



**PARLIAMENTARY FORUM
ON ENERGY & ECONOMY**

Is privatization the only option for distribution companies (DISCOS)?

BRIEF PAPER



The Parliamentary Forum on Energy and Economy is a cross-party group of parliamentarians focused on addressing the nexus between energy and economy. It is a platform for open discussions, research-based debates and candid conversations within its members as well as with experts, representatives of civil society, policymakers, policy implementers and, most importantly, the citizens of Pakistan on the issues and problems that bind energy and economy together. We believe that these cross-party interactions and discussions will better inform everyone involved in their respective domains, contributing towards possible solutions to the energy-economy crisis.

INTRODUCTION

Pakistan's energy crisis has been caused by a series of policy failures including the flawed power purchase agreements (PPAs) with Independent Power Producers (IPPs), inadequate and old power transmission system and inefficient and ineffective power distribution system. As a result of these problems, the power sector's circular debt has ballooned to nearly 2.5 trillion rupees. While the federal government is pursuing the privatization of electricity distribution companies (DISCOs) as a possible solution to this crisis, this step itself cannot rectify the multiple problems that the power sector is suffering from.

It is important to note here that these DISCOs were carved out of the Water and Power Development Authority (WAP-DA) in the 1990s because the system before their creation was deemed to be inefficient, ineffective and broken. Over the last two decades, however, the DISCOs have become a part of the problem they were supposed to solve. Instead of improving their bill recovery, reducing their technical and financial losses and streamlining their management, they are struggling to maintain their administrative and financial capacities and are reeling under untenable losses. Pakistan's international development partners, particularly the World Bank and the International Monetary Fund (IMF), propose privatization as the primary solution for improving the existing situation. The government seems to agree with them.

The Parliamentary Forum on Energy and Economy organized a public event in Islamabad on 3rd September 2024. It was attended by more than 20 members of the National Assembly and Senate, with the National Assembly Speaker, Sardar Ayyaz Sadiq, opening the consultation. Its other participants included former energy and finance minister, former and current senior government officials, energy experts, researchers, members of the civil society and journalists.

One of the most important conclusions drawn during the event was that the decision to privatize DISCOs was too important to be taken in haste and without a thorough, honest and evidence-based debate within the parliament and in the public. In the absence of such a debate, the participants concluded, we run the risk of making decisions which we might be regretting a few years later – just as we have witnessed with the privatization of K-Electric. It not just provides its consumers with the costliest electricity in the country, it also still requires and receives state subsidies worth hundreds of billions of rupees to keep itself running.

The question here is: Why privatizing DISCOs? Given below are some of arguments being made in favour of privatization:

EFFICIENCY

The advocates of privatization believe that the DISCOs fail to provide reliable and affordable electricity largely due to their weak governance. Weak enforcement of laws against electricity theft and bill defaults and ineffective regulatory oversight have exacerbated their inefficiencies. So, they argue, these companies should be privatized to make them more efficient.

FINANCIAL LOSSES

Most of the distribution companies are suffering from colossal financial losses. In 2023-24 alone, DISCOs, including the K-Electric, reported financial losses of 281 billion rupees due to transmission and distribution inefficiencies. They also lost another 380 billion rupees due to their failure to recover electricity bills. Caused by a combination of theft, poor infrastructure, faulty metering and outdated equipment and other socio-cultural and economic factors, these losses have made the national grid very fragile both technically and financially and contributed significantly to the power sector's circular debt. The protagonists of privatization argue that these financial losses will be curtailed once these companies are privatized. However, it must be highlighted here that K-electric continues to suffer losses despite having been privatized for almost two decades.

TECHNOLOGY

Admittedly, most of the distribution companies are outmoded and require investments in infrastructure upgrades. One of the strongest arguments in favor of their privatization is that their prospective private owners might be more inclined than their current government administrator to invest in technological advancement in their metering, energy distribution, and billing.

DONOR COMMITMENT

It is now an open secret that privatization is also one of the conditionalities of the Extended Fund Facility (EFF) loan being provided by the International Monetary Fund (IMF).

