Tiara Dews
1350 Fairmont Street, NW
Apartment 15
Washington, DC 20009
202-319-1121

- Ms. Teen DC?
- ~~50 M&M Boxes?~~
- Letter of Congratulations?

Mother: Cheri Dews

8/24

Mayor Williams
would like a copy of
anything we send.

Tom Tucker 727-6770

8-25
Misel -
Justin Cooper (Dual office)
wants a regular congrats
sent to Tiara Dews - Ms Teen
DC. Mayor Williams office
wants a copy of the letter
we send.
OK to send to Cheri?

DCb.

GOVERNMENT OF THE DISTRICT OF COLUMBIA
EXECUTIVE OFFICE OF THE MAYOR
OFFICE OF THE DEPUTY CHIEF OF STAFF - EXTERNAL RELATIONS

FACSIMILE TRANSMITTAL SHEET

TO: Debbie Byrd
FROM: Tom Tuckee
COMPANY: EOP. White House
DATE: 8-24-00
FAX NUMBER: 456-2215
TOTAL NO. OF PAGES INCLUDING COVER: 4
PHONE NUMBER:
RE:

☐ URGENT ☐ FOR REVIEW ☐ PLEASE COMMENT ☐ PLEASE REPLY ☐ PLEASE RECYCLE

NOTES/COMMENTS:

ONE JUDICIARY SQUARE - SUITE 1100
441 4TH STREET, NW
WASHINGTON, DC 20001
TELEPHONE NO (202)727-6770
FACSIMILE NO (202)727-0875

2000 MISS TEEN USA® Pageant

2000 MISS DISTRICT OF COLUMBIA TEEN USA

Shreveport, Louisiana

Tiara Christen Dews

HOMETOWN

District of Columbia

AGE

17

HEIGHT

5'10"

HAIR COLOR

black

EYE COLOR

dark brown

In today's society, women play prominent roles in business, politics, education, sports, entertainment, and the arts. What are the two primary contributions pageants make for today's women?

In contrast to the pageants of the 70's and 80's, today's pageants allow women to showcase not only their beauty, but their intelligence and multidimensional talents. This is important to the development and reinforcement of young women's self-confidence and independence in a time when women are breaking into previously male-dominated fields such as science, engineering and business.

Are you currently attending school or involved in any educational studies? If so, what are you studying? Where? What are your eventual goals?

Yes. I plan to attend Hawaii Pacific University in the Fall. I will major in Asian studies while fulfilling my pre-med requirements. Upon graduation from college, I plan to attend medical school and subsequently pursue a career in transplant surgery.

What is the single, most important message a titleholder can convey?

She should convey a balance plate of maturity, intelligence, humor, grace, class, personality, and femininity.

Name one personal accomplishment (in addition to being a state titleholder) that makes you especially proud.

I was fortunate to serve as a model for a bronzed statue at Bringham Women's National Hospital. This art piece, "4 Times Marquerite," celebrates the life of woman. In hindsight, I'm proud to have been chosen as a part of someone's artistic vision.

What have you learned about yourself during the past year?

Over the past year I discovered I was mentally and emotionally stronger than I previously believed. I no longer criticize myself for things I cannot control. I know this may sound like a cliché, but sometimes your best isn't good enough for other people. I realized that there has to be some type of acceptance within yourself in order to be content.

What is your most treasured possession?

My most prized possession is something that people take for granted: it's United States Citizenship! People don't appreciate the rights and privileges that we have. I value these things as gifts from our ancestors whose blood, sweat and tears paved the way for our lives today.

What is the best advice you could give to the next generation?

The best advice that I could give is to never get into debt. I believe that debt equals loss of freedom-freedom to spend time with your family, your children and your passions in life.

Describe what you think the role of women will be in the 21st century.

In the beginning of the 21st Century, I see women acquiring leadership positions that will implement social, religious, political, and economic change, not just in America, but around the world. Towards the end of the century, I see women acquiring positions as prominent mathematicians and physicists

Describe how you envision yourself in five years.

Educationally, in five years I would have earned my bachelor's degree in Asian studies and fulfill my pre-med requirements. Spiritually and mentally, I don't know who I'll be in five years. It depends on the problems life presents me in order to evolve as a person.

What are your hobbies?

My hobbies include acting, dancing, reading and

'interview

writing poetry, modeling, watching late night movies, dining at international restaurants, and shoe shopping.

August 12, 2000

Dear Mr. President,

I'll always treasure that marvelous medal of Freedom — especially the fact that it came from your hand. I treasure even more that you reacted so quickly and so positively to the concept that the U.S. should take the lead within the U.N. in providing a school lunch every day for every child in the world. Your prompt offer of the first $300 million at the G-8 meeting in Japan will insure

JP total -Fyi- BC

copied Podesta Lay Verveer Cohen

George McGovern
Ambassador
U.S. Mission to the United Nations Agencies for Food and Agriculture
Via Vittorio Veneto, 119/A
00187 Rome
Telephone: 06 4674 3500
Fax: 06 4788 7043

that we get started now. The traditional U.S. percentage of U.N. operations is 25 percent; so if the other countries will come up with $900 million, that gives us 1.2 billion the first year. Perhaps some of our billionaire friends, Bill Gates, Warren Buffet, Ted Turner, the Saudi & Kuwait rulers, etc. would respond to a call from you. I would like to see government money matched by private sources. Will probably need 3 billion the second year and double that the third year as more and more children are drawn in. Love to you and Hillary.

605 Groff Lane
Stevensville, Mont.
59870

THE WHITE HOUSE
WASHINGTON

Podesta
cc'd Gene
Need to cc Hrc

THE PRESIDENT HAS SEEN 8-25-00

EXECUTIVE OFFICE OF THE PRESIDENT
COUNCIL OF ECONOMIC ADVISERS
WASHINGTON, D.C. 20502

THE CHAIRMAN

August 23, 2000

MEMORANDUM FOR JOHN PODESTA

FROM: Martin N. Baily

SUBJECT: The Electricity Market in California

This summer, California consumers have experienced both price spikes (notably in San Diego) and supply interruptions (unprecedented black-outs in the Bay Area). During June, wholesale prices for electrical power in California increased on average 270% over the same period in 1999, resulting in over $1 billion in additional payments for electricity. During the week of June 14, purchasers of California power spent $1.2 billion on electricity, 300% more than they paid during the same period in 1999. Milder weather and lower price caps, instituted in the wake of the June price spikes, have stabilized the California market in July and August. At the present time, prices are capped at $250 per MGW hour. On August 21, the California Public Utility Commission set retail caps, under which San Diego consumers who limit consumption will pay no more than $68 a month.

Background

Historically, electricity was seen as a natural monopoly and California utilities owned and operated all elements of the State's electric system. The Public Utility Commission regulated the entire system of utility generation distribution and transmission through its control of retail rates. The Federal Energy Regulatory Commission (FERC) regulated wholesale transmission rates and power transactions between utilities and between utilities and generators. In 1996, the Public Utility Commission (PUC) instituted fundamental structural reform directing the utilities to "unbundle" their integrated systems by:

- Transferring pricing of California's electricity generation to the FERC and creating the Power Exchange (PX), a private nonprofit organization;

- Creating incentives for utilities to sell their generation facilities to private companies;

- Transferring operational control of the utility-owned transmission system to the Independent System Operator (ISO), a private nonprofit organization which would manage the transmission system and its day-to-day operations under FERC oversight;

Electricity Market Structure

The new system of buying and selling power, and the rules that govern those sales, is complex. The Power Exchange (PX) conducts an "hourly one-day-ahead auction." Generating companies bid to supply electricity into the wholesale market, stating how much power they wish to supply at what price for each hour of the next day. Wholesale buyers (such as the old utility companies) estimate and order the power they think their business and residential customers will need (hour by hour). On the basis of hourly supply and demand bids and orders, the PX sets the price to be paid to all power sellers. The ISO then directs the flow of electricity throughout the State.

In practice electricity demand may not match the estimate made the day before. And some electricity or spare generating capacity may be needed to keep the electricity network stable. Hence the ISO conducts a real-time electricity market allowing it to instantaneously balance load by ramping generators up and down. There are a number of auctions for these so-called "ancillary services" where generators can bid. Furthermore, the ISO has signed long term "reliability-must-run" contracts with some generators whose power is used to keep the transmission system stabilized.

California did not move immediately to a full market auction system. There were transition problems associated with "stranded assets"--plants that were built under the old system of regulation that were considered uneconomic in the new competitive environment. During a transition period, price regulations were retained. In San Diego in mid 1999 San Diego Gas and Electric said it was ready for the free market and price caps were raised to $750 per MGW hour. Prices for peak demand periods then soared. As noted above, the lower cap has now been restored in San Diego and remains in effect elsewhere in California. These wholesale price caps, approved by the FERC, limit the market's ability to drive prices up during periods of short supply.

Currently, the law requires that California electric utilities, which serve the vast majority of California customers, purchase all of their power through the ISO and the PX. However, individual (usually large) customers and marketers may purchase power outside the PX by signing "bilateral" contracts with marketers or generators. The ISO's centralized system still directs the flow of electricity, but prices and service conditions are established by private contract.

The Independent System Operator administers a graduated system of increasing alerts to maintain operating reserves - the buffer capacity needed at all

times to keep the electric system stable and functioning. When forecasted reserves for the next day fall below 7%, then 5%, then 1.5% the ISO first issues public appeals and other measures to increase supply, then interruptible customers (typically industrial uses) are curtailed, and then finally residential and commercial customers are blacked out to keep the system from crashing.

Explaining Power Interruptions and Price Spikes

Of the two problems, the California power interruption is easier to explain. On June 14, Pacific Gas and Electric was required to intentionally interrupt nearly 100,000 customers (residential and small business) for the first time in its history. This event was precipitated by voltage instability related to gaming on the previous day, import limitations, power plant maintenance, and record temperatures, 103 degrees. Import capacity on the transmission system was limited to keep the voltage levels on the grid stable. The loss of generation in the Northwest and work being done by Bonneville Power Administration on the British Columbia Hydroelectric Tie limited California's ability to import power.

The price spikes in San Diego are best explained by a combination of high peak demand, insufficient generating and transmission capacity, and strategic action by electricity suppliers.

Based on the experience of the UK and other parts of the US, the electricity market is especially vulnerable to the exercise of market power, even by firms with relatively small market shares. Electricity cannot be stored and demand is very insensitive to price in the short term. Companies have learned to act strategically in the power auctions varying their price and quantity bids to push prices up. In an environment of short supply, it is particularly easy for companies to capitalize on the situation. The companies follow a strategy that makes them money, given the rules of the auction.

The PUC is limited in what it can do to relieve customers' liability for these wholesale costs. The federal "filed rate doctrine" requires States to pass through to utility customers the costs of electricity that are purchased subject to federal tariffs. Thus, the FERC ultimately controls how much a firm pays for wholesale power. The PUC may, however, inquire whether the power company's purchasing strategies were reasonable and resulted in reasonable rates. The PUC may exclude from retail rates recovery of costs determined to have been imprudently incurred.

Conclusions

There are two root causes of the problems in California.

- Regulatory uncertainty has discouraged investment in generating facilities and transmission networks. If generating capacity is plentiful it is harder for

THE PRESIDENT HAS SEEN
8-25-00

companies to push prices up. If there are adequate transmission facilities, power can be purchased from other regions to meet short-term peaks in demand (such as those caused by hot weather). The better the transmission system, the more competitors there are and the less is the ability of a given company to manipulate the market.

- California did not learn from the experience of the UK, Australia and other US states (the WSJ of August 4 described problems in several states). There is a serious problem with the auction system they instituted in that it is ~~vulnerable to price manipulation.~~

Deregulation can bring substantial benefits to consumers. But there are risks involved and the design and regulation of the market for power must be done carefully. I have attached an article by Severin Borenstein and James Bushnell, which discusses the issues at length. It may be more than you want to know.

cc: Sylvia Mathews, OMB
David Beier, OVP
Karen Tramontano, WH

cc: MB, MG, JS

Is there a coherent vision for competitive electricity markets?

Electricity Restructuring: Deregulation or Reregulation?

BY SEVERIN BORENSTEIN AND JAMES BUSHNELL

RESTRUCTURING IN THE ELECTRICITY INDUSTRY IS spreading across the United States and around the world. Some of these initiatives are well under way—for instance, in California, Pennsylvania, Australia, Norway, and the United Kingdom—but far more are in the design and early implementation stages. There also are bills in Congress to encourage the formation of open markets for electricity. The restructuring process has achieved some significant successes—most notably keeping the lights on. But serious problems—some predictable, others not—have also arisen.

