

I have chosen this subject because the privatization of power, as an economic policy, is a reflection of a fundamental change in our political economy which will have a significant impact on the future of our economy.

2. In the 1990s, following the lead of the Reagan and Margaret Thatcher policies of encouraging privatization as an economic policy, it had a very significant impact on Malaysia's political economy (I have explained this in my speech on 16.2.12 at the Selangor Club which is distributed). It shifted the role of government as a guardian of public good which has been institutionalized in various public bodies like the Tenaga Nasional Berhad, to private corporations of selected companies. Prior to the privatization of power, there were some disturbing events, which shifted the focus of the people through the help of the media in understanding the economic realities and the needs of power for the purposes of the economic development of the country. I have in mind, particularly, the massive black-outs that preceded the privatization. There was extensive media coverage, followed by public concern, to the reasons for this extraordinary happening. Unfortunately, there has never been an inquiry to explain. Be that as it may, in the public mind, the privatization of TNB as a sole supplier of this essential public good was given a justification. There has been no public debate as to whether the privatization of the power needs of the nation is in the interest of the people and nation. However, the consequence of the privatization of power, particularly the surplus of capacity of 50% reflects a certain urgency in rethinking the wisdom of some of the policies with regard to privatization of power.

3. As a matter of fact, I think one needs to get the terminologies correct in understanding the significance of the privatization of power. I'm particularly referring to the term "independent power producers." The economic reality of the privatization is that the terminology does not explain enough because the reality is that they are private power producers rather than independent power producers. As private power producers our understanding of their role in the economy and the overall public policy becomes clearer. Therefore, I would prefer to use "private power producers" rather than "independent power producers" by way of explaining the shift from institutional private good to private power producers. I shall use both terms interchangeably.

a) There were 5 successful private power producers who benefited from the privatization policy. None of these private power producers had any previous experience in producing power. But what was common to all the successful investors was that they were well politically connected. All the 5 successful private power projects were gas fuel sourced from domestic natural gas

resources supplied by Petronas. The financing for the private power production was completely domestic with the EPF playing a key role in providing and acquiring of the bonds that were issued to finance the project. It is said that the 5 consortiums in the first wave of the investments were guaranteed a return of 20% but that their actual returns were even higher. The significance of this in relation to the overall economy and its effect on the disposable income of the people is yet to be quantified to understand the impact of privatization of power under the terms of the Agreements.

b) The Power Purchase Agreements signed between TNB and the private power producers (IPPs) are agreements which have been declared to be Official Secrets and as such are not available for public scrutiny to understand the implications it will have on the economy and the people in the short term and in the long term. There have been calls for transparency of these Power Purchase Agreements without success. There are many public policy ramifications in considering these Power Purchase Agreements as Official Secrets. But there are certain significant factors which we can consider. What is known is that the Agreements are of a long term nature on a "take or pay or fix charge" basis which is imposed on the TNB to pay regardless of whether the power generation capacity is utilized optimally. With regard to this first generation agreement it appears that the fuel cost risk will be borne entirely by TNB and the terms of Power Purchase Agreements strongly favour the private power producers. Its implications on the economy and the cost of living seem to be ignored. It is reported that the unit cost of electricity purchased from the private power producers is in some cases nearly double TNB's own generation cost. The Power Purchase Agreements seem to be influenced by political considerations that are shrouded by the Official Secrets Act. However, the government maintains a golden share in TNB. The significance of it is yet to be seen in terms of its influence in the overall strategy of our economy and the cost of living on the public.

4. One of the IPP projects was the Bakun Hydropower dam project, expected to generate 2400MWs and provide electricity supply to Peninsular Malaysia from Sarawak through undersea cables. The project was originally awarded in 1994 to a Sarawakian timber tycoon who did not have any prior experience in dam construction. Vast tracts of forest were already cleared of timber and natives were moved from their native customary homes when the Asian financial crisis struck causing the project to be shelved. Compensation reportedly in the region of a billion ringgit was paid to the concessionaire. The project has been subsequently revived incurring massive cost overruns. Today there is a lack of clarity as to whether the original goal of the dam to supply electricity to the Peninsula will be realized, and if so, at what cost, both financial and environmental. The Bakun dam was included in Transparency International's Monuments of Corruption Global Corruption Report 2005.

