



## **For Immediate Release: Tuesday, January 31, 2013**

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## **In case you missed it...**

Jeffrey Michael's **Valley Economy** blog:

Monday, January 28, 2013

### **BDCP Benefit-Cost Analysis Is Going Off-Track**

"I attended the second update on the new BDCP benefit-cost analysis on Thursday. I was optimistic after the initial meeting in November, but I am not anymore. In November, I was optimistic because they had finally agreed to do benefit-cost analysis, hired a good economist to lead it, and appeared open to feedback.

"After this latest meeting, I am left with the impression that they are not responsive to feedback, and that the analysis is not really directed by the economists or established benefit-cost principles. It is directed by Jerry Meral, the Governor's chief advisor on the BDCP, who is not fair and impartial, let alone qualified to direct benefit-cost analysis. He has a clear mission to implement the Governor's vision for the twin tunnels, and he is keeping the consultants on a short leash. He does not appear to be following key elements of his agency's own benefit-cost guidelines.

"In many cases when participants make good suggestions that would make the analysis more consistent with accepted guidelines, the economic consultants defer to the boss (Mr. Meral) or state that it is outside the scope of work. The scope of work should be really simple, one sentence is sufficient really. "Conduct a peer-reviewed, independent, benefit-cost analysis of the key elements of the BDCP following recently published guidelines by the Department of Water Resources (2008)." Mr Meral shouldn't be dictating anything. He should just send comment letters like everyone else.

"[Update 1/29: I just became aware that the scope of work has been posted. I see nothing in this scope that changes my opinion. The lengthy scope of work is inconsistent with DWR's own guidelines for this type of analysis, contains no provisions for peer review, and provides draft documents to the water contractors first.]

"Here are several areas where I feel the benefit-cost analysis is heading off-track.

### **"Incorrectly Bundling The Tunnels Together With the Habitat**

"B-C principles are clear on this issue, and the principle is clearly stated in DWR's own rules. Each of the major components of the BDCP must independently satisfy the benefit-cost test. Since the big controversy surrounding the BDCP are the proposed tunnels, B-C guidelines clearly indicate that

conveyance (i.e. the tunnels) should be analyzed separately.

“This element of proper B-C analysis seems to bother people who see BDCP principally as an environmental restoration package. My initial draft B-C analysis was criticized for ignoring environmental benefits of BDCP, which misses the point. It was an analysis of the tunnels - not the whole BDCP.

“This concern can be avoided by considering a proper range of BDCP alternatives. These alternatives, including no-tunnel with seismic levee upgrades, and various sizes and configurations of water conveyance (i.e. the NRDC small tunnel proposal) should all be paired with appropriate habitat and operations that meet the requirements of an HCP under the ESA.

“All these alternatives would then have roughly equivalent environmental values. Thus, the environmental values would cancel out when comparing alternatives and allow the resources of the benefit-cost analysis to squarely focus on the critical questions of conveyance.

“Unfortunately, Dr. Meral appears to be prescribing an analysis that ties the habitat improvements to building a tunnel. This is invalid, and his own consultants have even said so by stating that the ESA doesn't require the tunnels, and the habitat investments could be made without the tunnels.

#### **“Inadequate Alternatives**

“This is closely related and somewhat redundant with the above concern. However, it is so important it needs to be emphasized.

“Mr. Meral has made it very clear that they would only be looking at one alternative, the Governor's plan, and comparing it to a no action alternative. This is a clear source of bias, and is well-known way to game benefit-cost analysis.

“At minimum, there should be a strong no-tunnel BDCP scenario (similar to the DPC economic sustainability plan) and a strong small tunnel scenario (similar to the NRDC plan). The alternatives need not be limited to that, but those two are musts. If these alternatives are included, then I wouldn't complain if the No Action alternative were dropped entirely from the analysis.

“I actually think an analysis of this type would be clearer, faster, and cheaper, because it would largely avoid the morass of non-market environmental valuation and allow clear apples to apples comparisons of conveyance options.

#### **“Is the Value of Regulatory Uncertainty Back? Playing games with the No Action alternative.**

“This meeting also raised a new red flag for me. While the consultants are restricted to only consider one alternative to achieve the BDCP goals, it sounds like the consultants have been given the liberty to play games with the No Action Alternative. I say that because Dr. Sunding kept mentioning that the results are sensitive to the level of water exports in the No Action Alternative, strongly suggesting he is going to lower water supplies in the No Action Alternative below the 4.7maf average, potentially as low as 3maf. The 4.7maf number is based on the current biological opinions governing operation of the projects, and is consistent with the BDCP's draft EIR documents and the definition of No Action that has been used

in every BDCP related presentation I have seen to date.

“This is a distortion of how No Action alternatives are typically defined in B-C analysis and in EIRs. The No Action alternative assumes a continuation of current conditions and policies. A future deviation from current policy would only be considered in rare cases if it is the clear direction and intention of the relevant government agency, in this case, the Department of Water Resources (DWR). However, DWR is litigating the current biops along with the Delta water exporters, and is on public record in court that they feel they are too restrictive and that higher levels of exports should be allowed. So it seems to me that the only deviation from a No Action alternative based on the current biological opinions that could be remotely justified is an increase in water exports, not a decrease in water exports, and certainly not to something as low as 3 maf.

