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California dreaming? Not in Malaysia, surely

WAS it a really big shock when Prime Minister Datuk Seri Dr Mahathir Mohamad last week said blackouts in California prompted the Government to re-examine the power industry's restructuring process?

For many industry observers, it was hardly the case.

Clues had been leaked a few weeks earlier in the Eighth Malaysia Plan (8MP). The document outlined the Government's planned target in the next five years and stated that industry reforms would continue to take place.

However, a gradual approach would be adopted in introducing a market mechanism in order to attract investments as well as ensure an adequate and reliable supply of electricity, it added.

The industry appeared to be on course for major developments following self-initiated moves at Tenaga Nasional Bhd (Tenaga) in 1997. It reorganised major businesses into three distinct divisions - generation, distribution and transmission.

Subsequently, an asset disposal programme was initiated. The message was clear; Tenaga would reduce its interests in generation activities and focus on distribution and transmission.

A year later in 1998, the Government set up a task force at the Economic Planning Unit to establish an Independent Grid System Operator, a regular feature of mature markets where the power sector is fully opened for competition.

Many had expected the local sector to undergo the same transformation and the creation of a power pool, a mechanism that can deliver low electricity prices, was anticipated to take place in 2007. Understandably, many people got excited.

Independent power producers (IPPs) were excited about bidding for Tenaga power plants that were up for sale.

Analysts quickly crunched the numbers involved, predicting the utility to make billions from its sale and tackle its piling debt situation most effectively. Some even thought that the 8MP would contain details on how the industry would move forward.

Even financial journalists could not hide their enthusiasm for the industry's future. The concept of pooling, where the price of power will be exposed to the vagaries of supply and demand, was expounded to the public.

To have a pool, there must be a seller (power producer), and a buyer (power supplier). This will be the wholesale market where a supplier will buy electricity at the best possible price from the producers.

The retail market is where suppliers will sell power to end-users. Examples of the pools success are plentiful in European countries.

But the latest five-year plan quickly poured cold water on these expectations and as such, the Prime Minister's remarks were not unexpected.

The objectives of restructuring are clear, simple and also very attractive.

Fostering competition among utilities will ultimately benefit consumers who will pay for cheaper electricity. But as common sense stipulates, it is easier said than done and California was and still is, a perfect example of restructuring gone bad.

The sunshine state, which is also home of Silicon Valley, started the process in 1996 and put into motion laws to split the market into

generation and distribution.

Power generators would own the plants and sell electricity to distributors or suppliers. Suppliers would then sell the juice to consumers.

The buying and selling of electricity between generators and suppliers were done through the pool that acted like a clearing house. Wholesale prices of power traded on the pool was deregulated, meaning the price of power was allowed to fluctuate according to the forces of supply and demand.

But in the retail market, suppliers faced a cap on how much it could charge its customers.

The system would have worked fine if the system possessed excess capacity or to put in other words, if supply exceeded demand. But California has not built a new power plant in the last 10 years, so supply was getting tight. Demand eventually soared, exacerbated by a hot summer and the price of gas that is used as fuel by generators increased.

Faced with a shortage of supply, wholesale prices skyrocketed. Suppliers borrowed large amounts of money to pay for power on the wholesale market but this extra cost could not be passed on to consumers due to the ceiling price.

As a result, power suppliers piled on huge debts to carry its business. Pacific Gas & Electric has filed for bankruptcy to seek protection from its creditors while Southern California Edison intends to sell its transmission assets to the state.

Furthermore, rolling blackouts have become a normal occurrence in California.

Despite the California episode, the Government is still planning to undertake a gradual reform according to the 8MP. Two major blackouts during the 1980s will serve as a reminder that although progress is desirable, the industry has to be restructured without any failures.

It is all the more important because Malaysia needs continuous foreign direct investment to help achieve a fully-developed nation status in the next 19 years. One of the major factors that will help achieve this target is to have a competitive power sector.

Thus, the 8MP took note of Californias case of which the first lesson is to have surplus capacity. That is why one of the Government's objectives in the five-year period is to ensure the adequacy of electricity supply.

In addition, other means of restructuring is also being pursued by the authorities.

The most obvious example is new capacity that will be commissioned in the next five years. Some 8,800 megawatts (MW) will be commissioned in that period, the bulk of which, will be undertaken by IPPs, the 8MP said.

This means that Tenaga's share in the generation market will drop in tandem with the rise of IPPs' capacity.

Regulatory reforms are also part of the restructuring process. In this regard, an Energy Commission will be formed to replace the Department of Electricity and Gas Supply. The Commission will help the Government in planning for the industry's future.

California will serve as a stark reminder to governments that rushing ahead with deregulation or restructuring can prove fatal for economic development.

But as mentioned above, there are many success stories of industry restructuring and this serves as a consolation for Malaysia that needs to learn as much as it can from others.

For instance, the grand daddy of all power pools is still alive and kicking in Britain, which started its restructuring process more than 10 years ago. The industry is also said to have achieved its objective as

electricity prices have fallen during the period.

Perhaps, greater attention can be paid to the British model.