Philippines power grid to be contracted out to private operator

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The Philippines government announced in July a new round of bidding to be held on December 12 for a 25-year concession contract to construct, finance, operate and maintain the facilities and assets of the National Transmission Corporation (TRANSCO)—the country's electricity transmission grid. President Gloria Arroyo, who has rammed through a series of so-called market reforms, is no doubt counting on the estimated $US4.6 billion contract to help ease the government's debt burden.

The decision to effectively privatise the corporation will have a negative impact on the poorest layers of the population, who will eventually pay higher prices for electricity, and on employees. The transfer of corporate functions will leave the winning bidder under no obligation to accept current workers or preserve existing jobs, salaries and security of tenure. The new managers will be able to "cherry-pick" among the more than 3,600 employees.

In turn, the government will be able to reorganise TRANSCO, declare redundancies that strip away civil service protection and terminate employees who have not transferred or been offered a contract. Inevitably, the ensuing scramble for available jobs will pit worker against worker in a race to cut wages and conditions and boost profits for the new operator.

TRANSCO employees are already among the most exploited in the country's energy industry. Salaries have been frozen since 2003, despite an annual inflation rate of around 6 percent. On average, according to a 2004 Mercer HR survey, TRANSCO base salaries are estimated to be 93 percent below the median market rates for the Philippines energy industry. Overtime pay is routinely denied, even for transmission linesmen, who at times work around-the-clock repairing toppled transmission lines and towers in this typhoon-prone country.

Benefits are meagre, amounting to just $US50 a month. Life and health insurance is grossly inadequate. Accident death insurance, for instance, is only $200 and health coverage averages just 30 percent of the actual cost. Not surprisingly, TRANSCO recently announced an operating surplus of more than $90 million just for the first quarter of 2007 and a net income of $320 million in 2005.

The forthcoming bidding is another step in the restructuring of the power industry that began soon after the fall of dictator Ferdinand Marcos in 1986 and has continued under successive governments. Its defenders claim that privatisation is necessary to overcome "inefficiencies", counter rising electricity costs and overcome the government's inability to finance further expansion. Projections are that the 7 percent annual growth in energy demand will require an additional 10,000 megawatt (MW) of installed capacity by year 2012.

However, the restructuring is, first and foremost, bound up with the pressure from investors and finance institutions, both local and international, to remove all barriers to maximising profits. At each step, measures have been introduced and implemented that guaranteed investors against possible losses, redistributed revenue streams from the public to the private sector, and stripped consumers and workers of any protection from capitalist rapaciousness.

Previously, the government-owned National Power Corporation (NPC) had a power generation and transmission monopoly. This ended in 1986 when President Corazon Aquino issued an executive order (E.O. 215), allowing private investors to build and operate electric power plants. According to the Philippines Center for Investigative Journalism, E.O. 215 was a particularly blatant concession to the Lopez family, a political ally and one of the richest in the Philippines, who own the largest power distribution corporation, Manila Electric Company or MERALCO. Aquino's decision allowed the Lopez family to branch off into power generation and become a direct competitor to the NPC.

The Lopez-owned First Gen Corp. is now the largest independent power producer in the Philippines, with announced profits of $72 million for the first half of 2007. Meanwhile, MERALCO itself, which lights up Metro Manila—the National Capital Region and surrounds, with a population of more than 20.5 million people—made a profit of $10 million for the first quarter of 2007. Last year, it boasted net earnings of $260 million.

While doling out concessions to political allies, the Aquino regime, despite warnings of increasing energy demand, starved the NPC of financial resources as it diverted public resources to pay off its debt to international finance institutions. By the end of Aquino's term, the Philippines was wracked by 8- to 12-hour brownouts, occurring virtually every day. Unserved energy needs reached an estimated 3,000 gigawatt (GW) hours with economic losses estimated by the World Bank to be between $600 million and $800 million or 1.5 percent of the GNP.

Granted emergency powers by Congress to address the power crisis, Aquino's successor as president, Fidel Ramos, wasted no time in allowing the private sector to cash in. Beginning in 1993, the Ramos regime directly negotiated 35 projects with various independent power producers (IPP). By 2001, NPC generating capacity accounted for just 59 percent of the country's total generating capacity of 11,685 MW. The IPPs contracted by NPC accounted for 31 percent or 3,667 MW. The IPPs contracted by distribution utilities such as MERALCO accounted for the rest.

The IPP contracts with the NPC are filled with onerous provisions: take-or-pay guarantees that oblige the government to pay for energy capacity, whether it is used or not; loans taken out by the IPPs to finance the power plant construction are backed by sovereign guarantees; fuel-cost guarantees require the government to buy the fuel for the IPPs operations; and, since IPP loans are raised internationally, a provision requires the government to pay for foreign exchange fluctuations. By December 2004, according to an Asian Development Bank report, the NPC's long-term IPP lease obligations stood at a massive $13.62 billion, while IPP fuel costs shouldered by the government averaged an estimated $620 million annually.

The next step was taken by the Arroyo regime in 2001. Amid charges of vote buying to secure support, Arroyo rammed the Electrical Power Industry Reform Act (EPIRA) through the Philippines Congress. The law, supplemented by other legislation, spun off NPC's transmission assets to form TRANSCO and stopped the NPC from building new generation plants or even purchasing power through bilateral contracts. As a result, the expected future growth of 10,000 MW in energy demand became the exclusive preserve of private companies. The legislation also passed on more than $4 billion of the NPC's debts to taxpayers and imposed a universal charge on all consumers or end-users, mainly to pay for the stranded costs and debts of the NPC and the electric cooperatives, estimated to total at least $2.3 billion. Moreover, the EPIRA also provided the legal framework for the sell-off of government assets and future termination of NPC and TRANSCO employees.

