

Comments on ADB's Energy Strategy (version May 2007)

To: energystrategy@adb.org

From: Ms. Ana Maria R. Nemenzo
Freedom from Debt Coalition
Philippines

Date: 28 July 2007

Comments of the Freedom from Debt Coalition (FDC) on ADB's Draft Energy Strategy Paper & Consultation Process

Dear Mr. Um,

The Freedom from Debt Coalition (FDC), a multisectoral coalition in the Philippines advocating for reforms in the debt and fiscal, including privatization, policies of the government, submits its herewith comments on ADB's draft Energy Strategy Paper. The restructuring and privatization of the power industry has been one of the major campaign/advocacy areas of the Coalition since 1997 when the government then, with the prodding of ADB, was beginning to pursue the full privatization of the power sector.

Since 1998, even prior to ADB's approval of the US\$300-million Power Sector Restructuring Loan for the country, FDC has actively campaigned against the passage of then Omnibus Power Bill that would restructure and privatize the power industry. However, the Bank's program loan to the country gave a big push for the bill to move.

The restructuring/privatization process was undertaken within the framework of the ADB's 1995 Energy Policy, and later given impetus by the Bank's 2000 Energy Policy Review/strategy. The ADB's prescription for full recovery costs, reduction of subsidies, aggressive promotion of private sector involvement in the energy sector and the creation of an enabling environment for private investors, among others, was reflected in the Electric Power Industry Reform Act (EPIRA) and eventually in the operations of the restructured power industry.

The Coalition and its allies strongly opposed the measure because we felt that it was biased in favor of the private sector – the big corporate capital – and did not protect the interest of the public, especially the poor. Because of this, we anticipated that people would bear the greater cost and hardships of a restructured and privatized power sector based on EPIRA and the Bank's power sector restructuring program.

The Philippine experience has confirmed our worst fears. Despite the Philippines, being cited as one of the DMCs of ADB that is at the advance stage of power sector restructuring, high power rates – second highest in Asia and third highest residential and seventh highest industrial rates in the world –, and the National Power Corporation (NPC) and the government's ballooning power sector debts have become major problems in the country. The power sector restructuring

program of ADB has not addressed these so far. Unfortunately, neither does the Bank's energy strategy paper address these problems.

On the consultation process

First, the 60-day period is too short for a true and sincere consultation process to take place. It is not only the draft energy strategy paper that has to be reviewed in making comments, but other related documents as well such as the OED report. It took the bank more than a year to draft the consultation paper, yet it expects the civil society organizations to comment on it in just 60 days.

On the Draft Energy Strategy Paper

The draft strategy paper does not properly reflect the true state of the power sector in countries undergoing the Bank's prescribed reforms like in the Philippines. It presented the energy demand outlook, energy supply, climate change, the electricity access in Asia, and even investment outlook for ADB. But it does not have a section on the impacts of its power sector reforms in its DMCs. It is not only the pace nor the status of restructuring or privatization that has to be considered in determining the strategy that will be set in the next years. More important is to take into account the impact so far of its restructuring and privatization programs in the countries concerned. Even the OED report cited by ADB in the draft strategy paper is silent on this: "The energy sector reforms have enjoyed varying degrees of success. The key variable in each country has been the level of internal support for the reform program. One common lesson that emerges from power sector reforms is that they take many years, and in many case, far longer than originally expected. Progress is sometimes slow and there are setbacks." (p.11) What were the setbacks?

Further, the strategy paper refers to the recommendations of the Medium Term Strategy II (MTS II) pertaining to the energy sector as guide or direction in achieving the poverty reduction agenda. It only identified the need for strategic approach to address issues on the environment (climate change) and on sustainability of energy(p.13). Even in the preceding sections of the draft strategy on sectoral issues and options that have been allegedly analyzed by the Bank to provide a rationale for a more focused strategy to address climate change and assist DMCs in meeting their energy needs, the consultation paper failed to identify socioeconomic issues such as the impact of high power rates and ballooning government/power sector debts. The consultation paper appeared to consciously avoid mentioning such socioeconomic issues even when it touched the privatization in the Philippines, "Progress in the Philippines has been mixed – interest in privatization has been limited, the wholesale electricity spot market (WESM) competition started in mid-2006, and the transmission and distribution tariffs are being regulated. In addition, the risk of judicial review has diminished the regulator's effectiveness." (p.23) It does not mention that the WESM in the Philippines is faltering, resulting in increase in electricity tariffs due to price fixing, and competition was absent. Meanwhile, it treated judicial intervention as something negative in discussing regulation when it was through the legal courts that the public found protection from abusive practices of power utilities and incompetence of the regulators.

