

# A (Generally) Welcomed Update

Reviewed by *Richard L. Gordon*

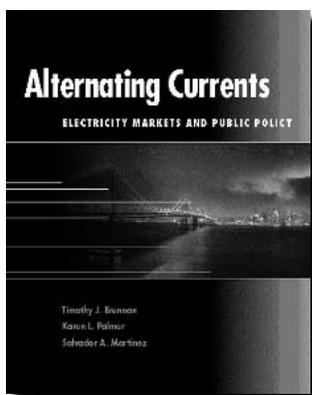
## ALTERNATING CURRENTS: Electricity Markets and Public Policy

By Timothy J. Brennan, Karen L. Palmer,  
and Salvador A. Martinez.

Washington D.C.: Resources for the Future;  
210 pp.

In 1996, a six-person team at Resources for the Future (RFF) prepared an excellent primer on electricity restructuring, *A Shock to the System*. Since then, electricity markets have undergone significant development and new issues have emerged. As a result, *Shock* lead authors Timothy Brennan and Karen Palmer, along with Salvador Martinez, have released an updated primer entitled *Alternating Currents*.

Reviewing the earlier book in the Spring 1997 issue of *Regulation*, I said it “succeeded admirably.” With qualifications, the same holds true for *Currents*. The new volume’s greatly expanded discussion improves on the prior book’s valuable, readable overview, making *Currents* an even better primer than *Shock*. In particular, the new book adds an excellent, largely balanced discussion of the 2000-2001 California energy crisis. *Currents*’s review of other experiences is also helpful. Its updated treatment of stranded costs continues nicely to summarize the issues, making clear that the



magnitudes involved were greatly exaggerated by incumbent energy producers and that, as usual, political clout governed government’s choices.

*Currents*’s chapter on rate setting gives some sense of the intrinsic drawbacks of regulation and deals well with replacing cost-of-service rules with price caps. However, the new book’s competition chapter is disappointing. The discussion shifts back and forth between observations about competition in electricity and treatment of antitrust laws and their implementation. The chapter’s different parts are generally well done but they do not seem to coalesce. In contrast, the chapters on balancing and dispatching, reliability, and federal and state responsibilities nicely summarize the issues involved. The review of publicly generated power delineates well its drawbacks.

**Some criticisms** The main shortcoming of the new book is that it exhibits less skepticism about regulation than did *Shock*. Assuaging interventionist arguments seems more important to the authors than recognizing the drawbacks of regulation. For example, *Currents*’s concerns over rate-of-return regulation are too muted. The book also is excessively concerned about cross-subsidization. In *Currents* as in *Shock*, the authors worry about utilities’ practice of allocating costs of unregulated activities to regulated ones. That concern may be misplaced, and the problem is very different from the social engineering that motivates the rightly criticized rate structures that are the conven-

tional examples of cross-subsidization.

The new chapter on competition shows no recognition that strong criticisms exist about antitrust doctrine. The book’s skeptical treatment of complaints about inadequate contracting by California utilities seems a near miss—the authors approach, but do not reach, the warning that such contracts would have been economically unenforceable in the California case as they often have been with radically changed economics. Similarly, *Currents*’s discussion of public power raises the concept of multiple uses of federal dams without consideration of the relevance; the desirability of shifting to market pricing for hydroelectric power is given too muted a treatment.

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*Alternating Currents* is a respectable successor to *A Shock to the System*.

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A lesser case occurs in the new book’s shortening of its predecessor’s discussion of the Public Utility Holding Company Act. *Shock* attributed to the act’s proponents the often-reiterated argument that it sought to overcome cost-allocation problems. *Currents* states that argument as fact. That acceptance ignores the fact that cost allocation is an economically fallacious concept. Therefore, problems arise however electric power is structured and regulated.

My earlier review rationalized the prior RFF failure to cite literature. *Currents*, on the other hand, makes a welcomed effort to do so and is generally well done. However, the citations significantly underrepresent the skeptics of various proposals; Peter VanDoren’s “The Deregulation of the Electricity Industry: A Primer” (Cato Policy Analysis No. 320) is the only citation from the critics of regulation; Cato’s “Energy Crisis?” website ([www.cato.org/electricity](http://www.cato.org/electricity)) does not make the book’s list of websites.

In sum, *Currents* is more comprehensive than *Shock* and serves as the best available introduction to electricity market restructuring. It is recommended—but only with the caveat that it is too tolerant of intervention. R

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**Richard L. Gordon** is a professor emeritus of mineral economics at Penn State University. He has written extensively on the economics of energy and other public policies, including the new book *Antitrust Abuse in the New Economy: The Microsoft Case* (Edward Elgar Publishing). He can be contacted by e-mail at [rlg3@psu.edu](mailto:rlg3@psu.edu).