**Highs and lows of energy pricing**

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It is generally complained that energy costs or prices are high in Pakistan. The recent rupee devaluation has made the issue more visible and sensitive. Expensive energy and high imported content of both capital and commodity has made things very critical.

It is really electricity prices which are high in Pakistan. Other energy prices are not high – comparatively speaking. The affordability issue may be a separate and broader debate. Petroleum products prices in Pakistan are quite competitive (even lower in many respects) with prices in the region and even elsewhere.

Pakistan is classified by international organizations as a low petroleum taxation country. However, there are many proposals around for introducing cheaper brands (low RON) gasoline for motorcycles. There are proposals likewise to reduce diesel price vis-à-vis gasoline which has potential to reduce public transportation costs of both people and goods.

Gas prices are also low in Pakistan as compared to the region. There is no lifeline low consumer tariff in either India or Bangladesh. Neither are there five or six domestic gas tariffs in the region which in Pakistan are there to optimize and benefit the domestic consumer. Admittedly, the large domestic consumers have to bear the brunt. In the small consumer category, even the rich benefit from the low prices for which something is required to be done.

In case of industries, special tariff has been issued for zero-rated export sectors. High Qatar LNG import prices have increased average cost of gas and the rupee devaluation has had a major impact on gas tariff. There is probably no escape in this respect. Gas distribution losses may be halved in medium term only, but that may have an impact of five percent on prices only. There are proposals to separate the gas pricing policy from the overall economic and industrial policy for which direct government subsidies have been recommended. Pending gas sector restructuring and reforms are expected to have some improvements as well.

Biogas has long been neglected; it could have had multifarious impact on price, supplies, waste management, rural and agricultural development. Biogas, in addition to its use in cooking, can be used as Bio-CNG and can also be fed into the grid. Gas companies would have to take interest in it in order to have significant impact.

Electricity costs /tariff is indeed very high; twice or more as compared to the region or otherwise; the main reason being the non-tradability of electricity. Electricity prices, therefore, are subject to all kinds of anomalies, manipulations and profiteering. High capital and financial costs are largely responsible for this. Excess capacity created by investor pushed projects has put an extra load of capacity payments. It is alleged that capital padding and zero-equity syndrome has been more of a norm than exception, enhancing the supply costs and capacity payment.

The cost manipulation has been institutionalized and protected by the so-called up-front tariff system wherein the regulator takes unto itself to determine the costs as opposed to cost-plus or other systems wherein the investor has the legal responsibility and the latter can be punished for cost-fudging and manipulation. The vendors-investors-lenders combine manages to mislead the regulator, who participates in it knowingly or unknowingly. Admittedly, an up-front tariff system is fast-track and is generally liked by the investors but can play havoc with the consumer tariff.

High rates of return to the extent of 17 or 18 or 20 percent have also contributed to the high cost of electricity. Similar is the case for interest rates margins (LIBOR & KIBOR); LIBOR and KIBOR have increased since aggravating the problem and increasing costs. The LIBOR margin is the same whether it is a small local investor or a rich international investor or if it is G-to-G contract. In G-to-G projects, interest rates ought to be lower as being akin to suppliers’ credit concessional rates. Because sales are guaranteed and capex is usually higher than in competitive bidding environment, a suitable discount in interest rates would have been in order.

There are other areas as well where grossly excessive tariff components have been awarded; O&M charges of some projects are five times higher than other projects; other cost elements can be pruned; undeserved escalations have increased the wind power tariff of some projects to Rs26.00. Cash flow based tariff and short repayment periods have pushed the debt liabilities upfront. It all adds up. Government and PTI circles seem to have similar misgivings. A high-level government committee has been investigating the issue of high profitability of IPPs. Reportedly, some IPPs have agreed to settle and adjust more egregious issues.

The solution may be competition, a simple type and not the market exchange type, at least in the near future. Competition has considerably reduced electricity production cost, in all parts of the world, in case of solar and wind power.

There are three kinds of competitions – EPC cost bidding; tariff-based bidding; and three, electricity market and exchange mechanism. EPC cost bidding has some good examples like the recent ADB-financed Jamshoro coal power plant tariff where significant cost reductions have been obtained as compared to the other comparable CPEC projects. It is a separate matter that an order has not been placed yet for the most beneficial second phase of Jamshoro tender.

Another good example is low CAPEX obtained through competitive bidding of RLNGCC power plants of a combined capacity of some 5000 MW. It is a separate issue that high-cost Qatar LNG has made electricity from these projects expensive as well. Adjustments in the tariff of these power plants are possible under spot gas supply which may also remove impediments to privatization of these power plants. The government is reportedly considering it. Admittedly, competition can also be hijacked and manipulated. However, adequate safeguards are possible and would have to be enforced.

What is the way forward? Renegotiations of contracts, as argued by some, may not be feasible. Reforms can be done for new projects and must be undertaken. Fortunately, there is new leadership at Nepra (as well as in government) which has had no part in the mistakes of the past and may be able to correct the situation to some extent, if not all. A third party review of Nepra tariff policies and determinations may be organized by Nepra itself or in association with the government. The review should be conducted by credible consultants so that controversies are settled and corrective actions are identified.

There are still some windows of opportunity; cheaper solar and wind power may make quite some impact, provided competition is brought in. The government’s new macro-economic framework and anti-money laundering measures will have some impact. The new oil and gas concession regime, if implemented seriously, will improve supply and economics of both the power and gas sectors. More innovation in tariff slabs may bring improvements in generation capacity utilization. Reforms and reorganization may cut down unnecessary overheads.

Splitting DISCOs into smaller companies has been on the agenda for a long time now. This may be an impediment to privatization. T&D losses reduction will also have some impact. Transmission investments can eliminate congestion and improve capacity utilization and thus reduce costs. KE is integrated with the NTDC system, permitting higher flows and avoiding unnecessary capacity payments. Inefficient GENCOs are to be shut down.

Furnace oil has become cheaper internationally which should be genuinely translated into lower prices locally. There is heat rate and fuel theft controversy. The need for diligence has never been higher.

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