Ineffective measures

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On July 12, 2023, the International Monetary Fund (IMF) approved a nine-month Stand-By Arrangement (SBA) worth $2.25 billion, and the newly elected government is currently negotiating the release of the final tranche of $1.1bn.

Last year, the government implemented the Circular Debt Management Plan 2023 under the SBA, which resulted in a twice-revised electricity base tariff (Rs7.9 per kWh for fiscal year 2023 and nearly Rs5 per kWh for FY24).

This led to more than doubling the tariff for bulk power and commercial, and higher slabs for domestic consumers. This is in addition to the quarterly adjustments (Rs9.5 in FY23) and monthly fuel price adjustments (Rs8.8 in FY23). The government is expected to raise tariffs again to satisfy the IMF.

The tariff increase, as also mentioned in the IMF's first review report of the SBA, was to contain the circular debt stock to its FY23 level of Rs2.3 trillion. In FY23, despite increasing tariffs, the financial gap reached nearly Rs403bn due to lower recoveries and unaccounted transmission and distribution (T&D) losses from Rs218bn in FY20.

An increase in tariffs has not decreased the circular debt

With the increase in tariff, there was an increase in T&D losses, and the recovery rate was also affected — instead of managing circular debt, an increase in tariff led to debt rising from Rs2.3tr to Rs2.6tr in three months from July 2023 to October 2023.

Although the power distribution companies (Discos) recoveries improved from 90 per cent in FY22 to 93pc in FY23, their receivables rose to approximately Rs1.7tr in FY23, compared to Rs1.5tr the previous year.

Meanwhile, the recovery ratio for privatised K-Electric plunged to 93pc in FY23 from 97pc in FY22. The tariff increase has made it difficult for the utility provider to collect dues from the electricity customers.

Moreover, as reported in the National Electric Power Regulatory Authority's (Nepra) State of Industry Report for 2023, consumption and sales declined significantly despite the increase in electricity consumers in FY23 — the decrease is more noticeable in domestic and industrial consumption.

If this trend continues, the per-unit cost of electricity will increase further due to the system's surplus take-or-pay generation capacity. The share of the capacity purchase price in the consumer-end electricity tariff is already very high (38pc). When unused or lost to inefficiencies, the existing capacity adds to the circular debt.

Instead of improving their performance to counter commercial and operational losses, distribution companies resort to prolonged and unjustified loadshedding in areas with more commercial losses. This revenue-based loadshedding has resulted in the underutilisation of power plants, increasing capacity costs.

Adversely, this strategy prevents electricity from reaching even the compliant consumers in the same areas, forcing them (who can afford it) to use more expensive means of electricity generation, such as solar net metering.

The number of net-metering consumers in the Central Power Purchasing Agency-Guarantee (CPPA-G) system has increased by about 49pc over the past year. The only drawback of net-metering connections in surplus generation capacity (particularly on a Take-or-Pay) is that other consumers may suffer due to underutilisation of existing capacity. Consumers pay capacity charges through their bills when they consume this energy.

An increase in tariff increases the production cost for various economic sectors. According to a recent study at the Pakistan Institute of Development Economics (Pide), circular debt induced a 10pc increase in a firm's share of energy costs, raising industrial production costs by 12.5pc and adversely affecting its export competitiveness.

The best way to deal with the issue of electricity circular debt is to increase productive energy use. Making grid electricity more appealing to productive sectors is necessary to recover capacity payments, ie offering them tariffs without cross-subsidy.

Additionally, Pakistan's per capita electricity consumption is one of the lowest in the world. Increasing per capita electricity consumption at affordable rates is crucial for improved living standards and sustained economic growth.

In the last year, not only was there an increase in the base tariff, but the financial cost surcharge increased exponentially from Rs0.4 per kWh to Rs3.4 per kWh. It covers the government's financial obligations (circular debt). The objective is to pay the markup parked in Power Holding Private Limited (PHPL) and stop the flow of circular debt.

However, the proliferation of these surcharges shifts risks away from utility operators and investors and onto consumers. Besides increased costs to compliant consumers, surcharges result in more inefficiency in the distribution system — it reduces Discos' incentives to improve.

Additionally, revenues are collected for the Federal Board of Revenue (FBR) using electricity bills.

Customers pay sales tax at 18pc per kWh and electricity duty at 1.5pc per kWh. Sales tax is also charged on fuel price adjustments, and income tax is deducted from non-filers' bills.

Determining a consumer's active taxpayer status based on their bill alone is challenging. This policy has negatively impacted the cash-starved electricity distribution sector's revenue. Hence, electricity bills should not be used as an FBR agent — this will reduce consumer end tariff by more than 25pc.

Furthermore, a progressive tariff structure unfairly burdens compliant consumers. In FY23, 74pc of consumers paid less than the national average tariff—they can't all be poor. There is ample evidence that households install multiple meters or opt for illegal means to remain in lower slabs.

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