ZNFU Position on Proposed ZESCO Tariffs 2009/2010

SUMMARY

Given the prevailing economic circumstances and the already high cost of agricultural production in Zambia, the proposed tariff adjustments must be deferred until the economic crisis is over. **The timing is not right.**

Without belaboring the point, the agriculture sector certainly requires a preferential treatment given its attendant effect on employment creation, inflationary benefits to the economy, etc, the Union is making an appeal for, if deferment is not possible though it is the most preferred option, a downward revision of the proposed rate of adjustment on electricity tariffs to be equaled to the extent of the prevailing inflation rate, which is around 12..8%.

Below are the full details of the submission.

ZNFU SUBMISSION TO THE ENERGY REGULATION BOARD PUBLIC HEARING ON ZESCO'S PROPOSED TARIFF ADJUSTMENT FOR 2009/2010

INTRODUCTION

The Union is grateful for this opportunity to share our comments and suggestions on Zesco's application to the Energy Regulation Board (ERB) to revise electricity tariffs upwards. In developing this position, we took time to review the information that has been provided to us through the announcement by Zesco and subsequently, further details contained in the "Energy Regulation Board Public Consultation Paper on Zesco's Application to Revise Electricity Tariffs for Financial Years 2009/10 to 2011/12".

Additionally, we must also indicate that through past interaction with Zesco and the ERB we have had access to information on the utility's performance, the problem areas and the remedial actions that need to be undertaken as recommended in the Zesco's Cost of Service Study done jointly by ERB and ZESCO. Therefore, the purpose of submitting our comments is intended to contribute positively towards the process bestowed on ERB as an institution that should ensure that any tariff adjustment made by Zesco is in line with fair commercial business practices.

The application by Zesco highlighted many challenges that the company is facing ranging from the changing macroeconomic conditions, that is, the negative effects of inflation, depreciation of the Kwacha and rising interest rates. Other factors that have necessitated the adjustment were highlighted as; the updating of the method of determining tariffs introduced by the Cost of Service Study, the need to raise resources to be devoted towards improvements in the areas included in the Key Performance Indicators (KPIs), the need to invest in new power generating facilities to resolve the power deficit problems, the need to shift all maximum demand customers to a time of use tariff and above all the need to bring Zesco's tariffs to levels that are comparable to what is charged in other countries in the region.

Zesco further disclosed that their tariffs are second lowest in the region after Zimbabwe and they range from 2.6 to 3.9 US Cents per kilowatt. According to ZESCO, the low tariffs have been identified as one of the factors that has made it unattractive for the private sector to invest into new power generation projects.

The ERB statement further elaborated the above mentioned justification into more detail highlighting that Zesco has submitted that since the last tariff adjustment, new factors had emerged making it necessary to adjust the tariffs upwards. On the expenditure side, the implementation of Key Performance Indicators (KPIs) requires that more resources are devoted towards capital investment and rehabilitation of the existing infrastructure.

However, it is equally important that the proposed tariff adjustment and magnitude of this adjustment is discussed in relation to the prevailing economic environment. We believe that paying a blind eye to the economic difficulties that businesses are going through could have severe negative consequences on the very survival of operations that Zesco depends on to survive. The hostile macroeconomic environment illuminated in the application by Zesco is real and the resulting negative effects are being felt by all sectors although the extent may vary.

In the agricultural sector for instance, the timing of this adjustment is inappropriate because casting back to the last farming season, agriculture is emerging from a very difficult period due to sharp increases in the cost of fuel, fertilizer and chemicals all critical inputs in farming. Since these products are all imported, the costs are unlikely to drop in the domestic market although there has been a drop in the dollar prices of fuel and fertilizer in the international markets because of the depreciation of the Kwacha. Farmers also saw additional costs on the domestic front because of land rent, crop levies and labour. Land rent was raised by as much as 500% in some cases. These factors plus the hostile macroeconomic environment have had a negative effect on the viability of farming.

