

Independent Power Producer (IPP) Debacle in Indonesia and the Philippines:

Path Dependence and Spillover Effects

By

Xun Wu¹ and Priyambudi Sulistiyanto²

Abstract

In the early 1990s power shortages in a number of Southeast Asian countries prompted governments in these countries to open up their power sector to private investors, resulting in a wave of independent power producer (IPP) projects. Much of the promised gains for IPP, however, remain elusive more than a decade after IPP model was introduced. The state-owned electricity companies' financial obligations to the IPPs have sky-rocketed after the Asian financial crisis and consumers have seen significantly increased electricity rates. More important, the policy options for restructuring the power sector have been severely constrained. Our paper analyzes the impacts of timing and sequence in which private power was introduced by focusing on the political economy of the IPPs in Indonesia and the Philippines. We find that what was considered as a quick fix to the power shortage problems in these two countries has several unintended consequences due to path dependence and spillover effects, and that the efficiency argument for private power may become irrelevant due to political patronage and corruption.

¹ Assistant Professor, Lee Kuan Yew School of Public Policy, National University of Singapore.

² Assistant Professor, Southeast Asian Studies Programme, National University of Singapore.

Introduction

After decades of state monopoly on electricity production, in the early 1990s private sector participation in electricity generation through Independent Power Producer (IPP) was perceived as an inevitable policy option to deal with severe power shortages in several Southeast Asian countries (Haggard and Noble, 2001; Dubash, 2002; World Bank, 2004). This initiative was encouraged and facilitated by development agencies that considered it as an imperative step towards liberalization and privatization of a vital sector. It was argued that IPP would not only relieve the governments from the financial burden of capacity expansion in power sector, but also lead to more competition, higher efficiency, and ultimately, lower electricity rate for consumers. The realization of these gains, however, requires proper regulatory environment.

Calls for the participation of private investors in electricity generation were met with great enthusiasm in Southeast Asia. Private investors, especially the utility companies from the US and Europe, acted quickly to take advantage of this opportunity, pouring in billions of dollars into electricity generation for Southeast Asian countries. By 1997, when the region was hit by the Asian financial crisis, twenty-seven IPP contracts in Indonesia had been signed between the state-owned electricity company PLN and private investors. In the Philippines, the agreements for 37 IPPs, accounting for 40% of the generation capacity of the country, had been reached. Other Southeast Asian countries such as Malaysia and Thailand also experienced similar growth in IPP during the period.

However, the boom was busted abruptly during the Asian financial crisis. All of a sudden, the state-owned electricity companies in these countries found themselves in deep financial troubles in honoring the IPP contracts, mostly with the take-or-pay clause under which they have to pay for the electricity no longer in need due to the contraction of the economy. To make things worse, the payment for many of these IPPs was denominated in US dollar while the revenues for the electricity companies were in local currencies, resulting in skyrocketing financial debts for the electricity companies due to the depreciation of local currencies. For example, the exchange rate for Rupiah went down from 2,450 to 10,000 for

a dollar, and the electricity rate would have to increase by 70% to reach its pre-crisis level. Electricity companies saw no option but to pass on the cost increases to consumers but the rate hikes couldn't have come at a worse time. The rate hikes prompted dramatic public reactions and stirred political turmoil in these countries.

The increased media attention brought about by the public outcry to the rate hikes led to the revelation of some dark sides of IPPs. Corruption and other irregularities were found widespread in IPP contracting process. For example, a recent review of the IPP contracts in the Philippines showed that half of them subject to irregularities in either financial or management aspects or both. In Indonesia, most of the 27 IPPs have local partners who are either relatives or close friends of the former president Suharto. Under enormous pressure from both the public and the electricity companies, the governments chose to renegotiate the terms in the power purchase agreements (PPAs) for IPPs, but reneging these contractual arrangements severely undermined governments' efforts in restoring the confidence of the foreign investors. In less than a decade, the initial enthusiasm about IPP was replaced by skepticism, distress, and agony.

