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Inevitable rise in power tariff

The decision to raise electricity rates is a foregone conclusion after the Khan-led administration formally requested a bailout package from the International Monetary Fund (IMF). The objective of a raise in rates is to achieve full cost recovery, a standard normal multilaterals' conditionality designed to minimize subsidies that, in turn, would assist in reducing the budget deficit. There is no question that the country is at present in the throes of an unsustainable budget and current account deficits and any attempt to achieve full cost recovery with respect to a utility would go some way in achieving economic sustainability.

However, there are two mitigating factors that disable any meaningful projection of exactly where the Khan-led administration is headed. First, the Supplementary Amendment Finance Act 2018 does not deal with subsidies and one is compelled to look at the unrealistic budget presented by the Abbasi-led government in April 2018, dismissed at the time as pre-poll rigging, to ascertain total subsidy allocation for the current year. The April budget envisaged 174 billion rupees in total subsidies with 134 billion rupee subsidies to Wapda/Pepco and another 15.4 billion rupees subsidy to K-Electric (and with respect to K-Electric, it is relevant to note that last year's budget allocated 15.5 billion rupees as subsidy while the revised amount was double that - 33.4 billion rupees). Thus the subsidy to the energy sector was substantial, has been historically substantial, and there is no indication as to what measures, if any, the current government is considering in this regard.

Secondly, a repeated pledge made by Prime Minister Imran Khan and the Federal Finance Minister Asad Umar is that any measures that raise utility tariffs and/or taxes would be limited to those with ability to pay and not passed onto the vulnerable and the poor. While few would challenge this praiseworthy objective yet the fact of the matter is that it would be extremely difficult if not outright impossible to contain the effect of a rise in tariffs to those who can afford it or on domestic prices as and when the international price of critical imports, particularly crude oil and its refined products, rises. Granted that the government can implement measures that would ensure that the subsidy targeted to the poor rises in direct proportion to the tariff raise; however a rise in electricity tariffs, a major input for all productive sectors of the economy, would impact on the general price level whose impact cannot possibly be limited to those who have the ability to pay.

The government has decided not to pass on the electricity rate rise on five zero-rated industries - textiles, leather products, surgical goods, sports and carpets - with the objective of ensuring that exports are not impacted. This is a good decision, carried over from the previous administration, but this would hopefully reduce the strain on the rising trade deficit and on the current account deficit but is unlikely to limit the erosion of the disposable income of the common man.

As matters stand today, the April budget's inflation forecast of 6 percent is expected to be surpassed with the IMF projecting an inflation rate of 7.5 percent for the current year, because of: (i) the decision of the US to impose second set of its sanctions on Iran and the more recent turmoil in the oil market after the Khashoggi probe. It is feared that international oil prices would maintain their upward trend in the immediate future at least; and (ii) tax on petroleum products is easy to collect, though it is an indirect tax whose incidence on the poor is greater than on the rich, and pending reforms in the tax structure raising taxes on petroleum and products has been traditionally the easiest and the quickest way to increase revenue.

To conclude, the government needs to make some realistic assessment of what measures need to be taken, what their impact would be on key macroeconomic indicators and at the same time begin to implement reforms in the power and tax sectors immediately.

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