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PERSPECTIVES

Energy Subsidies and Circular Debt

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The mid-year budget review highlighted losses and circular debt one of the fiscal risks confronting the economy. Improving the governance, reducing tariff differential subsidies, and improving subsidy targeting can help us to reduce circular debt. The last IMF program was kicked off in 2008 to 2012. One of the Fund's conditionalities was to reduce energy subsidies to ease out fiscal burdens. In 2008 electricity subsidies was around 2.4 % of GDP, buy the end of program in 2012 it was reduce to around 1.4% of GDP.

Reduction in subsidies at one hand reduces fiscal deficit, and on the other hand affect poor households welfare by increasing in energy prices. Pakistan again has finalized another Fund's program with the same conditionality of reduction in energy subsidies. We believe that energy subsidies are untargeted and urban rich segment of the society is the biggest beneficiary. Therefore, It should be reduce but the welfare of the poor segment of the society should not be impaired by channelizing subsidies to the poor households, or through different social safety nets program.

Pakistan is facing energy shortages over the past many years. Competing use for resources is one of the most fundamental reasons. Energy mix for electricity generation and consequent circular debt are also aggravating the situation. Government has paid more than one trillion rupees as Tariff Differential Subsidy (TDS). " The TDS is the difference between the electricity tariff (plus certain surcharges) paid by consumers and the allowable costs of electricity utilities determined by the regulator, NEPRA". However, TDS being an untargeted subsidy, is not only piling financial burdens but also resulting in welfare loss.

TDS, which accounts for more than 90 % of the subsidies, is an untargeted subsidy and urban rich segment of society are the largest beneficiaries of this subsidy. Reduction of TDS also reduces fiscal deficit significantly and thus eases out financial hardships for the government. Similarly, the amount paid to the poor household in lieu of TDS is not fully spent for purchasing electricity, rather it is directed towards other needs as well. Improved productivity augments electricity consumption, reduces electricity prices, generates employment opportunities ,results in better wage levels and thus contributes towards improved household welfare.

The recommendations in this article is being in line with New Growth Framework (NGF) which will not only help policy makers to devise a long term and sustainable solution to the problem of power outage but will also help mitigating its negative social and economic implications.

Figure: Electricity Tariff Structure

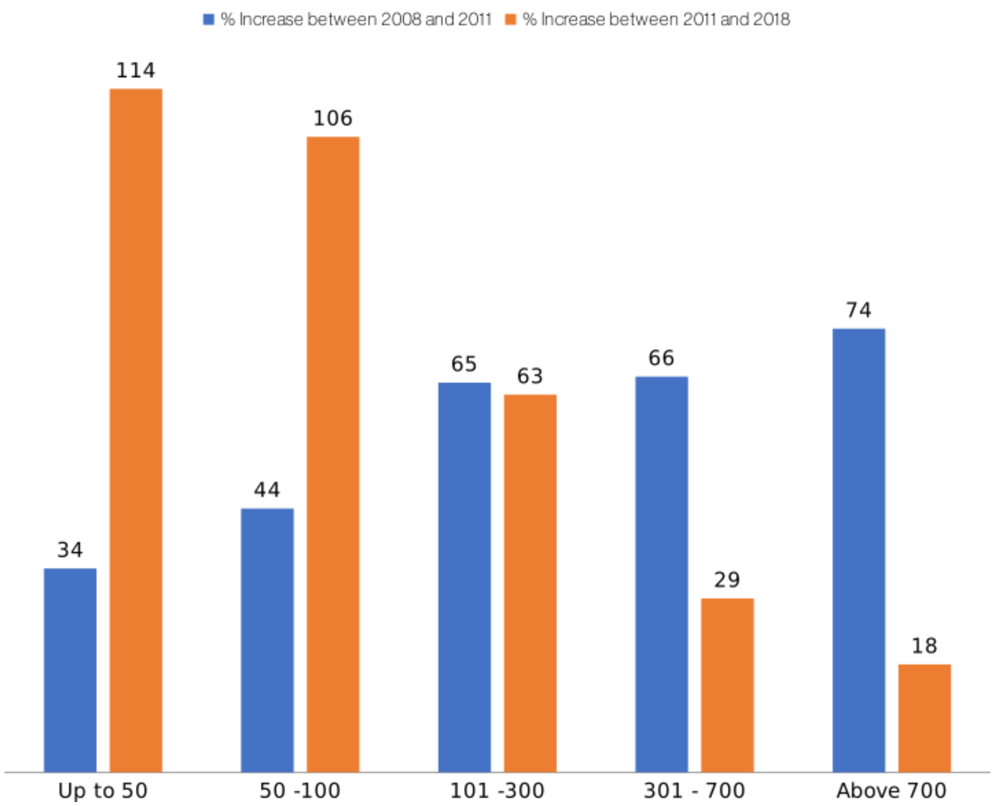
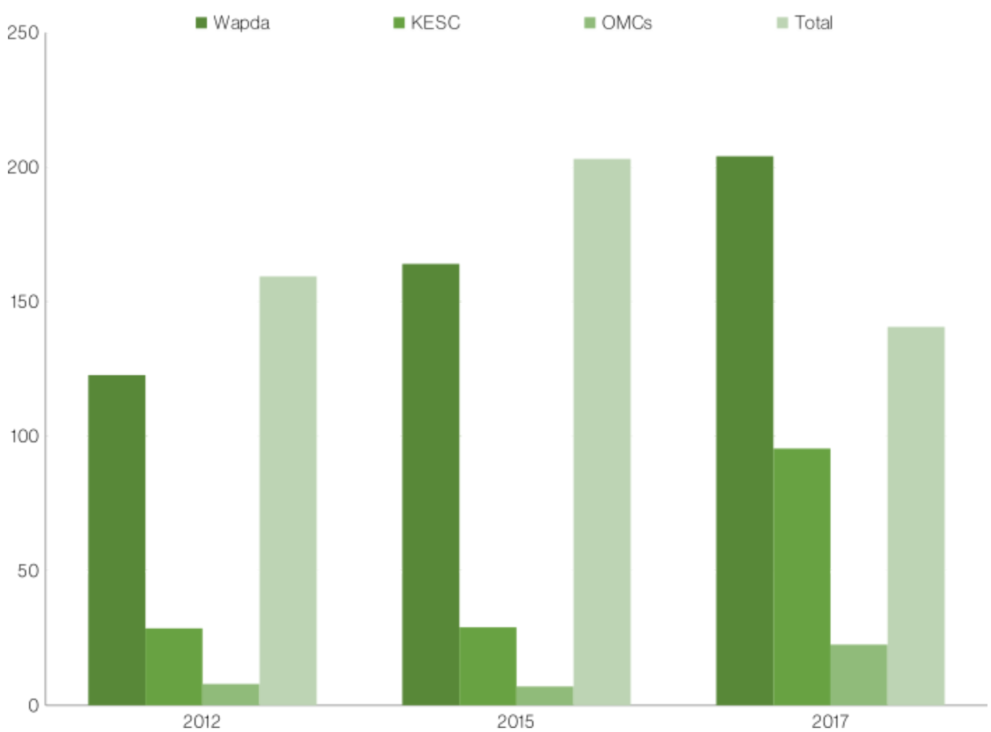


