



## **Pathfinder Economic Flash**

### **Electricity and Petroleum Sector Reforms: Let Consumer be the King**

In the past two years, rarely has a week passed without a news item which highlighted the losses, poor quality of products and services, inefficiencies and possibly corruption in the electricity and petroleum sectors. This was not a new phenomenon. A decade ago, a current Senior Minister was moved to call four of the State – Owned Enterprises (SOEs) including the Ceylon Electricity Board (CEB) and the Ceylon Petroleum Corporation (CPC), “Monsters” that swallow up large amounts of scarce resources and yield very disappointing returns.

In the recent past, allegations of corruption leading to the import of low quality petrol and diesel, interruption of power supply, references to the “Diesel Mafia” in the electricity industry have led to criticisms and charges being directed at politicians, bureaucrats and the entire management of the CEB and CPC.

Huge financial losses of the CEB and the CPC have also affected the financial stability and integrity of the State Banks and have undermined public finances.

Both CEB and CPC have common characteristics. They are solely owned by the State meaning public funds have been invested in them. Both enterprises are highly integrated. The CEB is a virtual monopoly in transmission and distribution with a near monopoly role in large-scale electricity generation. The CPC, which until 2002 was a highly integrated monopoly still remains so in the import, storage and refining fields, while retailing has been shared with the Indian Oil Corporation (IOC). One of Sri Lanka’s foremost advocates of competition in infrastructure provision has remarked that “the only thing worse than a monopoly is a duopoly”

Sri Lanka must eliminate the huge financial losses and improve the efficiency of these two important sectors. This is essential for achieving the fiscal consolidation without which it is impossible to achieve the low inflation, low interest and competitive exchange rate environment necessary for accelerated growth on a sustained basis.

### **Benefiting Consumer and Creating an “Energy Hub”**

Under these circumstances, it is inevitable that a government with a commitment to accelerated, sustained growth and envisioning to make Sri Lanka an ‘Energy Hub’ will be

compelled to change the status quo of the two institutions in the years to come. Can the restructuring of these two institutions be delayed any longer?

While the fiscal consolidation necessary to reduce the burden on the Treasury and the other macro economic implications are important factors to be taken into consideration. Even more significant is the impact on ordinary consumers, whether it is households or businesses. Occasional blackouts, voltage fluctuation, breakdown of vehicles and problems in the transport sector, in general, have affected the ordinary public in their day-to-day lives. Those who believe in maintaining SOEs without reform, despite inefficiency, corruption and the drain on the government finances need to be reminded of the suffering of the large population of consumers.

### **Evidence Based Policy Recommendations?**

According to the sector experts, neither CEB nor CPC managements can clearly identify the specific functional areas where the losses and inefficiencies exist. For example, the CEB, is the largest generator. It also manages the island wide transmission and distribution network. Each and every consumer is compelled to bear the burden of losses, inefficiencies or malpractices at these different levels and stages. In order to identify and rectify these problems the minimum required is effective unbundling of the institution going beyond the current Strategic Business Unit concept.

Similarly, the CPC too is entirely responsible for the import, storage, distribution and retailing. Each of these is a different business function. Restructuring should lead to opening up of each of these business activities for competition, while the existing government entity should be encouraged to enter into Private Public Partnerships (PPPs) for improving management, technology and more importantly infusion of fresh capital, as was done successfully in the case of Sri Lanka Telecom.

Another reform area that the government has to consider is the removal of price controls, price fixing and other such inefficient interventions allowing the competition to stabilize the relevant markets. Government owned monopolies do not respond to incentive-based regulatory mechanisms in pricing. They don't have any incentive to improve efficiency. Therefore, the objective of price setting fails under this structure. This has been proven over the years in the petroleum and electricity sectors. The major part of the large losses incurred by these institutions is hidden subsidies. Not only is there a question of transparency, but there is also a major affordability issue. As a lower-middle-income country with no access to aid, Sri Lanka can no longer afford untargeted subsidies. However, these reforms have the potential to provide greater relief to the needy through a combination of cross subsidies and well designed transfer payments.

### **Pragmatism: Not Just Theory or Dogma**

The Pathfinder Foundation does not present the case for reform as mere theory, concept or an ideology. Reforms in Sri Lanka's Telecom sector has clearly demonstrated the tremendous

benefit of privatization, PPPs, foreign direct investment and competition to the consumers, industry and the economy in general. Those of us who paid Rs. 300 – Rs 400 per minute for overseas calls when Sri Lanka Telecom was a government monopoly today pay a fraction of that amount. A subscriber waiting list no longer exists. Improved communication has resulted in increased efficiency and a higher quality of life for ordinary citizens of Sri Lanka. Many such examples can be found in other Asian countries such as India, South Korea, Malaysia and Singapore.

Unbundling, de-monopolising, creating competition or inviting private sector participation into Electricity and Petroleum sectors should and will not deprive the deserving disadvantaged and vulnerable segment of the population from being supported by the government. Similarly extension of services particularly the electricity supply to the remote areas in the country could be further improved with the introduction of Universal Service Obligation or a similar measure. Instead of reducing support for the disadvantaged and needy; the efficiency gains achieved through reforms can create the opportunity for increased assistance to them.

In the final analysis the Pathfinder Foundation believes that bold decisions to restructure and create competition in the electricity and petroleum sectors will ultimately bring immediate benefits to the consumers, industry and the country. Of course, the markets too reward political leaders who take bold decisions to reform. This has been amply demonstrated in the telecom sector.

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