



THE CALIFORNIA INSTITUTE FOR FEDERAL POLICY RESEARCH

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To expand communications between Washington and California, the California Institute provides periodic faxed bulletins regarding current activity on Capitol Hill which directly impacts our state. Bulletins are published weekly during sessions of Congress, and occasionally during other periods. The e-mail edition is made possible in part by in-kind contributions from Sun Microsystems and IBM Corp.

FINANCE EXAMINES EDUCATION RELATED TAX CUTS

On Wednesday February 14, the Senate Finance Committee held a hearing on education related tax credits. The following issues were addressed by the Committee and its witnesses: 1) making permanent and extending to graduate students the tax-free status of employer paid education benefits (Section 127) ; 2) expanding the deductibility of student loan interest payments; 3) expanding contributions to K-12 and postsecondary education IRAs; expanding the ability to finance school construction and modernization through tax-exempt bonds.

Chairman Charles Grassley (IA) and Ranking Member Max Baucus (MT) spoke in favor of their legislation, S. 133, to make permanent the Section 127 tax-exempt status of employer-paid education benefits and to extend it to include graduate education. Janet Parker, of Amsouth Bank and representing the Section 127 Coalition of business, labor, and education groups also testified in support of the legislation.

During questioning Sen. John Breaux (LA) commented that President Bush's tax plan does not include any of the education-related tax incentives addressed at the hearing and expressed concern that they would continue to be excluded from the Bush plan.

Sen. Tom Harkin (IA) argued that U.S. infrastructure needs will total \$1.3 billion over five years, and asked to craft a bill which includes tax credits to finance \$25 billion in school construction.

Once posted on the Committee website, testimony of witnesses may be obtained at: <http://www.senate.gov/~finance/>.

BANKING PANEL BEGINS EXPORT CONTROL HEARINGS

The Senate Banking Committee held a hearing on reauthorizing and streamlining U.S. export control laws on Wednesday, February 14. The Committee heard from two former Defense Department officials: John J. Hamre, now President and CEO of the Center for Strategic and International Studies, and Donald A. Hicks, currently Chairman of Hicks & Associates.

Mr. Hamre testified that export controls must be based on a framework of partnerships between U. S. companies and the federal government to eliminate the current adversarial nature of the process and convert it from a transaction-based licensing system to a process-based approach. In his view, the federal government should license the export control procedures used by a company. If the company instituted acceptable internal controls then it would be free to export controlled commodities without individual

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licenses. The federal government's role would then shift to monitoring and approving the internal control procedures.

Mr. Hicks testified on the impact of globalization on national security and how to enhance U.S. military dominance in the face of globalization. Overall, he argued that the Department of Defense must shift from "protecting" militarily relevant technologies to "preserving" the military capabilities essential to meeting national security objectives in the face of continued globalization. This shift is necessitated by the fact that current technology controls ultimately fail to deny access to militarily useful technology, Mr. Hicks argued.

The witnesses testimony can be obtained through the Committee's website at:

<http://www.senate.gov/~banking> .

COMMERCE SUBCOMMITTEE HOLDS HEARING ON CALIFORNIA ENERGY CRISIS

On Thursday, February 15, the House Commerce Subcommittee on Energy and Air Quality held a hearing entitled "Electricity Markets: Lessons Learned from California." The hearing was intended to focus on the cause or causes of the state's energy woes. Witnesses and Members of Congress from other states were quick to point out differences between their state's electricity market and that of California, but there was considerable concern that California's difficulties will directly or indirectly impact the national grid in a major and detrimental fashion. Full Committee Chairman Billy Tauzin (LA) noted that California's economy represents 12 percent of the nation's, and that this "could be just the first sign of what could be problems all over America." Chairman Tauzin commented that he has no intention of moving a price cap bill, whether standalone or otherwise.

Witnesses at Thursday's hearing were Carl Wood, a member of the California Public Utilities Commission (CPUC); Mr. John M. Quain, Chairman of the Pennsylvania Public Utility Commission; Dr. Alan R. Schriber, Chairman of the Ohio Public Utilities Commission; Mike Travieso, Maryland People's Counsel; Peter Esposito, Vice President of Regulatory Affairs at Dynegy Inc.; John Rowe, CEO of Exelon Corporation; Robert Levin, Senior VP for Planning and Development at the New York Mercantile Exchange; Adrian Moore, Executive Director of the Reason Public Policy Institute; and John Fielder, Senior Vice President of Regulatory Policy and Affairs at Southern California Edison.

