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The California Economy Is On the Brink of Disaster

by Marsha Freeman

On Feb. 8, a U.S. District judge in California had the courage to make a ruling regarding the state's current energy crisis, based on a concept that has all but eluded the policymakers in Sacramento, not to mention Washington: the need to serve the public good. He ruled that electricity wholesalers, who had threatened to cut off supplies to utilities, had to continue to sell power because "the state of California is confronting an energy crisis of catastrophic proportions."

Two days earlier, in granting a temporary restraining order to the state to force the conglomerates to supply power, regardless of their concerns that two of the state's utilities face bankruptcy, Judge Frank Damrell, Jr. stated that not issuing the order could cause "obvious irreparable harm to the public." The court order was necessary, because early on Feb. 7, President Clinton's Executive Order expired, which had forced wholesalers to continue to sell power to California's utilities. President George W. Bush had said that he would not extend the order, and he did not.

The Independent System Operator (ISO), which operates the state's electric grid, brought the case to court, stating that were the supply of the 4,000 megawatts at issue to be interrupted, there would be "a serious impact on the safety, health, and welfare of not only Californians, but everyone in the Western U.S." The ISO stated that the resulting blackouts would affect not only California, but the entire Northwest.

Judge Damrell's ruling will extend to at least Feb. 16, when there will be another hearing. But, thanks to the failed policies being pursued in California, and the malicious policy of the Bush Administration, there is no end to the crisis in sight.

Will the State Go Under, Too?

Gov. Gray Davis (D) and the California state legislature have been trying to cobble together measures they hope will provide adequate power for their citizens, prevent huge rate increases, keep the utilities out of bankruptcy, and keep the state itself solvent.

On Feb. 1, the legislature authorized $500 million to finance the state's purchase of electricity on the spot market. The state soon found itself spending more than $40 million a day to keep the lights on. On Feb. 5, Governor Davis sent lawmakers a letter saying that the state had already exhausted the fund, and will need an additional $500 million by Feb. 15. This amount was approved on the promise that the state would be negotiating long-term contracts, at lower prices, to assure a cheaper supply.

The long-term contracts are to be paid out of a $10 billion bond issue, under which the state will buy the power, and sell it to the utilities at close to the real cost. The state will have to make up the difference between what the utilities pay, and what the contracts require. But, one catch is, according to State Treasurer Phil Angelides, that the bond sale will not be ready until May.

Assuming that there is a market for the bonds, the arrangement still leaves the state paying top-dollar spot-market prices for another three months. At the rate of more than $1 billion per month that the state is now paying for power, California may well see its $8 billion budget surplus literally go up in smoke.

On Feb. 6, Governor Davis announced that the first series of long-term contracts were close to finalization. While this announcement was given great fanfare, in fact, the contract will initially provide a pitiful 500 MW to the state, out of more than 10,000 MW needed immediately, to supplement the power already under contract, and that produced by the utilities, municipal generators, and others. And even that 500 MW will not be available before the warm weather peak-demand period begins in late Spring.

So, in fact, the state will most likely continue to have a monthly power bill of more than $1 billion through the Sum-

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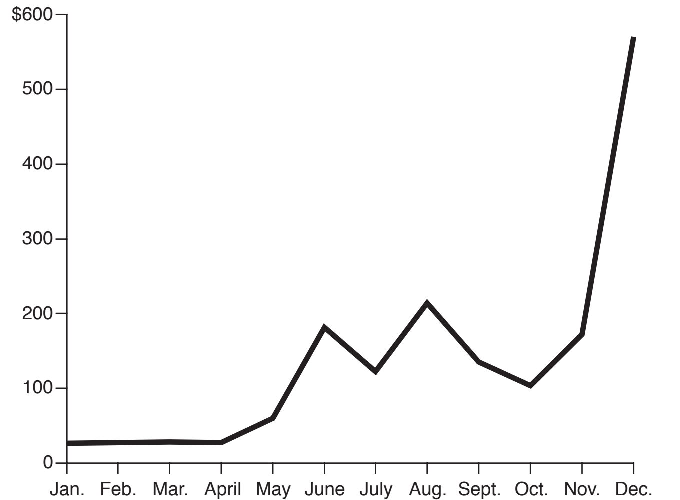
California Gov. Gray Davis and the state legislature have been trying to cobble together measures they hope will provide adequate power for their citizens, prevent huge rate increases, keep the utilities out of bankruptcy, and keep the state itself solvent. But the Bush Administration is blocking effective action.

FIGURE 1
Monthly Average Western Regional Peak Electricity Price, 2000
(Dollars per Megawatt-Hour)



Source: Bonneville Power Administration.

mer. When the hot weather comes, and the peak demand increases from the current range of about 30,000 MW to 45,000 MW, spot-market prices could jump from the current average of $300 per megawatt-hour to more than $1,000 per megawatt-hour, as it did last year. The state will be quickly burning through its $10 billion bond money.

Governor Davis had hoped to cap the long-term contracts at $55 per megawatt-hour. Reports indicate that the rate will be at least $60. One year ago, California utilities were paying $30 per megawatt-hour. So, the state is now locking itself into paying, minimally, double the fair and reasonable price, for three to ten years. And, it will be paying back $10 billion in bonds, at 7-8% interest, for the privilege of overpaying the suppliers.

'Protecting the Consumer'

Much noise was made, when the bill for the bond issue was passed, that the law will "protect the consumer." The Republicans have been adamant about not raising residential rates to help the utilities pay off their debt. But, within the confines of the proposals to keep the utilities out of bankruptcy, rate increases for consumers are inevitable.