As other jurisdictions refashion their electricity markets, they seem to be incorporating little of the experience from the markets that are furthest along in the process. That is unfortunate, because there are important and quite general lessons that can be gleaned. Probably the two most salient lessons are that the short-run benefits are likely to be small or nonexistent, and the long-run benefits, while compellingly supported in theory, may be very difficult to document in practice.

More concretely, market power among generators is likely to be a more serious and ongoing concern than has been anticipated by most observers. As a result, the roles of transmission capacity and demand-side elasticity are likely to be even more important than previously suggested. In general, the nonstorability of electricity, combined with very little demand elasticity and the need for real-time supply/demand balancing to keep the grid stable, has made restructuring of electricity markets a much greater challenge than was inferred from experience with natural gas, airlines, trucking, telecommunications, and a host of other industries.

Severin Borenstein is director of the University of California Energy Institute and professor of business at the University of California Berkeley's Haas School of Business. **James Bushnell** is director of research at the University of California Energy Institute.

THE ORIGIN OF ELECTRICITY INDUSTRY RESTRUCTURING

ANALYSIS OF THE ELECTRICITY INDUSTRY BEGINS WITH the recognition that there are three rather distinct components of it: generation, transmission, and distribution. Once electricity is generated, whether by burning fossil fuels, harnessing wind, solar, or hydro energy, or through nuclear fission, it is sent through high-voltage, high-capacity transmission lines to the local regions in which the electricity will be consumed. When the electricity arrives in the region in which it is to be consumed, it is transformed to a lower voltage and sent through local distribution wires to end-use consumers.

In the United States, all three of these vertically related sectors have typically been tied together within a utility, which has been either investor-owned and state-regulated or owned by the local municipality. For many years, each

sector was thought of as a natural monopoly. In the transmission and distribution sectors, effective competition would require that rival firms duplicate one another's wire networks, which would be inefficient. If wires owned by different companies were allowed to interconnect to form a single network, the laws of physics demonstrate that there would be significant externalities: the flow on one line affects the capacity of other lines in the system to carry power. Generation was argued to be a natural monopoly because of the large scale of efficient generation plants and the losses that occurred with long-distance transmission, which made it more efficient to have local areas served by one or a small number of generating plants.

Few people argue that the basic economics of transmission and distribution have changed. But, over time, the optimal scale of generating plants has declined, not increased, as many thought it would in the 1960s and 1970s with the growth of nuclear power. In addition, technology improvements reduced the losses that occurred during transmission, making it more feasible for plants hundreds of miles apart to compete with one another.

Thus, in the 1980s, a movement began to increase the efficiency of the generation sector by letting independent entrepreneurs compete to supply power to the utility. This was encouraged by the federal government in 1978 with the Public Utility Regulatory Policy Act (PURPA). Under PURPA, utilities were required to buy power from "qualifying" independent power producers (mostly small generators or ones using renewable energy sources) at a price equal to the "avoided cost" of the utility. Many states, however, set very high levels for the avoided costs, levels that were certainly much higher than the actual marginal savings to the utility of not producing the power itself. The result was that many utilities signed long-term purchase contracts at very high prices. Those prices looked especially bad as the cost of natural gas fell in real terms through the 1980s and 1990s, making most other generation sources much less economic.

Over about the same period of time, accidents, unforeseen construction costs, increased safety regulation, and higher-than-anticipated upkeep and waste disposal costs changed nuclear power from the cheap, clean power source advocates had promised to expensive white elephants. Under the regulatory agreement between states and the utilities, consumers still had to pay for the plants despite the fact that they turned out to be unwise choices.

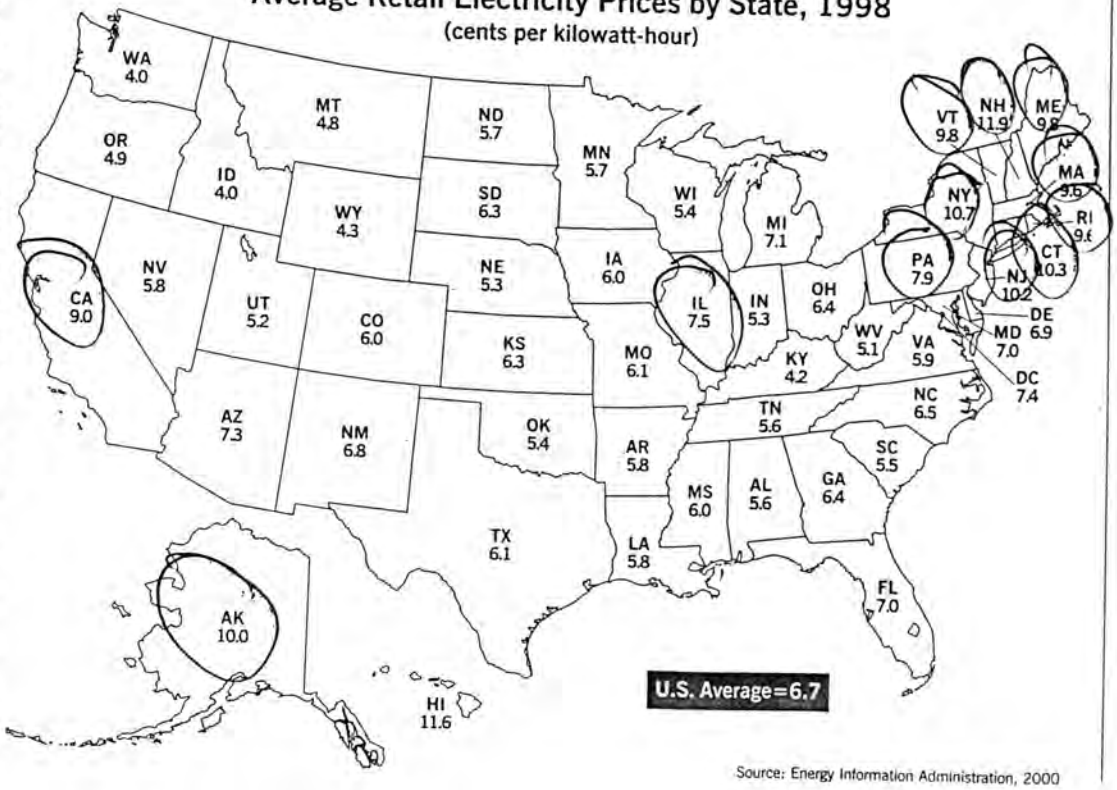
Uneconomic PURPA contracts and nuclear power investments were the primary reasons that some states found themselves in the 1990s with electricity prices that were well above the going-forward cost of building and operating new gas- or coal-fired power plants. Other states—those that had not pursued nuclear power and had been more cautious in signing long-term contracts under PURPA—retained relatively low prices. That contrast was probably the driving force behind the restructuring movement in the United States.

THE POLITICAL ECONOMY OF ELECTRICITY RESTRUCTURING

THE DISPARITY IN ELECTRICITY PRICES WITHIN THE UNITED States is evident from Figure 1. In regions such as California and the Northeast, residential rates have averaged as much as 10 cents per kilowatt-hour, while residents in some neighboring regions have been paying half that much. Some of these differences can be attributed to different natural resource endowments across regions—most importantly, hydroelectric opportunities—but a far larger share results from the need to pay for bad (at least in retrospect) investments and contract decisions made during the 1960s,

Figure 1

Average Retail Electricity Prices by State, 1998
(cents per kilowatt-hour)



Source: Energy Information Administration, 2000

1970s, and 1980s. Underlying those decisions had been the belief that natural gas prices would be far higher by the year 2000 than they have turned out to be, thanks to the deregulation of natural gas in the late 1970s and early 1980s.

Because these rate gaps stem from expenditures and commitments that are for the most part irreversible, they reflect differences in historical average costs, not marginal cost. A fairly robust, although imperfect, market for wholesale power trades between utilities, independent power producers, and a handful of large customers has operated through most of the 1990s. That wholesale market helped to equalize the marginal cost of production of utilities, subject to physical and institutional constraints on transmission access.

The success of the wholesale market also left many asking for more. While wholesale trades within a regulated environment allowed the customers of high-cost utilities to reap some marginal benefits, it did not allow them to escape the more significant burden of paying for the sunk costs of past investments, known in the industry as "stranded investment." Yet, the latter cost was the source of most of the rate disparities. The policy process has therefore largely been driven by the desire to cut costs that, being sunk, cannot be cut, only redistributed.

Economists and policy analysts have long argued that the most significant potential gains from electricity restructuring will stem from changing the way investment and consumption decisions are made.

This is not to say that there are not legitimate economic rationales behind restructuring the industry, only that such rationales do not get much play in the public discussions of these reforms. Deregulation or restructuring has the potential to produce gains in three broad sectors of the electric utility industry: operations, investment, and consumption.

The evidence indicates that regulated investor-owned utilities in the United States have done a reasonable job of efficiently generating power given their portfolio of generating assets. Labor accounts for only 12 percent of the total cost of supply electricity and is more productive in the United States than in other countries. Therefore the prospects for short-run efficiency gains on the supply side of this industry are quite modest. Indeed, there is evidence that operational efficiency has decreased under restructuring. This is in part due to significant alterations to operational practices that have been made to accommodate a generation market, and in part due to market power, which we discuss further below.

Economists and policy analysts have long argued that the most significant potential gains from electricity restructuring will stem from changing the way investment and consumption decisions are made. Since the bulk of the rate disparities in this country are due to investment decisions that turned out badly, it stands to reason that what is "broke" in this industry is the process that produced those poor investment decisions. Firms that do not have the security of a guaranteed rate of return on their investments will be more prudent in their capital expenditures and the way they manage risk.

The last, largely untapped, source of potential efficiency gains in the electricity industry lies on the consumer side. The cost of producing electricity fluctuates widely by hour or even by minute, and the market prices of deregulated power even more so. Consumers have had little opportunity to respond to these price fluctuations. They have instead paid a flat rate that reflects the average cost over months or years. Because consumers do not see prices that fluctuate with changes in the interaction of supply and demand, they cannot respond when there is a scarcity (such as on a very hot summer afternoon) by reducing their consumption (such as by turning their air conditioner from 75 to 78 degrees) and receiving savings that reflect the high value of the power they have foregone.

Note that it does not take deregulation to implement better consumer price response, although proponents of restructuring have argued that stodgy old regulated utilities have little incentive to pursue such initiatives. Thus far in the United States, real-time consumer price response has not developed either in regions that have restructured or in those that have remained under traditional regulation. However, as we discuss below, the need for price-responsive demand is much greater in a less-regulated environment.

THE COMPETITIVENESS OF ELECTRICITY MARKETS

AS WE HAVE MENTIONED, THE ELECTRICITY RESTRUCTURING movement has been driven in large part by changes in generation technology and fuel prices that have made it economic to generate with smaller units, and by the integration of separate utility systems into larger regional networks, which has increased the size of the market that could be served by individual generators. For some, those changes have been enough to conclude that electricity generation no longer requires any more government regulation than the markets for other commodities: natural gas, crude oil, gold, orange juice, or coffee.

Impediments to Competition But a number of factors make electricity a different, and much more difficult, case. First, electricity is extremely costly to store. The technologies for storage—for instance, hydroelectric pump storage (pumping water uphill to store as potential energy) or bat-

teries—are quite inefficient. Combined with the high cost of storage is the need to balance supply and demand second-by-second. A shortfall or surplus of electricity means not only that a few consumers do not get all the power they would like; it can endanger the stability of the entire electricity grid. It is as if a late delivery from UPS to one location caused flat tires to develop in all other UPS trucks in the region.

Exacerbating the challenges created by costly storage and the need for real-time supply/demand balancing is the fact that almost no end-use consumers of electricity even have the technology to observe, let alone respond to, real-time prices. Demand is virtually completely inelastic in the short run. Thus, little or none of the supply/demand balancing can be done on the demand side, unless the grid operator forcibly curtails consumption. In the rare instances that this blunt instrument is used, it imposes significant costs on the consumers whose electricity supply is curtailed and often has political repercussions. Short-run supply elasticities are not a great help either in these markets. Generating units have hard capacity constraints that imply marginal cost turns steeply upward at a certain output. The combination of very inelastic short-run demand and supply (at peak times) with the real-time nature of the market (costly storage and grid reliability requirements) makes electricity markets especially vulnerable to the exercise of market power.

To see why this is the case, think about the dreadful summer afternoon when the temperature and humidity are at peak levels and the grid needs virtually all resources in production in order to meet the tremendous demand for electricity to run air-conditioning units. If the grid has only a few percent margin of reserve capacity at that time and there is a producer that is supplying more than a few percent of the total output, then that producer is *pivotal* in meeting the demand. Put differently, that producer can ask for an extremely high price in order to deliver the power and consumers—more specifically, the local utility that represents them in the wholesale power market—will pay it.