Given below are the challenges, options and recommendations identified during the event:

KEY CHALLENGES

CROSS SUBSIDIES AND UNIFORM TARIFF

Electricity sector has a uniform tariff policy for the whole of Pakistan. This policy makes DISCOs cross subsidize each other: those doing better financially subsidizing those which are in a poor financial shape. If profitable DISCOs are privatized and thereby are not obligated to subsidize other DISCOs, it is still not clear if this will bring down their electricity prices because these prices are not determined by subsidies alone. On the other hand, the DISCOs left out of privatization might have to charge even high prices once their privatized counterparts stop cross-subsidizing them. Together these two factors challenge the argument that privatization will result in cheaper electricity for consumers in the near future.

WEAK REGULATORY AND INSTITUTIONAL FRAMEWORK

Pakistan's energy sector suffers from weak regulatory institutions. They face serious challenges in enforcing contracts that can ensure transparency, fairness and equitable distribution of risks between the government and the private sector while protecting the end user or consumer from overbilling, load shedding etc. We have seen, for instance in the case of K-electric, how the consumers suffer from both overbilling and load shedding either because the regulator

is unable to protect them or it is unable to exercise and enforce its regulatory powers. A weak regulatory environment makes it equally difficult for the regulator to ensure transparency and accountability of the privatized entities.

ENFORCEMENT OF LAWS AND REGULATIONS

The critics of privatization argue how a private entity will ensure bill recovery when the government with all its might has been unable to do so. Also, they ask, will the private owners/managers of DISCOs be allowed to penalize or disconnect government agencies for not paying their bills by the due date? Since there are no clear answers to these questions, these factors may deter the private sector from taking up loss making entities.

FINANCIAL AND ADMINISTRATIVE CONSTRAINTS

The government has selected the best managed and most profitable DISCOs for privatization in the first phase. These companies mostly cater to industrial consumers and urbanized middle classes which often pay their electricity bills more regularly than others. The real challenge will be faced in the case of DISCOs suffering from huge losses such as Sukkur Electric Power Company (SEPCO), Hyderabad Electric Supply Company (HESCO) or Peshawar Electric Supply Company (PESCO) which generally cater to rural and poorer sections of the society. Overstaffing and a culture of patronage has wrecked them to the extent that the private sector will be reluctant to take them up as they are. Without the power to shed their staff and penalize and eventually disconnect government agencies for not paying their bills by the due date, the private owners/managers of DISCOs will not be able to reduce their financial and technical losses.

THE GREAT SOLAR RUSH

Pakistan is one of the fastest growing solar energy markets in the world. In the last 24 months, it has imported solar panels worth more than two billion dollars from China. Home owners, business concerns and industrial units are using these solar panels to produce their own electricity because they find DISCO-provided grid electricity both highly costly and unreliable. Consequently, the demand for DISCO provided electricity has been decreasing consistently over the last many months. This will certainly pose a serious challenge to the privatization of DISCOs because the departure of their customers to off-grid solutions will mean that their cost will go up and their incomes will go down. Given these challenges, what are the policy options available for reforming/restructuring the power distribution companies?

OPTIONS

PUBLIC-PRIVATE PARTNERSHIPS (PPPs)

Instead of privatizing DISCOs entirely, a PPP model can be adopted – with private sector entities managing electricity distribution companies without owning their assets. This model has been successfully implemented in countries like Turkey where management concessions given to the private sector improved the efficiency of the distribution system, eventually leading to its full privatization in some areas. The Turkish model, however, also shows that the handing over of distribution management to the private sector may lead to higher electricity prices for consumers in the short run. It can also result in the denial of electricity to marginalized consumers. To avoid these problems, it is essential to have a well-defined contractual framework that ensures the protection of marginalized consumers, provides clear mechanisms for the resolution of disputes that might arise from arbitrary bill recovery methods and/or the use of load-shedding as a punishment and includes strict performance benchmarks for the holders of management concessions.

