

Be careful of power deregulation

By Viresh Fernando

As the Sri Lankan government considers its options in dealing with the country's increasing shortage of electrical power, it is essential that all stakeholders engage in an open discussion of the experiences of other jurisdictions, and be cautious of the advice that is proffered keeping in mind that "free advice is only worth what you paid for it".

In the United States, Enron, the world's largest energy company is now bankrupt, following disclosure of malpractices including electricity price manipulations. The State of California, where electricity power supply was de-regulated, faced huge price increases and rotating "brownouts" last summer. Nevada, the American state that is synonymous with gambling, voted overwhelmingly (in November 2002) to not gamble when it comes to electricity privatization.

In the U.K., a significant over supply of power forced British Energy, the now privately held former electricity monopoly of the British Government, to sell power at well below the cost of production. It also invested heavily in power generation systems in other countries including purchasing nuclear generating capacity in Canada.

In early December 2002, the British Government confirmed that it was extending a government loan of one billion pounds sterling to British Power so that the company could at least temporarily fend off insolvency.

In Canada's largest province Ontario, the quadrupling of electricity prices just three months after privatization provoked howls of protest from consumers, and even led to a open revolt by cabinet members, who initiated public petitions against their own government!

This not only forced the ideologically "free-market" oriented Conservative Party to roll back prices to pre-privatization levels, but also to bring in even more complex re-regulation of the market.

This about face by the provincial government to the "energy price crisis" left the business community feeling completely betrayed. It is now all but certain that the government will face a backlash from voters in the forthcoming election, because consumers feel that a tra-

dition of abundant energy and stable prices has been sacrificed at the altar of "free-market" ideology.

In the only other Canadian province (Alberta) that has attempted deregulation, the government has only been able to continue with its plan by effectively bribing consumers with huge subsidies of electricity rates.

Economic and political considerations

There are at least three interesting questions Sri Lanka should consider in regard to energy deregulation and privatization. Should the electric power market be unregulated, privatized or both? Secondly, should a developing country try free-market solutions to increase the availability of electric power, when even comparatively wealthy economies are unable to pull it off?

Thirdly, should Sri Lanka not be very cautious in taking advice from Canadians, when Canadian experience with deregulation and privatization of electricity, as in the US, is not by any means a success given the hasty recourse to effective price capping of electricity that has taken place in the provinces and states where it was tried.

Perhaps also, one can ponder whether any political party can withstand the enormous risks that are inherent in energy privatization and non-regulation?

It is clear that some form of regulation is necessary in regard to unique necessities of modern life such as electrical power, water, telephone services, education and health care.

Therefore, "deregulation" effectively means the reduction rather than the wholesale elimination of governmental control of various aspects of the electricity market. Privatization, on the other hand, means permitting non-governmental entities to provide services that were previously, solely, undertaken by the state.

In permitting companies such as Aggrekko to generate electricity and sell it to the Ceylon Electricity Board, Sri Lanka very clearly has both "unregulated" as well as "privatized" aspects of the electricity market.

The central issue that all Sri Lankans must now address is the type and extent of regulation and privatization that is economically necessary and politically justified. A secondary, but nonetheless important issue, is to whom should the govern-

ment turn for advice.

Case studies of "market failure"

The received wisdom is that for deregulation to be successful, there has to be at least a small oversupply of power at the start of the process. In Britain, however, there was so much over-capacity that companies were forced to cut prices below operating costs forcing them into virtual insolvency.

In California the opposition to the building of nuclear plants because of safety concerns, and the opposition to coal fired plants because they would exacerbate California's famous smog problem that was affecting the health of thousands of people, had led to a chronic shortage of power produced within the state. This forced California to purchase electric power from plants situated as far away as British Columbia, Canada.

Out of state power is purchased on what is known as the "spot" market, which even without price manipulation can result in prices up to ten times the regular price. When rogue companies such as Enron were able to capture and manipulate the market Californians found themselves paying as much as twenty times the regular price for electricity during peak consumption periods.