In most markets, there are other constraints that keep a single firm with a fairly small percentage of production from driving up the price by a large amount. If the good is storable, the buyers, or marketers in the middle, can store product to defend against such vulnerability. If end-use consumers receive the price information before buying, their own hesitancy to pay extreme prices discourages the seller from asking such a price. If there is supply elasticity, one firm demanding a high price for its output will just shift market share to another supplier. Each of these attributes is much less prevalent in electricity markets than in most other industries. The result is that the ability of firms with even modest market shares to exercise market power is greater than in most markets. That is why concentration measures that are widely used to diagnose the potential for market power are not very informative when applied in electricity markets.

The Specter of Volatile Prices What complicates this analysis, and makes these market power discussions so controversial, is that the same factors that exacerbate market power in electricity would combine to produce volatile electricity prices even if there were no attempt by sellers to exercise market power. Even absent market power, inelastic demand and supply will naturally lead to high prices at peak times as demand rises above the production capacity of generators in a market and further price increases result in little additional supply or reduction of demand. The prices would then efficiently reflect the scarcity of supply relative to demand.

The ability of firms with modest market shares to exercise market power is greater than in most other industries. That is why concentration measures are not very informative when applied to electricity markets.

Unfortunately, it is easy to show that in such a situation a firm of more than microscopic size can almost always do better than passively accepting these scarcity rents, attractive as they might be. By withholding a bit of its supply (or offering it to the market at an extremely high price), such a firm can drive the price still higher while losing little demand, and boost its profits. Thus, while it is easy to argue that volatile prices would be seen in even a perfectly competitive market with these attributes, it is equally easy to demonstrate that if firms of notable size are not exercising market power, they are doing so out of the goodness of their heart and against the interest of their shareholders.

In industries where market power is present, government regulation certainly can still lead to outcomes that are even less attractive to consumers. One reason is that market power is usually self-correcting. Short-run exercise of market power will usually attract entry of new competitors. Even the threat of such entry can act to discourage incumbents from pushing prices too high, just as the threat of demand response in the longer run can discipline producer behavior. Unfortunately, these effects might not be particularly strong in the electricity industry, and the evidence from existing electricity markets is not encouraging.

The reason is the simple economics of time discounting. Neither new entry nor demand-side responsiveness is likely to happen quickly. With environmental and other licensing restrictions, new entry can easily take three to

five years. Likewise, the technology for real-time price notification and response by consumers is not widely available and not likely to be for a number of years. And a seller's payoff to exercising market power now can be extremely high. Furthermore, the uncertain regulatory environment may actually encourage sellers to take profits while they can, since they do not know what the competitive or regulatory landscape will look like a year or two from now.

Some industry participants and observers have responded to evidence of market power by arguing that because market power is present in every market, it should not be a concern here, or even that market power is *necessary* in order for firms in electricity markets to recover their full costs and earn a reasonable return on their investment. Both claims are incorrect.

There is simply no support in theory or practice for the claim that firms—even firms in capital-intensive industries—must exercise market power in order to cover their costs.

First, market power is widespread, but there are also many examples of industries in which there is virtually no producer market power—for example, gold, natural gas, orange juice, and soybeans. What these goods have in common with one another and with electricity is the nearly perfect homogeneity of the product. In such markets, market power is not a necessary result, but the special aspects of electricity markets discussed above make it much more difficult to prevent the exercise of market power in the electricity industry than in other industries.

Second, there is simply no support in theory or practice for the claim that firms—even firms in capital intensive industries—must exercise market power in order to cover their costs. Production of most of the goods listed on the commodity page of *The Wall Street Journal* is capital intensive, yet most exhibit virtually no market power and still producers continue in business. Producers in those markets are able to earn scarcity rents, which means that the price they receive is greater than their marginal cost for most units they sell. Scarcity rents are also available to producers of electricity. Whether they sell in a centralized exchange or through bilateral arrangements, producers receive prices that reflect the market conditions, not their own marginal cost. Furthermore, in all markets established to date, sellers have the opportunity to earn some payments beyond the market price for power in return for being available on a standby basis as an emergency resource for the grid operator. Finally, economic theory does not support an argument that price must exceed the competitive level for firms to break even. In fact, under reasonable conditions, the absence of market power leads to normal returns on investment with exactly the socially optimal quantity of electricity generation capacity.

REGULATION: OUT WITH THE OLD, IN WITH THE NEW

IN IMPLICIT OR EXPLICIT RECOGNITION OF THE VULNERability of electricity markets to market power, almost every organized electricity market currently operating around the world has in place some form of price or revenue cap. In some markets this is described as a "software" limit: the bidding software simply cannot accept too many digits in the bid. In others, such as Australia, prices are capped at a "value of lost load," a proxy for consumption value. In many regions, price caps have been considered a necessary expedient to bridge the gap between current conditions and a world in which electricity markets feature price-responsive demand.

One of the more notorious pricing incidents occurred in the California Independent System Operator's (ISO) market for replacement reserve, a form of standby power. Following the confusion surrounding an order from the Federal Energy Regulatory Commission (FERC) deregulating the prices of this form of reserve, prices surged from the previously regulated range of $10 per megawatt to $9,999 per megawatt. Some market participants apparently thought that the ISO could not accept bids exceeding four digits, when in fact the price during the period in question had no limit at all, and a bid in the millions of dollars per megawatt would have been acceptable under the existing market design. Shortly after that incident, the ISO requested from FERC the ability to cap prices, and subsequently they were limited to $250 per megawatt for all ancillary services.

Economists in these markets have periodically been asked to derive the "right" level of price cap for such markets. The trade-off this engenders is a familiar one to economists. If the price cap is set too low, in the short run it will discourage production from high-marginal-cost plants, whereas in the long run it will lead to disinvestment in the industry as producers are unable to cover their cost of capital. If the price cap is set too high, the exercise of market power will cause significant wealth transfers from consumers to producers. The negative consequences of market power are not limited to transfers, however. Prices that are raised to artificially high levels as a result of the exercise of market power, rather than actual scarcities, can stimulate inefficient entry and can depress the expansion of electricity intensive enterprises.

So, in most electricity markets we are left with regulation by price caps. The price caps restrict the exercise of market power, but they also implicitly determine the scarcity

value to be collected by suppliers. Some market participants—sellers—have bemoaned the use of any price caps, arguing that they do not exist in "real" markets so should not be used here. It is clear, however, that without some sort of "backstop" price cap, there would be times in most markets when the price could rise without bounds. Until real-time price-responsive demand is feasible on a significant scale, price caps will remain a necessary evil. The dirty secret of restructuring is that it is replacing old forms of regulation with new ones.

CAN TRANSMISSION SAVE RESTRUCTURING?

WHEREAS ENTRY OF NEW PRODUCERS TAKES YEARS IN THE electricity industry, importation of electricity from neighboring areas can happen instantaneously. The problem is that these imports are limited by the capacity of the transmission lines between regions. Once a transmission line reaches its capacity, there is effectively no further ability to import. The same problem arises within grid systems, where a small area can be isolated, on the margin, from the rest of the system when transmission lines into the area become congested. Such "load pockets" exist in New York City and San Francisco, for instance, making those regions dependent not only on imported energy but also on a handful of local generators whose output is necessary to sustain reliable network operations. This is not an isolated phenomenon: *more than half* of the 288 generation units in the California ISO system have been designated as "must-run" for reliability purposes under some conditions. What electrical engineers call reliability concerns economists call local market power.

Various forms of alternative regulation have been applied to deal with local market power. Some of these regulations make sense, others do not. In the Pennsylvania, New Jersey, Maryland pool, the operators are given wide-ranging powers to reset the bids of generators that have been deemed to be exercising local market power. In the United Kingdom, generators were threatened with a referral to the Monopolies and Mergers Committee. In California, the reliability must-run contracts have remained at the center of controversy for nearly two years.

One of the most straightforward, and probably economic, ways of promoting competition would be to increase the contestability of separate geographic markets by beefing up the transmission infrastructure that serves them. With sufficient transmission capacity, attempts to raise prices in smaller regions become unprofitable because such attempts simply draw supply from neighboring regions. In fact, adding transmission capacity can actually decrease its use: the *threat* of competitive imports can be sufficient to forestall the exercise of market power.

It seems then that construction of additional transmission capacity would be an important component of electricity restructuring. But transmission lines can be costly to upgrade. More importantly, by its very nature, transmission capacity creates huge winners and losers among suppliers and consumers of electricity. The distributional effects can easily be orders of magnitude greater than the efficiency effects. If your firm owned all the generation in New York City, how would you feel about proposals to beef up import capabilities into the city? The economic and political dynamics that have arisen in the electricity industry resemble those surrounding trade policy, as firms seek to preserve their advantages in serving local markets. Generators inside load pockets have much to learn from the U.S. steel industry.

Generically, the production of electricity is no longer a natural monopoly, but at specific locations and specific times, companies with even small market shares still can exercise substantial market power. To ensure viable competition, some combination of generation and transmission capacity increases must take place. These capacity increases may in themselves be inefficient. The question then becomes: are the costs of sustaining competition less than those of sustaining regulation?

Until real-time price-responsive demand is feasible on a significant scale, price caps will remain a necessary evil. The dirty secret of restructuring is that it is replacing old forms of regulation with new ones.

THE RECORD SO FAR

IN CALIFORNIA AND A NUMBER OF OTHER MARKETS, ADVOcates of restructuring have seen prices fall over the past few years and have declared victory. But independent of restructuring, electricity prices were expected to decline during this period in many parts of the United States. In California, for instance, as the sunk investment in nuclear plants was paid off and the high-cost PURPA contracts expired, even under old-style regulation consumers would have seen their prices fall. Restructuring could not make those stranded investments disappear, and old-style regulation could not make their impact continue indefinitely.

Instead of being distracted by historical accounting, one might ask just how competitive electricity markets have turned out to be. This is a first step in comparing the costs and benefits of restructuring. Catherine Wolfram, in "Measuring Duopoly Power in the British Electricity Spot Market" (*American Economic Review* 89), finds that prices exceeded competitive levels by around 20 to 25 percent in the England and Wales pool, and Severin Borenstein, James

Bushnell, and Frank Wolak (in their working paper, "Diagnosing Market Power in California's Deregulated Wholesale Electricity Market") estimate that energy purchase costs in California averaged about 16 percent above competitive levels during 1998 and 1999. These average figures mask large fluctuations in the severity of market power, which has been greatest during peak demand periods. In addition, evidence from California and New England, as well as from England, indicates that market power was felt more severely in markets for capacity and reserves than in markets for the energy itself.

These outcomes have transpired in a context of significant continued regulation. When California operated under a $250 price cap for energy before October 1999 (at which time it was raised to $750), the limit was binding on many occasions. Many generators were also earning significant revenues from reliability must-run contracts. In England, generators have been subjected to average-price caps, threats of antitrust enforcement, and periodic jawboning from regulators. Regulators in England also imposed sales of power under vesting contracts, set at administrated prices, on the incumbent suppliers, as well as minimum purchase quotas for British coal. In short, these results should not be construed as the extent of market power that would be experienced in a completely deregulated electricity market.

England provides perhaps the most serious cautionary tale about electricity restructuring. A high level of dissatisfaction with the outcomes in the British power market has led to a near total demolition of those market institutions. Much of the blame that has been placed upon the market's design should more properly be attributed to the market structure, which has remained fairly concentrated. The British experience with electricity markets over the past decade has so seriously eroded faith in markets that ominous "good behavior" clauses have been proposed as a requirement for generation firm licensing there. Such clauses have the potential to be far more arbitrary and intrusive than the traditional forms of regulation that have been employed in the United States during the twentieth century.

CONCLUSIONS

THE MOVEMENT TOWARD LESS REGULATION AND MORE reliance on market processes in the electricity industry has enormous potential benefits but also potential risks. A move toward deregulation that does not take the issue of market power seriously can undermine the goals of industry restructuring and even, as in the case of England, produce a regulatory backlash. Any restructuring initiative must recognize that the lack of economic storage and of price-responsive demand can produce serious market disruptions. Furthermore, levels of transmission capacity that may have been adequate under regulation may not be able to support effective competition.

In restructured electricity markets, some level of market power seems likely to persist. Given the enormous size of this industry, even small amounts of market power imply large transfers from consumers. This means that for consumers restructured electricity markets may in fact be *more* costly in the short run than were their regulated predecessors. For restructuring to benefit consumers, the long-term gains stemming from improved investment decisions on both the demand and supply sides of the industry must be sufficient to outweigh the potential short-run costs. Unfortunately, measuring those long-term benefits will be very difficult because it will rest on comparing the efficiency of investment under restructuring with the investment that would have occurred if traditional regulation had continued.

