

California Dreaming... of Cheap Electricity

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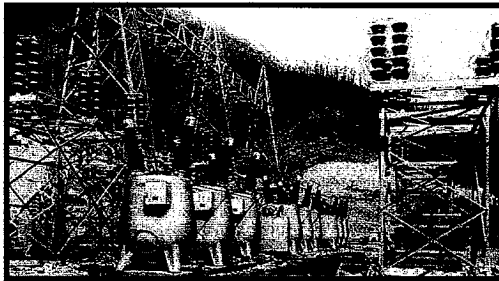
Along with the weather forecast, the media in California carries updates on the likelihood of electrical power blackouts. How can the home of many of the world's top technology companies be so short of the fuel of the information age, electricity?

In California, between 1990 and 2000, demand for electricity increased by 25%, while generating capacity fell by almost 2%. Agreements with the neighboring states of Washington and Oregon allow

California to balance its electricity requirements. California imports electricity from its neighbors to the north during the daytime, (when California needs the electricity to power factories and offices), and returns the electricity to the northern states during the evening for heating and lighting purposes.

Attempting to achieve lower electricity prices

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and more secure supplies, California began to deregulate the market for electricity in 1996. In general, deregulation of the electricity industry separates it into three components: production (called generation), retailing (selling to the final consumer) and distribution (moving the electricity from the generator to the consumer). Under deregulation, only the price charged for distribution services is controlled.

Unfortunately, the Californian deregulation legislation is flawed: retail prices are fixed, while generators are free to price according to supply and demand.

In response to sharply higher crude oil and natural gas prices, electricity generators raised their prices. Retailers, buying from the generators at higher market prices but selling at low fixed prices, now face bankruptcy.

Although California has some of the toughest environmental protection legislation in the world, electricity consumers, paying

below-market prices, have no financial incentive to conserve energy. This same legislation has prevented generators from building new power plants.

Sixty-five percent of the electricity output of Washington and Oregon comes from water (known as hydroelectric) power. Below normal rainfall and snowfall in these states over the past three years means that they have less electricity to exchange with California.

In summary, environmental factors and government action have restricted the generation of electricity, while low, fixed retail prices have encouraged electricity demand. Allowing the retail price of electricity to match supply with demand will promote conservation efforts and attract additional supplies. These new supplies can be environmentally friendly; higher crude oil and natural gas prices are encouraging development of alternative energy sources, such as wind and solar power.