While the IPP debacle in Southeast Asia has received a lot of attention both in the academic literature and the media, some critical aspects of the decisions over the timing and sequence of introducing private power are yet to be fully analyzed. Our paper aims at filling the gap. First of all, our analysis challenges a conventional wisdom that introducing private power was inevitable choice in Southeast Asia given the power shortages in the early 1990s. We argue that it was largely due to the political economy considerations through which IPPs attained their prominence. Second, we test the notion that IPP debacle in Southeast Asia was largely due to the unpredictable circumstances brought about by the Asian financial crisis. While Asian financial crisis was indeed the catalyst for the collapse of the IPPs, the roots of the vulnerability of IPPs were planted deeply in the weaknesses in governance in these countries. Third, while much of the attention has been focused on some short-term impacts of IPPs, such as excess capacity and rate hikes, the nature and magnitude of the long-term impacts have been largely neglected. These long-term effects might be

irreversible because of path dependence and lock-in, and the stigma emerged from the IPP debacle may be an obstacle for market-oriented reforms in other sectors.

By focusing on the political economy of IPPs in Indonesia and the Philippines, our paper seeks to contribute to a steadily growing literature on the timing and sequence of privatization in relation to other market-oriented reform measures. The experience in privatization in developing countries in the last two decades suggests that the timing and sequence are critical to the success of privatization (Ronald, 1994; Brown, 2002; Fink, Mattoo and Rathindran, 2002). In the context of the privatization in transition economies, Ronald (1994) argues that privatization without first establishing the effective institutional infrastructures may spoil the emerging private financial sector and prevent a gradual hardening of budget constraints. Brown (2002) attributes the success in infrastructure privatization in Argentina, Chile, New Zealand, and Spain to the fact that all these governments had decided and articulated, either before or concurrently with privatization, the policy objectives, market structures, and regulatory systems. Fink, Mattoo and Rathindran (2002) explicitly tested the hypothesis regarding sequence of privatization and the introduction of competition in telecommunication reforms in developing countries, and they found delays in the introduction of competition may adversely affect performance even after competition is eventually introduced.

While much of the literature focuses on the optimal sequence of reform measures from a normative perspective, our paper provides an explanation of why the governments are tempted to get the wrong sequence of reform measures in the context of IPP debacle in Indonesia and the Philippines. The paper is organized as follows. In the next section, we describe the power shortages in Indonesia and the Philippines and various policy options (or different sequences of policy measures) to solve the problem. In the third section, we focus on the political economy of IPPs and explain the prominence and fast penetration of the IPP in Indonesia and the Philippines. The fourth section analyzes the impacts of Asian financial crisis on the IPPs and some unintended consequences of the IPP debacle outside the power sector, and the fifth section focuses on the impacts of IPP debacle on the power sector restructuring. We conclude in the last section with some observations on the

importance of the decisions over the timing and sequence for reform policies as well on the political economy considerations of these decisions.

Power Crisis and Policy Options

Indonesia's economic growth in the early 1990s was quite impressive. Its average real GDP grew at about 7.6 percent per year from 1990 to 1995. The Philippine economy also grew at 2.3 percent per year after an economic slump for nearly a decade. Fast economic growth contributed to the increase in electricity demand by increasing the total amount of economic activities and by shifting towards more electricity-intensive industries (Henisz and Zelner, 2001)

The fast growing demand for electricity put tremendous pressure on electricity supply industry already in stress. Demand for electricity in Indonesia grew at about 11.8% over the decade to 1994/95, and according to PLN's forecast, the electricity demand could increase at 16.7% to 17.8% annually up to year 2005 (IEA, 1997). Power crisis was looming as PLN's total installed capacity fell short of meeting the total demand (*Far East Economic Review*, 1990). In comparison, the situation in the Philippines was far more severe. Brownouts often ranged from four to 10 hours in the country, and in 1992, the excess demand amounted to 48% of total system capacity (*Far East Economic Review*, 1993). Power shortage decreased industry output, reduced worker productivity, and undermined the governments' efforts to attract foreign direct investment.