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THE WHITE HOUSE
WASHINGTON

August 25, 2000

MR. PRESIDENT:

John asked that we forward the attached to you.

Lisel Loy

9-4
Per AR, ok to provide extra copy to Chris Warden in Sperling's office. MS

THE PRESIDENT HAS SEEN 8-25-00

EXECUTIVE OFFICE OF THE PRESIDENT
COUNCIL OF ECONOMIC ADVISERS
WASHINGTON, D.C. 20502

THE CHAIRMAN

August 23, 2000

MEMORANDUM FOR JOHN PODESTA

FROM: Martin N. Baily

SUBJECT: The Electricity Market in California

This summer, California consumers have experienced both price spikes (notably in San Diego) and supply interruptions (unprecedented black-outs in the Bay Area). During June, wholesale prices for electrical power in California increased on average 270% over the same period in 1999, resulting in over $1 billion in additional payments for electricity. During the week of June 14, purchasers of California power spent $1.2 billion on electricity, 300% more than they paid during the same period in 1999. Milder weather and lower price caps, instituted in the wake of the June price spikes, have stabilized the California market in July and August. At the present time, prices are capped at $250 per MGW hour. On August 21, the California Public Utility Commission set retail caps, under which San Diego consumers who limit consumption will pay no more than $68 a month.

Background

Historically, electricity was seen as a natural monopoly and California utilities owned and operated all elements of the State's electric system. The Public Utility Commission regulated the entire system of utility generation distribution and transmission through its control of retail rates. The Federal Energy Regulatory Commission (FERC) regulated wholesale transmission rates and power transactions between utilities and between utilities and generators. In 1996, the Public Utility Commission (PUC) instituted fundamental structural reform directing the utilities to "unbundle" their integrated systems by:

- Transferring pricing of California's electricity generation to the FERC and creating the Power Exchange (PX), a private nonprofit organization;

- Creating incentives for utilities to sell their generation facilities to private companies;

- Transferring operational control of the utility-owned transmission system to the Independent System Operator (ISO), a private nonprofit organization which would manage the transmission system and its day-to-day operations under FERC oversight;

Electricity Market Structure

The new system of buying and selling power, and the rules that govern those sales, is complex. The Power Exchange (PX) conducts an "hourly one-day-ahead auction." Generating companies bid to supply electricity into the wholesale market, stating how much power they wish to supply at what price for each hour of the next day. Wholesale buyers (such as the old utility companies) estimate and order the power they think their business and residential customers will need (hour by hour). On the basis of hourly supply and demand bids and orders, the PX sets the price to be paid to all power sellers. The ISO then directs the flow of electricity throughout the State.

In practice electricity demand may not match the estimate made the day before. And some electricity or spare generating capacity may be needed to keep the electricity network stable. Hence the ISO conducts a real-time electricity market allowing it to instantaneously balance load by ramping generators up and down. There are a number of auctions for these so-called "ancillary services" where generators can bid. Furthermore, the ISO has signed long term "reliability-must-run" contracts with some generators whose power is used to keep the transmission system stabilized.

California did not move immediately to a full market auction system. There were transition problems associated with "stranded assets"--plants that were built under the old system of regulation that were considered uneconomic in the new competitive environment. During a transition period, price regulations were retained. In San Diego in mid 1999 San Diego Gas and Electric said it was ready for the free market and price caps were raised to $750 per MGW hour. Prices for peak demand periods then soared. As noted above, the lower cap has now been restored in San Diego and remains in effect elsewhere in California. These wholesale price caps, approved by the FERC, limit the market's ability to drive prices up during periods of short supply.

Currently, the law requires that California electric utilities, which serve the vast majority of California customers, purchase all of their power through the ISO and the PX. However, individual (usually large) customers and marketers may purchase power outside the PX by signing "bilateral" contracts with marketers or generators. The ISO's centralized system still directs the flow of electricity, but prices and service conditions are established by private contract.

The Independent System Operator administers a graduated system of increasing alerts to maintain operating reserves - the buffer capacity needed at all

times to keep the electric system stable and functioning. When forecasted reserves for the next day fall below 7%, then 5%, then 1.5% the ISO first issues public appeals and other measures to increase supply, then interruptible customers (typically industrial uses) are curtailed, and then finally residential and commercial customers are blacked out to keep the system from crashing.

Explaining Power Interruptions and Price Spikes

Of the two problems, the California power interruption is easier to explain. On June 14, Pacific Gas and Electric was required to intentionally interrupt nearly 100,000 customers (residential and small business) for the first time in its history. This event was precipitated by voltage instability related to gaming on the previous day, import limitations, power plant maintenance, and record temperatures, 103 degrees. Import capacity on the transmission system was limited to keep the voltage levels on the grid stable. The loss of generation in the Northwest and work being done by Bonneville Power Administration on the British Columbia Hydroelectric Tie limited California's ability to import power.

The price spikes in San Diego are best explained by a combination of high peak demand, insufficient generating and transmission capacity, and strategic action by electricity suppliers.

Based on the experience of the UK and other parts of the US, the electricity market is especially vulnerable to the exercise of market power, even by firms with relatively small market shares. Electricity cannot be stored and demand is very insensitive to price in the short term. Companies have learned to act strategically in the power auctions varying their price and quantity bids to push prices up. In an environment of short supply, it is particularly easy for companies to capitalize on the situation. The companies follow a strategy that makes them money, given the rules of the auction.

The PUC is limited in what it can do to relieve customers' liability for these wholesale costs. The federal "filed rate doctrine" requires States to pass through to utility customers the costs of electricity that are purchased subject to federal tariffs. Thus, the FERC ultimately controls how much a firm pays for wholesale power. The PUC may, however, inquire whether the power company's purchasing strategies were reasonable and resulted in reasonable rates. The PUC may exclude from retail rates recovery of costs determined to have been imprudently incurred.

Conclusions

There are two root causes of the problems in California.

- Regulatory uncertainty has discouraged investment in generating facilities and transmission networks. If generating capacity is plentiful it is harder for

companies to push prices up. If there are adequate transmission facilities, power can be purchased from other regions to meet short-term peaks in demand (such as those caused by hot weather). The better the transmission system, the more competitors there are and the less is the ability of a given company to manipulate the market.

- California did not learn from the experience of the UK, Australia and other US states (the WSJ of August 4 described problems in several states). There is a serious problem with the auction system they instituted in that it is ~~vulnerable to price manipulation.~~

Deregulation can bring substantial benefits to consumers. But there are risks involved and the design and regulation of the market for power must be done carefully. I have attached an article by Severin Borenstein and James Bushnell, which discusses the issues at length. It may be more than you want to know.

cc: Sylvia Mathews, OMB
David Beier, OVP
Karen Tramontano, WH

cc: MB, MG, JS

Is there a coherent vision for competitive electricity markets?

Electricity Restructuring: Deregulation or Reregulation?

BY SEVERIN BORENSTEIN AND JAMES BUSHNELL

RESTRUCTURING IN THE ELECTRICITY INDUSTRY IS spreading across the United States and around the world. Some of these initiatives are well under way—for instance, in California, Pennsylvania, Australia, Norway, and the United Kingdom—but far more are in the design and early implementation stages. There also are bills in Congress to encourage the formation of open markets for electricity. The restructuring process has achieved some significant successes—most notably keeping the lights on. But serious problems—some predictable, others not—have also arisen.

As other jurisdictions refashion their electricity markets, they seem to be incorporating little of the experience from the markets that are furthest along in the process. That is unfortunate, because there are important and quite general lessons that can be gleaned. Probably the two most salient lessons are that the short-run benefits are likely to be small or nonexistent, and the long-run benefits, while compellingly supported in theory, may be very difficult to document in practice.

More concretely, market power among generators is likely to be a more serious and ongoing concern than has been anticipated by most observers. As a result, the roles of transmission capacity and demand-side elasticity are likely to be even more important than previously suggested. In general, the nonstorability of electricity, combined with very little demand elasticity and the need for real-time supply/demand balancing to keep the grid stable, has made restructuring of electricity markets a much greater challenge than was inferred from experience with natural gas, airlines, trucking, telecommunications, and a host of other industries.

Severin Borenstein is director of the University of California Energy Institute and professor of business at the University of California Berkeley's Haas School of Business. **James Bushnell** is director of research at the University of California Energy Institute.

THE ORIGIN OF ELECTRICITY INDUSTRY RESTRUCTURING

ANALYSIS OF THE ELECTRICITY INDUSTRY BEGINS WITH the recognition that there are three rather distinct components of it: generation, transmission, and distribution. Once electricity is generated, whether by burning fossil fuels, harnessing wind, solar, or hydro energy, or through nuclear fission, it is sent through high-voltage, high-capacity transmission lines to the local regions in which the electricity will be consumed. When the electricity arrives in the region in which it is to be consumed, it is transformed to a lower voltage and sent through local distribution wires to end-use consumers.

In the United States, all three of these vertically related sectors have typically been tied together within a utility, which has been either investor-owned and state-regulated or owned by the local municipality. For many years, each

sector was thought of as a natural monopoly. In the transmission and distribution sectors, effective competition would require that rival firms duplicate one another's wire networks, which would be inefficient. If wires owned by different companies were allowed to interconnect to form a single network, the laws of physics demonstrate that there would be significant externalities: the flow on one line affects the capacity of other lines in the system to carry power. Generation was argued to be a natural monopoly because of the large scale of efficient generation plants and the losses that occurred with long-distance transmission, which made it more efficient to have local areas served by one or a small number of generating plants.

Few people argue that the basic economics of transmission and distribution have changed. But, over time, the optimal scale of generating plants has declined, not increased, as many thought it would in the 1960s and 1970s with the growth of nuclear power. In addition, technology improvements reduced the losses that occurred during transmission, making it more feasible for plants hundreds of miles apart to compete with one another.

Thus, in the 1980s, a movement began to increase the efficiency of the generation sector by letting independent entrepreneurs compete to supply power to the utility. This was encouraged by the federal government in 1978 with the Public Utility Regulatory Policy Act (PURPA). Under PURPA, utilities were required to buy power from "qualifying" independent power producers (mostly small generators or ones using renewable energy sources) at a price equal to the "avoided cost" of the utility. Many states, however, set very high levels for the avoided costs, levels that were certainly much higher than the actual marginal savings to the utility of not producing the power itself. The result was that many utilities signed long-term purchase contracts at very high prices. Those prices looked especially bad as the cost of natural gas fell in real terms through the 1980s and 1990s, making most other generation sources much less economic.

Over about the same period of time, accidents, unforeseen construction costs, increased safety regulation, and higher-than-anticipated upkeep and waste disposal costs changed nuclear power from the cheap, clean power source advocates had promised to expensive white elephants. Under the regulatory agreement between states and the utilities, consumers still had to pay for the plants despite the fact that they turned out to be unwise choices.

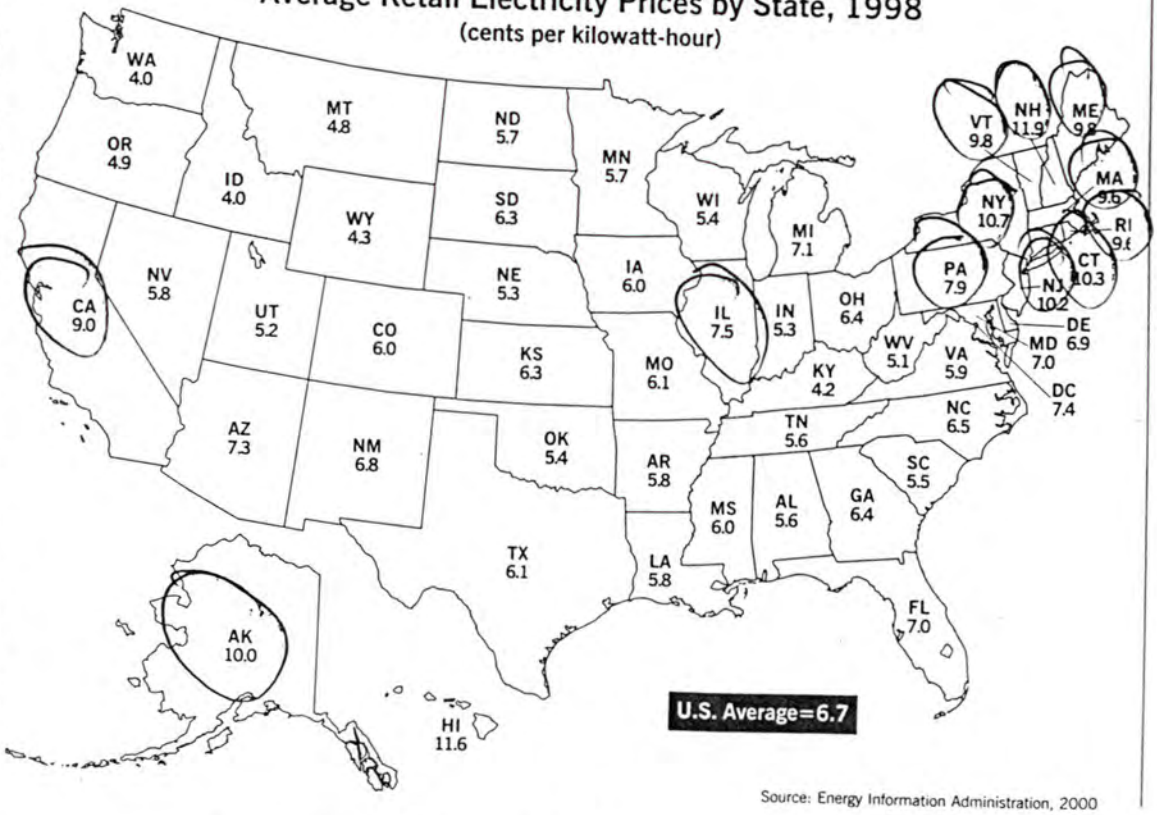
Uneconomic PURPA contracts and nuclear power investments were the primary reasons that some states found themselves in the 1990s with electricity prices that were well above the going-forward cost of building and operating new gas- or coal-fired power plants. Other states—those that had not pursued nuclear power and had been more cautious in signing long-term contracts under PURPA—retained relatively low prices. That contrast was probably the driving force behind the restructuring movement in the United States.

