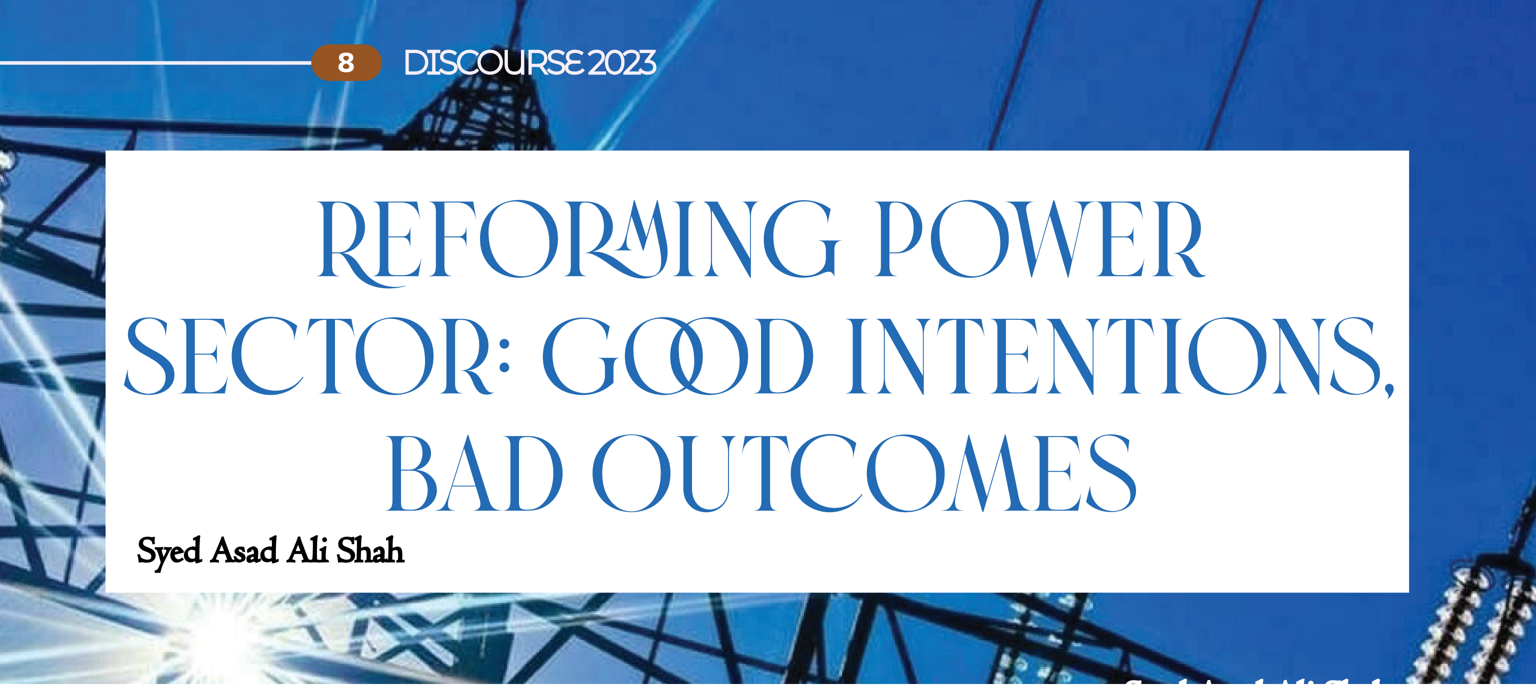

REFORMING POWER SECTOR: GOOD INTENTIONS, BAD OUTCOMES

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Pakistan's power sector has been bleeding the country for decades, thanks to ill-conceived policies, poor governance and flawed implementation of reforms. In the last three decades, we have seen a series of well-intentioned reforms aimed at boosting efficiency, greater availability, and safeguarding consumers' interests. However, instead of delivering on these objectives, the outcomes have been nothing short of disastrous. Pakistan now boasts the unique distinction of having the world's highest electricity tariff, a staggering circular debt of Rs. 2.4 trillion, and persistent reliance on imported fuels, contributing to recurrent current account deficits. It's a classic example of how good intentions pave the road to Hell.

UNRAVELLING WAPDA

In the 1990s, the first major reform was the unbundling of the Water and Power Development Authority (WAPDA). Prior to this, WAPDA was an all-encompassing powerhouse responsible for every aspect of electricity: generation, transmission and distribution. In 1994, this initiative created the National Transmission & Distribution Company (NTDC), five thermal generation companies (GENCOs), and five distribution companies (DISCOs). The idea was to improve efficiency and eventually privatise these entities.

