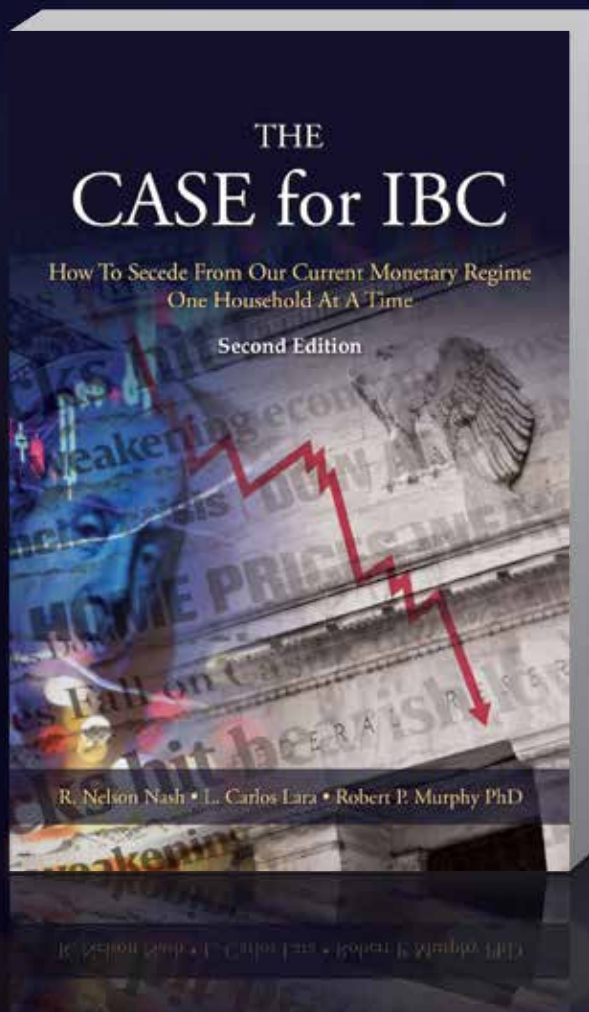
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# Get The Economics Right

**Interview with  
Bill Peacock**



**Bill Peacock is the vice president of research at the Texas Public Policy Foundation. Bill directs the research of the Foundation to ensure its accuracy, integrity, and application of free market principles to the issues facing Texas and the nation. His own research focuses on economic freedom and growth, energy, property rights, and regulatory issues.**

**Prior to joining the Foundation, Bill was a legislative and media consultant, and worked in the Texas Legislature and in the executive branch. He has a B.A. in History from the University of Northern Colorado and a M.B.A. with an emphasis in public finance from the University of Houston. He lives with his wife, Kelly, and son, William, in Austin, Texas, where they attend Redeemer Presbyterian Church.**



*Note: The economists and financial professionals interviewed in the LMR are given the freedom to express their views, without necessarily implying endorsement from the editors.*

**Lara-Murphy Report:** How did you discover Austrian economics?

**Bill Peacock:** Its funny that you ask because I don't really remember the exact source. It was in 1989—before the Internet. We didn't have Google searches, so we had to rely on old-fashioned sources of information like magazines, catalogues, print circulars, etc. But somehow through those mediums I discovered the Foundation for Economic Education and wound up at one of its weeklong economics seminars at its old headquarters in Irvington-on-Hudson, NY.

I do remember being blown away by ideas from the Austrian School that I'd never been taught in school. My teachers that week,

including Hans Sennholz, Bettina Bien Greaves, and Richard Ebeling, were likewise amazing. I was hooked.

I started reading books, attended the first Austrian Scholars Conference in (I think) 1995, and later attended Mises University. I took some great courses from the old version of Mises Academy, including three from one of you (Murphy) that walked us through Murray Rothbard's *Man, Economy, and State*. Even after about 20 years of studying Austrian economics, those courses—and Rothbard's book—opened my eyes to economic truths I had never seen before.

