



Pathfinder Economic **BLAST**

This is the first in a new series of Pathfinder Foundation releases which will focus upon and highlight issues that require immediate attention. Lack of urgent action would have severe adverse consequences for an enterprise, a sector or the economy as a whole.

Changing the Pillow to Cure the Headache: Tariff Adjustment without Restructuring the CEB

The Pathfinder Foundation (PF) welcomes the efforts currently underway to address the chronic losses incurred by the CEB; and congratulates the Public Utilities Commission of Sri Lanka (PUCSL) and other stakeholders for conducting a professional Public Hearing. PUCSL is also to be commended for its proactive stance in cutting the costs put forward by the CEB to the tune of Rs. 40 billion.

However, it is extremely disappointing that the public debate has revolved almost entirely on the extent and nature of the tariff increase to make it more cost-reflective. It has focused on three over-arching themes: (I) ways and means of reducing the cost of electricity; (II) the impact of tariff increases on low-income families and businesses, particularly energy-intensive economic activity; and (III) the tariff structure and the extent of subsidy/cross-subsidy. These are clearly important issues. However, focusing merely on adjusting the tariff structure, based on whatever cost-cutting is possible under the existing inefficient and non-transparent system, is to miss the point entirely. It is similar to “changing the pillow to cure the headache” i.e. it amounts to treating “the symptom rather than the cause!” Introducing a cost reflective tariff to a highly integrated, state owned monopoly is arguably the easiest solution for the government, the regulator and the CEB, if the welfare of consumers or the competitiveness of the entire economy is to be disregarded. Such a course of action does not make demands in relation to professional management or efficient regulation.

Unfortunately, during the public consultation quite a few professionals, experts in the fields of electricity and regulation, as well as representatives of political parties and consumer organizations seemed to have forgotten the need for fundamental structural reforms of the energy

sector, especially the CEB. Many professionals who have been advocating the unbundling of the CEB; maintaining separate management and financial structures; and introducing external audit functions also focused mainly on a cost reflective tariff, while implicitly condoning the status-quo.

The political will that has been mobilized to tackle the massive losses of the CEB should be utilized to roll out more fundamental reforms. Merely adjusting the tariff structure is no guarantee that the underlying problems that contribute significantly to these losses will be resolved. No sustainable solution will be found. Failing to address the underlying problems is likely to result in the continuation or even aggravation of the negative issues related to the financial viability of the CEB, and indirectly to the balance sheets of the state banks.

The PF would like to reiterate that the fundamental reforms which need to be addressed include:

1. Unbundling of the CEB, i.e. create separate “subsidiaries” managing the distinctly different functions of generation, transmission, distribution and probably even retailing to help increase efficiency and enhance the transparency of financial management and operations. Even generation capacity has diverse characteristics based on source, age and ownership which make it possible to unbundle it as separate operating entities.
2. Adoption of financial management practices and discipline as well as up to date ICT and other technologies to ensure prudent dispatching.
3. Broadbasing the power sector through opening it up to new players and creating an environment to ensure a competitive pricing mechanism.
4. Further liberalizing Petroleum imports, storage, distribution and retailing so that the Ceypetco & IOC duopoly is ended (an internationally renowned Sri Lankan regulatory expert pronounced that the only thing worse than a monopoly is a duopoly).

In order to roll-out meaningful reforms the authorities must: 1) PUCSL should attach strong conditionality to the renewal of the license of the CEB as well as other operators; and 2) the government should introduce new legislation to strengthen the regulator.

The PF acknowledges that urgent action needs to be taken to adjust the tariff to protect the financial health of the CEB, the state banks, the CPC and ultimately the government balance sheet. However, unless CEB restructuring is undertaken, this annual ritual of public consultations on the electricity tariff will only be a short term, unsustainable patchwork solution.