In 1995, Ontario residents elected a neo-conservative government which ran on a simplistic platform of less government spending, lower taxes and privatization. In 1998, the government passed legislation to break up Ontario Hydro, its vertically integrated electricity monopoly into three independent arms.

The power generation sector would own or lease the existing plants and build new plants. As part of this aspect of privatization a government owned company named Ontario Power Generation (OPG) now owns 70 per cent of the generating capacity. It is required to downsize its power generation ownership percentage to 40 per cent over the next four years. (Prior to its insolvency, British Energy entered in to a twenty-year lease to operate one of the nuclear plants).

All the transmission and distribution was to be handled by a company named Hydro One Inc., which would for the foreseeable future be owned by the provincial government.

The marketing and sale of power to households and businesses was to be in the hands of lo-

cal municipally owned entities called local distribution companies, as well as privately held companies.

A fourth entity called the Independent Electricity Market Operator (IMO) was created to operate the high voltage transmission system and function as a bourse, matching the demand for power by the resellers and the power offered to the electricity grid by power producers.

The former monopoly's accumulated debt of approximately US\$25 billion was passed on to consumers by imposing a surcharge.

Market based pricing of electricity commenced in May 2002. Almost immediately, the problems associated with a so-called "free-market" in power became apparent to market insiders and to the government, but consumers remained largely oblivious of the consequences.

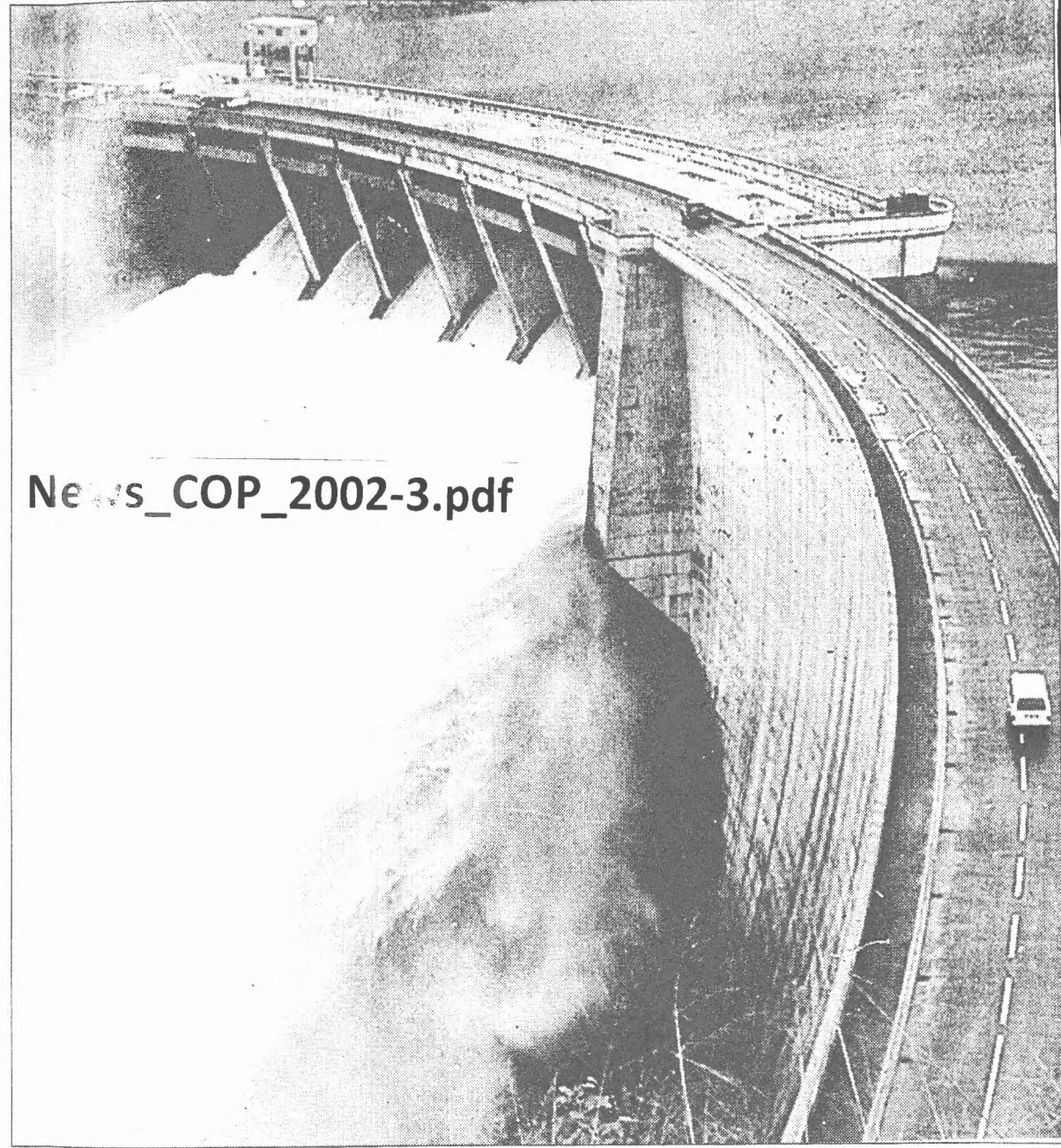
An unusually hot summer and the resulting increase in demand for air conditioning led to severe shortages of electricity. This forced the independent market operator to purchase power from high cost power producers within the province as well as from neighbouring provinces and from the United States, pushing retail prices to over four times the former regulated price. However, because of quarterly billing procedures, consumers only became aware of the enormous price jumps only in late October of this year.