THE POLITICAL ECONOMY OF ELECTRICITY RESTRUCTURING

THE DISPARITY IN ELECTRICITY PRICES WITHIN THE UNITED States is evident from Figure 1. In regions such as California and the Northeast, residential rates have averaged as much as 10 cents per kilowatt-hour, while residents in some neighboring regions have been paying half that much. Some of these differences can be attributed to different natural resource endowments across regions—most importantly, hydroelectric opportunities—but a far larger share results from the need to pay for bad (at least in retrospect) investments and contract decisions made during the 1960s,

Figure 1

Average Retail Electricity Prices by State, 1998
(cents per kilowatt-hour)



Source: Energy Information Administration, 2000

1970s, and 1980s. Underlying those decisions had been the belief that natural gas prices would be far higher by the year 2000 than they have turned out to be, thanks to the deregulation of natural gas in the late 1970s and early 1980s.

Because these rate gaps stem from expenditures and commitments that are for the most part irreversible, they reflect differences in historical average costs, not marginal cost. A fairly robust, although imperfect, market for wholesale power trades between utilities, independent power producers, and a handful of large customers has operated through most of the 1990s. That wholesale market helped to equalize the marginal cost of production of utilities, subject to physical and institutional constraints on transmission access.

The success of the wholesale market also left many asking for more. While wholesale trades within a regulated environment allowed the customers of high-cost utilities to reap some marginal benefits, it did not allow them to escape the more significant burden of paying for the sunk costs of past investments, known in the industry as "stranded investment." Yet, the latter cost was the source of most of the rate disparities. The policy process has therefore largely been driven by the desire to cut costs that, being sunk, cannot be cut, only redistributed.

Economists and policy analysts have long argued that the most significant potential gains from electricity restructuring will stem from changing the way investment and consumption decisions are made.

This is not to say that there are not legitimate economic rationales behind restructuring the industry, only that such rationales do not get much play in the public discussions of these reforms. Deregulation or restructuring has the potential to produce gains in three broad sectors of the electric utility industry: operations, investment, and consumption.

The evidence indicates that regulated investor-owned utilities in the United States have done a reasonable job of efficiently generating power given their portfolio of generating assets. Labor accounts for only 12 percent of the total cost of supply electricity and is more productive in the United States than in other countries. Therefore the prospects for short-run efficiency gains on the supply side of this industry are quite modest. Indeed, there is evidence that operational efficiency has decreased under restructuring. This is in part due to significant alterations to operational practices that have been made to accommodate a generation market, and in part due to market power, which we discuss further below.

Economists and policy analysts have long argued that the most significant potential gains from electricity restructuring will stem from changing the way investment and consumption decisions are made. Since the bulk of the rate disparities in this country are due to investment decisions that turned out badly, it stands to reason that what is "broke" in this industry is the process that produced those poor investment decisions. Firms that do not have the security of a guaranteed rate of return on their investments will be more prudent in their capital expenditures and the way they manage risk.

The last, largely untapped, source of potential efficiency gains in the electricity industry lies on the consumer side. The cost of producing electricity fluctuates widely by hour or even by minute, and the market prices of deregulated power even more so. Consumers have had little opportunity to respond to these price fluctuations. They have instead paid a flat rate that reflects the average cost over months or years. Because consumers do not see prices that fluctuate with changes in the interaction of supply and demand, they cannot respond when there is a scarcity (such as on a very hot summer afternoon) by reducing their consumption (such as by turning their air conditioner from 75 to 78 degrees) and receiving savings that reflect the high value of the power they have foregone.

Note that it does not take deregulation to implement better consumer price response, although proponents of restructuring have argued that stodgy old regulated utilities have little incentive to pursue such initiatives. Thus far in the United States, real-time consumer price response has not developed either in regions that have restructured or in those that have remained under traditional regulation. However, as we discuss below, the need for price-responsive demand is much greater in a less-regulated environment.

THE COMPETITIVENESS OF ELECTRICITY MARKETS

AS WE HAVE MENTIONED, THE ELECTRICITY RESTRUCTURING movement has been driven in large part by changes in generation technology and fuel prices that have made it economic to generate with smaller units, and by the integration of separate utility systems into larger regional networks, which has increased the size of the market that could be served by individual generators. For some, those changes have been enough to conclude that electricity generation no longer requires any more government regulation than the markets for other commodities: natural gas, crude oil, gold, orange juice, or coffee.

Impediments to Competition But a number of factors make electricity a different, and much more difficult, case. First, electricity is extremely costly to store. The technologies for storage—for instance, hydroelectric pump storage (pumping water uphill to store as potential energy) or bat-

teries—are quite inefficient. Combined with the high cost of storage is the need to balance supply and demand second-by-second. A shortfall or surplus of electricity means not only that a few consumers do not get all the power they would like; it can endanger the stability of the entire electricity grid. It is as if a late delivery from UPS to one location caused flat tires to develop in all other UPS trucks in the region.

Exacerbating the challenges created by costly storage and the need for real-time supply/demand balancing is the fact that almost no end-use consumers of electricity even have the technology to observe, let alone respond to, real-time prices. Demand is virtually completely inelastic in the short run. Thus, little or none of the supply/demand balancing can be done on the demand side, unless the grid operator forcibly curtails consumption. In the rare instances that this blunt instrument is used, it imposes significant costs on the consumers whose electricity supply is curtailed and often has political repercussions. Short-run supply elasticities are not a great help either in these markets. Generating units have hard capacity constraints that imply marginal cost turns steeply upward at a certain output. The combination of very inelastic short-run demand and supply (at peak times) with the real-time nature of the market (costly storage and grid reliability requirements) makes electricity markets especially vulnerable to the exercise of market power.

To see why this is the case, think about the dreadful summer afternoon when the temperature and humidity are at peak levels and the grid needs virtually all resources in production in order to meet the tremendous demand for electricity to run air-conditioning units. If the grid has only a few percent margin of reserve capacity at that time and there is a producer that is supplying more than a few percent of the total output, then that producer is *pivotal* in meeting the demand. Put differently, that producer can ask for an extremely high price in order to deliver the power and consumers—more specifically, the local utility that represents them in the wholesale power market—will pay it.

In most markets, there are other constraints that keep a single firm with a fairly small percentage of production from driving up the price by a large amount. If the good is storable, the buyers, or marketers in the middle, can store product to defend against such vulnerability. If end-use consumers receive the price information before buying, their own hesitancy to pay extreme prices discourages the seller from asking such a price. If there is supply elasticity, one firm demanding a high price for its output will just shift market share to another supplier. Each of these attributes is much less prevalent in electricity markets than in most other industries. The result is that the ability of firms with even modest market shares to exercise market power is greater than in most markets. That is why concentration measures that are widely used to diagnose the potential for market power are not very informative when applied in electricity markets.

The Specter of Volatile Prices What complicates this analysis, and makes these market power discussions so controversial, is that the same factors that exacerbate market power in electricity would combine to produce volatile electricity prices even if there were no attempt by sellers to exercise market power. Even absent market power, inelastic demand and supply will naturally lead to high prices at peak times as demand rises above the production capacity of generators in a market and further price increases result in little additional supply or reduction of demand. The prices would then efficiently reflect the scarcity of supply relative to demand.

The ability of firms with modest market shares to exercise market power is greater than in most other industries. That is why concentration measures are not very informative when applied to electricity markets.

Unfortunately, it is easy to show that in such a situation a firm of more than microscopic size can almost always do better than passively accepting these scarcity rents, attractive as they might be. By withholding a bit of its supply (or offering it to the market at an extremely high price), such a firm can drive the price still higher while losing little demand, and boost its profits. Thus, while it is easy to argue that volatile prices would be seen in even a perfectly competitive market with these attributes, it is equally easy to demonstrate that if firms of notable size are not exercising market power, they are doing so out of the goodness of their heart and against the interest of their shareholders.

In industries where market power is present, government regulation certainly can still lead to outcomes that are even less attractive to consumers. One reason is that market power is usually self-correcting. Short-run exercise of market power will usually attract entry of new competitors. Even the threat of such entry can act to discourage incumbents from pushing prices too high, just as the threat of demand response in the longer run can discipline producer behavior. Unfortunately, these effects might not be particularly strong in the electricity industry, and the evidence from existing electricity markets is not encouraging.

The reason is the simple economics of time discounting. Neither new entry nor demand-side responsiveness is likely to happen quickly. With environmental and other licensing restrictions, new entry can easily take three to

five years. Likewise, the technology for real-time price notification and response by consumers is not widely available and not likely to be for a number of years. And a seller's payoff to exercising market power now can be extremely high. Furthermore, the uncertain regulatory environment may actually encourage sellers to take profits while they can, since they do not know what the competitive or regulatory landscape will look like a year or two from now.

Some industry participants and observers have responded to evidence of market power by arguing that because market power is present in every market, it should not be a concern here, or even that market power is *necessary* in order for firms in electricity markets to recover their full costs and earn a reasonable return on their investment. Both claims are incorrect.

First, market power is widespread, but there are also many examples of industries in which there is virtually no producer market power—for example, gold, natural gas, orange juice, and soybeans. What these goods have in common with one another and with electricity is the nearly perfect homogeneity of the product. In such markets, market power is not a necessary result, but the special aspects of electricity markets discussed above make it much more difficult to prevent the exercise of market power in the electricity industry than in other industries.

Second, there is simply no support in theory or practice for the claim that firms—even firms in capital intensive industries—must exercise market power in order to cover their costs. Production of most of the goods listed on the commodity page of *The Wall Street Journal* is capital intensive, yet most exhibit virtually no market power and still producers continue in business. Producers in those markets are able to earn scarcity rents, which means that the price they receive is greater than their marginal cost for most units they sell. Scarcity rents are also available to producers of electricity. Whether they sell in a centralized exchange or through bilateral arrangements, producers receive prices that reflect the market conditions, not their own marginal cost. Furthermore, in all markets established to date, sellers have the opportunity to earn some payments beyond the market price for power in return for being available on a standby basis as an emergency resource for the grid operator. Finally, economic theory does not support an argument that price must exceed the competitive level for firms to break even. In fact, under reasonable conditions, the absence of market power leads to normal returns on investment with exactly the socially optimal quantity of electricity generation capacity.

There is simply no support in theory or practice for the claim that firms—even firms in capital-intensive industries—must exercise market power in order to cover their costs.

REGULATION: OUT WITH THE OLD, IN WITH THE NEW

IN IMPLICIT OR EXPLICIT RECOGNITION OF THE VULNERability of electricity markets to market power, almost every organized electricity market currently operating around the world has in place some form of price or revenue cap. In some markets this is described as a "software" limit: the bidding software simply cannot accept too many digits in the bid. In others, such as Australia, prices are capped at a "value of lost load," a proxy for consumption value. In many regions, price caps have been considered a necessary expedient to bridge the gap between current conditions and a world in which electricity markets feature price-responsive demand.