At the hearing, Rep. Christopher Cox (Newport Beach) lamented that California is paying out \$1 billion per month due to this problem, a cost being paid for by Californians, either as utility ratepayers or as taxpayers.

Rep. Henry Waxman (Los Angeles) disputed criticism that stiff environmental regulations are in part to blame for the electricity crisis. "Some want to blame the Clean Air Act for California's problems," Waxman said, adding "If air pollution laws are causing the problem, then why is Los Angeles not having a problem." (The Los Angeles Department of Water and Power supplies electricity to the city's residents; as a municipal entity it is exempt from the 1996 restructuring.) He also noted that power supplier Reliant Energy has been quoted as stating that there has been no substantial reduction in generation due to compliance with air quality rules.

Rep. Mike Doyle (PA) criticized California for not building new power plants since deregulation began in 1996, despite growth as much as 15% per year since then. He noted that when Pennsylvania started deregulation in 1997, the state's rates were 15% above the national average, and rates are now 4% below the national average. He added that it will be important to examine the relationship between deregulation and environmental regulations.

Rep. Tom Sawyer (OH) focused on the importance of improving and expanding the transmission grid. He quoted an Los Angeles Times piece which warned that California could raise generation to sufficient levels but still be subject to shortages due to a lack of transmission capacity.

Some California Members of Congress had sought to increase the California attendance at the hearing. Rep. Sam Farr (Carmel), on behalf of the California Democratic Congressional Delegation, wrote to Subcommittee Ranking Member Joe Barton (TX) urging that the hearing include a California Members panel and other relevant panels. Rep. Bob Filner (San Diego), who is not a member of the Commerce Committee, criticized the hearing for not including other experts and elected officials from the state, asking, "How can you learn lessons from California's experience if Californians aren't testifying?" He commented that, "It is disheartening that the subcommittee saw fit to keep those of us who have been working on this issue out of today's hearing. It is my hope that another hearing will be held on the West Coast -- to allow Californians and their elected representatives to share their experiences with the panel."

The CPUC's Carl Wood testified that the root of California's problem is "the premise that provision of electricity as an essential service could be effectively traded on the day ahead and hour ahead spot markets absent the full range of generation procurement options." He added that, "the flaws in the system adopted reflect this belief--the pool structure that was established; the accompanying reliance on wholesale trading in lieu of native generation; California's retreat from integrated resource planning; and the unmet promise of 'customer choice.' A balanced reliance on the mix of generation procurement options available has historically been necessary to maintain reliable, reasonably priced electricity -- and it remains so today." He lamented FERC's unwillingness to exercise its authority under the Federal Power Act to protect consumers from unjust and unreasonable rates.

John Fielder from Southern California Edison testified that the company has exhausted its credit and has limited cash reserves, and thus it has suspended payment for power and some of its outstanding debts and is "implementing major cost reduction measures totaling nearly half a billion dollars annually, which will reduce our workforce by approximately 1850 positions and limit critical investments in the electric system." Yet these measures are still inadequate, he said, noting that "even the most drastic cutbacks we could possibly make would only generate enough cash to buy another few weeks' worth of wholesale electricity." As causes of the problem, Fielder cited actions by nearly all players: FERC's overreliance on competitive markets to control prices even when it was clear that California's market was not functional; CPUC prohibiting or restricting utilities' ability to purchase power in forward markets; utility companies' insufficiently predicting market moves; and generators taking advantage of the situation. He advocated the imposition of temporary cost-based price caps or load-differentiated price caps as fair to both consumers and sellers. Fielder noted that the utilities had tried seven times to gain authority to enter into bilateral contracts, but by the time last summer that they received permission to do so, their creditworthiness was inadequate to be strong negotiators. "We need some type of respite from FERC to work ourselves out of this situation over the next few weeks and months," he said. "We simply don't have the money to keep paying these exorbitant spot market costs."