“I asked Dr. Sunding if this low water export scenario would be part of an additional HCP alternative, and he said no, it would be the No Action alternative. I wouldn't mind including a no-tunnel alternative with lower water supplies than the current Biops, but such an alternative should be a BDCP alternative (i.e. meeting the requirements of an HCP under the Endangered Species Act), packaged with habitat and levee investments that would generate comparable levels of environmental benefits and seismic risk reduction to water supplies.

“With this manipulation of the No Action Alternative, I believe Dr. Sunding is trying to resurrect his value of "regulatory certainty" theory in the form of a super restrictive No Action Alternative. This hides it by not including regulatory certainty as a separate value category like he did in his July presentation on economic benefits. However, it effectively embeds the concept inside the valuation of water supplies and seismic risk.

“Until this is cleared up, I am taking back my praise from 2 months ago that he has dropped the regulatory certainty argument. A No Action alternative should be relatively non controversial, but the discussion in this meeting makes me worried that they are going to adopt whatever creative definition of the No Action alternative is necessary to justify the Governor's twin tunnels.

### **“Blowing Up Earthquake Risks**

“This is now the 4th time I have seen Dr. Sunding present the losses of an earthquake induced Delta collapse that conveniently occurs in 2025, the date the tunnels are assumed to be complete. Of course, assuming this perfect timing generates the largest possible numbers for his table.

“In addition, he always presents the earthquake risk reduction benefits as raw numbers without multiplying by the probability it happens. The scope of work they developed for the "benefits analysis" last year stated that this would be multiplied by probabilities, but he isn't doing it in presentations. Why? Even the exaggerated DRMS estimates placed the probability at about 2% per year. He also includes 2 and 3 year outages that are thought to be highly improbable. I applied the DRMS probabilities to his tables and found the present value of earthquake risk reduction to be no more than 5% of the construction cost of the tunnels.

“Most irritating to me, Dr. Sunding is assuming that the state will not eliminate the earthquake risk to water exports through seismic levee upgrades. The probability that this will be done in a No Action, No Tunnel alternative is certainly greater than zero, and I would argue this is far more likely than the 3 maf of

exports he is seriously discussing as part of his no action alternative. Building the tunnels will probably mean that there will be no seismic upgrades of Delta levees which will result in unnecessary enormous losses of lives, property and economic activity in the event of the big earthquake event. From this broad perspective, I could make an argument that the Earthquake value of the tunnels is negative.

“I believe my suggestion that the earthquake risk reduction benefits of the tunnels are negative (in other words it is a cost, not a benefit, since it will result in poor seismic protection for everything else that matters in the Delta) is far less of a stretch than the "regulatory certainty" theory Dr. Sunding has conjured up.

### **“Super Low Discount Rate**

“The consultants presented a justification for an unusually low discount rate of 2.275%. One could present equally convincing justification for a 7% discount rate, especially when focused on opportunity costs of state funds rather than today's currently low long-term interest rates that are being manipulated in unprecedented ways by the Federal Reserve.

“Another reasonable approach is to look at the DWR guidelines here. In January 2008, when DWR issued its guidelines recommending a 6% discount rate, the yield on a 30 year Treasury Bond averaged 4.33%. BDCP is arguing that today's super-low market interest rates suggest a lower discount rate should be used. At the end of last week, the 30 year Treasury bond yield was 3.14%, which is only 1.19 percentage points lower than when they released their guidelines endorsing a 6% discount rate. So I don't see how DWR can make a market interest rate argument for lowering the discount rate by much more than 1 1/4%, which would be a discount rate of 4.75%.

“This is an unsettled issue in Economics, and it isn't going to be settled now. The proper way to handle this is to do a sensitivity analysis that shows the results with a range of values, say 2% to 7%.

“A low discount rate is the oldest trick in the book for biasing a B-C analysis in favor of a project, and by adopting a single, super low discount rate, they are just fueling perception of a rigged study.

### **“Concerns With the Non-Market and Recreation Values**

“I mentioned two of these in the meeting: the noise and visual pollution of the intakes, and accounting for the lost non-market values of prime farmland. And it isn't clear to me that BDCP would result in any net gain in recreational values. After all, the folks who are currently in the Delta recreational business are some of the biggest opponents.

“I also have concerns with the benefits transfer approach, but I won't bother with that here. As discussed above, I believe this is an area of intense controversy. And it is really unnecessary, because what folks really want is a benefit-cost analysis that focuses on the tunnels.”

*Restore the Delta is a 7000-member grassroots organization committed to making the Sacramento-San Joaquin Delta fishable, swimmable, drinkable, and farmable to benefit all of California. Restore the Delta works to improve water quality so that fisheries and farming can thrive together again in the Sacramento-San Joaquin Delta. [www.restorethedelta.org](http://www.restorethedelta.org)*