5. As TNB is required to purchase a pre-determined amount from the IPPs at fixed costs, when demand falls, as was the case during the 1998 economic crises, TNB faced overproduction and had to put a stop to its own power generating plant, resulting in both inefficiency and loss of profitability. Additionally, "a higher than necessary cost of power resulted in financial losses to the government controlled utility, higher prices to consumers, and arguably an inefficient allocation of society's resources". Against this however is the fact that "timely expensive power is a far superior outcome than blackouts that discourage FDI and domestic investment and stunt economic growth.

6. Whilst this is arguably true, the type of FDI that is attracted should also be considered. For example, with Bakun, the power is expected to be used in aluminium smelting plants. Apart from the numerous environmental concerns this poses, this arguably fails to fit into our plans of becoming developed by 2020, a high income nation with skilled workers. Aluminium smelting is considered a sunset industry in many developed countries.

PROPOSAL

7. In light of the increase in electricity tariff to the consumer (average 7%) resulting from gradual reduction of fuel subsidy amidst an increase in global fuel prices, and potential future tariff increases, it is to be studied:

- a) The impact on the economy especially in terms of the direct and indirect inflationary pressures this presents;
- b) The impact in terms of purchasing power to different segments of the Malaysian society;
- c) Is this the appropriate time to remove subsidies when the global economic pressures are already resulting in inflationary pressures in the country, or are there other concerns such as the

Privatisation of Power and Public Policy

Written by Tengku Razaleigh Hamzah
Wednesday, 17 October 2012 00:00 -

high electricity supply reserve margin or leakages due to corruption/patronage that should be addressed first to remove the shortfall in finances?

d) What would be an adequate reserve capacity? What are the costs/benefits of operating at the present considerably high reserve capacity and is it feasible to continue this in the future? Are there special circumstances in Malaysia that warrant this high reserve capacity which incurs both capital and operating costs?

e) How should the additional profits that Petronas makes with the subsidy removal be invested for the national interest?

f) Can this tariff increase be assuaged by the proposed Feed-in-Tariff for renewable energy and if so to what extent?

g) Do the circumstances of this increase present opportunities which the nation should seize, for example, to move towards cleaner electricity production and efficiency in electricity use as well as reduction in wasteful spending/consumption? Is enough being done to optimize this, and what are the expected positive outcomes? It is encouraging to see that Malaysia is one of the six ASEAN countries that have agreed that member countries should use peak demand management measures to cope with the up-trend in regional power consumption. Measures that have been employed in other countries include providing "subsidies to industries and businesses that use electricity during off-peak hours so as to reduce the government's massive financial burden of having to invest in power-reserve capacities". What are the measures that Malaysia is considering to manage peak electricity demand?

h) Is the tariff increase expected to contribute towards achieving Malaysia's aspiration of reducing carbon emissions intensity of GDP by up to 40% of 2005 levels by 2020 as announced by YAB Prime Minister in 2009? If so, what is its anticipated impact?

i) How would coal prices be affected by the rise in oil and gas prices? There appears to have been a "sympathetic" increase in coal prices already, should this trend continue, would the public be subjected to further tariff rises given the move towards coal making up a greater portion of the energy mix under the fuel diversification policies? Would this be in line with the country's carbon emission reduction aspiration?