Worse, the strategy paper is crafted in such a way that the Bank continues to push for so-called reforms in the power sector but it does not hold itself responsible or accountable if its strategy fails: "Risks are numerous and hence such reform initiatives need careful assessment, political will, tariff rationalization, enabling legislation, improved corporate and financial management, and independent regulatory mechanisms, which are often difficult to ensure." (p.23) The paper also mentions that ADB has limited influence in the implementation of the strategy.

The paper contradicts itself. While it recognizes that privatization may not necessarily be an efficient option in some cases, "...Transformation from government run organizations to a completely private sector operation is a difficult transition and not necessarily the most efficient path."(p.23) and "Full privatization has had very limited success in the region. Stalled privatization... and strong resistance to privatization... indicate that the overall aim of privatization may no longer be relevant. Privatization may perhaps better be viewed as one of the possible means to attain a better level of governance,"(Appendix 5, p.77), other parts of the strategy paper show that the Bank continues to push for sector restructuring and privatization: "although progress has been slow due to delays in enabling legislation, insufficient consultations with stakeholders, apprehensions regarding tariff increase, and lack of time bound roadmaps, ADB will continue to assist DMCs in the restructuring and reform of the energy sector through technical assistance and project support. Private sector participation will be encouraged;" "regulatory regimes operate best if they are based on the understanding that competition, where feasible, is the best regulator of economic activity in the sector" (p.75) and "the ADB will continue to encourage DMCs to phase out gradually the subsidies to the power subsector, minimize the internal cross subsidies and adjust tariffs at regular intervals to cover the costs of supply and generate internal cash to meet a reasonable proportion of the system expansion costs."(p.76)

The strategy paper clearly affirms the power sector restructuring and reforms that the ADB has pushed in countries like the Philippines through its 1995 Energy Policy and 2000 Energy Strategy. It reiterates the need for the Bank's continued involvement in power sector reforms, i.e., to push for power sector restructuring and privatization of the power industries in the DMCs and further encourage participation of the private sector.

More borrowings by the government may be entailed in ADB's pursuit of instituting its "reforms" in the power sector of DMCs as it was explicit in the strategy that ADB will continue to provide technical assistance support to the regulators in operationalization of the regulatory authority including tariff and subsidy analysis. ADB will also extend assistance to DMCs that are establishing competitive electricity markets. Unfortunately, the direction of its tariff and subsidy analysis, as well as in establishing so-called competitive electricity market is showing to be beneficial to the power utilities, but not to the consumers as debts and other liabilities of state-owned utilities as well as of private distribution utilities are being passed on to the consumers.

There is nothing new or refreshing in the draft energy strategy paper of the ADB as it does not address the problems besetting the Philippine power sector today. Much less does it acknowledge ADB's contribution to the current mess caused by the reforms it has pushed in the Philippines. The following are so far the outcome of ADB's power sector "reforms" in the country:

1. More increases in electricity rates are being experienced under the restructuring and privatization program. From only about P5/kwh prior to the enactment of the Electric Power Industry Reform Act (EPIRA) which embodies ADB's power sector restructuring program, power rates in Metro Manila have more than doubled to about P10.50/kwh. The following are some of the major causes of high power rates:
 - the government increased the generation rates to attract more investors/private sector to participate in the privatization of government's generation assets.
 - EPIRA legitimized the payments to expensive and onerous independent power producers (IPPs) contracts not only of NPC but also of private distribution utilities like Meralco (the biggest distribution utility in the country) that have been grossly disadvantageous to electricity consumers. Because of these contracts

- an overcapacity has been very expensive for the consumers who pay for idle capacity.
- NPC's debt burden is passed on to consumers in the form of universal charge. Consumers, rich or poor, are compelled to pay this charge.