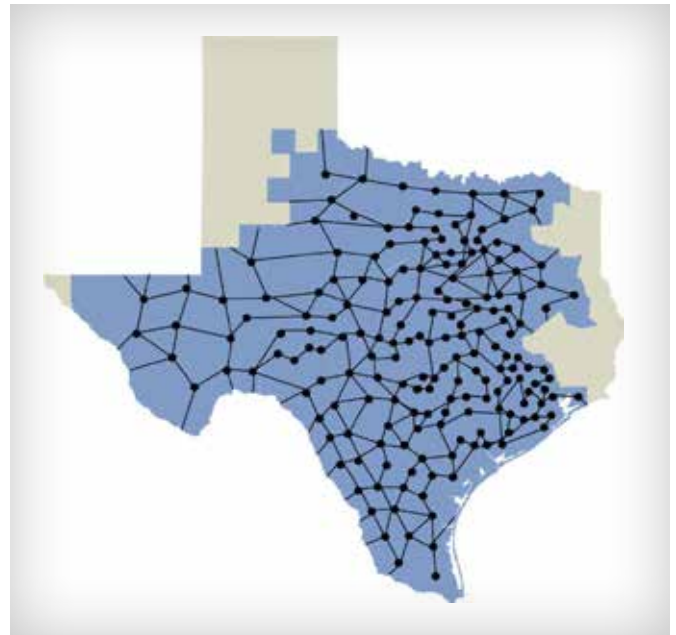
My favorite non-Mises and Rothbard books on Austrian economics include *Foundations of*

*the Market-Price System* by Milton M. Shapiro, *Economics for Real People* by Gene Callahan, *Foundations of Economics: A Christian View* by Shawn Ritenour, and Bob (Murphy)'s *Lessons for the Young Economist*.

I've spent the 30 years since the FEE seminar incorporating the principles of Austrian economics into my professional career, first as a regulator and more recently as a policy analyst for the Texas Public Policy Foundation, a free-market think tank in Austin, TX. In both my own research and as an editor, I have found that the economic principles I have learned through the Austrian School apply to any situation in any market dealing with any issue, be it energy, telecommunications, health care, or property rights. Get the economics right, and you are more than 50 percent of the way toward understanding the issue, no matter how complex it might be.

**LMR:** We understand that in your work on energy economics, you have found that Austrians have unique insights, even compared to other free-market economists. Can you explain for our readers?

**BP:** It is a little-known fact—which may be surprising given how much Texans like to brag—but Texas has the most competitive electricity market in the world. Our “energy-only” market design means that prices, not regulators, are the main determinant in how much energy generation gets built each year to keep up with demand. The result—as Austrians would expect—has been a more efficient market with (generally) lower prices and increased reliability.



Of course, not everyone likes competitive markets—including some of the competitors, so the market has been constantly under attack since it became fully functional in 2007.

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Additionally, the fact that it functions more on prices than any other electricity market has made it a profit center for renewable energy generators, who can use their subsidies to undercut the price of any traditional generators. Because of these challenges, we have

done a lot of research with the help of some excellent free-market economists.

Yet I've found that sometimes even classical free-market economists balk at taking on market power, the pricing of products above marginal costs, and other issues usually related to anti-trust theory. As competitive as the Texas market is, it is still illegal to engage in market power "abuse." While the definition

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of what constitutes abuse is nebulous, one sure way for a company to catch the attention of Texas regulators is to have a market share larger than 5 percent and price its electricity in our day-ahead or real-time markets above its marginal costs. Such activity got the former TXU slapped with a fine of \$210 million in 2007, which was later significantly reduced when TXU agreed to pay a fine without admitting guilt.

This understanding of markets seems to stem from a reliance on, or obsession with, the model of perfect competition. Although everyone admits that perfect competition is

just a construct designed to help us understand how markets work, in reality it seems to be the standard by which economists judge markets. This is certainly the case with most regulators, but also the case at times with otherwise solid free-market economists. And try as I might, I've had little success with pushing [Mises' construct of] the evenly rotating economy as a viable alternative.



**LMR:** From the perspective of free-market economics, what makes the Texas energy market so special?

**BP:** As I have already noted, it is a heavy reliance on prices to balance supply and demand that sets the Texas energy market apart from others.

Don't get me wrong, there are still regulations and protocols that hinder price formation. This includes the previously discussed prohibitions on market power abuse, plus wholesale price caps, ancillary market services, and a relatively recent administrative price

adder.

Yet Texas' energy-only market still stands above the two other basic types of energy "markets": the rate of return model (which dominate the western and southern states) in which regulators set prices, and hybrid "capacity" markets (found largely along the East Coast and Midwest) where regulators use some mechanism (usually auctions) to set a price for capacity payments to generators—on top of the income generators earn for selling energy.

Perhaps what really sets Texas apart is how we got to this point. At the tail end of the deregulation craze that swept the nation starting in the 1970s, most states were considering how to get cheaper electricity from cheap natural gas in the 1990s. The answer seemed to be competition—building on the success of the earlier introduction of competition into the airline and trucking industries.

