

Meralco's pricing: an assessment



I. Introduction Meralco is a natural monopoly. Natural monopoly exists when a firm is able to supply the total market demand more efficiently because of economies of scale that allow the firm to lower its cost as it expands capacity. However, like any firm in a market situation where there is imperfect competition or in a less-than-competitive market, a natural-monopoly firm, when left to its own, tends to limit its output to a point where its marginal cost equals its marginal revenue but charge a much higher price than what would have prevailed when there is a highly-competitive market.

In a highly-competitive market, the output tends to settle at a point where marginal cost equals marginal revenue, which also equals its price and where the unit cost of production is the lowest possible because of competition. When the price is greater than unit cost and profits are high, more firms will come to compete in the market and drive down the price back to where it is just equal to unit cost. When the price is below unit cost, the resulting losses will drive out some of the firm from the market, thus raising the price back again to where it is just equal to the unit cost of producing the product concerned.

Because a natural monopoly, like any firm in an imperfect market, charges a price way above the equality of marginal cost and marginal revenue, it also produces at a certain level of output that is less than what would have prevailed when the market is highly competitive. These twin evils (higher price than necessary and lower output than possible), which arise from the presence of a monopoly, make for a very strong case for government intervention. In line with this, the researchers ought to know if Meralco has

really an absolute control over the output produced and therefore charge the highest price to increase their profit.

They also want to know the basis of pricing per kilowatt hour (kWh) and how do they implemented this to their consumer.

II. Methodology

The descriptive research method was used in this research, as it points out conditions and relationships that exist or do not exist. Furthermore, this method emphasizes more on descriptions rather than on judgments or interpretations. Descriptive research is thus a type of research that is primarily concerned with describing the nature or conditions and degree in detail of the present situation. (Landman, 1998: 59)

Descriptive data for research are collected by using different methods. It may be presented qualitatively or in verbal forms or symbols, or quantitatively in mathematical symbols, depending upon the nature of the material and the purposes for which one is doing research.

III. Respondents of the study

The respondents of this study consisted of Meralco consumers and some people from the Department of Energy (DOE). The above-mentioned respondents qualified to the most needed criteria of the researchers, who were currently situated at the survey site.

IV.

Discussion

A. Overview of Monopoly

A. 1 Definition of monopoly

Pure monopoly exists when a single firm is the sole producer of a product for which there are no close substitutes.

A. 2 Characteristics of Monopoly

Here are the main characteristics of pure monopoly:

- Single seller. A pure, or absolute, monopoly is an industry in which a single firm is the sole producer of a specific good or the sole supplier of a service; the firm and the industry

are synonymous. b. No close substitutes. A pure monopoly's product is unique in that there are no close substitutes.

The consumer who chooses not to buy the monopolized product must do without it. c. Price maker. The pure monopolist controls the total quantity supplied and thus has considerable control over price; it is a price maker (unlike a pure competitor, which has no such control and therefore is a price taker). The pure monopolist confronts the usual downward-sloping product demand curve. It can change its product price by changing the quantity of the product it produces. The monopolist will use this power whenever it is advantageous to do so. d. Blocked entry.

A pure monopolist has no immediate competitors because certain barriers keep potential competitors from entering the industry. Those barriers may be economic, technological, legal, or of some other type. But entry is totally blocked in pure monopoly. e. Nonprice competition. The product produced by a pure monopolist may be either standardized (as with natural gas and electricity) or differentiated (as with Windows or Frisbees). Monopolists that have standardized products engage mainly in public relations advertising, whereas those with differentiated products sometimes advertise their products' attributes.

B. Meralco and Pricing The Manila Electric Company, also known as MERALCO, is the Philippines' largest distributor of electrical power. The word MERALCO, is an acronym for Manila Electric Railroad And Light Company, which was the company's original name from 1903 to 1919. MERALCO is the Metro Manila's only electric power distributor and holds the power distribution franchise for

some 22 cities and 89 municipalities, including the whole of Metro Manila and Mega Manila region. B. 1 Retail price composition

IEC confirmed that the main component or 65 percent of the average of Meralco's retail pricing is the generation charge. Charges by independent power producers comprised 44 percent, National Power Corp. 's transmission billing was 35 percent, spot market pricing was 13 percent, and the ancillary service charge was 8 percent. The table below shows the composition of the total of retail price charged to consumers: IEC also estimated that the embedded fuel costs comprised approximately 50 percent of the total generation charge, while the transmission charge comprised 9 percent of the average tariff.

VAT and other taxes and statutory charges comprised 10 percent. Lastly, the distribution charge, which is the only part of electricity billing that goes to Meralco, comprised 16 percent of the average tariff. All other charges were thus collected by Meralco on behalf of third parties. B. 2 Price as Compared to other Countries IEC conducted a detailed survey and analysis of retail electricity tariffs and costs in 13 countries and two U. S. states, as well as a supplementary, less comprehensive " meta-analysis " of 27 countries in the Euro area and the 50 remaining U. S. states.

The 15 core markets in the survey included Malaysia, Thailand, Indonesia, South Korea, Taiwan, Japan (Kansai), Hong Kong, Singapore, Australia (WA), Sri Lanka, NZ, California (PG; E), Hawaii, Canada (Ontario) and South Africa. For each of the core markets, retail tariffs were calculated for residential, commercial and industrial customers. IEC enumerated seven factors behind Meralco's pricing as compared to other countries: subsidies, high intrinsic

cost of supply, import-parity fuel, grid size/plant mix, higher financing cost, geographical challenges and cross-subsidy in transmission rates.

Surprisingly, a number of countries in the study like Korea and Taiwan have electricity prices that are lower than Meralco's because of government policies that provide subsidies of up to 50 percent. The subsidies come in the varied form of frozen tariffs, sale of fuel to utilities at below market rates, and utility losses shouldered by the government. IEC noted that Meralco's estimated cost of supply was in the top quintile (9th highest and 19 percent above the average) among the 44 markets surveyed.