Consumer advocate Mike Travieso of Maryland and speaking on behalf of the National Association of State Utility Consumer Advocates (NASUCA) testified that electricity differs from other commodities insofar as it cannot be stored and is an essential item with inelastic demand. He commented that flaws in the California market include the cancellation of building permits, an overestimation of the amount of energy which could be saved through demand side management, and prohibiting utilities from entering into long term contracts. He mentioned that Pennsylvania, Maryland and most other deregulated states have price caps. Maryland has four to five megawatts excess capacity at present, while California's shortfall can be as high as seven megawatts.

Bob Levin of NYMEX stated that, "Perhaps the single most important thing that California failed to do in avoiding a supply and price crisis was to remove impediments in the electrical grid to true competition among buyers and sellers of electricity," adding that any California plan that addresses this issue should "support direct access to the market for all buyers and sellers -- the current system still greatly restricts access."

Peter Esposito of Dynegy, which owns roughly 5% of generating capacity in California's market, blamed demand growth without adequate supply growth to respond, overreliance on spot markets, and a lack of complete deregulation. He urged Congress not to move too quickly to re-regulate or cap prices.

Calling federal hydropower policy "ridiculous," Adrian Moore of the Los Angeles-based Reason Public Policy Institute noted that the Bonneville Power Administration (BPA) made huge profits selling power into California. He urged a major reappraisal of the federal role in federal electricity generation and transmission.

In conjunction with the testimony of Dr. Alan R. Scribner, Chairman of the Ohio Public Utility Commission, discussants noted that in California it takes as long as three years to site a plant, while in Ohio takes six to twelve months at most. If an application is considered in Ohio, there is little interaction at the local level; most of the decisions are made at the state level, between the environmental protection agency and the public utility commission.

Participants noted that CERA (Cambridge Energy Research Associates) this week released a report on the California situation (see <http://www.cera.com>). A recent CERA statement opined that, "California needs a mechanism to pay for capacity and needs to approve development plans each year for enough capacity to close the current gap and keep up with demand. These reforms are not simple--instead of using the appropriate type of bilateral contract or making the proper rules for a capacity market, California could mistake long-term energy

contracts for the needed capacity payment mechanism and create massive take-or-pay obligations in the future. In addition, the politics of 'not in my backyard' may subvert real attempts to site and permit needed supply."

Rep. Waxman inserted into the record a letter from California Air Resources Board Executive Officer Michael P. Kenny, which noted that California has already licensed 7,000 megawatts of new baseload power generation, and which disputed charges that environmental laws have prevented maximum utilization of existing generation and have prevented new generation from coming online.

Testimony from the hearing, as well as an archived audio webcast, will be available on the Committee's website at <http://www.house.gov/commerce/hearings/eaq02152001.htm>.

CALIFORNIANS REQUEST GAO EVALUATION OF WESTERN ELECTRICITY SUPPLIES

On Tuesday, February 13, nearly half of the California Congressional delegation, led by Rep. Mike Thompson (St. Helena) sent a letter to the Government Accounting Office (GAO) requesting an evaluation and presentation on what can be done to increase the electricity supplies in the West. The letter signed by 24 members of the delegation requests the GAO to describe the California electricity market, including consumption and in-state generating capacity.

The letter also requests the GAO to examine what private generating resources could be made available to the state, with an explanation of federal, state or local obstacles to utilizing the resources. The GAO will also examine the possible use of active or inactive power plants on military bases to augment the existing generating resources in the West. The members request that the results of the GAO study be submitted by early May 2001.

LEGISLATION INTRODUCED TO STUDY CAUSE OF HIGH NATURAL GAS PRICES

On Wednesday February 14, legislation was introduced by Rep. Mike Thompson (St. Helena) to launch a Congressional investigation into the causes of high natural gas prices. The legislation proposes that the National Academy of Sciences examine both the reason for recent increases in natural gas prices and whether the increases were caused by supply or transmission system problems.

The study, to be completed 60 days after enactment of the bill, would also determine whether federal action is necessary to create an emergency supply of natural gas. As reported last week, similar legislation was proposed by Sen. Barbara Boxer as an amendment to the Pipeline Safety Act (*Bulletin, Vol. 8, No. 5*). Boxer's amendment also calls for a study by the National Academy of Sciences of the causes of the increase in natural gas prices and the reason for the natural gas supply shortage.