Aside from the fast growing demand for electricity, the power shortage in Indonesia and the Philippines in the early 1990s stemmed from several fundamental structural issues in the power sector. First of all, the electricity had been provided by the state-owned electricity companies that were poorly run. Porter and McKinlay (1999) argue that many of the outages were not from inadequate capacity, but from breakdowns and poor maintenance, and there were no incentives for improving efficiency in management or maintenance. The system losses were 13.4% for PLN and 14% for NAPOCOR, considerably higher than other electricity companies in the region. Malhotra commented (2001) that, while the

installed capacity expanded sharply, the overall technical, institutional, and financial performance of these state-owned utilities had actually deteriorated.

Second, the electricity rates had been kept at low level in these countries, particularly in Indonesia, where electricity was subsidized heavily by the government and electricity rate could barely cover the marginal production costs. In Philippines, where the electricity rates were much higher than in Indonesia, the rates were still set at below the long-run marginal production costs. Low electricity rate dampened the incentives for reducing electricity consumption, and created a bias towards electricity-intensive industries. In addition, there was no mechanism by which to link the rates to increases in inflation, fuel costs, exchange-rate movements or other components of cost structure for supplying electricity, making it impossible to adjust the prices according to the imbalance between supply and demand.

Third, the responsibility of providing electricity at reasonable price was transferred from the governments to the state-owned electricity companies, but adequate resources were not given to these companies to fulfill their mandates. Governments were increasingly reluctant to use public sector funding or borrowing to finance the capacity expansion, leaving few options for the state-owned electricity companies to meet their obligations. The fact that the electricity price was set at below the long-run marginal costs created perverse incentives for the state-owned electricity companies to finance the capacity expansion.

While the looming power crisis and state-owned electricity companies' inability to adequately finance the capacity expansion certainly presented a compelling case for the private sector participation in electricity generation, other policy alternatives as well as timing and sequence of private sector participation should be examined. For example, raising electricity rate to the long-run marginal cost level (including the marginal cost of production and cost of expansion) may not only dampen the demand for electricity but also provide both the means and the incentives for the state-owned electricity to finance the expansion with their own resources. The removal of electricity price subsidies may increase interests in more efficient and careful use of electricity (Friedman, Meyers, Goldman, and Martin, 1993).

Other non-pricing demand-side-management (DSM) strategies can also be quite effective in reducing electricity demand. Such strategies might include the use of energy saving and efficient electric appliances, energy conservation awareness campaigns, and load management techniques. For example, a DSM program introduced by the Electricity Generating Authority of Thailand (EGAT) since 1993 reduced peak demand by 182 MW in 1998, and the average cost of savings from the DSM measures was US\$0.018/kWh, well below EGAT's long-term cost of US\$0.043/kWh to provide new electricity supply.

Even if the participation of private investors is both necessary and appropriate, the timing and sequence in which private investment is introduced is critical. Izaguirre (1998) points out that introducing private participation in generation without first—or at least simultaneously—undertaking deeper sectoral reforms is potentially problematic because it would reduce pressures to implement cost-covering retail tariffs. Newbery (2000) argues that the separation of the transmission from generation should precede the private participation in the generation because ownership stakes in generation is likely to favor its own generation over that of other owners. In addition, it is essential to establish credible and effective regulatory regime to protect the investors from opportunistic behavior of governments (Cook, 1999; Commander and Killick, 2000).

Wrong sequence in introducing the private power may be sub-optimal. For example, postponing tariff adjustments and delaying separation of transmission from generation reduce the creditworthiness of power purchasers, leading to demands from the private investors for long-term PPAs with take-or-pay clause and (or) government guarantee (Izaguirre, 1998). If the IPPs have confidence in the regulatory framework, they will not feel the need to sign long-term contracts; however, without such framework, the long-term PPAs become the only viable solution to bring private investors into electricity generation (Newbery, 2000; Crow, 2001).