8. In order to answer at least some if not all these questions comprehensively, a transparent analysis of what has occurred in the past in terms of the IPP agreements is required. Such an analysis is expected to show:

a) If there was an incremental cost to TNB as a result of the IPP agreements and if this was reasonable or excessive. If excessive, what proportion of this cost was passed on to the consumers? In other words, could the nation have enjoyed the same tariffs with gas subsidies being lower if TNB was not burdened with these excessive incremental costs?

b) If there was an incremental cost, was it justified? For example, was this an appropriate price to pay for power supply security and hence reasonable?

c) What was the analysis conducted to warrant the high reserve margin of about 40% and what analysis in terms of scenario planning and cost/benefit analysis was undertaken to justify this high reserve? In other words, was such a high reserve planned for, in which case what is its justification? Or, could better planning, have enabled TNB to lower operational costs and hence electricity tariffs? It is interesting to note that neighbouring countries like Thailand operate at reserves of around 22% which is already considered relatively high. In other words, how much savings would TNB have made without being encumbered with payments for this high reserve margin? Would it have made a difference if TNB was not obligated with contractual payments to IPPS, partly as a result of this high reserve capacity, or would the costs of potential electricity supply uncertainty outweighed any such savings?

d) What was the actual cost of encouraging consumers to use more electricity (to absorb the excess that TNB was obliged to pay for regardless of the reduction in demand) as was reported during the fall in demand during the Asian financial crisis? Subsidised gas would have been in a manner of speaking "wasted" to meet this artificial demand. A related issue is to examine to what extent this oversupply of electricity and TNB's payment obligations to the IPPs resulted in disincentives to promote electricity savings/efficiency even after the financial crisis ended, which in turn consumed more subsidized gas than necessary. Did this again give an inaccurate picture of electricity demand for the future which was then met by more capital costs being expended in building power plants?

e) To what extent did the IPPs, especially the first generation producers, benefit from the decision to allow IPPs into the business of power generation? What was the cost/benefit to the nation of operating on a closed private negotiations basis? Are accounts that despite being private sector players, the IPPs operations are not optimal and rely on the fuel price subsidy to mask their inefficiency justified?

f) What is the true cost/benefit of the Bakun dam project to the public? Who were the gainers, who were the losers, and what are the financial as well as other costs such as environmental, loss of native cultural rights, impact on ecological services? What are the benefits of this project?

g) Did we produce cheap energy for the right reasons? Have we formulated cohesive policies to ensure this? Were the benefits distributed equitably, particularly to benefit the lower income groups or did the rich receive a disproportionate size of the benefit? Did we attract "good quality" FDI which brought rise in local income, technology and raised quality of life across different 'income stratas or "bad quality" FDI which increased disparity in income, damaged the environment and quality of life and trapped us in the resource curse.

9. Taking an honest look at these issues will allow Malaysia to learn from the earlier experience in future undertakings and guide future decision making in managing and meeting electricity demand. Making the findings public will instill a much desired sense of confidence in the ability of the system to be accountable to the electorate. This is especially so at a time when managing energy/electricity security is required to not only be met in a cost efficient manner, but also to effectively meet the challenge of depleting resources and limiting carbon emissions to address global warming.

10. In meeting our future electricity demands, an open and transparent tender process for future IPP arrangements is imperative. This will allow for more competitive pricing of electricity while also meeting requirements for clean, secure and sustainable energy sources. Additionally, future arrangements with existing IPPs, especially those of the first generation should take into account the fact that they would have fully amortised their capital cost and already enjoyed considerably high profits. A relatively lower profit margin should therefore be negotiated with these IPPs in the interest of the nation, which could translate to unit cost savings for consumers.

CONCLUSION

11. Overall, Malaysia should take a holistic and integrated approach in planning for future electricity supply that includes not only security of supply at affordable costs, but also issues that affect development such as income distribution and sustainability as well as issues of growing concern such as environmental degradation and carbon emissions. In achieving a robust framework within which this can be done, we must learn from the successes and mistakes of the past. Transparency and openness are critical elements in enabling us to do so.

Speech In conjunction with Dato' Seri Utama Dr. Lim Chong Eu Lecture Series organized by Penang Club on Wednesday, 17.10.12 at 8.00 p.m.