One of the more notorious pricing incidents occurred in the California Independent System Operator's (ISO) market for replacement reserve, a form of standby power. Following the confusion surrounding an order from the Federal Energy Regulatory Commission (FERC) deregulating the prices of this form of reserve, prices surged from the previously regulated range of $10 per megawatt to $9,999 per megawatt. Some market participants apparently thought that the ISO could not accept bids exceeding four digits, when in fact the price during the period in question had no limit at all, and a bid in the millions of dollars per megawatt would have been acceptable under the existing market design. Shortly after that incident, the ISO requested from FERC the ability to cap prices, and subsequently they were limited to $250 per megawatt for all ancillary services.

Economists in these markets have periodically been asked to derive the "right" level of price cap for such markets. The trade-off this engenders is a familiar one to economists. If the price cap is set too low, in the short run it will discourage production from high-marginal-cost plants, whereas in the long run it will lead to disinvestment in the industry as producers are unable to cover their cost of capital. If the price cap is set too high, the exercise of market power will cause significant wealth transfers from consumers to producers. The negative consequences of market power are not limited to transfers, however. Prices that are raised to artificially high levels as a result of the exercise of market power, rather than actual scarcities, can stimulate inefficient entry and can depress the expansion of electricity intensive enterprises.

So, in most electricity markets we are left with regulation by price caps. The price caps restrict the exercise of market power, but they also implicitly determine the scarcity

value to be collected by suppliers. Some market participants—sellers—have bemoaned the use of any price caps, arguing that they do not exist in "real" markets so should not be used here. It is clear, however, that without some sort of "backstop" price cap, there would be times in most markets when the price could rise without bounds. Until real-time price-responsive demand is feasible on a significant scale, price caps will remain a necessary evil. The dirty secret of restructuring is that it is replacing old forms of regulation with new ones.

CAN TRANSMISSION SAVE RESTRUCTURING?

WHEREAS ENTRY OF NEW PRODUCERS TAKES YEARS IN THE electricity industry, importation of electricity from neighboring areas can happen instantaneously. The problem is that these imports are limited by the capacity of the transmission lines between regions. Once a transmission line reaches its capacity, there is effectively no further ability to import. The same problem arises within grid systems, where a small area can be isolated, on the margin, from the rest of the system when transmission lines into the area become congested. Such "load pockets" exist in New York City and San Francisco, for instance, making those regions dependent not only on imported energy but also on a handful of local generators whose output is necessary to sustain reliable network operations. This is not an isolated phenomenon: *more than half* of the 288 generation units in the California ISO system have been designated as "must-run" for reliability purposes under some conditions. What electrical engineers call reliability concerns economists call local market power.

Various forms of alternative regulation have been applied to deal with local market power. Some of these regulations make sense, others do not. In the Pennsylvania, New Jersey, Maryland pool, the operators are given wide-ranging powers to reset the bids of generators that have been deemed to be exercising local market power. In the United Kingdom, generators were threatened with a referral to the Monopolies and Mergers Committee. In California, the reliability must-run contracts have remained at the center of controversy for nearly two years.

One of the most straightforward, and probably economic, ways of promoting competition would be to increase the contestability of separate geographic markets by beefing up the transmission infrastructure that serves them. With sufficient transmission capacity, attempts to raise prices in smaller regions become unprofitable because such attempts simply draw supply from neighboring regions. In fact, adding transmission capacity can actually decrease its use: the *threat* of competitive imports can be sufficient to forestall the exercise of market power.

It seems then that construction of additional transmission capacity would be an important component of electricity restructuring. But transmission lines can be costly to upgrade. More importantly, by its very nature, transmission capacity creates huge winners and losers among suppliers and consumers of electricity. The distributional effects can easily be orders of magnitude greater than the efficiency effects. If your firm owned all the generation in New York City, how would you feel about proposals to beef up import capabilities into the city? The economic and political dynamics that have arisen in the electricity industry resemble those surrounding trade policy, as firms seek to preserve their advantages in serving local markets. Generators inside load pockets have much to learn from the U.S. steel industry.

Generically, the production of electricity is no longer a natural monopoly, but at specific locations and specific times, companies with even small market shares still can exercise substantial market power. To ensure viable competition, some combination of generation and transmission capacity increases must take place. These capacity increases may in themselves be inefficient. The question then becomes: are the costs of sustaining competition less than those of sustaining regulation?

Until real-time price-responsive demand is feasible on a significant scale, price caps will remain a necessary evil. The dirty secret of restructuring is that it is replacing old forms of regulation with new ones.

THE RECORD SO FAR

IN CALIFORNIA AND A NUMBER OF OTHER MARKETS, ADVOcates of restructuring have seen prices fall over the past few years and have declared victory. But independent of restructuring, electricity prices were expected to decline during this period in many parts of the United States. In California, for instance, as the sunk investment in nuclear plants was paid off and the high-cost PURPA contracts expired, even under old-style regulation consumers would have seen their prices fall. Restructuring could not make those stranded investments disappear, and old-style regulation could not make their impact continue indefinitely.

Instead of being distracted by historical accounting, one might ask just how competitive electricity markets have turned out to be. This is a first step in comparing the costs and benefits of restructuring. Catherine Wolfram, in "Measuring Duopoly Power in the British Electricity Spot Market" (*American Economic Review* 89), finds that prices exceeded competitive levels by around 20 to 25 percent in the England and Wales pool, and Severin Borenstein, James

Bushnell, and Frank Wolak (in their working paper, "Diagnosing Market Power in California's Deregulated Wholesale Electricity Market") estimate that energy purchase costs in California averaged about 16 percent above competitive levels during 1998 and 1999. These average figures mask large fluctuations in the severity of market power, which has been greatest during peak demand periods. In addition, evidence from California and New England, as well as from England, indicates that market power was felt more severely in markets for capacity and reserves than in markets for the energy itself.

These outcomes have transpired in a context of significant continued regulation. When California operated under a $250 price cap for energy before October 1999 (at which time it was raised to $750), the limit was binding on many occasions. Many generators were also earning significant revenues from reliability must-run contracts. In England, generators have been subjected to average-price caps, threats of antitrust enforcement, and periodic jawboning from regulators. Regulators in England also imposed sales of power under vesting contracts, set at administrated prices, on the incumbent suppliers, as well as minimum purchase quotas for British coal. In short, these results should not be construed as the extent of market power that would be experienced in a completely deregulated electricity market.

England provides perhaps the most serious cautionary tale about electricity restructuring. A high level of dissatisfaction with the outcomes in the British power market has led to a near total demolition of those market institutions. Much of the blame that has been placed upon the market's design should more properly be attributed to the market structure, which has remained fairly concentrated. The British experience with electricity markets over the past decade has so seriously eroded faith in markets that ominous "good behavior" clauses have been proposed as a requirement for generation firm licensing there. Such clauses have the potential to be far more arbitrary and intrusive than the traditional forms of regulation that have been employed in the United States during the twentieth century.

CONCLUSIONS

THE MOVEMENT TOWARD LESS REGULATION AND MORE reliance on market processes in the electricity industry has enormous potential benefits but also potential risks. A move toward deregulation that does not take the issue of market power seriously can undermine the goals of industry restructuring and even, as in the case of England, produce a regulatory backlash. Any restructuring initiative must recognize that the lack of economic storage and of price-responsive demand can produce serious market disruptions. Furthermore, levels of transmission capacity that may have been adequate under regulation may not be able to support effective competition.

In restructured electricity markets, some level of market power seems likely to persist. Given the enormous size of this industry, even small amounts of market power imply large transfers from consumers. This means that for consumers restructured electricity markets may in fact be *more* costly in the short run than were their regulated predecessors. For restructuring to benefit consumers, the long-term gains stemming from improved investment decisions on both the demand and supply sides of the industry must be sufficient to outweigh the potential short-run costs. Unfortunately, measuring those long-term benefits will be very difficult because it will rest on comparing the efficiency of investment under restructuring with the investment that would have occurred if traditional regulation had continued.

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Erskine

These should help — I'll try to send something union organizing —

— BC

THE WHITE HOUSE

Office of the Press Secretary
(Providence, Rhode Island)

HAS SEEN
8-25-00

For Immediate Release July 28, 2000

REMARKS BY THE PRESIDENT
AT FRIENDS OF PATRICK KENNEDY LUNCH

Private Residence
Barrington, Rhode Island

3:03 P.M. EDT

THE PRESIDENT: You have to be 33 years old to have that kind of energy. (Laughter.) You know, Patrick is -- he celebrated his 33rd birthday, but he looks like he's about 23. And he told me that story that he told you -- remember when he started his remarks and he talked about being grounded, he was supposed to go to his birthday party and he was grounded by bad weather. The first time he said it, I thought one of his parents made him stay home for bad behavior. (Laughter.)

Don't pay any attention to this; we're all just jealous, Patrick. (Laughter.)

I want to thank Bill and Nancy for opening this magnificent home; this beautiful, beautiful place. And for giving me a reason to come to Barrington. I hope I can come back. I really think it's amazingly beautiful. (Applause.)

I want to thank Senator Reed for being here with us and for his truly outstanding leadership in the Senate. I want to thank Ted and Vicki and Joan for being here to support you, Patrick. You deserve it. And everything you said about your dad is the truth. (Applause.)

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When Patrick was up here bragging on his father, I leaned over to Bill and I said, you know, you would be hard-pressed to name 10 people who have served in the United States Senate in the entire history of America who have done as much good as Ted Kennedy has. And I think that's very important. (Applause.)

I want to thank your former Governor, Bruce Sundlan, and your former Lieutenant Governor Bob Leese, (phonetic) for being here and Lieutenant Governor and all the mayors and legislative leaders. And there are a lot of people here who helped me from the beginning, but I want to especially mention Joe Pellino (phonetic) and Mark Weiner, (phonetic) and Ira Magaziner and his whole family for being there for me when I was just what then-President Bush referred to as a governor of a small, southern state. (Laughter.) And I was so naive, I thought it was a compliment. (Laughter.) And I still do. (Laughter.)

I want to thank Patrick for giving me the opportunity to come here for him today. I don't know anybody in the Congress who works as hard as he does. I don't know anybody in the Congress any more devoted to his or her constituents than he is. I don't know anybody in the Congress on the good days and the bad -- and, believe me, you get your fair share of both down there -- who is always up, always there, always focused, always doing what he's supposed to do. You should be very proud of what he has done with his life for you and the people of Rhode Island. (Applause.)

I think it is truly astonishing that one family has produced so many people so devoted to public service. His cousin, Joe, did a great job in the Congress. His cousin, Kathleen, I think is the finest Lieutenant Governor in the entire United States -- unbelievable in terms of what she's been able to accomplish. (Applause.)

But over the long run, if you will just stick with him, his energy and consistency and dedication will make a unique mark on Rhode Island and on the United States, and I want you to stick with him. And besides that, he's now raised all this money for these other people in Congress, and they owe him everything. I mean, if we get the majority, they may move the capital up here, for all I know, just because of Patrick. (Applause.)

Let me just say, too, on behalf of Hillary and myself and Al and Tipper Gore, I want to thank the people of Rhode Island for being so good to us, and to me, especially, for through elections. I stopped at a school on the way here and read my radio address for tomorrow morning. And on the way I stopped and shook hands with a lot of the folks that were on the street. And I turned to one of my aides and I said, you know, I want to spend the rest of my presidency in places where I got 60 percent of the vote or more. (Laughter and applause.) I was pretty happy. But I'm very grateful to you.

And I guess the remarks that I make today are sort of like what we at home used to call preaching to the saved. But I hope you will listen to what I have to say; and I know that you have friends not only all over this state, but all over this country, and I hope you will share it with them.

Some people think I'm crazy for doing what Patrick said I am. I've never worked harder in an election for myself than I'm working for our congressmen and our senators and our Vice President. And, of course, there is one particular Senate race I have more than a passing interest in. (Laughter.) But I'm doing it for other reasons.

I come here today a little -- actually, reluctant to speak because the night before last was the first time in two weeks I've been to bed before 2:00 a.m. because we were at Camp David working on those Middle East peace talks. And I'm not sure I'll remember what I say when I finish, because I'm still a little tired.

But let me tell you what I think is most important, and what I'm concerned about. Patrick had it right; I always tell people, there's only three things you need to know about this election. It is a big election, there are big differences, and only the Democrats want you to know what the differences are. What does that tell you about who you ought to vote for?

But let me explain what I mean by that. We're in the midst of the longest economic expansion in our country's history, including those which occurred in wartime, and we've had no war. All the social indicators are going in the right direction. The welfare rolls are half what they were when I took the Oath of Office; the crime rate is down; the teen pregnancy rate is down.