Once 70 percent of all government-owned power plants are sold, the EPIRA will usher in retail competition among generation companies and electrical energy suppliers or brokers for "a contestable market". Generation and supplier costs will then become unregulated. Subsidies and, after 10 years, even the so-called lifeline rate for small consumers using less than 50 kWh/month, will be removed. In the first year the contestable market will be comprised of all end-users with a monthly average peak demand of at least 1 MW. Each year, the contestable market will be expanded, by lowering the monthly average peak at which end users are included. Eventually even residential users will be part of this market.

Arroyo's legislation also established the Wholesale Energy Spot Market (WESM), through which generating companies, distribution utilities and energy suppliers can buy and sell electricity without necessarily negotiating bilateral contracts with each other. Like the electricity markets in Australia and New Zealand, the WESM is a gross real-time market, requiring all generation companies to bid in order to be dispatched or allowed by the system operator to supply electricity. A bid involves both the amount of power and its price.

Bidding will be conducted every hour. Generation companies with the lowest bid price for that hour will be dispatched first. The price of the electricity on that hour will then be set by the bid price of last generation company needed for that hour—in other words, by the generation company with the highest price for the electricity needed. This is called the market clearing price or the system marginal price. During normal operations, there will only be one system marginal price. But during abnormal operations, when, for example, parts of the grid are cut-off from the rest, different marginal prices will arise. Different generation companies will be able to set the marginal price at each cut-off part of the grid.

The actual price charged by the market to the distribution utilities or paid to the generation companies is then set through a system of nodal pricing. To the system marginal price, charges for network losses and transmission line congestions will be added. The calculation based on a number of factors is quite complex, but in essence it means the generation companies will receive high prices for electricity delivered, while all costs associated with transmission are passed onto consumers.

In the Luzon grid, where the WESM is already operational, the average monthly load weighted average price fluctuates violently. In June 2006, it fell as low as P2.7/kwr or $0.05/kwr. In May 2007, it reached as much as P7.3/kwr or $0.15/kwr. This is more than 164 percent higher than NPC rates. A previous high mark set on October 2006 at P6.8/kwr or $0.14/kwr drew accusations of price gouging and calls for an investigation. No investigation was conducted in the end because, as a 2002 World Bank report previously warned, the bid-based market was "too difficult to monitor for abuse of market power for all but the most advanced developing country". And, as the World Bank conceded, even California was "having well-publicised problems with this approach".

Essentially, the market is functioning as designed. After all, as the WESM Operator states, it was meant to "maximise the economic gains for trading participants." In other words, the purpose is to guarantee large profits, inevitably placing heavy burdens on working people.

The transmission costs that TRANSCO and the distribution utilities charge to the consumers are still subject to review and approval by an Energy Regulatory Commission. But the price determination methods have been changed from the Rate of Return Base (RORB), which previously allowed a 12 percent return and fair and reasonable costs. A new "forward-looking" method has been instituted that sets a Maximum Allowed Revenue for a regulatory period, based not only on the existing assets of TRANSCO and distribution utilities but also on projected capital expenditures, system losses and corporate and other taxes. Best of all for the banks and other financial institutes, it allows a return on capital that encompasses not only interest, but also a country-risk premium.

Early this year, the Energy Regulatory Commission raised TRANSCO's Maximum Allowed Revenue to more than $600 million annually for the next three years. This is more than 100 percent above the 2006 net income of TRANSCO.

The complexity of price determination and the restructuring of an integrated industry only underline the artificiality of the electric spot market being established. Electricity is not a simple commodity like toilet paper. Its production, distribution and finally, even its consumption, require stability, coordination and planning across the electrical system. The restructuring replaces this conscious human control with the unconscious processes of the market. Arroyo's legislation attempts to impose control on these market processes through legal sanctions and performance undertakings. But, as in the case of the privatised Metro Manila water concessions, performance undertakings can be delayed, revised and even ignored.

The May 2007 report of the WESM operator alludes to some of this profit-driven behaviour. It complains of generation companies not following the "must offer" policy because the load was below their minimum capacity. In other words, generation companies preferred not to run generators rather than supply energy to the system when profits could not be maximised. This behaviour can cause system instabilities, leading to electricity cut-offs and even blackouts. Nevertheless, instead of sanctions, the WESM operator recommends, in order to limit this behaviour, that the practice be "legalised" by allowing trading participants to officially cancel or withdraw their bid offers during a certain period.

The previous period of state-owned energy generation and transmission in the Philippines was no "golden age". State ownership was not a "socialist" measure. Individual private businesses lacked both the high capitalisation and technical skills necessary to take on the task of developing the electric energy industry. It was therefore handed over the government to establish and run on their behalf. The government drew from the surplus value extracted from the working class both locally, in the form of taxes, and internationally, in the form of foreign loans, to do so.

Over the past three decades, however, production has become globalised under the pressure of the falling rate of profit. Measures such as state ownership in any industry are now regarded as an intolerable barrier to international capital. Surplus value previously siphoned off to the public sector must be returned to the private sector. Revenue streams must be diverted back to private hands. Governments have to be downsized. Every publicly-owned asset, from water systems to ports, are to be sold. Every public service, from education to medical care, are to be handed over to the private sector. Everything must be subordinated to private profit.

The restructuring of the power industry is a part of this process. The end result of allowing the unfettered operation of the market will not be cheap, reliable power for working people, but rising levies, job losses, electricity cutoffs and, in all likelihood, brownouts and blackouts.

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