The need for cost reflective tariffs in Malawi

In our last entry, we delved into how the ongoing implementation of reforms in the power sector is playing a critical role of stimulating interests of private sector players or Independent Power Producers (IPPs) to invest in power generation.

But as highlighted in previous entries, it would be a futile attempt for the country to lay beautiful infrastructure in the power sector when, on one hand, there are no incentives for potential investors to enter the market and help generate more electricity.

In other words, investors in power generation want assurance that the tariff structure in the country they are investing in, is able to allow for sufficient revenues so that their investment should cover costs and future capital injections. This, therefore, brings us to this week's subject matter of why Malawi urgently needs a cost reflective tariff in the power sector.

A cost-reflective tariff simply means that the tariff paid by the customer should be equal to the cost of supply for that customer.

From the power sector perspective, cost reflectivity is attained when the tariff on the ground is able to recover all the allowable costs of each regulated and licensed activity within the generation, transmission, distribution and supply value chain.

Malawi as a country does not operate in isolation. That is why, at regional level, the country was party to Southern Africa Development Community (SADC) Energy Ministers Conference in 2008 which agreed to endeavor to reach cost reflective tariffs by 2013.Later in 2015, only two out of 15 member states reported to have attained a cost reflective tariffs.

The attainment of cost reflective tariffs target was later shifted to the year 2019.Under the $350.7 million Malawi Compact, the Government of Malawi committed to a phased implementation towards a full-cost recovery tariff in the Millennium Challenge Corporation (MCC) Compact agreement.

Today, Malawi sits on a list of countries with lowest rates of installed electricity capacity in Southern Africa.One reason explaining such a decimal performance in electricity generation capacity is the unwillingness of investors to come on board and invest in the wake of low electricity tariffs.

It sounds logical that for electricity producers and sellers to be assured that they will remain intact in business, they ought to recover all their costs of producing their goods and services, and also make a reasonable profit for further re-investment in their respective businesses.

Hence suffice to state that one other importance of having a cost-reflective tariff in the power sector is that it will have a net effect of protecting investors, producers and sellers of electricity and also consumers as there will be a win-win situation.Investors (IPPs) would be guaranteed of good Return on Investment (ROI) while customers on one hand would enjoy seamless electricity supply.

In other words, expectations are high that making tariffs cost reflective, would help speed up the modernization of power grid, expand Malawi's access to electricity and therefore guarantee availability of electricity in the country.

From the explanation above, one, therefore, observes that raising electricity tariffs now would be a necessary evil and would demonstrate Malawi Government's commitment to improving the financial viability of the power sector as agreed in the Compact agreement with MCC.

As highlighted last week, the passing of the Electricity Act Amendment Bill in June 2016, coupled with the formulation of IPP Frameworks for potential investors in the energy sector have brought hope for increased power generation soon.

However, achieving cost-reflective tariffs would even make things sweeter as whoever invests in the power sector would be assured of enough returns and have enough resources for business expansion at the same time.

Over the years, Malawi's electricity tariffs have remained non-cost reflective and this has done the power sector more harm than good.

Of course, in recent years tariffs have marginally edged upwards from $0.02/kWh in 2012 to $0.08/kWh in April 2014 but this remains below the desired thresholds to achieving full cost recovery.

Currently, a consultancy on Cost of Service analysis to determine appropriate tariff levels at ESCOM is underway and is on course.This study, being funded by MCC, will enable the parastatal develop correct and appropriate tariff application governing the electricity tariff regime, once completed.

The basic rationale is to help ESCOM achieve a full cost reflective tariff whose objective is to ensure that ESCOM becomes financially viable.

Hence the outcome of the study will help inform the cost reflective tariff as being proposed by the power sector reforms under the Malawi Compact.

It is common knowledge that a robust power sector requires a sound financial base. For this to happen, the power sector must assure investors of enough revenue collection to necessitate new and modern investments. In short, electricity customers should be in a position to pay for the electricity they use so that the same money goes towards maintaining and operating an efficient power network with more people accessing reliable electricity.

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For more information on the Malawi Compact please visit our website on
http://www.mca-m.gov.mw/

You can also visit the MCC website on
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