Numerous states attempted to make this move. The most notorious was California, which couldn't quite bring itself to actually



deregulate anything. Thus, the pseudo-market they wound up with was near the epicenter of the Enron scandal. Higher natural gas prices in the 2000s, which meant higher electricity prices, scared others off. Only Texas made it to something resembling a true electricity market. Then a series of decisions made by regulators, including the all-important energy-only design, got us to where we are today. All of this was accomplished with support from Democrats and Republicans in the Texas Legislature. This outcome is something that would be very unlikely to happen today.

**LMR:** We understand though that there are potential troubles on the horizon for energy markets, both in Texas and the U.S. more broadly. Can you elaborate?

**BP:** In both Texas and the broader U.S., there are two main sources of the problems American are facing in the energy (electricity) market.

The first is direct intervention in pricing. Whether it is the measures I have already mentioned, restrictions on ownership, or monopoly transmission, markets are not being allowed to function competitively, which in turn is leading to higher prices.

The big problem, however, is the obsession by policymakers with saving the planet through renewable energy. Not only is this effort increasing prices, but it could move us toward a reliability crisis in the not-too-distant future.

Efforts to manipulate energy markets are

nothing new to the U.S. In the 1970s, subsidies and mandates for synthetic fuels were the response to the fear that the U.S. was running out of oil and natural gas. Congress even banned the use of natural gas for regenerating electricity for a while, until the miscalculations by “peak oil” advocates became apparent.

Of course, today it is the abundance of fossil fuels that is threatening the planet. So this time it is renewable energy that will come to the rescue—at great expense.

The Texas Public Policy Foundation has estimated that subsidies for wind energy alone through the federal Production tax Credit will cost U.S. taxpayers \$65.1 billion from 2008 through 2029. Texas will spend an additional \$20 billion on wind and solar energy over a similar time frame.

More than the cost, though, are the reliability concerns that renewables bring. While Texas leads the nation in new installed wind capacity, the turbines only meet that capacity level when the wind is blowing, which it is not always doing. This intermittency — which is also inherent in solar power — is what dooms efforts to mandate increased use of renewable energy.

A recent Foundation paper by Charles McConnell shows that when we need power the most — during the hottest days of the year — wind power isn’t available. There is a big difference in the installed capacity of wind and the deliverability of reliable electricity when needed.

As McConnell writes, “during the four highest summer and three highest non-summer electricity peaks of the last three years, the vast majority of installed wind capacity was a ‘no-show’ for Texas.”

The more wind and solar power generation increases, the greater the reliability problem will be because of the intermittency of these sources. Europe has already run headlong into this problem, and the U.S., especially Texas, is not far behind.

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**LMR:** Finally, can you discuss the mission of the Texas Public Policy Foundation? In your view, what are the pros and cons of state-based think tanks as opposed to national ones, such as the Heritage Foundation or Cato Institute?

**BP:** The Foundation’s official mission is to “promote and defend liberty, personal responsibility, and free enterprise in Texas and the nation by educating and affecting policymakers and the Texas public policy debate with academically sound research and outreach.”



The Foundation is the largest state-based think tank in the U.S. One reason for this is we are in Texas, the largest “conservative” state in the country with relatively less government interference in our lives than most other states.

We’ve been able to take advantage of this in part because of the growing dissatisfaction with the ability to make any progress toward liberty in Washington D.C. So we work with similar organizations in other states to return those “powers not delegated to the United States by the Constitution, nor prohibited by it to the States ... to the States respectively, or to the people.”

I think the advantage we and our sister state-based organizations have over national think tanks is that we aren’t so Washington focused, that we look first to the states, or to people, to take care of their own problems. Though certainly our friends in national think tanks have come to see this more clearly in recent years as well.

I think the big challenge that we and similar organizations face is not so much because we are state based but simply because of the nature of think tanks generally. Often, in order to promote liberty, we must advocate for change in the laws and policies of our state or the federal government. Yet anytime legislative, executive, or judicial action is the



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means of moving toward liberty, it is not all that difficult to slip into the fatal conceit that we can do this by using the power of government, along the lines of “compassionate conservatism.” While we have internal structures built-in to guard against this slippage, it still requires constant vigilance to ensure we remain committed to our principles.



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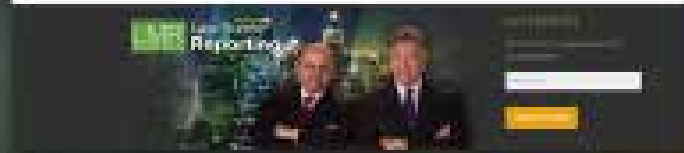
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