The cost of producing and delivering electricity in Luzon (and in the Philippines, more generally), it seems, was intrinsically high largely because of the high price of imported fossil fuel. Interestingly, IEC also pointed to the relatively small grid size, geographic challenges of transmission and higher cost of financing costs as reasons for high intrinsic cost of electricity that Meralco sells. In fact, IEC noted that eight of the 10 highest cost markets in the survey are island nation/states, and this factor may be a fundamental cost multiplier.

Because 80 percent of power generation in Luzon was fuelled with imported fuels, electricity prices are expected to remain high. This is the reality of a country that is dependent on imported fuels. Also, the Luzon grid size is smaller and therefore had a high dependence on hydro which requires a higher reserve margin requirement. The weighted average cost of capital in the Philippine power sector is higher than most countries in the region. Debt cost is relatively high and loan tenors are shorter. Transmission costs are also inherently high as power has to be transmitted across several islands.

Lastly, the higher cost of transmission to consumers in the Visayas is subsidized by consumers in the Luzon grid. A study conducted by the company and commissioned by Meralco found that at the beginning of 2012 the Philippines had the 2nd highest electricity rates in the region and the 9th highest out of 44 international markets. In the study, which was standardized for type of customer, time period, currency price and resource rates, he came to a number of conclusions about why consumer electricity rates in the Philippines are relatively high for the region and internationally.

Several of the issues don't seem to have a near term solution in sight. 1. The government doesn't subsidize energy. The main reason prices are likely to stay high is the Philippines can't afford to subsidize its electricity as other countries in the region do, 3/4 of the reason energy costs are high is because the government doesn't apply subsidies to keep tariffs artificially low. Several neighboring countries -- Thailand, Indonesia, Malaysia, Korea and Taiwan -- all have lower tariffs because of government subsidies.

He said up to and sometimes over 50% of costs in these countries are subsidized since government policies freeze tariffs, sell fuel at below market rates and make government shoulder business losses. 2. It's expensive to produce energy in the Philippines. Philippine power generation relies largely on imported fuel pegged to high international fuel prices, The country is making efforts to explore more of its own natural gas resources, but finding deposits and setting up production facilities will take years. In the meantime, the country is reliant on high cost international fuel. 3. Challenging geography.

Because the Philippines is made up of thousands of islands, it does not have a unified electricity grid and there are several providers. "In principle," said Morris, "the bigger the grid the cheaper the cost" which can be spread out among more customers. However he thought that creating a unified grid in the Philippines would be problematic given the terrain. He noted that transmission costs are more expensive because power has to be sent across several islands. IEC found that 8 of the 10 highest cost markets in the survey were island nations or states, which could be a "fundamental cost multiplier. He said, "It is expensive to make electricity, transmit it and distribute it in this country... I can't see that problem changing in the next 20 years." 4. Ineffective plants. He pointed out that when some plants don't work well, it is necessary to have a reserve plant, which means additional costs. "The higher your reserve margin the higher the total cost of supply," he said. He added that the reserve margin of the Philippines was probably around 20% but should actually be between 33% to 35% since the country has had brownouts in the last year, which he said "means you don't have enough capacity to meet reliable demand.

C. Government's Intervention to Pricing Natural monopolies traditionally have been subject to rate regulation (price regulation), although the recent trend has been to deregulate wherever competition seems possible. For example, long-distance telephone calls, natural gas distribution, wireless communications, cable television, and long-distance electricity transmission have been, to one degree or another, deregulated over the past several decades. And regulators in some states are beginning to allow new entrants to compete with existing local telephone and electricity providers.

Nevertheless, state and local regulatory commissions still regulate the prices that most local natural gas distributors, regional telephone companies, and local electricity suppliers can charge. These locally regulated monopolies are commonly called “ public utilities. ” Meralco as Regulated Monopoly Meralco is a publicly owned and listed company, meaning that anyone can share in the potential price appreciation of its shares and can receive a portion of company profits when dividends are declared. This company is a public utility, which means it has a monopoly in the delivery of service to the public.

In return for the benefits of not having any competition, the government regulates how much profit the company can make. Normally, the regulated price that it sells its services to the public depends on the rate of return or profit the company will make and that is controlled by the government. In theory, without government regulation, Meralco could charge whatever price it wanted and the public would have no choice but to pay or not have electric service. But Meralco prices are under government control.

Therefore, the government has an obligation to keep the price charged as low as possible to serve the best public interests while, at the same time, allow enough return to keep the company financially sound, able to expand and enhance company business interests and allow the shareholders to makemoneyon their investment. V. Conclusion A public utility must serve both the public interest and the interest of its investors. However, because of the government control of pricing, it is the absolute obligation of government regulators to protect and serve the public interest.

It is not the job of the Meralco management to protect the public. That is the government's job. It is not the job of government to protect the Meralco

shareholders. That is the management's job. Then, after the regulations are set, it is management's responsibility to protect shareholder interests within the boundaries that the regulators establish. If we were the shareholder of Meralco, we want the company to charge P50 per kilowatt-hour so my company can make a lot of profit. As a consumer, we want the government to keep electricity prices as low as possible while insuring reliable service.

Any reasonable person can see that there can be an inherent conflict of interest in those two positions. That is why public utilities function best when privately owned and operated and regulated by the government. VI.

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Polytechnic University of the Philippines College of Accountancy Sta. Mesa, Manila
 Meralco's Pricing: An Assessment ECON 2023 Submitted to:
 Submitted By: Janine Simbulan Christian Derrick Villafranca Ma. Margarita Matawaran Jemilyn Milan
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