We have the highest homeownership in our history. We have the lowest poverty rate among single-parent households in over 40 years, the lowest unemployment rate among women in 40 years, the lowest minority unemployment rate ever recorded. Our country is at peace and we've been able to be a force for peace from Northern Ireland to the Balkans to the Middle East and throughout the world.

So what's the big deal here? Well, in my lifetime we have never had such an opportunity to build the future of our dreams for our

children. But we also know that even though things are going very well, nothing stays the same forever, America is changing rapidly and there are big challenges out there on the horizon.

So I say to you, not in any morose way -- I mean, I'm just as happy as the next guy -- and for my age, I'm almost as happy as Patrick. (Applause.) But I want you to listen to this. How a nation deals with a unique moment of prosperity, a democracy, is just as stern a test of our judgment, our values, our wisdom, our character as how we deal with adversity.

You didn't have to be a genius in 1992 to know we needed a change. This country was in trouble. We quadrupled the debt of the country in 12 years, and reduced our investment in the future.

We were in trouble. The country was becoming more divided socially. The politics of Washington were stuck in sort of a partisan verbal warfare. And we had to change. Now, people think there may be no consequences to change one way or the other.

Well, what I want to say to you is this: however people vote this year, they will be voting for change. There is no doubt about that. The question is, what kind of change will we vote for. This is profoundly important. And countries are like individuals. There's not a person out here who is over 30, at least, who can't remember one time, at least one time in your life when you made a huge mistake, professionally or personally, not because things were going so poorly, but because things were going so well you thought there was no penalty to the failure to concentrate. It's almost endemic to the human condition.

And I see a lot of people nodding their heads. You know I'm telling the truth. That's the only thing I'm worried about this year. People just sort of saying, gosh, things are going so well, you couldn't mess this economy up with a stick of dynamite. There doesn't seem to be much difference to me, all these people are so nice.

Now, that basically is the message of our Republican friends. Near as I can tell, the message of the Bush campaign is just that. I mean, how bad could I be? I've been governor of Texas; my daddy was President; I own a baseball team. (Laughter.) They like me down there; everything is rocking along hunky-dory. Their fraternity had it for eight years, give it to ours for eight years -- because we're compassionate and humane and we're not like what you think about us from watching the Congress for the last five years. That's the message isn't it? Blur, blur, blur. Blur all the distinctions.

Well, there is a difference. And that's what I want you to tell every friend you've got all over this country. Whatever decision the American people make, I will gladly accept. And I've already had so many gifts in life I could never complain about anything that happens to me. But I want my country at least to make this decision knowing what the alternatives are and knowing that there are consequences for whichever choices we make. And let me just give you a few.

There is a huge difference in economic policy -- massive. This year already, the Republicans have passed -- not this calendar year, but over the last 12 months -- tax cuts totalling over a trillion dollars. They're going to Philadelphia to advocate another tax cut way over a trillion dollars. In other words, they propose to spend 100 percent and more of the projected surplus over the next 10 years on tax cuts -- all of it. And if they enact them in a year, which they would do if they had the White House and the Congress, they would be there, but the money may not be.

Let me ask you something. Did you ever get one of those letters in the mail, like from Ed McMahon saying, you may have won $10 million. Now, if you got one of those letters and you went out the next day and committed to spend $10 million, you ought to be for them; if not, you had better stick with us. (Laughter and applause.) You think about that.

If I ask you what your projected income is for the next 10 years, you think hard. How much money are you going to make over the next 10 years? If I ask you to come up here right now and sign a binding contract to spend 100 percent of it, would you do it? If you would, you ought to support them. If not, you better stick with us. Now, you're laughing, but that's exactly what the deal is.

Now, our proposal is different. Our tax cuts are less than 25 percent of their $2 trillion-plus. But we give more tax benefits to the 80 percent of the American people that are the first four quintile. Which means in the short run, most of you who can afford to be here today would do better with theirs than with our curs. But 80 percent of the American people would actually get more relief under our plan than theirs, even though we spend less than a fourth as much.

And what do we do with the rest? Well, first of all, we're not going to spend it because we don't know if it's there yet. Secondly, we think some money should be invested in the education of our children. We have the largest number of students in our country's history -- (applause) -- we have the most diverse number of students in our country's history. We have kids in these classrooms bursting at the seams and we want to make them smaller. We have school districts who can't afford to build buildings and we want to help them build them. We have kids that come from troubled homes and troubled neighborhoods that need after-school and summer school programs, and we want to give them those opportunities.

And I've been working on education seriously now for more than 20 years -- seriously -- going to schools, talking to teachers, talking to principals, watching how they work. And I can tell you we know more now than we have ever known about how to turn these failing schools around.

I was in a school in Spanish Harlem the other day, in New York City where, two years ago, 80 percent of the children were reading and doing math below grade level. Today, 74 percent of the kids are reading and doing math at or above grade level. (Applause.)

I was in a school in rural Kentucky the other day -- (applause) -- where -- (laughter) -- your national ambitions are being outed, Patrick, you've got broad bases. (Laughter.) So I was in this school in rural Kentucky. Over half the kids on the school lunch program. Four years ago, one of the failing schools in Kentucky. Four years. They went from 12 percent of the kids who could read at or above grade level to almost 60 percent. (Applause.) They went from 5 percent of the kids who could do math at or above grade level, to 70 percent. They went from zero percent of the kids who could do science at or above grade level to almost two-thirds in four years, and they're one of the 20 best elementary schools in Kentucky. We can turn these schools around, folks. We can do that. (Applause.)

But you can't say that we care more about our children than anything, but we're going to take the money and run. You've got to save some to invest in them. And in health care and in the environment and in science and technology and in health research.

So I think this is very, very important. And it's not like you hadn't had a test run here. We tried it their way for 12 years and we've tried it our way for eight years, and you do have a record here.

You cannot let this election unfold as if there are no differences in economic policy and no consequences to the decision the American people will make.

The same thing is true in health care policy. We're for a strong patients' bill of rights that Senator Kennedy has led the way on, and they're not. We're for a Medicare prescription drug program that all the seniors in our country who need it can buy into. We would never create Medicare today -- never -- without prescription drugs. The only reason it was done that way in 1965 is that health care in 1965 is that health care in 1965 was about doctors and hospitals.

Today, if you live to be 65, your life expectancy is 82 or 83 years. And it's about keeping people out of the hospital and keeping them healthy, and extending the quality as well as the length of their lives. We would never create a Medicare program without prescription drugs today.

And Patrick's right -- there are people every week who choose between medicine and food. This is a big difference -- and what kind of country are we going to live in. There are big differences on environmental policy.

You know, one of the things I'm proudest of is that we have -- Al Gore and I have set aside more land for future preservation for all time than any administration in American history except those of the two Roosevelts in the continental United States -- ever. (Applause.)

Now, in the primary, their nominee said if he were elected, he would reverse my order creating 43 million roadless acres in our national forests -- something that I think would be an environmental terrible mistake. So make no mistake about it -- there are big differences here.

We believe you can improve the environment and grow the economy and they basically don't.

And there are big differences in crime policy. Patrick talked about this. The previous President vetoed the Brady bill and I signed it. (Applause.) And they said -- and we lost the House of Representatives, in part, because I signed that and the assault weapons ban, because they scared all the gun owners in the country into believing we were going to take their guns away and they wouldn't be able to go hunting.

And I went up to New Hampshire, I remember, in 1996, where they beat one of our congressman. And I said, I know you beat him because he voted with me on the assault weapons ban and the Brady bill. And I told all these hunters, I said, now if you missed a day in the deer woods, you ought to vote against me, too, because he did it for me, because I asked him to. But if you didn't, they didn't tell you the truth and you need to get even. And they did and we won.

But the point I want to make to you is, there is a huge, philosophical difference. The head of the NRA said the other day that they would have an office in the White House if the Republican nominee won. What I want you to know is, they won't need an office, because they'll do what they want anyway. And we just have a difference of opinion there.

Al Gore, he wants to close the gun show loophole and require child trigger locks, and stop the importation of these large-capacity ammunition clips, and require people when they buy handguns to have a photo ID license showing they passed a background check and they know how to use the gun safely. I think that's the right thing to do, and

they don't -- and they honestly don't. But I do.

And the American people need to know there are consequences here. And if they agree with them, then they ought to vote for them. But at least they have to know. There are big differences on our ideas about what it means to be genuinely inclusive. We're for the hate crimes legislation. Some of them are, but most of them aren't.

We're for employment nondiscrimination legislation; we can't get it passed. Senator Kennedy has been working on it a long time. We're for raising minimum wage and they're not. I'll bet they will do that before the election, because that's pretty hard to defend. But we've been trying to do it for over a year.

Ted Kennedy has worked with them for over a year trying to raise the minimum wage. The strongest economy we've ever had. The last time we did it in '96, they said it was a job-killer disguised in kindness. They said it would cost a terrible number of jobs. And that would lead to skyrocketing juvenile crime because we were going to throw all of these kids out of work by raising the minimum wage. And since they said that, we've got 11 million more jobs and the lowest juvenile crime rate we've had in 25 years. (Applause.) It's not like we don't have any evidence here.

So what's the point I'm trying to make? There are big differences, and we have evidence. So how could Patrick not be successful in his quest if people really believe there are no consequences to their failure to concentrate if they really don't know what the differences are?

You know, we wouldn't be around here after 226 years -- 224 years if the American people weren't right most of the time. That's the whole premise of democracy. Most of the time, the people get it right on most of the issues if they have enough information and enough time.

So that brings me to this next point I want to make. Their clear objective is to blur all these differences. You don't ever hear them talking about that primary they had for president, do you? You don't ever hear them talking about the commitments they made in the primary. They just want to make like that never happened. But it did happen.

Now, here's what I want to say to you. I think we can have a positive election. I'm tired of 20 years of politics where people try to convince the voters that their opponents were just one step above car thieves. And you're tired of it too, aren't you? The whole politics of personal destruction. We ought not to have that.

We Democrats ought to stand up and say, as far as we know, from the presidential nominee to the vice presidential nominee, to their candidates for Senate and the House, our opponents are honorable, patriotic people who differ with us. And we think elections are citizen choices about the differences. That's what we ought to do. (Applause.)

But they have now taken -- but after basically trying to be the beneficiaries of this torrent of venom we've seen in American politics over the last 20 years, they have now taken the position that we're running a negative campaign if we tell you how they voted.

We see this in New York all the time. If you tell people how I voted, you're being negative. I've got a right to hide my voting record from the people. (Laughter.) How dare you tell them how I voted. This is a choice, folks. It will have consequences. I know it's a beautiful place and the economy is doing great, we're all in a good humor. But I'm telling you, we might never have another time in our lifetimes when the country's in this kind of shape -- never have a chance like this to

build the future of our dreams for our children.

And I want to say this about my Vice President really quickly; I guess he still is, I haven't seen him in a while. (Laughter.) There are four things you need to know about Al Gore. One is, there have been a lot of vice presidents who made great presidents. I believe President Kennedy's Vice President, Lyndon Johnson, did some magnificent things for this country. I believe Theodore Roosevelt made a great president. I know Thomas Jefferson made a great president. I know Harry Truman made a great president.

There have been a lot of vice presidents who were great presidents. There has never been a person who, as vice president, did as much for the economy, for technology, for the environment, for economic opportunity for poor people and to help this country to have a foreign policy that promotes peace. Nobody has ever remotely done what Al Gore has done as Vice President of the United States -- ever in the history of the country. You need to know that. (Applause.) And the American people need to know that. It's not even close.

The second thing you need to know is, he's got a good economic policy; and I already explained that. When you talk to people you tell them the Ed McMahon story. Just tell them: You get that letter saying you may have won $10 million; if they want to spend it they should support the other side: if not, they ought to stick with us.

The third thing that I think is important is, is he understands the future. And we need somebody in the White House who understands the future; the Internet, the human genome developments. That's all great and exciting, but your banking and financial records are on somebody's computer. Don't you think you ought to be able to say yes before somebody gets them? Your little gene map is going to be out there somewhere. Don't you think that you ought to know that nobody can use it to deny you a job or a raise or health insurance? You need somebody that understands the future.

The last thing is: He wants to take us all along for the ride. And I want to be in a country where my President wants us all to go; blacks and whites and browns, the abled and the disabled, straights and gays, everybody that will work hard, play by the rules, obey the law, do their part. I think we ought to all go along for the ride. (Applause.)

You've got your great secretary of state running for the United States Congress, in part because we now live in a country which says we will not look at people who have physical disabilities as if they are disabled; we will look at their abilities and think about what they can do and what they can do. And I think that's important and think about what they can do and what they can do. And I think that's important. Let me just -- I'll close with this.

I graduated from high school in 1964. And our country was still profoundly sad because of President Kennedy's death. And I was a white southerner who believed in civil rights. We were in the middle of the longest-- what was then the longest economic expansion in American history.

