BUSINESS
RECORDER

SHORT-, MEDIUM-TERM ECONOMIC CHALLENGES — I

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The new government faces formidable challenges. We feel a two-way division of these challenges is most appropriate: Immediate and Short-to-Medium term. We have previously reflected on the immediate challenge of restoring the broken macroeconomic framework in several articles. Today we discuss the economic challenges which the new Government has to deal with once it has formulated a stabilization plan for the immediate challenges. We would do so in several articles.

The foremost challenge that affects not merely the fiscal finances but also the efficacy and competitiveness of our businesses is the power sector. Just as the Government applies its attention to restoring the macroeconomic framework, it has to devote special attention for addressing the power sector issues. Indeed, power sector reforms would form a prominent item in any agenda of reforms even for stabilizing the economy. What are the issues afflicting the power sector? We discuss them in an order of priority.

Circular debt (CD) is the most fundamental issue threatening the viability of the sector. Historically, circular debt comprised both tariff differential subsidy (TDS) and the cash shortfall resulting from the inefficiencies of the sector relative to the operating parameters set by the regulator. Over the years, helped primarily by low oil prices, the TDS became an insignificant component of CD (though there is a risk that this may be resurfacing soon with rising oil prices).

Let’s first discuss the stock of CD. We have to distinguish between the CD that has been paid through borrowing and parked in Power Holding Private Limited (PHPL), which requires allocation and placement across DISCOs. The second part of CD is the one that is outstanding and overdue for payment. Availability of correct and timely information about the status of CD – its size and division between two types – is not readily available. A news report dated 11 July 2018 based on the press talk by Joint Secretary, Power Division, indicated that the CD has swelled to Rs.1032 billion, with Rs.499 billion requiring payment and Rs.533 billion paid and parked in the PHPL. The immediate focus has to be the payment of Rs.499, even if it means initially parking it in the PHPL so that the constrained supply, held up for want of liquidity, is released. We would discuss separately how to deal with the PHPL debts.

We turn to analyzing the unpaid part of the circular debt. Apart from its payment, it is important to identify the sources giving rise to accumulation of circular debt so that we may understand how to stop its continued accumulation. There are at least three major sources responsible for the CD. The first source is the inadmissibility of actual losses of Discos (recipient of final consumer tariff). Roughly, on a combined basis, against 18% actual losses, 15% losses are allowed. On an estimated generation of 120 Twh (terra watt hours), this means around 4 Twh is lost. At an average tariff of Rs 11/Kwh, cost of 1 Twh is Rs 11 billion giving a total value of loss as Rs 44 billion.

The second source is the shortfall in recoveries. Although in recent years higher recoveries have been shown, some of it is due to overcharging of subsidy not due to consumers yet taken as revenue accrued to the Discos. We assume, generously, the recoveries to be around 90%. This leaves a hole of 10% in revenues and a cash shortfall of Rs 110 billion.

Third, there is the sales tax charged on unrecovered bills. The tax system requires immediate payment of tax at the time of billing. This leads a revenue hemorrhage of Rs.19 billion. Taken together, the cash shortfall is Rs.173 billion or about Rs.15 billion per month, which is 13.14% of total billing. Notice, all these losses are in proportion to the electricity supplied. With rising supplies, as would happen with the addition of impending supplies, the overall size of this loss would keep rising.

Who is responsible for these losses and who should foot the bill. This is a very delicate question and the answer depends on one's outlook about the role of the Government and responsibility of the consumers. The propriety demands that in a commercial service all costs and benefits should be internalized to the cost of providing the service. Thus all costs, incurred while providing the service, with all incidental costs, should be passed on to the users, as is the norm in business. The regulator can surely disallow certain costs so long as those can be absorbed within the surplus generated by the producer for otherwise the producers would be unable to continue production. Please also notice that we have a situation of a monopolist as far as DISCOs are concerned since all of them are owned by the Government of Pakistan. There could surely be an inefficient and loss-making monopolist, but all its costs have to be borne by the users – over and above the cost of subsidy that the Government chooses to provide.

Another view is that these losses are the responsibility of the Government and must be picked by it. This is an untenable position except if it is done on an exceptional basis, as was done in 2013, and that also in the form of recapitalization of DISCOs. The Government is already carrying a significant burden of tariff differential subsidies, agriculture packages, Balochistan tubewells and several other obligations. Adding the additional cost of circular debt would put unbearable burden on the budget. Most importantly, bearing the cost on the budget, when not everyone in the country has access to electricity, would mean that all Pakistanis would be bearing the cost. Thus asking those who have nothing to do with this service to bear its cost, as it would imply when paid out of budget, there would be a serious issue of equity. The cost must be borne by those receiving the service.

This takes us to the issue of tariff determination and reflection of all costs therein incurred by DISCOs while providing this service. The notions of CD and TDS were introduced in our lexicon since 2007 when Nepra started awarding individual tariffs to Discos. Earlier, the erstwhile power wing of Wapda would combine the entire cost of service together with investment requirements and determine an average tariff, at which no circular debt or TDS accrued. For last more than a decade, numerous efforts to revert to the old methodology, so long as DISCOs remain in government ownership, were thwarted by inactivity and indifference of concerned officials.

Mercifully, the Parliament has recently passed an amendment in the existing law that would enable tariff determination as per the old methodology. Under Section-39 (previously Section-31) of the Regulation of Generation, Transmission and Distribution of Electric Power Act 1997, dealing with tariff determination a new sub-section 4 has been added which stipulates: 4) subject to sub-section (2) and (3), the authority shall, in the public consumer interest, determine a uniform tariff for distribution licensees wholly owned and controlled by a common shareholder, on the basis of their consolidated accounts.

In the first instance, this provision should immediately be pressed into action. The tariff currently notified is for 2015-16. Power division should take appropriate actions to seek the tariff for 2016-17 and for 2017-18 on the basis of this new provision.