2. More debts have also been created, not only for the state-owned power corporation, but for the national government as well:

- Since the US\$300 million power sector restructuring loan the ADB extended to the Philippines in 1998, it has had to extend additional assistance (loans and TAs) of nearly \$500M. From 2001-2006, 99.6% of the ADB assistance to the Philippine energy sector has been in the area of power sector development. Not because the first loan was such a resounding success, but because this is the only way the ADB knows how to keep the flame of power sector restructuring alive in the Philippines. At this point, the ones with the biggest stake in defending the power sector reforms are the creditors themselves.
- after 6 years of implementation of the power sector reform program through EPIRA, the huge debts (which was one of the reasons for privatizing NPC) are still there, and it is ballooning. From only about P500 billion (both long term debts and lease obligations to the IPPs) in 1998, when the power sector reform program was approved, the debts and obligations have ballooned to about P1.4 trillion. The truth is, ADB has supported two of the early contracts entered by NPC by providing loan and/or equity that is why it is silent on the public's call for cancellation of onerous IPP contracts. One of these became the template for most of the contracts that followed.
- ADB itself is alarmed about the debt problem in the power sector. It has estimated the total financing requirement for the power sector to reach \$9.1 billion for the period 2006 - 2010. This so-called financing requirement will cover assumed loans from NPC and deficits or losses from the NPC contracts with the IPPs. To address this, more borrowings have to be incurred by the Philippine government, as well as more rates increases to be shouldered by the electricity consumers. Part of this \$9.1 billion will be sourced from ADB. \$450 million was already released by the Bank in December 2006 under the Power Sector Development Program Loan. Without this new loan and other loans, consumers will have to pay P2/kWh for the stranded contract costs rather than the original projection of the ADB of 40 centavos per kWh.

3. The promise of energy efficiency/reliability is not assured as well until now. Despite excess generation capacity the country continues to experience brownouts that are now becoming almost regular.

4. Its competitive electricity market model -- the wholesale electricity spot market -- is not proving to be working in the country as competition is not taking place at all. On the contrary, it has shown its weakness and how it is prone to further abuse by the private sector as this model is not fit in countries like the Philippines where the market is small.

The strategy paper stresses governance, but ADB's understanding of governance in relation to the power sector is warped and flawed as manifested in the Philippine experience during the controversial passage of EPIRA. Citizens and consumers were excluded from the legislative and policymaking processes that enacted the ADB power restructuring reforms. Two legislators

actually went to the ADB to share their firsthand experience with payola (payout) given to legislators in the House of Representatives to pass the Electricity Power Industry Reform Act. The ADB did not act on this disclosure. The ADB funded a \$750,000 consumer impact assessment of the power sector reforms, which the proponents in government then used to assure the public that electricity would be cheaper. But the ADB shared the results of this study much later, and only after the FDC made a lot of noise about its lack of transparency. It turns out the study assumed that electricity would be cheaper, that's why the impact assessment said most consumers would benefit. Even the understanding of ADB of independent regulation must be questioned. Because in the Philippines, it would seem that what the ADB and other creditors want is for the regulator to be "sensitive" to providing the "right" incentives to the private sector participants in the power sector, and not to protect the public interest.

Power sector reforms are not about providing access to all, or to reduce/lower GHG emissions. They are about pushing corporate power interests, the same interests that abused the market, captured the regulators, and have relied on coal because they don't have to bear the costs of CO2 emissions

Privatization, electricity competition model is not a "one-size-fits-all" model. Stress on competitive market is flawed. For the market to be competitive, it has to be well administered, requires good governance which the Philippines does not have. The competitive electricity market in the Philippines is not failure-proof as shown in the experience of WESM where price manipulation can happen. FDC studies have found out that the immediate factor of price manipulation is the oligopolistic environment in WESM. The market concentration to the Power Sector Assets and Liabilities (PSALM) traders and its high market share creates an oligopolistic situation for the collusion and cartel pricing by the four PSALM trading teams.

The new energy strategy does not make any room for participatory planning, empowerment of the communities/consumers, making legislators/utilities/etc accountable. It pushes the sector in the opposite direction because of the overwhelming bias for the industry/ corporate players. Neither sufficiently address the key challenges related to making the public sector more efficient and accountable

Rather than drafting a new energy strategy, the ADB must instead seriously review its Energy Policy. More remains to be done by the Bank in terms of its sincerity in reducing poverty in the region. It must review/assess the impacts such as debts created by the contracts with independent power producers. It must then stop supporting the onerous and harmful power contracts or projects. And it must desist from pursuing privatization of the power industry in countries like the Philippines. Further, the Bank must review and cancel debts in the energy/power sector that have not benefited, have caused damage to, and/or aggravated the sufferings of the public.

The views expressed in this paper are the views of the authors and do not necessarily reflect the views or policies of the Asian Development Bank (ADB), or its Board of Directors or the governments they represent. ADB makes no representation concerning and does not guarantee the source, originality, accuracy, completeness or reliability of any statement, information, data, finding, interpretation, advice, opinion, or view presented.