However, despite separate boards of directors of each company, the old guard from WAPDA continued to hold sway. Instead of empowering the boards of such companies, the control transferred from WAPDA, Lahore to Power Division of the Federal Government in Islamabad (PD). Board members have mostly been selected based on their political or other connections rather than merit, and were frequently changed with changes in governments. The primary goal of establishing effective governance at company level and running them as commercial corporate entities was never realised. Furthermore, the objective of privatisation and regulation by an independent body remained elusive. In essence, this well-intentioned reform ended up doing more harm than good, thanks to centralised micro-management by PD

INDEPENDENT POWER PRODUCERS: BIGGEST SHOCK TO THE SYSTEM

The second most important reform, also initiated in 1990s, was the Government seeking to attract private investment through Independent Power Producers (IPPs). The idea was to generate more electricity to meet the surging demand of electricity leading to the 1994 policy. Conceptually, it made sense, but the rush for more electricity, regardless of the cost and reliance on imported fuels, created an even bigger mess. Despite criticism and corruption allegations of 1994 policy, similar policies were implemented in 2002 and 2015. The consequences of these policies, especially the 2015 policy, driven by very high returns to the IPPs at minimal risk using imported fuels, have been horrendous, as reflected from staggering amounts of capacity payments to such IPPs: estimated to be Rs. 2.2 trillion in 2022. Easy availability of billions of dollars under CPEC and sole focus of increasing generation capacity at any cost, further compounded the issue leading to a situation where the country generated surplus expensive capacity that was being paid but not used.

ESTABLISHING INDEPENDENT REGULATOR

The third crucial reform involved the creation of an independent regulatory body, the National Electric Power Regulatory Authority (NEPRA), in 1997. NEPRA objectives were clear: regulate the entire electricity generation, transmission and distribution landscape, ensuring efficient, reliable and affordable electricity while protecting consumers' interests and promoting competition.

Unfortunately, structural issues and the composition of NEPRA have hindered the realisation of these objectives. The most critical aspect of an independent regulator is the quality of leadership, considering the importance of this sector to the economy and the central importance of the regulator. Therefore, major investment was required in selecting the best-in-class people with specialised knowledge, experience and independent thinking. Instead, such positions have been mostly populated with retired bureaucrats lacking the decisiveness, initiative, and risk-taking spirit that is needed for effective regulation. Furthermore, NEPRA's authority is hampered by the overwhelming presence of the federal government in the power sector. Understandably, its ability to regulate government entities, considering that the government is also the appointing authority of NEPRA leadership, is severely constrained.

KE PRIVATISATION

The fourth major reform was the privatisation of Karachi Electric Supply Corporatoin (KESC), now Karachi Electric (KE). The privatisation initiative was the right thing to do, but the manner in which it was done, without proper shortlisting processes, was what led to its demise. This major oversight resulted in selection of bidders who had no expertise to run a complex utility. Thus, this strategic privatisation could not deliver the anticipated benefits, as evident from KESC's escalation in financial troubles, high consumer electricity costs, and huge tax-payer funded subsidies post privatisation. Review of its annual reports after privatisation in 2005 highlights that transmission and distribution losses remained stagnant or increased until the original shareholders sold majority ownership and control to Abraaj in 2009. KESC's financial losses escalated from Rs. 23 billion in 2006 to Rs. 87 billion in 2011, despite significant government concessions. The first year KE generated profits was in 2012, of around Rs. 2 billion. This was sustained for a period of five years upto 2016 – in which reasonable returns were observed. However, such profitability has been possible due to huge subsidies from GoP, as reflected in the tariff differential claims, which is reflected by the company as its revenue. Further, in the last seven-year multi-year tariff (MYT) period – from 2017 to 2023 – KE's financial position has considerably deteriorated. As per the last published financial statements for 9 months ended March 31, 2023, the KE had incurred a loss of Rs. 39 billion, and the loss for the year ended June 30, 2023 is likely to be over Rs. 45 billion. All of these losses have been financed through debt at exorbitant costs that will drain its future viability. Furthermore, KE's balance sheet reflects over Rs. 400 billion worth of receivables from the Government of Pakistan, a significant portion of which are still to be determined, and such receivables have been increasing with time without any indication of whether and when such amounts will be realised.

The power crisis has deepened with time. It is a serious problem with significant adverse consequences for Pakistan's economy and the quality of life of its citizens. It is a major factor eroding productivity and has a major contribution in creating huge public debt and persistent balance of payments crises. To navigate this complex issue, the government must embark on comprehensive reforms and ensure their effective implementation.

The way forward should entail the following steps:

- Reforming the regulatory framework to enhance NEPRA's capacity and achieve its independence and effectiveness, including its restructuring to establish a Policy Board on the pattern of SECP to enable timely policy guidance and oversight, as well as improving the criteria and remuneration structure of its members purely on merit rather than federal and provincial quotas.
- Ideally, there should be one energy regulator that should be achieved by combining NEPRA and Oil and Gas Regulatory Authority (OGRA) and top leadership positions of members should be filled with people of caliber who have successful track records and international experience preferably without restriction on nationality. In this context, we should learn from our middle eastern neighbours who hire many non-nationals purely on merit in key positions.
- Pursuing swift privatisation or entering into performance-based public-private partnerships for power generation and distribution companies to ensure that those charged with governance of such companies have stakes in their success as well as failure. In other words, develop a framework of accountable governance. In doing so, the government should learn from the experience of KESC with privatization.
- Until the privatisation of GENCOs and DISCOs, the government should focus on improving board governance of such entities by appointing good quality boards together with an appropriate framework that makes the boards accountable to the Ministry of Energy's power division.
- Ensuring that all future investment for generation of electricity are in renewables and Thar Coal, the cheapest domestic source of energy to ensure energy security.
- Power division should expedite preparation of National Electricity Plan in consultation with NEPRA and other stakeholders.
- One of the biggest issues with the Government Ministries, divisions and agencies is indecisiveness on major issues. GoP needs to make a policy whereby timely decisions are made on all strategic matters of public interest.

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