Figure: Tariff Differential Subsidies



Residential electricity subsidies in Pakistan cost 0.8 to 2 % of GDP in 2014-15 estimated by World Bank. The cost of subsidies are enormously increasing to more than one trillion in recent past. This substantial increase in subsides is not only hindering GDP, but it also costing fiscal deficits significantly, and not easing out financial hardships for the government. If we look into the budgeted figures of electricity related subsidies it ranges from Rs 97,849 million in 2007-08 to Rs 140,600 million in 2017 which is more than 30%.

If we look in to the revised figures that are only available for 20017-08 (Rs 314,614 million) to 2010-11 (Rs 372,066 million). In these four years the increase in electricity subsidies are approximately 18 % but if have data for the recent years it might be more 30 % based on budgeted and revised figures.

The tariff structure is based on the slabs of monthly household consumption. These slabs are up to 50 units, 50 to 100 units, 101-300 units, 300-700 units, and greater than 700 units. The increase in electricity tariffs for these slabs are 34 %, 44%, 65%, 66%, and 74% from 2008-11. Between 2011-18 electricity tariffs were further increased to 114%, 106 %, 63%, 29% and 18% respectively.

A highly concessional lifeline tariff is provided for the household who consumes less than 50 units. But if we see the burden on electricity tariffs on household that consumes less than 50 units is increased by 114 %. And, this burden is substantially decreasing on the households that consume relatively more electricity. It seems that the rich segment of the society enjoys electricity subsidies more than the poor segment of the society.

Pakistan Institute of Development Economics (PIDE) estimated welfare impact of policy intervention to assess the welfare changes after the policy (reduction of subsidies). When electricity subsidy is cut, total welfare decreased by 69.6 billion, where the rich urban are the most affected. However, we also find mild welfare reduction on all farm households who are relatively poor than urban rich.

We believe that the recent introduction of the energy tariff by the government is a right policy measures to reduces fiscal deficit, circular debt, and ease out financial hardships of the government. However, TDS need to more targeted to protect the welfare the low and middle income people. Recently launched Ehsaas Program is the right move to increase/compensate the welfare of the low and middle income people affected by the high cost of energy.

Improve Subsidy Targeting: The PIDE study reveals that Tariff Differential Subsidy is an untargeted subsidy and urban rich segment of society are the largest beneficiaries of this subsidy. Moreover, removal of TDS results in high electricity prices and poor household especially rural poor are hit hard by this policy intervention. The analysis provides the insight that TDS, which is meant for providing relief to the poor, is benefiting rich class the most and thus may be phased out or be made more targeted to reap its benefits.

Reduce Tariff Differential Subsidies: Reduction of TDS reduces fiscal deficit significantly and thus eases out financial hardships for the government. If subsidies are reduced, the power sector will potentially improve. Money available from discounted subsidies can easily be transferred to oil and gas suppliers.

In this way, the smoother flow of finance can be confirmed and circular debt can be recharged. Improvement in productivity of electricity sector has tremendous implications for the economy and the welfare of poor households. Improved productivity augments electricity consumption, reduces electricity prices, generates employment opportunities, results in better wage levels and thus contributes towards improved household welfare.

Improve governance: Governance system and financial management of GENCOs and DISCOs should be improved by separating board management and ownerships. Some serious steps with reference to better generation mix; such as improving coal mines and gas fields are also required to get rid of circular debt and to eliminate load shedding and improve electricity productivity.

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