When the Ontarians saw the effects of privatization on their electricity bills, the reaction was instantaneous and intense. Working people, senior citizens (retired people), business owners, trade union groups, newspaper editorials, opposition as well as government members of the provincial legislature, and to every body's surprise, even some members of the cabinet of ministers, petitioned the provincial premier to re-introduce price regulations.

Then, under public pressure, the government announced that energy prices would be frozen at the pre-privatization levels going back to the initial date of privatization in May 2002, and going forward till at least the year 2006.

Thus, the government abandoned significant privatization of the retail power market for the foreseeable future.

The government's retreat has at least two significant consequences. By keeping the cost of



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Water flows through the sluice gates of Victoria dam

power artificially low, it has taken away any incentive consumers may have had for conserving electricity. Secondly, by signalling that it would actively intervene in the market when it was politically expedient to do so, the government created a major disincentive for private sector players to invest in more capacity.

Policy imperatives for Sri Lanka

Sri Lanka has a chronic shortage of electricity. Its current thermal power sources are dependant on highly volatile price of petroleum-based inputs. Despite promises to the contrary, the proposed coal fired plant in Trincomalee will be a source of significant pollution and could have negative effects not only on the health of area residents, but perhaps more importantly for the government, on the recently revived tourism industry. Most importantly, the government is strapped for cash.

An affordable of supply of power is essential to the development of the country. Sri Lanka is not in apposition to turn to

neighbouring jurisdictions to purchase power at times of peak demand. The challenge is to find solutions that respond to all of these issues.

Many alternative energy sources could compliment traditional forms of electricity generation. The potential of solar power, proposed over twenty years ago, has not been fully exploited. Biomass as a source of power has received little practical attention in Sri Lanka. The use of wind turbines is another complimentary source of power.

Wind turbines account for up to thirty per cent of energy in some Scandinavian countries, and are also popular even in the energy abundant Canadian province of Alberta. Several investors from Europe and North America have expressed interest in investing in this method of electricity generation for Sri Lanka, because of the two thousand mile coastline. In the larger cities, up to ten megawatts of power could be generated from municipal garbage in a non-polluting manner. While assisting in dealing with the acute problem of the shortage of sanitary

landfill sites in urban areas, garbage to power incineration would also alleviate the negative health and hygiene issues associated with the landfills.