DEVOLVING DISCOS TO PROVINCES

Under the 1973 Constitution, electricity is a concurrent subject, with Article 157 providing that both the federal and provincial governments share jurisdiction to produce, transmit and distribute electricity. Transferring DISCOs to provincial governments in a phased manner, therefore, not just follows the constitutional scheme, it might also increase their administrative efficiency because the provincial governments are both better suited and better placed to monitor their performance. The provincial administrations are also equipped and constitutionally empowered to help DISCOs in recovering bills and preventing electricity theft. Provinces, however, must first demonstrate their financial capacity and administrative ability to manage these entities effectively. A pilot devolution program can be launched for selected DISCOs before implementing it nationwide. In any case, provinces must be on board in the process of restructuring/reforming DISCOs at all levels and the federal government must seek their policy inputs before making any decision about the future of the electricity distribution system.

PRIVATIZATION WITH STRONG REGULATORY OVERSIGHT

If privatization of DISCOs is to be pursued in any case, it can be carried out in phases with clear performance-based contracts and consumer protection mechanisms to prevent monopolization and price gouging. The scope of privatization must be clearly defined, ensuring that key infrastructure (such as poles, wires, grids, substations and properties) remains under public control. Lessons learnt from K-Electric's privatization must be incorporated in the privatization framework to save the consumers of privatized DISCOs from the problems that electricity consumers in Karachi are already facing.

LIBERALIZING THE ELECTRICITY MARKET

A wholesale power market can be developed in phases to allow consumers to purchase power directly from producers. This market can break the government's monopoly over power supply, encouraging competition among power producers, driving down costs and improving service quality. It, however, needs to be accompanied by:

- ◊ Grid modernization, grid strengthening and digitization of transmission and distribution systems to ensure the reliability of electricity supply.
- ◊ Strengthening of regulatory oversight to preempt and prevent irregularities, contract violations and unfair practices.
- ◊ Consumer protection mechanisms to avoid market manipulation and cartelization.

USING TECH-BASED SOLUTIONS: SMART METERING AND DIGITALIZATION

Introducing technological innovations can improve the performance of loss-making DISCOs. For instance, advanced metering infrastructure (AMI) and smart grids can help reduce theft, improve billing efficiency and enable real-time monitoring of the electricity supply and consumption. Smart metering has been successfully implemented in several countries – including India which like Pakistan had high electricity losses until recently.

RECOMMENDATIONS

COMPREHENSIVE REFORMS

The privatization of DISCOs will not resolve the energy crisis unless it is accompanied by the reforming/restructuring of generation and transmission of electricity, strengthening of the national grid, and measures to make electricity affordable and reliable. The single biggest issue today is the high cost of electricity. Privatizing a few profit-making DISCOs may marginally improve the governance of the sector but it will not contribute majorly to price reduction. We, therefore, recommend that a holistic plan be developed for the whole of the country, that includes all steps required for the energy sector's reform/restructuring before embarking on the privatization of DISCOs.

RESTRUCTURING LOSS-MAKING DISCOS

Contrary to the IMF advice – mentioned in its staff statement earlier this year -- that the most inefficient DISCOs must be privatized first, the government has included the most efficient ones in its privatization list such as Faisalabad Electricity Supply Company (FESCO), Gujranwala Electric Power Company (GEPCO) and Islamabad Electricity Supply Company (IESCO). The government must first consider the reform/restructuring of loss-making distribution companies and engage the provinces fully in carrying out their reform/restructuring.

LEARNING FROM GLOBAL BEST PRACTICES

The government must study and adapt successful privatization and restructuring models from comparable middle-to-low-income countries, keeping in view Pakistan's specific context.

CONTEXT-SPECIFIC APPROACH

The government should avoid a one-size-fits-all model because it cannot be feasible across all DISCOs. Each of them should be evaluated and restructured individually, keeping in view their ground realities, the state of their grids and equipment, their service area and their financial status. Many stakeholders, including some provincial governments, have pointed out that a wholesale privatization may not offer the solution to the problems that the energy sector is afflicted with. Such privatization may reduce the financial and electricity losses of the privatized DISCOs but it will leave many other problems, including an equitable, reliable and affordable access to electricity, unaddressed.

ENHANCED PROVINCIAL ROLE

The federal government should engage the provinces actively while discussing and devising strategies for the restructuring/privatization of DISCOs to ensure local and context-specific solutions. Engaging the provinces is also important for a smooth implementation of future strategies/plans vis-à-vis DISCOs. Also, before finalizing any plans to privatize or restructure a DISCO, we need to explore if it can be transferred to the relevant province in the medium to long run in a gradual and phased manner.