However, the rationale for alternative policy options (or different sequence) may be overwhelmed by a set of political economy considerations that are predominant against the backdrop of the political reality in Indonesia and Philippines in the early 1990s. The

proposal to raise electricity rate to improve financial conditions of the state-owned electricity companies would deem to be a politically unpopular move because the electricity has been considered a strategic political resource for politicians in these two countries. Second, introducing competition by restructuring the sector would encounter several difficulties while there aren't apparent winners in the constituencies. The needs for privatizing and breaking-up the vertically-integrated electricity companies would almost certainly encounter fierce resistance from these companies. Third, the restructuring is highly complex, demanding expertise that was not readily available in these countries. Brown (2002) notices that efforts to establish regulatory and market institutions and the availability of the resources to undertake these efforts is rarely commensurate with the enormity of the work to be done. Last, the restructuring would take relative long period of time to complete, a luxury the decision-makers in these countries felt they wouldn't have given the urgency of power crisis. From their perspectives, prolonging power shortage could easily turn to thorn political issues that might be exploited by the oppositions.

Political Economy of IPPs

An apparent quick solution they found was in IPP. In 1990, the Philippine government passed the Republic Act 6957 which provided the legal framework for private sector participation in infrastructure development, and the Energy Crisis Act (Republic Act No. 7648) was promulgated to empower the executive branch to fast track the IPP projects in 1991 when the power crisis became full blown (Abrenica, 2002). Indonesia enacted Presidential Degree 37 in 1992 (Keppres 37/1992), which stipulated that private entities could be involved in power generation, transmission and distribution, opening the door to private power. It is no coincidence that the governments in the two countries not only both chose the IPP model to deal with power shortage, but also both decided to do so with negligible restructuring and reform (Newbery, 2000).

The prominence for IPP in both countries can be interpreted as the result of the convergence of interests among private investors, development agencies, and politicians.

The private investors, especially utilities from the US and Europe, were looking for investment opportunities because of the excess supply in the industrialized world. Malhotra (1997) argues that deregulation in the developed countries forced utilities to look for investment opportunities in developing countries. In the early 1990s, Southeast Asian countries such as Indonesia and the Philippines offered great prospects for investments because of the strong growth in electricity demand.

Development agencies embraced such a move wholeheartedly as they considered the IPP as a part of the overall efforts towards liberalization and privatization of the sector. It was well argued that the introduction of IPPs would end the monopoly of the state-owned electricity utilities, imposing pressure for them to increase efficiency level. The ideological arguments also got a boost from some early success of introducing IPPs in other developing countries. The World Bank and other development agencies encouraged the IPPs by conditioning their lending on the private sector participation in the state-controlled sectors, and some even played more active role by directly providing technical assistance.

The politicians also found IPP model appealing because of its seemingly low political risks. Although the state-owned electricity companies would have to give up monopoly in power generation under this arrangement, they would be better-off than under other alternatives aiming at more fundamental structural changes in the sector, and they felt they still have the upper hand as they would be the single buyers of the electricity from IPPs. The injection of capital from private sector would at least temporarily defer tough decisions such as price increase. In addition, mega millions dollars IPP contracts certainly would project positive images of key decision-makers internationally while voters are convinced of their determination and ability to end power shortages.

Along with the power crisis, the convergence of the interests among private investors, development agencies and politicians created a unique policy window for the fast rising of IPP. The power crisis legitimized the fast-tracking of the IPP proposal in the decision agenda, while the private sector backed up with financial resources and the development agencies supplied with the intellectual capital. Politicians rendered their supports

unconditionally as they saw this as an opportunity to reap in sizable political gains at minimal risks.

Such enthusiasm about the IPP, however, was at least partially fueled by misperception and unrealistic expectation. It was assumed that IPPs could relieve the governments from the budgetary burden for financing the power projects, but this is a misperception in the context of Indonesia and the Philippines. Under take-or-pay clause typically found in PPAs, the state-owned electricity companies have to buy a minimum quantity of the electricity under specified prices (mostly denominated in USD) even if the electricity is not needed. These PPAs had effectively committed the governments to billions of dollars worth of potential contractual obligations due to exposure to potential risks originating from economic slowdown or currency depreciation or both (as the case in the Asian financial crisis). In addition, the claim that introducing private power would drive down electricity rate because of increased competition couldn't be further from the truth. The IPPs are protected from any competition by the long-term PPAs, and at the same time they also pose no threat to other generators because they have no spare capacity to increase their market shares. Intentionally or incidentally, however, it was not communicated effectively to the public as well as the decision-makers about the misperception and unrealistic expectation over IPP, delaying a much needed public discourse on the true costs and benefits of private power.