With a past of political and economic colonialism, Sri Lankans have to be cautious with "experts" who tend to be driven by ideology with little appreciation for local social, economic and political realities. Sri Lanka can marshal adequate expertise locally, and from the ex-patriot Sri Lankan communities abroad, and not fall prey to "expert colonialism" in dealing with the energy crisis.

A source of reliable and affordable power is a matter of national security and should not be subject to pro western investment rules of the World Trade Organization, the General Agreement on Trade and Tariffs and the imminent signing of free trade agreements with the United States as well as other countries.

Using its own expertise Sri Lanka should approach the Asian Development Bank, and the World Bank for the necessary long term capital loans for the develop-

ment of the energy sector. Part of the money ought to be re-loaned to companies that have majority Sri Lankan ownership to implement renewable and non-polluting power generation schemes that are consistent with the Kyoto Accord. Some of the money ought to be used to initially subsidize the price of power to control the cost of living with subsidization to be phased out over a long time. An ethical watchdog such as Transparency International could be invited to perform annual audits on the proper utilization of funds.

By making choices that are imaginative and progressive Sri Lanka can become exemplary as a developing country addressing its current power shortages and future demands.

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Coking coal firm clinches big supply contract

Venkatesh Coke and Power Ltd., the Indian firm that plans to build a metallurgical coal plant and a power station in Trincomalee, has clinched a long-term contract to export its output to a big German supplier of raw material to steel mills.

The company has set up a subsidiary called Venkatesh Industries Ceylon Ltd and intends to invest around \$220 million (Rs 21 billion) on a plant that will produce 750,000 metric tonnes of low ash sulphur Metallurgical Coke per annum and generate electricity for a 110MW power station.

The plant would convert coal to coke, a raw material that goes to make steel, which would be ex-

ported, said Duminda Jayatilake, a director of Venkatesh Industries Ceylon.

Coking coal is different from thermal coal used to produce electricity. It has a sulphur content much lower than that of thermal coal and is therefore more environmentally friendly, he said.

"Also, the fly ash content in thermal coal is very high. We'll be using low ash coking coal from Australia."

Venkatesh Industries Ceylon plans to import 1.2 million metric tonnes of coking coal a year and produce and export 750,000 metric tonnes of coke.

The company's export markets

are mainly India and South Africa.

"Our met coke (metallurgical coal) is being presold for the next 15 years," Jayatilake said. "We have a sale contract with RAG of Germany, one of the biggest buyers of metallurgical coke, which they will sell to steel mills."

The coal would be shipped in big bulk carriers to Trincomalee, one of the few ports with the draft of at least 13.5 metres required to handle big cargo ships.

The power plant to be built at Trincomalee by Venkatesh Industries will add 805 million kWh units of electricity to the national grid.

"This project is a reflection of more private sector initiative than

government contribution," Industries Minister Rohitha Bogollagama told a news conference recently.

The project is sponsored by Venkatesh Coke and Power Ltd of India and Angleton Ltd, of the Isle of Man, U.K. The Venkatesh Group is assisted by Thyssen Krupp and RAG from Germany and Belships from Norway.

The project has been given "Preliminary Clearance" by the authorities.

"This has also been given under conditions as it was needed to get the site cleared and to proceed with the basic needs to build it," said R.A.D.P. Samaranayake, Director of the Coast Conservation Au-

thority.

A spokesman for Venkatesh Industries told the Sunday Times FT: "This is an environmentally friendly project and it saves 8000 tonnes of carbon dioxide (CO₂) a year. So it does not need the Environmental Impact Assessment (EIA)."

The project will generate employment for over 3,000 people during the construction of the plant and nearly 300 once it is set up.

The project is expected to earn Rs 6.65 billion per year and nearly Rs 133 billion over the time span in which the project lasts.

The project could exceed the foreign investment for last year, which totalled just \$80 million.