

# POLICY NOTES

## Moultrie Considers the Financial Impacts of Natural Gas and Electricity Deregulation

*by Andy Welch and Richard W. Campbell*

Historically, public and private firms have provided electricity and natural gas to the public in tightly regulated markets. In recent years, however, residential, commercial, and industrial consumers have pressured state legislatures to deregulate these industries. In Georgia, the gas industry was deregulated in 1998 through passage of the Natural Gas Competition and Deregulation Act (SB 215). Although deregulation of the electric industry in the state has not yet occurred, electric industry officials suggest that the industry may be fully deregulated within 10 years.

Since deregulation will open the traditionally closed natural gas and electric industries to outside competitive market forces, it will likely affect the budgets of many Georgia cities. The Municipal Gas Authority of Georgia (MGAG) and Municipal Electric Authority of Georgia (MEAG) provide natural gas and electricity, respectively, to approximately 100 Georgia cities that own utilities. These municipally owned utilities will have to meet market rates for natural gas and electricity or face a likely loss in the number of customers and a decrease in their income. This could pose a serious policy challenge for cities that depend on utility income to support general fund operations.

MGAG and MEAG cities have been able to set rates and profit levels that, in some instances, are far higher than would be permitted in deregulated markets. Deregulation will force these cities to align rates and profits (transfers) with those in the overall market: their rates must not only be competitive with those of other Georgia cities but also with the rates of investor-owned utilities, membership corporations, and providers in other southern states.

The city of Moultrie, Georgia, operates its own natural gas and electric utilities; and with deregulation of the natural gas industry and the anticipated deregulation of the electric industry, the city's mayor and council asked the Carl Vinson Institute of Government to examine how deregulation would affect its finances. The study focused on three interrelated factors: the extent to which the city transferred revenue from its utility funds to its general fund, thereby subsidizing general government operations; how the city power and gas rates compared with those of competitors; and how accurately the city charged and accounted for the costs of distributing gas and electricity.

The Vinson Institute study found that the city's general fund revenues and expenditures would be affected significantly by utility deregulation. Using revenue and expenditure data from the city's FY 1999 Comprehensive Annual Financial Report, the following were among the major conclusions and estimated impacts:

- Revenues in the general fund and other funds (i.e., water/sewer, solid waste, and airport) will need to be increased significantly if the gas and electric funds are to be competitive in a deregulated environment.
- The practice of transferring funds from its utility operations to the general fund, which has kept city taxes (e.g., property) relatively low, will be less feasible after deregulation.

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*Cities that depend on utility income to support general fund operations could face a serious policy challenge.*

- Transfers from the electric fund will total \$2,361,571, accounting for nearly two-thirds (64.1 percent) of total transfers and one-third (30 percent) of total general fund revenues.
- Transfers from the gas fund will total \$981,833, accounting for more than a quarter (26.7 percent) of total transfers and 12.5 percent of general fund revenues.
- For the city to be competitive in the electric industry, it must set aside funds to recover its share of MEAG's stranded costs—the fixed costs associated with energy production while the industry was regulated. If deregulation of the electric industry occurs in 2009 (as anticipated by MEAG), Moultrie would need to set aside \$134,000 per year (.69 mills/kWh).
- Moultrie can prepare itself for deregulation by changing some of its current financial management practices. The total impact of eliminating cross-subsidies, fully allocating costs, and limiting interfund transfers would amount to \$1,335,930 in the electric fund and \$512,134 in the gas fund.
- To be fully prepared for deregulation in both the gas and electric industries, the general fund will need an additional \$1,712,094 in revenue, which would include \$1,142,727 to make up for a revenue shortfall and \$569,367 to cover the estimated increase in expenditures.

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The estimated financial impacts of deregulation in Moultrie raise a number of issues for the city's policymakers. The most important of these include the following:

- To cover the cost of preparing for deregulation, is the city willing to increase general fund revenues, decrease general fund expenditures, or perhaps some combination of both?
- Is the city willing to take steps necessary to make its electric and gas rates competitive, including eliminating cross-subsidies, fully allocating costs among the city's funds (including the general fund), and/or limiting interfund transfers to amounts that are acceptable in the marketplace?
- Is the city willing to set aside funds each year in an effort to recover stranded costs associated with generating power? If so, what amount is it willing to put into cost recovery each year?

*What steps is the city willing to take to make its electric and gas rates competitive?*

The city of Moultrie has taken a number of important steps in response to these issues, including increasing its general fund revenues by raising the property tax millage rate from 7.18 to 9.18 mills and committing to setting aside \$200,000 per year to cover its share of MEAG's stranded costs. Moreover, the city's wholesale cost of power, as estimated by MEAG, will be approximately 10 percent lower in FY 2001 than in the preceding fiscal year.

## Selected Resources

Walters, Lawrence C., and Gary C. Cornia. 1997. "The Implications of Utility and Telecommunications Deregulation for Local Finance." *State and Local Government Review* (Fall): 172–87.

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