Some peculiarities in the IPP contracting process further eroded the chance of success for IPP, and they reinforce the notion about the importance of appropriate timing and sequence of reform measures. First of all, while the competitive bidding could potentially reduce PPA prices by 25% (World Bank, 2003), most of PPAs in Indonesia and the Philippines were concluded by exclusive bilateral negotiations instead of competitive bidding. Second, many IPP deals were initiated from unsolicited bid which might not reflect the needs and preference of the planning agencies for the power sector. The state-owned electricity companies were often forced to respond to these unsolicited in the very short period of time. Third, related to the first two peculiarities, the outcomes of negotiations of PPAs were often not made available to the public, effectively shielding them from public scrutiny (Cowell, 2004).

The reliance on exclusive bilateral negotiation, acceptance of unsolicited bid, and lack of transparency opened the doors for privileged deals and corruptions (Bosshard, 2002). In Philippine, an official investigation of 35 IPPs reported that many were developed through cronyism. For example, several projects are developed by relatives or close friends of then President Fidel Ramos. The most illustrative cases of cronyism in IPPs came from Indonesia, where 26 of the total 27 IPPs were concluded without competitive bidding. Not surprisingly, the majority of IPPs were connected to the Suharto's relatives or close associates. The Asian Wall Street Journal commented on July 28, 1999. "*You simply hooked up with a Suharto relative or friend, and in a typical arrangement, offered to 'lend' them 15 percent equity, repayable only when the electricity started to flow.*" The electricity rate concluded in these IPPs ranged from 5.75 to 8 cents per kWh, significantly higher than the long run average costs at the generation plants owned by PLN.

The political patronage and cronyism not only explain why the IPPs were overly expensive, but also account for why the expansion excessive. The development in IPP took on a life of its own as some politically connected groups teamed with the private investors to loot the governments through lucrative IPP deals. The expansion of the private power soon surpassed what's needed to balance off the demand and supply. In Indonesia, PLN was forced to sign contracts with more IPPs with instructions directly from then President Suharto even after PLN had clearly communicated to the government that the electricity from these proposed IPPs would not be needed. As bluntly put by Djiteng Marsudi, the former director of PLN, "*the power companies dictated terms to us because they had Indonesian's first family behind them. Resisting them was like suicide.*" In Philippines, additional 12 IPPs were signed after warnings from within the government and World Bank that an impending oversupply of electricity could push up prices (*Philippine Center for Investigative Journalism, 2002*).

By 1997, when the region was hit by the Asian financial crisis, twenty-seven IPP contracts in Indonesia had already been signed between the state-owned electricity company PLN and private investors. In the Philippines, the agreements for 37 IPPs, representing 40% of the generation capacity of the country, had been reached. The IPP frenzy in Indonesian and

the Philippines placed the power sector in these countries into a path heading to a dangerous zone.

Asian Financial Crisis, Renegotiation and Spillover Effects

The IPP frenzy in Indonesia and the Philippines was grounded to a halt by the Asian financial crisis in the middle of 1997. The crisis had several impacts on IPPs. First of all, the contraction of these economies led to reduced power demand and much of the planned capacity expansion was no longer in need in the short-run. Second, under the take-or-pay clause the state-owned electricity companies had to pay for electricity produced by IPPs that are no longer needed. Third, because the payment for most IPPs was denominated in USD, the depreciation of the local currencies during the financial crisis led to dramatic increase of state-owned electricity companies' financial obligations to IPPs. Over the first six months in 1998, PLN's net loss accumulated to US \$1.4 billion.

