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Paying For Power: *The Challenge of Municipalization* 97-01

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As the nation moves toward a restructuring of the electrical power industry through the introduction of direct competition between power producers, one of the difficult emerging issues is the disparity of treatment between government-owned utilities (such as Seattle or Tacoma City Light and various Public Utility Districts) and investor-owned utilities (such as Puget Sound Energy and Washington Water Power).

The term "municipalization" has been coined to refer to the efforts of government utilities to expand through competition into areas traditionally served by investor-owned utilities. In a state where public power already dominates (delivering 69% of the electric energy consumed in Washington), municipalization is a public policy question of serious magnitude.

As a free-market focused institution, the Washington Institute Foundation strongly supports the increase of competition in the sale of goods and services, including electrical energy. We do not favor government ownership of the means of production. And yet, some fear that may be the result if government-owned utilities compete without being required to operate on the proverbial "level playing field."

A recent study published by the Washington Institute Foundation examined the extent to which current government policies depart from the principal of neutrality between competitors. The report concludes that customers of government-owned utilities are now receiving power at rates substantially lower than they would if neutral policies were in place: that is that taxpayers in general are supporting lower rates for consumers of public power.

Public Power Users Benefit from a 38% Subsidy Equivalent

Through tax exemptions, preferential power purchasing provisions, and the ability to finance capital construction with lower interest tax-exempt bonds, government-owned utilities enjoy significant competitive advantages over investor-owned utilities. As long as each utility had a geographic monopoly over its customer base, these differentials had little competitive effect. With deregulation, these preferences distort economic competition between electrical producers.

The Washington Institute Foundation study concludes that elimination of the various preferences to public power would mean that public power utilities in the state of Washington, on average, would need to increase revenues, and therefore rates, by 38%. Cooperatively-owned utilities would need to increase revenues, and rates, by 72%. And all this just to operate on the same financial conditions as private utilities.

A significant point all should remember: the existing financial preferences do not "reduce costs," they simply shift them from certain consumers of electricity to taxpayers at large. Likewise, eliminating subsidies will not "increase costs" so much as shift them back from taxpayers in general to the specific users of publicly produced power. Today, customers of, say Puget Sound Energy, not only pay for the power they consume, they also contribute to the subsidies enjoyed by consumers served by Seattle City

Light. Policy makers at the state and federal level should consider whether a continuation of this cost shifting is justified.

The Elements of the Financial Preferences

The study analyzes three general categories of financial preferences.

Tax Exemptions. Investor-owned utilities pay federal income tax; government-owned utilities and cooperatives do not. Likewise, they pay Business and Occupation taxes, property taxes and other taxes. To some extent government-owned utilities make payments "in lieu" of taxes, but a significant disparity remains. If government-owned utilities paid taxes on the same basis as investor-owned utilities, their expenses would increase by 18%, and revenues and rates would need to increase to pay those expenses.

Cost of Capital Expenses. Power producers incur substantial capital costs to construct power generating and transmitting facilities (dams, power plants, high voltage transmission wires, etc). Investor-owned utilities must raise their capital like any other business, by selling bonds at market rates. Government-owned utilities finance capital costs through tax-exempt bonds, thus substantially reducing their interest expenses. The subsidy is, in effect, borne by the U.S. Government, and thus all taxpayers, through the income tax not paid by the holders of the bonds. If Washington's government-owned utilities paid market interest rates on capital financing, their debt service would be increased by $84,000,000 per year, requiring an increase of 3.5% in revenues.

BPA Power Preferences. A major power producer in the region is the Bonneville Power Administration (BPA). While it sells power to investor-owned utilities, government-owned utilities purchase the bulk of its power. Equalization of the playing field here would require $385 million more in expenses to government-owned utilities (money which would be paid to BPA and benefit the US taxpayers at large) and require a striking 16.5% increase in revenues to pay those costs. NOTE: policy makers interested in establishing fair competition could eliminate this preference simply by making power available to all purchasers on the same basis.

Conclusion

Restructuring of the heavily regulated market for electrical energy is a vital reform to enhance the health of our economy. Ignoring the policy implications of taxpayer subsidies to one set of competitors in the new environment would be unsound economics and bad public policy.