

## Preface

We initially expected this study to lead to a relatively short essay evaluating the efficiency implications of alternative proposals to reduce the role of regulation and increase that of market forces in the electric power industry. We wanted to analyze these proposals for two basic reasons. First, we were interested in understanding better the role market forces could play in improving the performance of the electric power industry, given its distinctive technical, economic, and institutional characteristics. Although we were aware of the large and growing body of literature and experience that makes clear the superiority of competition to economic regulation in most industries, it was unclear to us that one could apply lessons learned in those contexts to the electric power industry. Second, in part because the financial problems that regulated electric utilities had endured for a decade were beginning to seem inevitable and potentially costly consequences of regulation itself and in part because the Reagan administration was a strong proponent of deregulation generally, deregulation proposals were coming to be seriously discussed within the utility industry, the government, and the press. We felt that proposals concerning such fundamental structural changes should be viewed and evaluated from a broad perspective. They should not be considered simply as devices for getting around the difficulty of dealing properly with inflation in conventional public utility regulation or as a necessarily desirable extension of deregulation efforts in other industries.

The short essay we had planned grew into a long report delivered to the US Department of Energy in September 1982. We found that key technical, economic, and institutional features of the electric power industry had not been adequately considered in much of the writing on deregulation. Because of the complexity of the industry along all

three of those dimensions, our attempts to deal adequately with its unique aspects strenuously and successfully resisted condensation. Similarly we found that in order to evaluate deregulation proposals, which usually meant basic changes in the industry's integrated structure, it was necessary to describe and analyze in some detail the contractual arrangements that would be created to govern resource allocation if the reforms were adopted. This required us to grapple with fundamental questions about the relations between transaction characteristics and contractual and other governance structures and to do so in ways that dealt adequately with the special characteristics of electric power systems. Here too brevity did not prove feasible.

We hope that this book will be of interest to all concerned with the future of the US electric power industry. Although we evaluate in detail only reform proposals that rely primarily on deregulation, the analytical framework we develop and the industry background we present should be useful in evaluating other sorts of proposed reforms as well. More broadly, our fundamental approach, which stresses careful application of relevant economic principles after the relevant technical, economic, and institutional features of the industry are thoroughly understood, and which follows Coase and Williamson in treating firm and contract structures as endogenous, should be useful in the evaluation of structural and regulatory reform in other industries as well.

It is impossible to write a book, particularly one concerned with fundamentally empirical issues, without incurring large debts of various sorts. We are indebted to the Department of Energy for its support of our early research on deregulation of electric power. The MIT Center for Energy Policy Research has supported our work in a number of ways and has underwritten the publication of this study.

We have received useful comments on our work at various stages from many people. We would like to thank especially Catherine Abbott, Kent Anderson, Roger Bohn, René Malès, Guy Nichols, David W. Penn, Nick Ricci, Fred Schweppe, Bernard Tenenbaum, Mason Willrich, David Wood, and an anonymous reviewer. We are grateful to Bennett Golub, Robin Prager, and Nancy Rose for excellent research assistance and to Paul Church and Kathleen Smith for translating our scribbles and scrawls into manuscript form with skill, speed, and good cheer.

This study took substantially more time and effort than we had originally anticipated, and as a result our families have seen much less

**of us than we would have liked. It is traditional to thank spouses at this point, but we are more grateful to Barbara and Diane for putting up with us during the writing of this book than traditional thanks can convey.**