Electricity Tariff Increases: Celebration or Cause for Concern?

A lot seems to have happened in the power space over the last few days. First came the CBN announcement laying down specific rules for DMOs on what they can and cannot do with monies received on behalf of electricity distribution companies. We were also regaled with the efforts by FGN to avoid defaulting on payments to Azura IPP. Then came the bombshell, at least in the opinion of some industry watchers: The President approved significant electricity tariff increases – 73 percent in the first instance and by the time the second increase kicks in, total rise from the current position would be in excess of 130 percent. These news, alongside a series of other sobering headlines from last week (one in two Nigerians in the labour force is either unemployed or underemployed; inflation is on the increase; Nigerians now spend about 60 percent of their income on food, Nigeria borrows grain from ECOWAS to feed her citizens, etc.) are bound to agitate, or be of great concern to discerning minds.

Before dissecting the various issues, let us look at why these headlines elicit agitation and concern. Agitation because the consequences could have been avoided: The desperation and urgency of the authorities are apparent in the Azura case. If the same level of diligence had been accorded the negotiations in the first place, it is doubtful government would be where it is today. Likewise, if the way the tariff is calculated had been properly scrutinised, it is doubtful the clamour by the owners and financiers of the PHCN successor companies would have received such attention. Perhaps doing the right thing from the start is quite un-Nigerian. The default setting is to attempt to solve self-created problems that could have been avoided in the first place.

Why concern? The probability that the above developments will have a devastating impact on the wellbeing of the citizens of the “poverty capital of the world”. The expected consequences are higher prices of goods and services, leading to higher inflation, further unemployment, etc. A situation that will presumably be compounded if the looming recession materialises as the economy has reportedly contracted by 6.1 percent, having barely recovered from the last recession.

Of the series of recent news, the following three are noteworthy: the CBN announcement, the Azura payments, and the tariff increases.

CBN appears to be taking centre stage in running the economy. As the banker to the Federal Government, it became, by default, the de facto banker to the electricity industry. First, it played a key role in persuading the banks to provide finance to the would-be investors on the eve of the privatisation. Later, the liquidity problem caused by technical and non-technical losses led the Federal Government to mandate CBN to provide "market support" to the electricity industry. It is the inability of government to continue providing the credit support, considering its own revenue challenges, that must have driven the CBN to safeguard its exposure. No one seems to be asking the question of the causes of the shortfall.

What may come across as CBN using its regulatory powers to breathe some sanity into the financial position of the electricity industry is, to all intents and purposes, an overreach, as CBN has simply relegated the sector regulator to a casual bystander. CBN has stepped beyond its mandate and assumed a key function of NERC, namely, supervision of the electricity market. And that does not bode well for the future of the electricity industry and the real reform required to provide the energy to drive the economy.

As for Azura, the authorities were remiss in their responsibilities. The risks and contingent liabilities the PPA, PCOA and PRG were meant to mitigate or manage were not contingent. They were real risks merely waiting to happen, and happen they did. Alarm bells were sounded as far back as 2015, but evidently fell on deaf ears. Government was more focused on the willingness to provide what was considered the necessary mitigation required to facilitate the development of the power plant and less on its capability to fund or manage the expected liabilities.

Perhaps if more attention had been placed on capability, the necessary inquiries would have caused the spotlight to be focused on assumptions and parameters on which the financial viability of the plant was based. This would have led to financial modelling and sensitivity analysis not only to underpin the viability of the arrangement but would have thrown up issues and challenges that would allow the authorities to manage the situation better. Unfortunately, the level of diligence the developers and financers undertook to safeguard their interest was not replicated on the government side.

The second issue is the tariff increases, which ostensibly are to facilitate access to a US$1.5 billion facility from the World Bank to augment the financial position of the industry given the revenue challenges of government. One must ask whether an adequate assessment was undertaken to determine the implications and effects of tariff increases of 73 and 60 percent respectively, that is, the possible deleterious consequences on the economy and welfare of Nigerians.

Consider this: The bottom line is that a consumer who is currently paying ₦20,000 per month for electricity will end up paying ₦34,600 per month when the initial price increase takes effects in September 2020. The amount the same customer will pay in 2021 when the second increase is implemented is ₦46,600 per month for the same amount and quality of energy. This is a staggering increase. With the current realities of GDP contraction, lower oil prices, etc. we should brace ourselves for some serious economic challenges as real income declines, with a higher proportion expected to be spent on electricity and food already accounting for 60 percent of household income, food prices will tend upwards especially those that depend on electricity.

The distribution companies have been clamouring for tariff increases from inception on the grounds of non-cost reflective tariffs. However, what is 'cost-reflective' if there is no consensus on the areas that must be tackled to improve operational and financial performance by the authorities who are meant to balance the interests of consumers and service providers.

On the argument that prices are not cost reflective, the focus should be on appropriate pricing principles and efficient cost of production – after all, no one would support persistent disequilibrium of costs and price. The debate must, therefore, be on addressing the underlying systemic and structural deficiencies that consistently cause costs to diverge from set tariffs. Assuming a tariff increase will cure the myriad of sectoral challenges is naive. The overwhelming evidence is that any cure attributable to tariff increase is temporary at best. People adjust their consumption patterns in line with their disposable income. The implication is price increases that please service providers cause consumers to reduce consumption. This is basic economics.

Without addressing the underlying factors that drive cost to diverge from price, consumers will face further tariff increases in the future; this will negatively impact aggregate demand and cause shrinkage in supply and production. The factors which directly or indirectly influence costs and, consequently, prices), include: (i) technical losses, (ii) non-payment/theft of electricity, (iii) low capacity utilisation, and (iv) high operating and capital costs. Then there are unfavourable macroeconomic parameters, such as: high interest rates; a dearth of long-term development capital; the regular depreciation and devaluation of the Naira and heightened foreign currency exposure increase prices for imported equipment (virtually everything) utilised in electricity production and supply; denominating gas supply purchases in US dollars despite the fact that it is produced domestically; the lack of adequate risk mitigation instruments; and finally, inappropriate trading arrangements for electricity that add to cost of services, etc.

Moreover, the knock-on effect of tariff increases does not receive the attention it deserves. The fact that factories and businesses are regularly closing is not unconnected with epileptic and expensive power supply. There is a presumption on the part of the authorities and operators in the industry that prices can be increased inordinately. This may be applicable to most residential consumers: they have low price elasticity of demand, that is, they have little or no choice on source of power and their consumption is not that sensitive to price changes. The reality for job- and wealth-creating commercial and industrial consumers is the opposite: with higher elasticity, when faced with increased power prices that can make their products more expensive and less competitive they respond by investing and switching to self-generation or closing up shop.

It is worth noting that the various tariff increases the industry has witnessed in the past did not solve any of the electricity supply challenges in Nigeria. Neither have tariff increases improved operational or financial performance of the sector or supplied more energy to the economy. The authorities still need to decide how to make electricity available at a fair price to enhance competitiveness, create jobs and spur economic growth. Nigeria is at a crossroads: Urgent attention must be paid to addressing growing poverty, unemployment, the flagging economy and HDIs that are negatively correlated to economic growth, an electricity is a critical infrastructure that must be available. The issue is not just about the electricity industry. No, it goes beyond that: The basic economic welfare of the citizens and society will be pulverised if business as usual approach is maintained. Our welfare is imperiled with dire consequences for society simply because we have failed to diligently attend to the economy and balance the interest of all stakeholders. We should be deeply concerned and agitated by these recent developments.

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