COMPREHENSIVE RESTRUCTURING

Restructuring should be carried in all the DISCOs by breaking them into manageable parts, retaining the public ownership of their assets, equipment and systems and entrusting their management to qualified and experienced private sector companies. The performance of private management companies should be regularly gauged in terms of reduction in the DISCOs' electricity and financial losses, modernization and digitization of their distribution networks and the protection of the rights of their consumers, especially the marginalized ones.

SCRUTINIZING FINANCES

The latest financial position of all the DISCOs should be publicly disclosed, including their longstanding receivables that can no longer be recovered, market values of their properties, factual worth of their poles, transformers, wires, meters and other assets, and a complete and detailed picture of their liabilities and their loan servicing requirements.

CLEARLY DEFINED PRIVATIZATION SCOPE

The privatization process must specify which aspects of the power distribution system are to be privatized – including specifying whether infrastructure and assets (such as wires, poles, transformers, grids and properties) will also be transferred to the private sector. The scoping exercise must specify how competition will be introduced and encouraged within different tiers of power distribution system and whether private managements will have the power to hire and fire employees, penalize individuals, private businesses and government agencies for not paying their bills and remove illegal connections with the full backing of the law enforcement agencies.

REVISING TARIFF AND SUBSIDY MECHANISM

Power tariff structures must be adjusted/restructured to balance affordability with cost recovery, incentivize industrial consumers to use more grid electricity than they are doing now (to avoid seasonal demand fluctuations) and remove cross-subsidies in electricity tariffs (substituting them with targeted cash subsidies) while managing the political ramifications of this removal. The government must abolish the national uniform tariff to allow DISCOs to offer tailor-made incentives to different areas and different consumer categories to increase their consumer base. Furthermore, the government should engage with IMF to eliminate withholding and income taxes being collected through electricity bills and, thereby, lower consumer price.

LIBERALIZING ENERGY DISTRIBUTION

The government must devise a comprehensive plan to enable consumers to purchase electricity from multiple producers, phasing out government monopolies while maintaining the government's regulatory oversight.

STRENGTHENING THE REGULATORY FRAMEWORK

The National Electric Power Regulatory Authority (NEPRA) needs full financial and administrative autonomy to enforce its regulations strongly and effectively. At the same time, the technical capacity of NEPRA and other energy-sector regulators, should be improved provide them with administrative, financial and operational autonomy and give them the power to enforce their directives. NEPRA should be able to penalize under-performing DISCOs and ensure that they all comply with its efficiency targets. It should also initiate a transparent benchmarking system to rank the performance of DISCOs and incentivize improvements in it. Finally, it should have the power to open investigations against delinquent energy sector entities and punish them, including shutting down their operations, if allegations against them are proven.

ENHANCING PARLIAMENTARY OVERSIGHT

The parliament must fully engage with energy sector policies, plans and projects, playing its due oversight role. It must use its committee hearings to generate expert-driven inputs to make sure that all energy sector reforms/restructuring are sustainable and effective. The parliament must also expand its role in developing regulatory legislation to ensure that principles of equity and social justice are included in all energy sector policies, plans and projects, ensuring that the poorest of the poor are not left out of energy supply chain.

CONCLUSION

Although the entire energy system suffers from major flaws, the government believes that the privatization of DISCOs will at least resolve the problem of energy theft and leakages. Our forum, however, remains skeptical. Unless the energy sector reforms are comprehensive, centered on ensuring equitable and affordable electricity for all everywhere and have a long-term vision, piecemeal steps such as privatization may only complicate the problem further. With the national grid under massive pressure due to excess generation capacity, on the one hand, and the solar rush, on the other hand, affordability and availability of electricity will be key factors that will determine profitability of DISCOs for their prospective buyers. We, therefore, believe that the government should explore other options too such as handing over DISCOs to the provinces and/or giving their management to the private sector through concession agreement models. To explore all three options, the government must realize that provincial and parliamentary engagement with policymaking and policy implementation is essential.