

## FOCUS/Viewpoints

■ I.P.L. Png and Lee Soo Ann

# A privatised PUB should not relinquish power distribution

OVER 200 years ago, Adam Smith taught that unfettered competition between profit-maximising firms would yield economic efficiency.

Competition in the marketplace rewards the seller who offers the product at the lowest cost and encourages his business to expand; at the same time, competition imposes losses on high-cost sellers and drives them out of business. By doing so, competition produces the goods and services most desired by consumers at the lowest cost to society.

Perhaps inspired by Adam Smith, a wave of "deregulation" and "privatisation" recently has swept countries ranging from Japan, Britain and the United States, to Malaysia, Mexico, and New Zealand.

In Britain, telecommunications and gas have been privatised, and the Thatcher government plans to privatise electricity and water service as well.

The Singapore Government is actively studying whether and how to privatise the public Utilities Board (PUB). The PUB has sole responsibility for generation and distribution of electric power in Singapore. Electricity is a vital service on which every household, office and factory depends. So we should understand carefully whether to de-regulate and privatise and how to do so.

Since Adam Smith's famous insight, economists have identified several situations in which market competition might be inefficient. One is where provision of the product involves large fixed costs as is true of electricity distribution.

Distribution of electricity requires an extensive network of cables from a central station to each user, whether household, office or factory. To have two competing distributors of electricity would mean two parallel networks of cables resulting in wasteful duplication. So, in this market,

competition between two or more competing producers would be economically wasteful.

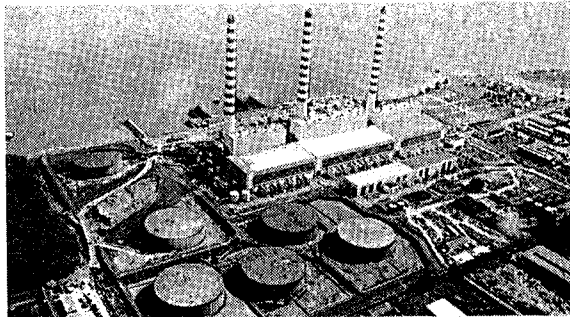
If, however, one firm were allowed free rein in the marketplace, it could exploit its monopoly position in a number of ways. For instance, it might set high prices so as to accumulate large profits, indulge in lavish investment on high-technology equipment, hire extra layers of managers or employ an unnecessarily large workforce. To safeguard public welfare, the appropriate government policy towards electricity distribution is to award a monopoly franchise to the PUB and to regulate the prices, investment and expenditures of the Board.

What should be the Government's policy towards generation of power? We believe that the market for electric power in Singapore has grown to such an extent that it can usefully absorb competition in power generation. If, however, the public is to realise the benefits of competition, it may be necessary to spin off and privatise the PUB's electricity generating segment.

It may even be socially beneficial to divide the privatised power generation business into several competing entities. Then the PUB would be given exclusive responsibility for electricity distribution and charged to procure electric power at the lowest cost from the competing generators.

If the PUB were allowed to generate electric power as well as distribute it, competition in the business of electric power generation might not be viable. One reason is that the generating segment of the PUB will enjoy special advantage over competing generators of electric power in access to operating and investment funds.

Like other statutory boards, the PUB at its inception was funded by the Government. It now has a substantial surplus



Senoko Power Station supplies much of the island's electricity needs

accumulated from ongoing operations. If the PUB is allowed both to generate and distribute power, it will be able to draw on this accumulated surplus and, in addition, draw from its distribution revenues to support the operating and investment costs of power generation.

In contrast, private enterprises must raise funds from the public either directly through share capital and loan stock or indirectly through fi-

electric power even if they are more economical. For example, an outside provider of power might offer a lower price for power but with different technical specifications. Owing to the technical nature of the business, it will not be easy for the supervising Ministry to distinguish legitimate engineering justifications against the outside source of power from spurious arguments. So outside providers will be at a disadvantage.

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financial institutions. Private enterprises must not only make profit, but they must yield a rate of return that is competitive with other forms of investment. As electric power generation is an extremely capital-intensive business, the PUB's special access to cheap funds gives it a critical advantage over private-sector competitors.

Another factor is that the PUB may discriminate against external sources of

Moreover, in the case of Singapore, two important and viable potential sources of competition in electric power generating are the national electricity boards in Indonesia and Malaysia.

Both Indonesia and Malaysia have ample and inexpensive supplies of oil and natural gas to fuel conventional generating stations. Both also have many isolated sites suitable for nuclear power generation.

Given these natural advan-

tages, it may well be economically efficient for Singapore to import electric power from Indonesia and Malaysia. For similar reasons, electric power is one of Canada's largest exports to the United States. If Singaporeans are to enjoy the benefits of such imports, it is necessary that the agent that buys electric power — the PUB — not discriminate between competing sources of power.

The Government should, of course, maintain a dedicated source of electric power for internal and external security, health, MRT and other essential government services. But this, too, should be obtained efficiently — the Government should invite the various competing generators of power to bid for the contract to supply this dedicated domestic supply of power.

Competition brings about economic efficiency only on a level playing field. If the PUB were allowed to generate power as well as distribute it, the two factors — special access to cheap funds and potential favouritism — would tilt the field of competition. Then the people of Singapore would not be guaranteed the electric power services most desired by consumers at the lowest cost.

By privatising the electric power generating segment of the PUB, the Government will subject the privatised generating enterprises to the same market constraints as private-sector competitors. Then the truly efficient will win the battle of marketplace competition and public welfare will be maximised.

*Dr I.P.L. Png is Assistant Professor at the John E. Anderson Graduate School of Management at the University of California, Los Angeles, and NUS Economics Professor Lee Soo Ann is currently at the University of British Columbia, Canada.*