OTHER ENERGY ACTION IN CONGRESS

On Thursday, February 15, Senate Energy and Natural Resources Chairman Frank Murkowski, (AK) outlined elements of an energy package to be introduced as legislation after the President's Day recess week. Elements are expected to include opening of the Arctic National Wildlife Refuge (ANWR) to oil drilling; increasing authorization for the Low Income Home Energy Assistance Program (LIHEAP) from \$2 billion to \$3 billion, with the program's emergency pot boosted from \$600 million to \$1 billion; studying pipeline capacities and interstate pipeline projects for both oil and gas; examining renewable energy grant programs; and various tax credits. The LIHEAP program provides a small share of funds (just 4.5%) because state-by-state funding allocations are pegged to each state's funding level back in 1984.

Senator Barbara Boxer is seeking to amend the Small Business Energy Emergency Relief Act of 2001 in order to permit loans to small businesses hurt due to spikes in the cost of electricity; the bill currently only covers spikes in heating oil, natural gas, propane and kerosene costs.

Last week, California Congressional Democrats met with experts from the Natural Resources Defense Council (NRDC) to discuss the interaction of environmental laws with current and potential proposals to deal with the California energy situation.

During the week of February 26, the bipartisan California Congressional delegation will meet with FERC Chairman Curt Hebert regarding the California crisis, and RAND will provide a briefing for the delegation regarding the subject.

DELEGATION BRIEFED ON EFFORTS TO CONTROL PEST THREATENING VINEYARDS

On Wednesday, February 14, staff of the bipartisan California Congressional delegation were briefed by Robert L. Wynn, Statewide Coordinator of the Pierce's Disease Control Program regarding the current status of efforts in California.

Pierce's Disease (PD) wiped out 300 acres of vineyards in Western Riverside County, and a new pest which currently threatens to spread it far and wide across the state is firmly established across Southern California, as far north as Santa Barbara, Ventura and Kern Counties. While the disease has been around for more than a century (it was actually called Anaheim Disease until it completely destroyed the then-sizeable Anaheim grape industry 100 years ago), it has been largely contained and isolated ... until now.

A recent infestation of a new and aggressive pest, the Glassy-Winged Sharpshooter (GWSS) is changing Pierce's Disease from a slow-moving, lightly-infecting problem into one that could end virtually all winegrape production in California. California Agriculture Secretary calls this "the most significant threat to California agriculture in 20 years."

The GWSS carries PD from vine to vine, but -- unlike previous vector pests which only infested a few plants nearest the edge of a vineyard -- the GWSS flies long distances into the center of vineyards and spreads the disease much more broadly. In addition, the GWSS can carry the disease as it moves from one species of plant to another; the list of hosts on which the pest can live is four pages long, and includes a wide variety of California's most common household landscaping and agricultural plants. The sharpshooter probably entered the state via infected nursery stock from the Southeastern U.S., where it lives in, but does little damage to, citrus crops. Because of PD and the widespread presence of the GWSS, Florida cannot grow grapes anyway, so there is little or no effort to control the pest there.

Wynn noted pointed out that nurseries in California are spending \$22 million per year, out of their \$70 million in total revenues, on containing the spread of the pest. Private and state funds are spent on inspections, field research, biocontrol, and treatment. He noted that the GWSS has been found in significant numbers recently in Fresno and Tulare Counties, and minor residential-area infestations were identified last fall in Contra Costa County (Brentwood), Sacramento County (Rancho Cordova), and Butte County (Chico), adding that PD is on the verge of severely harming the industry in Kern County. The pest was also found near, but not in, vineyards in the large wine-producing of the Santa Ynez Valley region.

Wynn expressed hope that the federal government will provide \$10 million in operations support for the state's control efforts as well as \$5.3 million in federal research support.

As program coordinator, Wynn acts as the primary point of contact for all activities related to the GWSS pest/disease complex in California. He is responsible for directing the industry, the California Department of Food and Agriculture (CDFA) and county agricultural commissioners in planning, coordination, and administration of all phases of GWSS operations. For further information about the problem and the status of the control efforts, see the CDFA website at <http://plant.cdfa.ca.gov/gwss/>.