And I really believed -- I was 17 and wide-eyed and I really believed that all the civil rights problems would be solved in Congress and in the courts. And I thought that economy was on automatic and it would go on forever, and all the poor people in my native state would be able to get an education and get a job. And everything was just going to be fine.

But we lost our concentration. And we got in trouble. And by the time I graduated from college we had two years of riots in the streets.

It was nine weeks after Martin Luther King was killed -- about six weeks, nine weeks after President Johnson said he couldn't run for reelection because the country was so divided, and two terrible days after Senator Kennedy was killed. And just a few months later, the previous longest economic expansion in American history was history. It doesn't take long to life a life. Nothing ever stays the same. We should be happy and thank God every day that we live in this time.

But the test is, what will we do with it. Thank you and God bless you. (Applause.)

END 3:30 P.M. EDT

THE PRESIDENT HAS SEEN
8-25-00

To C. Jennings fyi — BK

USA unhealthy for women

'Unsatisfactory' is norm across nation

By Rita Rubin
USA TODAY

A report that assesses the status of women's health at the state and national levels ranks Hawaii best and Mississippi worst.

"Making the Grade on Women's Health," to be released today by the National Women's Law Center, the University of Pennsylvania School of Medicine and the Lewin Group, a health consulting firm, evaluates states on the basis of health status and health policy. The authors plan to distribute the report to national and state policymakers.

Many of the benchmarks used in the report were taken from the Healthy People 2000 initiative by the U.S. Department of Health and Human Services. They include life expectancy, the death rate from breast cancer and the percentage of women who receive prenatal care in the first trimester of pregnancy.

States received a "satisfactory" grade if they met a benchmark, "unsatisfactory" if they came within 10% and "F" if they fell short by more than 10%. Each state also received an overall grade of satisfactory, unsatisfactory or F.

No state earned a satisfactory rating overall. Eight states and the District of Columbia flunked, and the remaining 42 states were deemed unsatisfactory overall.

In addition, no state met all 25 benchmarks for women's health status, and only one benchmark — the percentage of women 50 and older who received mammograms — was met by all 50 states and the District of Columbia, according to the report.

Other key findings:

- Nationwide, women earn 72.3% of what men earn, a gap that can affect women's access to health care.
- Only three states require insurers to cover the recommended screening for chlamydia, the most common bacterial sexually transmitted disease.
- No state met the national goal that all pregnant women receive prenatal care in the first trimester of pregnancy.
- In the District of Columbia, 22.8 women die out of every 100,000 who deliver a live baby, the worst rate in the nation, compared with top-ranked New Hampshire's rate of 1.9 maternal deaths for every 100,000 live births.

Many of the problems highlighted by the report affect men as well as women, acknowledges Marcia Greenberger, co-president of the Washington, D.C.-based women's law center.

"This report focuses on women's health, but we certainly would not want to suggest for a minute that attention doesn't need to be paid to men's health as well," Greenberg says.

The report uncovered many information gaps, such as a dearth of state-level health data for racial and ethnic groups, says Michelle Berlin, a physician who co-directs FOCUS on Health & Leadership for Women at the Pennsylvania medical school.

Says Berlin: "How can you figure out what you need to do if you don't have the data?"

Women's health by the numbers

When it comes to U.S. women's health status, a new report finds a wide range among states and the District of Columbia. The best and worst for some key indicators:

Women without health insurance
Hawaii 7.5%
Texas 28%

Women's life expectancy
Hawaii 81.3 years
District of Columbia 74.2 years

Women living in poverty
Utah 8.2%
District of Columbia 21.6%

Heart disease death rate per 100,000 women
Minnesota 65.4
Mississippi 141.2

Women who smoke
Utah 12.6%
Kentucky 28.5%

Women who are overweight
Arizona 21.9%
Mississippi 38.4%

Women 50 and over who had a mammogram in the past two years
District of Columbia 89.4%
Minnesota 64.9%

Source: Making the Grade on Women's Health

By Julie Snider, USA TODAY

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Podesta

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says a study out Monday.

In a three-month study, the diet, known as DASH — for Dietary Approaches to Stopping Hypertension — lowered homocysteine markedly compared with a typical American

people from heart disease and perhaps premature death.

Heart disease, the nation's leading cause of death, kills nearly 1 million people a year.

By reducing homocysteine levels, "the DASH diet can reduce your heart disease risk by 7% to 9% — and that's on top of the benefits of reducing blood pressure and cholesterol," says lead author Lawrence Appel of Johns Hopkins University in Baltimore.

day's *Circulation*. For the first three weeks, the volunteers ate a typical American diet. Then the volunteers were divided into three groups: One ate a typical diet; the second, a typical diet with additional fruits and vegetables; the third, the DASH diet.

The results:

- Volunteers on the typical American diet ate just 168 micrograms a day of folate, a vitamin that dramatically cuts homocysteine levels.
- Those who ate the typical diet plus additional fruits and vegetables consumed 314 micrograms of folate daily.
- Those in the DASH group ate more than 400 micrograms of fo-

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Ivo H. Daalder

Another Balkan War?

For the fifth time in a decade, war threatens to erupt in the former Yugoslavia. As with the wars in Slovenia, Croatia, Bosnia and Kosovo, Slobodan Milosevic's Serbia once again stands at the center of the violence. This time the conflict involves tiny Montenegro, which, together with Serbia, is all that remains of Yugoslavia.

If past is prologue, Montenegro's effort to liberate itself from Serbia's crushing embrace will exact a brutal response—and it will find the United States and NATO intervening only after the conflict has turned violent. But if Washington and its allies move swiftly to make clear they are fully committed to defeating any aggression emanating from Belgrade, they may be able to halt the slow slide into war.

For years, as Yugoslavia disintegrated in the early 1990s, the hard-line Montenegrin regime in Podgorica stood shoulder-to-shoulder with Milosevic. That changed a few years ago, when a younger generation came to power in elections in Montenegro that narrowly defeated the Belgrade-backed regime.

Since then, the energetic government headed by President Milo Djukanovic has sought to distance Montenegro from Serbia by moving closer to the United States and Europe. Montenegro refused to condemn NATO's actions in the Kosovo war and instead opened its borders to both the Albanian refugees streaming across the border and the Serb opposition escaping Milosevic's wrath.

For its stance, Montenegro was spared NATO bombing during the war and handed a de facto NATO security guarantee for the duration of the conflict.

After Milosevic's defeat at NATO's hands, relations between the two Yugoslav republics deteriorated rapidly. By August of last year, Djukanovic was demanding a fundamental change in their relationship, insisting that each republic have its own army, foreign policy and convertible currency. Failing that, Montenegro would hold a referendum on independence.

In the past year, Djukanovic has followed Western advice and held off on further moves toward a break with Belgrade. In return, Washington and the European Union have supported the Montenegrin government politically and with substantial financial aid.

But this careful balancing act is coming under increasing pressure from Belgrade, which sees Montenegro slowly slipping away from its grasp. In March Serbia imposed a total trade and economic blockade on Montenegro, barring passage of any goods across what until recently was an uncontrolled border. Milosevic has also beefed up the Yugoslav military presence and sent a battalion of paramilitary thugs into the area.

And in the most direct challenge to Montenegro, Belgrade last month changed the Yugoslav constitution, effectively stripping the small republic of any influence in the federation. With a divided opposition in Serbia—and Montenegro's decision not to participate in the Yugoslav elections now scheduled for Sept. 24—Milosevic's constitutional engineering will likely succeed in fortifying his position in power.

At that point, Belgrade can move against Djukanovic, using his failure to accept the new constitution as its pretext. Milosevic may also believe that a Washington distracted by the presidential campaign will not be willing or able to offer Montenegro military support.

The Clinton administration and its NATO partners have expressed concern about developments in Montenegro and warned Belgrade against using violence. But they have not provided Montenegro the security guarantee it wants, fearing that to do so could prompt a Montenegrin decision to declare independence. Instead, U.S. and NATO officials have warned of grave consequences while refusing to elaborate on what contingency planning may be underway.

But more must be done. The United States and it allies should publicly commit themselves to defend Montenegro and the Djukanovic government against any forceful attempt to undermine it from inside or out. Washington and its allies must make clear that this commitment includes the use of whatever force is necessary—and that they could continue to prosecute the war until Milosevic was removed from power.

Milosevic may try to make his last stand in Montenegro. He must not succeed. But only an immediate and unmistakable commitment to Montenegro's security can ensure that he won't.

The writer is a senior fellow at the Brookings Institution.

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Rolling Over on Safety

THE FIRESTONE tire recall story shows no signs of letting up. Much of the maneuvering now is between Firestone and the Ford Motor Co. as they play ping-pong with potential blame. They jockeyed this week over the pace of the recall, with Ford's president saying he's looking at steps to speed things up for Explorer owners. State Farm Insurance stepped up to say that it had told safety regulators two years ago of 21 failures of the [illegible] tires Firestone has recalled. The National Highway Traffic Safety Administration said it is now investigating 750 accidents and [illegible] that may be linked to such failures. Most of the accidents occurred when SUVs, usually Ford Explorers, on which a large percentage of the recalled tires were installed, rolled over after a tire failed. Though NHTSA has reached no conclusions about the accidents, the numbers focused attention once again on the fact that many SUVs, with a higher center of gravity than most passenger cars, are more likely to roll over in accidents. It also threw a spotlight on a decision awaiting Congress when it returns: whether to allow NHTSA to rate new-model vehicles on their likelihood of rolling.

After years of wrestling with the issue, NHTSA in May proposed a rollover rating system based on a mathematical formula involving vehicles' height and width. In general, SUVs will rate lower under this formula because of their basic design than will passenger cars, which are mostly closer to the ground. In announcing the system, Transportation Secretary Rodney Slater said he hoped the ratings would encourage manufacturers to come up with design changes that would improve their rollover scores. The informational ranking was a disappointment to many consumer and auto safety groups, which had hoped for a regulatory standard that automakers would be required to meet. But automakers, who have a big stake in the popular SUVs, criticized it sharply, saying it didn't take enough factors into account.

Less than a month after the ratings system was formally proposed, Sen. Richard Shelby (R-Ala.) added a provision to the transportation appropriations bill barring NHTSA from publishing the rankings until the National Academy of Sciences studies whether they are based on sound science. The Senate passed the bill with that provision in it. The House version does not contain the restriction, so a conference committee will have to decide what to do.

Congress should drop the Shelby provision. While the mathematical ranking may be simple and limited, NHTSA says it has found a high correlation between its results and real-world accident reports. Even the consumer and insurance industry groups that would like to see NHTSA go further say this is better for consumers than nothing, which is what they'll get during the nine months set aside for the NAS study. Do members really not want the public to know the propensities of these vehicles?

A Right to Discriminate?

A YEAR AGO, the courts and Congress looked as if they were about to punch a large hole in state and local anti-discrimination laws in the name of religious liberty. Both the 9th Circuit Court of Appeals and Congress were flirting with the notion that actions based on religious conviction ought not be subject to state and local civil rights laws—if a property owner, for example, refused on religious grounds to rent to gay or unmarried heterosexual couples in defiance of local fair housing rules. A broad and loose exemption of that sort would obviously have serious civil rights consequences. Fortunately, in the past few weeks, both the courts and Congress have taken a step back. And while the question of how to balance religious freedom with local civil rights ordinances is not going away, the reprieve is good news.

The full 9th Circuit Court of Appeals recently reversed a ruling by a three-judge panel from early last year. The panel had held that the First Amendment rights of religious landlords took precedence over state laws in Alaska and a local ordinance in Anchorage prohibiting housing discrimination on the basis of marital status. The full court didn't reach the merits of the dispute; the panel's decision was invalidated on procedural grounds. The reversal was welcome even so. If commercial landlords could escape anti-discrimination laws simply by claiming that they were an offense to conscience, the laws would have no meaning.

In a similar vein, Congress this summer stepped back from a bill passed last year by the House that would have required many state and local laws to give way when they burdened people's religious free exercise; no exception for civil rights laws was included. The narrower version Congress finally passed focuses on laws that restrict land use by religious institutions and on laws that prevent religious exercise by prisoners. The compromise by Sens. Orrin Hatch and Ted Kennedy should have no impact on civil rights laws and also seems safe from the types of constitutional challenges the earlier version invited.

But the legislative compromise and 9th Circuit decision will likely resolve the issue only temporarily. Local civil rights ordinances elsewhere are facing similar challenges. Ultimately, the balance between the two freedoms—of religion, but from discrimination—is one the Supreme Court will likely have to decide.

The Washington Post
Sunday, August 20, 2000

Trump
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