Contrary to a miscalculation by the politicians that the IPP model carries minimum political risks, the busted IPPs soon turned into political crisis in these countries. Unable to meet their financial obligations to the IPPs, the state-owned electricity companies were left with no choice but to raise electricity rate at a worst possible time, because the consumers were hit hard in multiple fronts during the financial crisis. PLN raised the electricity tariff by 30% in 1998, and power bills in the Philippines doubled to become the second highest in the Asia (Cowell, 2004). The rate hikes caused dramatic public reactions and stirred social unrest in both countries. By this time, some irregularities in the IPP contracting process were also coming into light, further intensifying the public resentment.

Civil society groups wasted no time calling for the cancellation of the IPP contracts and renegotiation of the terms for the IPPs that are in operation given the irregularities in the contacting process for many of these IPPs. Indonesian government responded quickly to either postpone or put on hold many IPPs, and PLN announced its intention to renegotiate all IPP contracts. In February 1998, PLN issued letters to three IPPs unilaterally setting an

exchange rate of 2,450 rupiah per dollar for its payment when the rupiah was trading at about 8450. The new government insisted that the project be renegotiated or canceled because of alleged stakeholder misdeeds before it came into power. The investors were shocked by government's decision and were left with no choice but to renegotiate with the government. By March 2003, PLN had reached agreements for 14 IPPs and renegotiated tariffs were mostly in the range of USD 0.042-0.0493, significantly lower than the USD 0.0575-0.08 specified in the original contracts.

Philippine's initial response to the crisis were more restrained although the impacts of the crisis to NAPORCOR were just as severe as to PLN. By 1999, the losses to NAPOCOR to honor minimum off-take agreements specified in the IPP contracts had grown roughly US \$10 million per week. However, the government went through great length trying to honor its contractual agreements to various IPPs, including shutting down the operation of NAPOCOR owned generation facilities that can produce electricity at much lower cost than the IPPs. Under the pressure from the public and the congress, however, the government took a somewhat harder line after 2000, and announced that it would allow IPPs to expand their existing facilities and guarantee their participation in a planned power pool only if they agreed to renegotiate existing PPAs. NAPOCOR tried to reduce the take-or-pay ratio from 70-75 percent of capacity to 55 percent.

Although the renegotiations of private funded infrastructure projects are not uncommon in developing countries, such efforts may incur significant costs. In the case of Indonesia and Philippines, the renegotiation of the IPPs had some unintended consequences that spilled over to beyond the power sector. First of all, the renegotiation of IPPs severely undermined the governments' efforts to boost foreign direct investments at the time when such investments were desperately needed. Foreign investors grew increasingly skeptical about these governments' commitment to protect the investors' interests, and it is no coincidence that both Indonesia and the Philippines experienced slowest recovery from the Asian financial crisis among the Southeast Asian countries. In addition, the overall costs of the financing infrastructure projects become much higher because of investors' concerns over the opportunistic behavior by the government. Both Indonesia and the Philippines have the

need for massive capital outlay for infrastructure projects, but investors demand hefty rate of return to compensate the potential risks of renegotiation as seen in the broken IPP deals. Last, the renegotiation has slowed down the development of market for alternative financing mechanism. Project bond market, for example, had been gaining currency prior to Asian financial crisis, and many new projects were seeking to access this credit market as a means to achieve financing. However, the renegotiation in IPPs prompted credit risk rating agencies to lower the grades of new issues, effectively turning off the bond market as a means to access US and European investors.

The IPP debacle also had other spillover effects beyond the financial aspects. The irregularities found in the IPP contracting process have fed into the popular movement against privatization in other sectors such as health care and telecommunication. The civil society groups against privatization have successfully directed the public outcry towards the electricity rate hikes to privatization in general. They depicted corruption as an unavoidable consequence of privatization. Proponents for privatization face bigger hurdle to mobilize supports after the IPP debacle.

Power Sector Restructuring and IPPs

Although the exact form of power sector restructuring differs from one country to another country, it typically involves four components: 1) the breaking-up of the state-owned electricity monopoly into several independent entities such as transmission, generation and distribution; 2) privatization the state-owned assets; 3) establishment of competitive power markets through market pools or retail competition; 4) creation of an independent regulator (Newbery 1999; Parker, 2003). Because of its potential impacts on employment and financial management, the power sector restructuring has often encountered heavy resistance from the state-owned electricity companies, especially the work unions.

