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A case for lower seasonal tariff

Energy cost and tariff have been increasing and may go further up. There is a need to explore ways and means for reducing these, wherever a reasonable opportunity exists.

There is some scope in increasing various kinds of efficiencies and reducing various kinds of leakages and losses. In this space, we will explore the possibility of reducing electricity cost and tariff by increasing capacity utilization and thus being able to offer a reduced seasonal tariff.

Electricity cost and tariff are projected to increase further due to two major reasons – rupee depreciation, from Rs105 (the exchange rate to which most of the power projects are pegged) to Rs150, the rate assumed by CPPA in doing its projections, as we will discuss in the following. There is an increase in LIBOR rates; the current LIBOR rate as assumed by CPPAG at 3.64 percent as opposed to 0.5 percent at which most of IPP tariff has been based. This would mean that at LIBOR+4.5 percent, the interest rates and thus debt servicing of the IPPs would increase from 5 percent to 8.14 percent. Energy projects are at varying stages of their debt cycle.

To give the reader an example, the current generation tariff for a wind power project is Rs28 per kWh as opposed to Rs4 per unit for new wind power project. The average PPP (Power Purchase Price) for 2019-20 has been projected to be Rs12.10 per kWh as opposed to under Rs10 per kWh earlier. Once expensive nuclear power comes in the increase would be even more. Thanks to the depreciated power plants and cheaper local gas that the increase may still be controllable.

When we examine the latest cost and energy forecast data for 2019-20 released by CPPAG recently, some interesting phenomena are readily discernible. Although such figures were available earlier also, the monthly cost data this time invites much attention. Electricity demand (MW) and consumption (GWh) in the winter are much less than those in the summer, reducing capacity utilization and increasing capacity charges (CPP) and thus the total generation cost (power purchase price-PPP). For example, the January cost is Rs14.47 per kWh while the July cost is Rs9.94. In January, the demand is only 16762 MW and in July, the demand is 25030 MW.

There is a temptation to wish and think that if consumption in winter is somehow increased, electricity cost can come down. We have tried to do this exercise. If we increase energy utilization by 21.88 percent, the total energy cost (PPP) comes down by 12.46 percent. If energy consumption is further increased, the potential for cost reduction further increases. However, the reverse may not be true – ie, if the price is reduced, demand may not go up in consonance with the cost formulae. It would depend on consumer propensity to save and many other factors such as market structure, consumer habits, labour conditions and work habits, technology etc. Secondly, the winter generation capacity may not be as much as dictated by the market. An obvious factor is less hydro generation.

The idea is worth exploring. Prima facie, there appears to be potential for application of this possibility. Industry may shift to higher production levels in the winter due to lower energy tariff or winter industries may acquire more competitiveness. Domestic consumers may shift to electrical heating (resistance or inverter ACs) instead of using LPG or natural gas.

In advanced countries, there is a retail competition regime whereby many suppliers compete to sell electricity or even gas to the consumers. On a wholesale level also, there is a share market type of energy exchange where prices are offered and accepted on the basis of supply and demand and thus considerable variations occur in whole sale prices. However, at the retail level, consumer tariff (especially residential one) is kept relatively stable based on the averaging.

There are dozens of tariff plans that are being offered by energy suppliers in the retail competition regime. One can divide these into two types – fixed tariff for one or two years and variable tariff, which may change monthly. So, there would be nothing abnormal in having a seasonal tariff that changes twice or four times a year. In Pakistan, there is already a provision of variable tariff wherein Fuel Price Adjustments are made monthly. Accordingly, fixed price (CPP) adjustment can also be made monthly or quarterly.

In Pakistan the government plans to have a competitive energy market wherein investment and pricing decisions are made by the market forces and the controversies in IPP prices and investments are done away with. This would reduce the role and liabilities of the government and is also expected to promote efficiency and reduce energy prices.

That's easier said than done; existing contracts are a major impediment in bringing new competition rules instead of the existing regulatory regime. There is always a possibility of what is called softly as 'anti-competitive behaviour'. Simply speaking, there are possibilities of price collusion and investment manipulations as is alleged in the case of sugar and cement. Still it is said that a bad market may be better than a bad government.

The opportunities for reducing energy cost and tariff in the short run are limited as the die is cast by the IPP contracts, mostly expensive. The most damage to the electricity price regime has been done by the so-called upfront tariff. In the medium to long term, there may be some possibilities: i) retiring the expensive IPP contracts; ii) and introducing cheaper renewable energy sources at reasonable contract terms and preferably through competitive bidding.

With improvement in the general economic conditions and the current account deficit, the exchange rate may assume a reasonable level conducive to reduction in energy cost and tariff. Nepra /CPPAG may like to examine this opportunity and undertake simulations to come to an optimized and reduced tariff in the winter which would maximize capacity utilization in the winter season..

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