When the bill passed both houses of the legislature, it included a provision that there will be no rate hikes for people if they use less than 130% of a so-called baseline. Usage above the baseline, which is supposedly what an average resident needs to run his home, is already charged at a higher rate, to encourage "conservation." The law stipulates that if the state finds it has to pay more for long-term contracts than it has projected, there will be increases.

"People who use more than 130% of baseline," according to Pacific Gas & Electric, include 53% of its customers, or more than 2 million people! The *San Francisco Chronicle* reported on Feb. 2, that lawmakers estimate that almost all customers could see a rate increase on about 30% of the power they use.

One of the measures Governor Davis and a half-dozen Western states governors have been lobbying Washington to implement, are region-wide caps, or ceilings, on the price that power suppliers can charge on the spot market. "Soft" caps of $150 per megawatt-hour for California which were ordered by the Federal Energy Regulatory Commission (FERC) late last year, proved to only make the problem worse. Suppliers who knew that they could sell the power for more, did not "offer" it for sale in California, but only in neighboring states without caps, where the sky was the limit on the price. This dramatically raised the spot-market price for the entire Northwest, as seen in **Figure 1.** For this reason, a number of Western states' governors have joined Governor Davis in calling for regional, not statewide, caps.

Even regional caps at $150 per megawatt-hour, while stabilizing the price somewhat, would *quadruple* the price that utilities paid for electricity a year ago. Assuming that suppliers would have no incentive to charge less than the cap, which is a reasonable assumption, the cap builds a hyperinflationary

rise in energy prices into the economy of these states, into the foreseeable future.

Ideological Blinders

Regional caps are not a course of action likely to be undertaken by the Bush Administration, in any case. Both Energy Secretary Spencer Abraham and FERC Chairman Curtis Hebert have already stated emphatically that they are opposed to caps. Some of the Republican governors in the West have joined their cause. The reasoning is that such Federal controls will "send the wrong signals" to the power suppliers, meaning that, unless the prices are allowed to rise, according to the (actually non-existent) "law of supply and demand," there will be no incentive for the construction of new power-generating plants. If suppliers know that they can charge whatever they want, they will increase supply, the theory goes. One wonders why wholesalers would build new plants at all, increasing supply and theoretically lowering the price, when they can fleece the region's economy at today's outrageous prices.

Controlling the price presents another "wrong signal," according to this ideology. Higher prices, the theory goes, will "encourage" citizens to conserve, thereby cutting back on demand and "naturally" pushing prices down. In the meantime, with the 50% and more rate increases being suffered by people in the West, there are already instances in which the elderly and those on fixed incomes are having to choose between paying their utility bill and buying food or medicines. Somehow, the human cost is not factored into the "supply and demand" equation.

The two utilities in California facing bankruptcy, Southern California Edison and Pacific Gas & Electric, also believed in the "free market"—up until last Fall. After the peaks in demand during a hot Summer, the utilities thought that the price would fall in the cooler Autumn, and they could recoup their Summer losses and get back to "normal" business. While the seasonal demand fell, the price never went back down to that of the previous years. So, today, the two utilities have $12 billion in debt they accumulated paying profiteering prices, and the only plan the state has come up with, is to have the taxpayer and electricity customers foot the bill.

Under the laws that are still on the books from the 1930s, the Federal government has the power to force the power wholesalers to charge only the cost of production plus a reasonable return. Under the U.S. Constitution's concept of the general welfare, those companies, making up to 300% profits, could be forced to refund the California utilities for the unconscionable prices that have driven them to near-bankruptcy. Returning regulation of this critical infrastructure to the Federal and state governments would mandate the construction of new power-generating facilities, and make the improvements in the national power grid that are necessary for long-term growth.

Nothing less than those measures will solve the problem.

Italy

Great Infrastructure Dominates Election

by Claudio Celani

Usually, one falls *from* the bridge. But on Jan. 23, the Italian government almost literally fell *on* the bridge—that is, the bridge across the Messina Strait, which does not yet exist, but should be built: It was only after Prime Minister Giulio Amato ordered the two relevant ministers, Vincenzo Visco (Economy) and Nerio Nesi (Public Works), not to attend the press conference to announce the definitive feasibility study ordered by Visco's and Nesi's very offices, that the Green Party withdrew its threat to resign from the governing coalition and to provoke a government crisis. Thus were journalists eyewitness to a Kafkaesque scene: The press conference took place without the ministers, who were represented by their offices' directors general, Barca and Fontana.

The bridge, says the study, is not only feasible, but also advantageous from an economic-strategic point of view. With a single suspension span of 3,360 meters, it will be a magnificent artifact, and will finally connect Sicily, the largest Italian region, to the European mainland. But, this is only one item in a long list of urgent projects necessary for Italy to overcome infrastructure bottlenecks, both at home and to upgrade the country's connections to the broader Eurasian Land-Bridge.

Another example is the high-speed rail connection between Turin, Italy, and Lyon, France, the "Transpadana" project, which was originally part of the European Union's Trans-European Network (TEN) first outlined in the "Delors Plan," as part of the southern East-West route from Barcelona, Spain to Ljubljana, Slovenia, and onward to Budapest and Kiev. The project has been blocked for ten years by local environmentalist opposition. But now, the Italian and French governments have finally decided that the Transpadana must be built, and signed an official treaty in January. When completed, the 254 km long line will reduce travel time from Lyon to Turin to 1.5 hours, from the current 3 hours, and travel from Paris to Turin to 3 hours. Part of the project is a new 53 km tunnel beneath the Alps, which will connect the Maurienne Valley in France with the Val di Susa in Italy.

Behind Rome's new activism, of course, lies an electoral rationale: General elections are planned in Spring, and large investment projects bring jobs—and votes. Currently, the candidate of the governing center-left coalition, former