1) MACROECONOMIC DEVELOPMENTS EFFECTS ON AGRICULTURE

The deteriorating macroeconomic conditions are already being felt and ultimately the price of agricultural products should increase. However, for producers of primary agriculture, it is not always feasible to pass on the additional costs to consumers through the necessary price adjustment because of price resistance and the following consequences appear almost immediately:-

1) Farmers cutting back on production to reduce the losses.
2) Local agricultural products become more and more uncompetitive against imported products.
3) Inflationary pressures emerge as everyone in the value chain tries to pass on part of the additional costs.
4) Farmers in a desperate situation end up selling at a loss which leads to failure to service bank loans leading to foreclosures on farms.

Therefore with this understanding, it is clear that electricity is a key input in most production processes hence the upward adjustment in tariffs has an inbuilt cost push inflation effect. Therefore, any huge leap in adjustment of electricity tariffs such as the proposed rates, could potentially derail any efforts being made by government to curb the rising inflation which has galloped to high levels in the last twelve months. In fact as indicated above, given the effects of the global economic down turn, it would not be advisable for Zesco to contemplate of any tariff adjustments as yet, not until the attendant effects of the economic crisis on the Zambian economy, the farming community in particular, are fully mitigated and the road to economic recovery is certain.

2) SOURCE OF FINANCING CAPITAL INVESTMENTS

While it might be justifiable that tariffs should be adjusted towards cost reflective levels, it is inconceivable to imagine that capital investments should be predominantly financed through raising electricity tariffs. In the submission, Zesco has indicated that 60% of the cost of capital expenditure will be financed by Zesco. This is very worrying because electricity tariffs could rise to levels that could suffocate business operations and set in motion a decline in production. Our view is that investment into power generation should involve both public and private investment, with government taking the lead in sourcing long term finance.

3) ZESCO'S TARIFFS COMPARED TO THE REGION

Zesco has time and again argued that the electricity tariffs are way too low in comparison to what is prevailing in other countries in the region. While this may be true, we find this argument misplaced because as a country, we are blessed with hydro power which is the cheapest source of energy. We should therefore ensure that it remains reasonably priced to a level that should attract investment into other sectors of the economy rather than trying to catch up to get to tariff levels in other countries in the region that do not have this resource.

4) PERFORMANCE ON THE KPIs

An assessment of Zesco's performance on the KPIs at the end of December 2008 showed improvements on metering of customers, quality of service, reduction of transmission losses and staff productivity. The Union recognizes these achievements, but it is evident that there is still a lot of work that needs to be done to improve on customer service and cash management. Instead of reducing the sums of money customers owe Zesco to reach the target set, that is reduce total receivables to 17% of turnover by 2010, this indicator increased to 66%. Clearly, this huge increase in unpaid bills owed to Zesco is very worrying and we would urge Zesco to share the strategy they have put in place to deal with this problem.

Further there is overwhelming evidence that Zesco needs urgent restructuring, particularly with a view to reduce its operational overheads.

5) VOLUME DIFFERENTIATED TARIFFS

On the revenue side, Zesco plans to implement the Volume Differentiated Tariffs (VDT) to inculcate prudence in the usage of power by residential customers. The ERB explained that this will be different from the current practice where electricity is priced based on an Inverted Block Tariff (IBT). The IBT structure is computed on a graduated scale hence it makes an allowance for minimum usage of electricity to be charged at a lower charge and the charge is higher as more units are consumed.

However, the VDT structure charges a uniform high tariff for all the electricity units consumed as long as consumption goes beyond the minimum, even when the electricity consumed exceeds the minimum usage by a few units. Clearly, this will become highly punitive and farmers who are classified as residential will be badly affected especially poultry farmers and small scale farmers in the per-urban and rural areas.

6) MINING

It is encouraging that Zesco has proposed an upward adjustment of 51 percent on power supplied to the mines. However, there is a lesson to be learnt from actions in the past. A year ago the mines were booming, the exchange rate was appreciating and it was a perfect time for an immediate adjustment of the tariffs on the mines but no increase was affected on the mines last year and now the fortunes of the mines have reversed. Our position on this is that, it is time the mines began to contribute a fair share to the cost of power in line with other sectors. As we have all seen these mines are here today, gone tomorrow whereas agriculture is long term and sustainable therefore any tariff adjustments should be carefully considered in respect of the likelihood of breeding negative growth to the agriculture sector.