The Asian financial crisis placed the state-owned electricity companies in Indonesia and the Philippines in a weakened position in resisting power sector restructuring. In addition, the

excess supply induced by the crisis created a more favorable condition for market-oriented reform initiatives. Last, the conditioning of the financial packages for rescuing these economies on the restructuring of the sectors also gave a big boost for the power sector restructuring. Some development agencies have provided technical assistance through power sector restructuring loans to these countries. The initial progress led to a sense of optimism about the future of power sector reform, and it was expected that the wholesale electricity pool be established by 2000 in Philippines and 2003 by Indonesia.

However, a close examination of the progress in power sector restructuring in Indonesia and the Philippines up to date indicates that the IPP debacle has created several obstacles to the restructuring. First of all, it is difficult to integrate the IPPs into competitive market framework. The existing IPPs are incompatible with the establishment of the competitive markets because IPPs don't have incentive to participate in the markets as they are protected by the PPAs, and this effect is especially pronounced in countries like Indonesia and the Philippines where the IPP plants account for a significant proportion of the overall installed capacity. Second, ironically as it may sound, the short-run excess capacity resulting from the IPP contracts actually bought some time for the state-owned electricity companies because the urgency under power shortage are removed. The rate hikes necessary to cover the high costs of IPPs also strengthened the financial position of the state-owned electricity companies and they become increasingly assertive after recovering from the initial shock of the crisis. Third, the privatization of the state-assets becomes more difficult in the aftermath of the IPP debacle because the long-term PPAs with IPPs makes the state-owned electricity companies less attractive for private investors who are contemplating acquiring stakes in these companies. Fourth, the forced renegotiation reinforced private investors' concerns over the political risk in investing in power sector in these countries, and they will seek more assurance from governments and charge a higher premium for capital if they are to be lured back to the power sector in these countries. Last, the failures in IPPs spoil the willingness of the public to make sacrifices to genuine power sector reform (Cowell, 2004), and the opponents of the power sector reform can exploit the resentment created throughout the IPP debacle to their advantages.

The stagnation of the power sector reform in the power sector reform in recent years confirms these points. Eight years after the crisis, not only is there no sight of the wholesale electricity pool as planned, the electricity sector reform in Indonesia was effectively terminated in December 2004, when the constitutional court of the country ruled that the Electricity Act is unconstitutional. The opponents of the reforms have won a crucial battle and the IPP debacle has contributed its fair share to their success. In the Philippines, while the reform is still on track according to the Electricity Sector Restructuring Law, the reformers have encountered immense difficulties to privatize the state-owned assets because of lack of interests from the private investors. The ill-timed IPPs in the early 1990s and subsequent failures have significantly diminished the chances of success in power sector restructuring, and the policy options have been severely constrained compared to the situation a decade ago.

Concluding Remarks

More than a decade after the private power was introduced in Indonesia and Philippines to solve the power shortage problems, the governments of these countries find themselves facing the same situation as it was a decade ago. The economy of these countries has performed very well over the last couple of years, and demand for electricity has grown steadily. Excess capacity, a short-run consequence from the IPP debacle, will soon be remembered as a problem of the past, and power shortages are once again in the horizon. IPP model seems to make a quite return to reclaim their prominence in the power sector, but the reformers for power sector restructuring so far have failed to take advantage of the favorable opportunity created by Asian financial crisis, and the progress in reform has been stalled after the initial optimism. The IPPs signed in the 1990s created formidable obstacles to establishing competitive market, and private investors become more skeptical about governments' commitment to protect the interests of investors after the forced negotiation of IPP contracts. More important, the public support for genuine power sector reform has also eroded as they continue to suffer from ill-planned and corruption-ridden IPP deals.

