Electricity Prices Are Rising – Why?

The Multi-Year Tariff Order (MYTO) is the regulation established by the Nigerian Electricity Regulatory Commission (NERC) to set the electricity prices (tariffs) in Nigeria. MYTO 1 has been in existence since 2008 and has now been reviewed to reflect the current realities of the Nigerian Electricity Supply Industry (NESI). MYTO 2 will be released shortly and is expected to come into force at the end of March 2012. The MYTO 2 tariff schedule will show an increase in the cost of electricity across all classes of customers.

Understandably, the public has concerns about this price rise. This factsheet will attempt to explain the rationale behind the rise, and to answer various questions concerning the power sector.

Q: Why can’t electricity improve before prices rise?

A: Producing electricity costs time and money

Time: Depending on the size and type, a power plant takes 3-8 years to build. Each plant needs to be connected to a fuel source, usually natural gas, and this involves building new pipelines to connect it to the gas pipeline network run by Nigeria Gas Company (NGC) which is a subsidiary of NNPC. Upon completion of the plant, it must be connected to the electricity transmission network so that the electricity produced can be delivered to end-users. The transmission lines are built and maintained by the Transmission Company of Nigeria. Each of the above parties has its own separate processes and priorities which in the past have not always been well coordinated.

Money: The average cost of building the simplest thermal power plant (open-cycle gas turbine) in Nigeria (assuming that gas pipelines and transmission infrastructure are provided) is $1.2m per MW (hydro plants can cost twice as much). There are two main sources of investment; public sector and private sector. The public sector is currently short of cash because there are many parts of the economy competing for government funds (e.g. education, health, security etc). The Federal and State Governments do not have the billions of dollars required to meet our electricity needs. That leaves the private sector as the only possible source of sustainable investment. In order for private investors to invest in power (rather than in other sectors of the economy), they must be able to recoup their investment in a reasonable time period and earn an attractive profit.

Q: Why hasn’t the Private Sector invested in power?

A: The Electricity Market in Nigeria is not profitable

Since independence, the power sector in Nigeria has been run as a public welfare service rather than a profitable business. Sustaining any public service depends on political commitment and public funding. In Nigeria, unreliable political will has led to inadequate funding and multiple inefficiencies in the system. The graph below shows the pattern of investment experienced:
What is clear from the graph is that the sector is still trying to recover from a pattern of under-funding that stretches back over 3 decades.

Now that the private sector has been invited to invest in power (in order to fill the huge investment gap that exists) it can only do so if it makes economic sense. In other words, the electricity business must be made profitable and sustainable. MYTO 1 attempted to make the sector profitable, but it failed to do so because certain projections were not realised and so the tariffs charged were neither sufficient to cover costs nor efficiently collected. The following table provides a snapshot comparison of MYTO 1 tariffs (in Naira per kilowatt hour) and tariffs charged in neighbouring countries as at 2009:

<table>
<thead>
<tr>
<th>Type of Tariff</th>
<th>Chad</th>
<th>Niger</th>
<th>Cameroun</th>
<th>Benin</th>
<th>Ghana</th>
<th>Nigeria</th>
</tr>
</thead>
<tbody>
<tr>
<td>Social Tariff (100kwh/month)</td>
<td>11.07</td>
<td>16.85</td>
<td>17.33</td>
<td>21.60</td>
<td>9.41</td>
<td>1.58</td>
</tr>
<tr>
<td>Residential Tariff (600kwh/month)</td>
<td>25.60</td>
<td>16.85</td>
<td>19.10</td>
<td>24.51</td>
<td>12.92</td>
<td>9.68</td>
</tr>
<tr>
<td>Commercial Tariff (1800kwh/month)</td>
<td>26.75</td>
<td>20.52</td>
<td>23.55</td>
<td>24.00</td>
<td>21.92</td>
<td>9.66</td>
</tr>
</tbody>
</table>

Source: Union of Producers, Transporters and Distributers of Electric Power in Africa (UPDEA) [www.updea-africa.org]

The table shows that Nigeria has the lowest electricity tariff in West Africa by far. Therefore, even if a private investor has millions of dollars to invest in power, it would make more sense to invest in Cameroun or Ghana than to invest in Nigeria.

Q: What will it take to improve the supply of electricity in Nigeria?

A: Cost-reflective tariffs, increased efficiency and stronger regulation

Tariffs must be set at a level which is sufficient to attract investment. As we have seen in Nigeria, if tariffs are too low, no private individual or corporation will invest. MYTO 2 aims to solve this problem by setting tariffs that ensure that investors recover their costs and earn a suitable return.
The inefficiency in the system is quite high. At least 40% of the revenue from power produced is lost through ageing infrastructure, outdated technology, power theft, inefficient accounting, poor billing and revenue collections. The Electric Power Sector Reform Act (2005) sets a reform agenda that requires the privatisation of government-owned generation and distribution companies to ensure that they are run with both efficiency and commercial orientation (something that is currently lacking). This is because unlike government institutions, private businesses cannot survive while losing money. Therefore, privatisation is expected to lead to fewer leakages in the system and improved services to the satisfaction of Nigerian customers.

NERC is the power sector regulator and is mandated by law to pursue and balance the interests of consumers, investors and the government. It does this through setting tariffs, licensing market participants, developing and enforcing technical standards and regulations, protecting consumer rights and removing all the road-blocks in the path of progress in the sector.

Q: What is NERC doing to improve the power sector today?

A: Many, many different things...

- MYTO 2 will increase the current cashflows of the sector which will provide for immediate needs. It will also attract investment that will increase the supply of electricity over the next few years (as we established above, increasing electricity supply is a time-consuming process). NERC has firm commitments from those who seek to hold generation licences that the new tariffs are good enough to enable them invest.
- NERC has negotiated a Federal Government subsidy for electricity tariffs amounting to N60 billion in 2012 and N50 billion in 2013 respectively. This means that even with the increase in tariffs, Nigerians are still not paying the full cost of electricity provided.
- NERC is in the process of developing a Renewable Energy Framework which will encourage investment in renewable energy and reduce our dependency on gas.
- In terms of consumer affairs, NERC is compelling the distribution companies to open forum offices to handle customer complaints. NERC is also opening several zonal offices around the country, which will enable it to be more accessible to consumers and help solve issues involving effective service delivery by the distribution companies.
- NERC is improving its ability to monitor the performance of its licensees by reviewing the periodic submissions it requires from them. It is also investing in an electronic platform which will speed up this data gathering process and enable faster regulatory action.

Conclusion

The increase in electricity prices will cause short-term discomfort but it is in the best interests of the sector and is a long awaited step in the right direction. NERC has put in place several palliative measures to cushion the effects of the tariff review as mentioned in the body of this write up. Therefore, Nigerians are expected to take part in the debate about the sector’s future and pay more attention to what is happening in the sector. As the regulator, NERC should be supported in its work (by government and consumers) because the reality is that without general support for NERC, our emergence from darkness will continue to be delayed. NERC should also be held accountable for its
responsibilities so as to keep it on its toes. With such support, it will be able to achieve its vision of “Electricity on Demand”.

Muhammad Wakil
NERC