CONGRESSIONAL CAUCUS ON METHAMPHETAMINE FORMED

Rep. Ken Calvert (Corona), along with Reps. Chris Cannon (UT), Brian Baird (WA), and Leonard Boswell (IA), has created the Congressional Caucus to Fight and Control Methamphetamine. Rep. Steve Horn (Long Beach) is among 20 members from both sides of the aisle who have joined the caucus so far.

The purpose of the Caucus is to direct members attention t the growing nationwide problems and dangers associated with abuse and production of methamphetamine. Over the last several years the number of meth labs that have exploded, causing personal and property injury, has grown dramatically, as have the number of meth labs seized throughout the United States. The Caucus has established several goals to raise awareness of the dangers of meth and to develop federal policy to fight the problem.

Members of the Delegation wishing to join the Caucus should contact Brian Wagner in Rep. Calvert's office at x5-1986.

BUSH ADMINISTRATION TO OPEN UP BORDER TO MEXICAN TRUCKS

Following an arbitration decision that current U.S. policy on border-crossings by Mexican trucks violates the North American Free Trade Agreement (NAFTA), the Bush Administration has indicated that it will at least partially open the border to more Mexican truck crossings.

The Clinton Administration had closed the southern border to Mexican trucks, arguing that they could not meet U.S. environmental and safety regulations. A U.S. trade official in the Administration has reiterated President Bush's support for opening up the border, although the exact details of how the Administration will carry out its NAFTA obligations has not been announced.

NAFTA had called for Mexican trucks to have some use of border state crossings by 1995 and complete access by 2000. The Department of Transportation, however, contended that public safety would be threatened because in 2000, 35 percent of all Mexican trucks crossing the border were denied operating rights because of safety violations. As a result, Mexican trucks to date have been restricted to areas within 20 miles of the border, where goods are then loaded onto American trucks.

The U.S.-Mexican arbitration panel found that the United States must consider Mexican applicants for border crossings on an individual basis, and cannot ban crossings across the board.

ELECTIONS EXPERTS BRIEF CALIFORNIA STAFF

On Tuesday, February 13, election reform experts from Booz-Allen & Hamilton briefed roughly 30 staff of the bipartisan California Congressional delegation regarding suggestions for helping federal, state, and local authorities cope with election reform issues. The firm has provided assistance to the National Association of Secretaries of State (NASS) task force on elections standards in their efforts to develop its newly released recommendations for improving the election process. They also worked with the State of California in conducting independent verification and validation of the California voter registration system. The briefing was co-hosted by the Hon. Jerry Lewis, Chair of the California Republican Congressional Delegation, the Hon. Sam Farr, Chair of the California Democratic Congressional Delegation, and the California Institute.

At the briefing, Booz-Allen & Hamilton Vice President Elliott Rosen described the process that the task force of twelve secretaries of state used to develop their recommendations. He noted that many of the proposed solutions to recent election problems have been focused on technology improvements, while the problems have been less technological than people- or process-oriented. The recommendations developed by the task force include ensuring equal access to the election system as well as adoption and enforcement of election day rules and procedures to reinforce the goal of equal access, modernizing voting processes, encouraging uniform standards, boosted funding, voter education and outreach, expanded poll worker recruitment and training, intergovernmental cooperation to make voter rolls more accurate, enhancing the integrity and timeliness of absentee ballot procedures, adopting a voluntary federal voting systems standard, training and certification of election officials, and data collection.

In addition to those recommendations, the task force also specifically urged Congress to fully fund the continuous update of the federal voting systems standards and voluntary management practices standards, promote intergovernmental cooperation and communication, and provide funds to states to implement state and local aspects of their above plans. For further information, contact Maria Alongi at 703-902-4897 or at alongi_maria@bah.com

NATIONAL CENSUS LESS UNDERCOUNTED THAN 1990; STATE FIGURES STILL PENDING

While no state-by-state figures are yet available, the net undercount of all Americans counted by the 2000 Decennial Census has been estimated to range from 0.96% to 1.4% of the population, according to the preliminary national figures based on a follow-up survey of 314,000 persons. Early results indicate that the Latino and African-American undercounts for the 2000 census may be half that of comparable 1990 levels. Some press reports quoted House Democrats as estimating the 2000 undercount at 3 million people.