What was considered as a quick fix to the power shortage problems in early 1990s has had several unintended consequences. The fact that the decision-maker had chose to introduce private power without first creating an enabling environment has locked power sector in a path in which contractual power becomes predominant model for future expansion despite of its many shortcomings. The IPP debacle as experienced in the two Southeast Asian countries also has impacts beyond the power sector. It contributed to the difficulties in attracting foreign investment, confined these countries to more expansive financing mechanism, and fed into the popular movement against privatization in various sectors. Policy-makers should pay close attention to these unintended consequences when deciding on the right timing and sequence for future reform initiatives.

The IPP debacle also implies that any economic gains promised by market-oriented reforms such as IPP could dissipate quickly in an environment where political patronage and corruption are pervasive. Proponents of reform should be mindful about the possibility that their ideologies could be exploited to legitimize rent-seeking schemes ventured by coalitions between politically connected interests and private capital. On the other hand, however, civil society groups should exercise greater care differentiating this possibility from genuine reform efforts that can eventual improve the welfare of the public. The power of these groups can be captured and misused by special interest groups to protect their own gains.

Reference

Bacon, Robert, and John Besant-Jones. 2001. "Global Electric Power Reform: Privatization And Liberalization Of The Electric Power Industry In Developing Countries." *Annual Review Of Energy And Environment* 26:331-359.

Bosshard, Peter. 2002. Private Gain – Public Risk? The International Experience with Power Purchase Agreements of Private Power Projects, *International Rivers Network*, 20 November 2002.

Brown, Ashley C. 2002. "Confusing Means and Ends: Framework Of Restructuring, Not Privatization, Matters Most," *International Journal Of Regulation And Governance*. January. Vol. 1. No. 2. Pp 115-128.

Commander, S. and Killick, T. (2000) 'Privatisation in Developing Countries: A Survey of the Issues', in (eds.) P. Cook and C. Kirkpatrick, *International Library of Comparative Public Policy*, 13 (1), pp.120-53.

Cook, P. (1999) 'Privatization and Utility Regulation in Developing Countries: the Lessons So Far', *Annals of Public and Cooperative Economics*, 70(4), pp.549-87.

Cowell, Ophelia, 2004. *All Hands on Deck: Why Power Sector Reform Is Everybody's Business*, Unpublished manuscript.

Crow, Robert Thomas. 2001. *Foreign Direct Investment in New Electricity Generating Capacity In Developing Asia: Stakeholders, Risks, and The Search For A New Paradigm*, unpublished manuscript.

Far Eastern Economic Revie. Nov 8, 1990. *Power Struggle: Indonesia's Electricity Monopoly Is Strained By Demand*

Fink, Carsten, Aaditya Mattoo, and Randeep Rathindran. 2002. An Assessment Of Telecommunications Reform In Developing Countries, *Policy Research Working Paper 2909*, World Bank.

Friedman, Rafael, Steve Meyers, Nina Goldman, Nathan Martin, 1993. Prospects For The Power Sector In Nine Developing Countries. *Energy Policy*.

- Henisz, Witold J. And Bennet A. Zelner. 2001. The Political Economy of Private Electricity Provision in Southeast Asia, unpublished manuscript.
- Izaguirre, Ada Karina. 1998. "Private Participation In The Electricity Sector—Recent Trends." *Viewpoint Note* No. 154. Washington, D.C.: World Bank.
- Izaguirre, Ada Karina. (2000) 'Private Participation In Energy', *Viewpoint Note* No. 208, Private Participation In Infrastructure Group, World Bank: Washington, D.C.
- Malhotra, Anilk, 1997. Private Participation In Infrastructure: Lessons from Asia's Power Sector. *Finance & Development*, December 1997.
- Newbery, David. 1995. "A Template For Power Reform." *Viewpoint Note* No. 54. Washington, D.C.: World Bank.
- Newbery, David. 2000. *Issues and Options For Restructuring Electricity Supply Industries*. Unpublished manuscript.
- Porter, Michael And Calum Mckinlay, Private Sector Participation and Infrastructure Investment in Asia: The Impact Of The Currency Crisis, consulting report.
- Roland, Gerard. 1994. On The Speed And Sequencing Of Privatisation And Restructuring, *The Economic Journal*, 104, Pp. 1158-1168.