



# **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!!!**