



## **Pathfinder Economic Flash**

### **The Electricity Price: A Necessary Evil and Must Stay on Course Why not Double the Samurdhi Payments?**

#### **Commendable Action**

The government is to be commended for its highly courageous decision to adjust electricity prices towards cost reflectivity. The political leadership and pragmatic policymakers have to be given considerable credit for setting aside short term political expedience and addressing a fundamentally unstable situation that could eventually have had a very negative impact on the financial viability of the two state banks and consequently the entire financial system. It is not just the broader financial system but the real economy involving SMEs and farmers for whom, the People's Bank was created, who are being adversely affected by the huge losses of public enterprises

#### **Beyond Political Opportunism to Strategic Policy Action**

The political consequences of the government's action have already become apparent. There has been a chorus of criticism from the political opposition, business and trade unions. It is true that the electricity price adjustment will push up prices and reduce the profitability of businesses in the medium-term. However, if political opportunism had deterred taking such remedial action, as in the past, it would have resulted in much worse implications not only in terms of its impact on growth, employment and incomes but also on the stability of the whole financial system. The massive losses of the CEB are on the balance sheets of the two state banks. "Business as usual" would have eventually undermined the financial integrity of these two institutions that account for 50% of the banking system. Hence, the stability of the whole financial system would have come under threat if these were not addressed. These losses would affect all Sri Lankans. If there was no movement towards cost-reflective prices, these unsustainable losses would have to be addressed by raising taxes resulting in increased prices of many other commodities, including essentials.

#### **Lower Interest Rates and Economy-wide Benefits in the Medium-term?**

The electricity price increase and the curtailment of CEB losses have also created space to reduce interest rates in order to provide a much needed boost to flagging growth in the economy. Therefore businesses, as well as the ordinary consumers, will have to have patience to experience

the positive impact of the electricity price hike in the months to come. Complementary reforms are necessary for this to materialize.

### **Still Subsidising: Why not Remove and Double the Samurdhi Payment**

The Pathfinder foundation learns that even with the current adjustment towards cost reflective pricing the Govt is subsidizing the household consumers to the tune of Rs 25 billion per annum. This is two and half times the total of expenditure on Samurdhi payments. Why not double the payments to the Samurdhi recipients amounting to nearly 40 per cent of the population, as provided in the PUCSL Act. This is in line with the recommendation by Chairman, LIRNEasia at the public consultation and the PF in its Economic Flash number 24 (28<sup>th</sup> of February 2013). This seems to have been conveniently ignored by all.

### **Creative Unbundling for Transparency, Accountability and Cost Reduction**

The electricity price adjustment is a very important and necessary first step. It should, however, be complemented by measures to restructure the CEB and structural reforms to strengthen the country's growth framework. In this regard the Pathfinder Foundation takes the liberty of publishing, with our own editorial changes, a set of proposals by internationally renowned regulatory and infrastructure expert Dr Rohan Samarajiva

### **Why Continue with Electricity Sector Reforms?**

1. **Maintaining Continuity of infrastructure reforms is important.** Realistically, the Government cannot make the investments necessary for the country's electricity requirements while continuing free health care, free education, free school uniforms, Samurdhi payments, fertilizer subsidy, railway travel subsidy etc, etc.. Continuity in infrastructure policy is important to investors in infrastructure projects, which have long gestation periods.
2. **Organizational reform of the CEB is long overdue.** This massive organization of over 18,000 employees has presided over multiple countrywide blackouts, strikes, etc. and has seen electricity prices escalate to a point of making the entire economy uncompetitive. If the CEB was a typical commercial organization it would by now be in bankruptcy. The burden of proof is on those who argue for the retention of the failed organizational structure, not on those who argue for change.
3. **Unbundling will increase business focus.** The general culture of integrated government-owned monopolies is one of inefficiency and lack of accountability. When you have managers who are responsible for specific functions such as generation and distribution/supply, accountability can be enforced. Properly regulated, generation and distribution companies can be held accountable for decent treatment of consumers and for improving system efficiency. If internal reorganization can do it, why has it not happened yet?

4. **Unbundling will yield useful information.** When the managers of a Distribution subsidiary of the CEB are held accountable for their bottom line and service delivery to customers, they will expose the actions of other entities that are causing delays, shortages and system failures (who will, in turn, disclose information about the distribution subsidiaries). With unbundling, more information will be generated and there will be better ways of ascertaining the reliability of the information. This is why the defenders of the status quo criticize unbundling as causing friction and additional transaction costs. An unbundled structure will also generate the information necessary for the work of the PUCSL, Ministry of Power and Energy and the Treasury.
5. **It is wasteful to stop the process now.** By stopping now, the work done on adjusting prices towards cost reflectivity, creating independent business units and transparent accounting procedures will be wasted. The attempts at establishing some form of realistic, cost-reflective pricing, complemented by targeted and explicit subsidies, must be continued unabated. The authorities would need to work out the political dynamics regarding the timing, sequencing and pace of such reforms.

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