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How China can resolve its power supply crisis

By [Ivan Png](#)

SHANGHAI is China's financial and business hub. Late last month, with daytime temperatures reaching 37 deg C, the city's electricity consumption surged to a weekly record of 14.35 million kilowatt-hours (kwh).

The city authorities resorted to asking 2,100 businesses to operate at night and 3,000 others to adjust operating hours.

Even high-profile multinational companies were not spared. General Motors and Volkswagen were ordered to suspend production for more than a week.

This episode mirrored a nationwide shortage of electric power. In Beijing, on July 22, the Municipal Power Supply Bureau imposed the capital's first brown-out of the year, disrupting supply to suburban areas for 47 minutes in the afternoon.

The Chinese government has certainly been working tirelessly to resolve the power crisis. Last month, Premier Wen Jiabao exhorted railway departments to 'do their utmost for the transport of coal for electricity generation'. In the first half of this year, Chinese railways shipped 480 million tonnes of coal, up 12.2 per cent over the same period last year. Ships have been diverted from overseas routes to domestic coal transport.

China is the world's second-biggest coal exporter. Last year, it exported 93 million tonnes of coal, including 80.8 million tonnes of thermal coal. This year, to assure supplies for electric power plants, the Chinese government limited coal exports to 80 million tonnes. China Coal Import and Export vice-president Zhou Dongzhou predicted that exports of thermal coal would fall to 70 million tonnes.

What more can be done? The government can fully liberalise the coal market and, specifically, cease regulating the price of thermal coal supplied to electric power plants.

Since the 1960s, the Chinese government has regulated the supply of thermal coal to power plants. It requires coal mines to supply power plants with about one quarter of their coal purchases at a contract price. Typically, that price is set below the spot market price. For instance, between last year and this year, while the spot market price of thermal coal rose by 25 per cent, the contract price rose by only 10 per cent.

As a result, many mines have ignored their power plant contracts and have sold coal on the spot market. Some power plants then cut back production, so exacerbating the national power shortage.

The government justifies its regulation of coal prices by its regulation of electricity prices. It regulates the latter to protect end-users. And to ensure the economic viability of electric power generation, it forces mines to sell coal cheaply to power plants.

This is clearly a case of 'two wrongs don't make a right'. Even if coal mines deliver at the contract price, power plants have an incentive to sell their cheap coal rather than burn it.

Some estimate that the nationwide power shortage will soon reach 30 million kilowatts, which is more than double Shanghai's peak consumption.

The solution obviously is to free both electricity and coal prices. Indeed, the National Development Reform Commission did increase electricity prices in June by an average of 2.2 fen (0.5 Singapore cents) per kwh in the eastern, northern, central and southern grids. But, apparently, this increase has not been sufficient.

There are two ways to resolve the electricity crisis: One is to increase supply, while the other is to curb demand. Higher prices can accomplish both. For instance, in 2001, when the western region of the United States experienced a power crisis, aluminium producers readily sold their electric power supplies to other, needier users.

The current power shortage is an economic problem. It was not caused by some unforeseen disaster. Therefore, it can be resolved by an economic solution. There is no need for Prime Minister Wen to exert himself pleading with the railways, shipping lines and power companies. The Chinese government should just sit back and let prices do the job.

The writer is Kwan Im Thong Hood Cho Temple professor and professor of business policy at the National University of Singapore.