Even the larger 1.4% figure for 2000 constitutes an improvement over the 1990 census, when the Census Bureau estimated that 1.6% of the U.S. population, or 4 million persons, were undercounted. California was undercounted by 2.7% in 1990, significantly above the national 1.6% rate -- a differential which cost California \$2

billion in lost formula funds, according to the General Accounting Office. While the state's 2000 undercount percentage is not yet known, California's marked improvement in response rates during last year's data gathering process gives hope that the state's undercount will be smaller than in the last census.

A Bush Administration decision is expected by early March regarding whether to adjust the 2000 census to account for any undercounting, a decision which could impact the reallocation of legislative districts and the distribution of nearly \$200 billion in federal formula grant funding. The Census Bureau is expected to make an initial decision, but the decision could be reversed, as was the case following the 1990 census.

According to preliminary estimates, the undercount for Hispanics declined from 4.99% in 1990 to between 2.22% and 3.48% in 2000. The undercount in the African American community was between 1.6% and 2.73% in 2000, compared to a 1990 level of 4.57%. For the Asian and Pacific Islander population, the undercount in 1990 was 2.36% while officials estimate that Asians in 2000 may have been slightly overcounted by 0.09% or could have been undercounted by as much as 2.01%. For whites, the undercount in 1990 was 0.68%, whereas it was between 0.44% percent and 0.9% in 2000. Though percentages may be lower, the actual number missed could be higher because of overall population growth.

BUSH TO HOLD NATIONAL MISSILE DEFENSE TALKS WITH RUSSIA AND CHINA

The Bush Administration has indicated willingness to hold a dialogue with China and Russia on a National Missile Defense System Proposal. The plan to build an anti-ballistic missile shield to protect the U.S. is opposed by both countries due to concerns about neutralizing strategic arsenals. Though the technologies for the system have not been identified, the Administration's proposed system is multilayered and would include lasers and missiles supported by a network of satellites and radar systems. The system would be designed to attack enemy missiles at each phase of flight, and it could be configured to include allied nations under its protective umbrella. While much attention is paid to key global powers, the primary goals of an NMD system may lie elsewhere. Rep. Steve Horn (Long Beach) noted recently that a missile defense system is "designed to inject uncertainty into planning by rogue powers and to provide a last-ditch defense against a small number of missiles." A significant portion of an NMD system would likely be developed in California.

REPORT EXAMINES HOLLYWOOD'S PLACE IN GLOBAL ENTERTAINMENT

A recent report, entitled *Can Hollywood Remain the Capital of the Global Entertainment Industry?*, examines whether Hollywood can retain its position as the world center of filmed entertainment. Michael Clough, the author of the report prepared for the Pacific Council on International Policy, finds that Hollywood can retain its status, but must "adapt to and take advantage of" the revolutions occurring in globalization and digitization.

Among Mr. Clough's conclusions are that few recognize that Hollywood's greatest advantage lies in the multifaceted pre-production/development phase of films and shows, rather than in the simpler process of actual production. According to Mr. Clough, digitization and the global dispersion of production and marketing make processes such as funding, developing scripts and recruiting creative talent more complex. Thus, "Hollywood's unrivaled experience in the development phase, coupled with the region's ethnic diversity, leaves the Southland ideally positioned to dominate this aspect of the industry."

Clough also addresses the issue of "runaway production" – where U.S. production companies move their operations to another country. Clough argues that Hollywood should capitalize on runaway production by tailoring its product to a global audience and putting aside its current premise that all films should be intended for initial release in the United States.

On the issue of digitalization – the conversion of images, sound, and text into computer readable data, Clough concludes that Los Angeles-based entertainment giants should focus on completing digital studios and ally themselves with digital effects companies in Northern California.

Finally, Clough concludes that Southern California is poised to succeed New York as the media capital of the United States, as the high-tech age signals the end of old divisions between different media. But to do so it must respond effectively to the exodus of major corporations from Los Angeles and the growing push from wealthy parts of the city to form independent municipalities.

The entire report can be downloaded from the Council's website at: <http://www.pcip.org> .