PACE
Public Private Partnerships for Access to Community Electricity
Ethiopia, Nepal, Sri Lanka and Uganda

Tariff setting for rural electrification
Mike Bess, Director International, ESD

2nd September 2003
Outline

- Key principles for tariff setting
- Economic efficiency through tariff setting
- Sustainability by getting tariffs right
- Differential tariffs – standard practice
- How to achieve equity through tariff setting
- Equity & financial viability – compatible objectives
Key principles for rural electricity tariff setting

• Most fundamental principle of tariff setting is cost recovery
• Tariffs need to be set to enable recovery of all costs, from cost of capital to operating costs
• However, most rural areas, without electricity, do not generate enough surplus to ensure full cost recovery
• Therefore, some sort of subsidies, grants, soft loans necessary to promote rural electrification
• But, some way must be found to ensure that these go to most efficient suppliers
Economic efficiency through tariff setting

• Historically, subsidies tend to go to those who need them less

• One of easiest ways to avoid this is to “bid” for tariffs or “compete” for subsidies

• Concept of “service equivalence” is applied

• Those who can assure similar or equal level of electricity service at lowest tariff (conversely, lowest subsidy) are most efficient

• This is ensured ONLY if service equivalency is ensured – i.e. same level of service to same sectors, same segments of population, etc.
Sustainability through proper tariff setting

- Two key principles have now become accepted:
  > Productive sectors should receive maximum support (investment, employment generation, revenue creation, etc.)
  > Service sector should be accessible to all

- Consequently, if focus on rural electrification is on productive uses & equal access to primary services, then rural electrification can be sustainable

- These are the two primary engines of rural development
Differential tariffs

- Not an electricity company in the world that does not sell electricity at different levels
- Differential tariffs are not simply “tax the rich to serve the poor”
- Differential tariffs seek to achieve the maximum returns on investment through both ability & willingness to pay
- Differential tariffs are always easiest in one-buyer market, which is mostly the case in rural electrification
- Consequently, important not to let “monopolies” gauge consumers
Achieving equity through tariffs

- Competition for subsidies one way to ensure equity
- Setting service requirements on suppliers is another (e.g., public lighting, electricity for schools, hospitals, clinics, water pumping, etc.)
- Moving from “light bulb in every house” enables equity to be defined in more global sense
- Even universal domestic electricity can be achieved through innovative means (block tariffs, load limiting, community self-policing, etc.)….but, difficult in many circumstances
Equity & sustainability – achievable objectives

• Basic quality of life can be increased substantially through improved community services
• This is major way to achieve social equity & spur development
• Can use tariff setting to ensure that those who can pay, do pay, but without gauging & without “killing the golden goose”
• All requires stakeholder participation & agreement – apples and oranges comparing tariff for a clinic with tariff for a maize mill!!!