INFORMATION ON REGIONAL ELECTRICITY DISTRIBUTORS (REDs)

5. Local Authority Surcharges in Namibia

Article 5 of 6, compiled by the Electricity Control Board (ECB) to clear misconceptions about REDs & related electricity matters.

INTRODUCTION

In 2001 the Electricity Control Board (ECB) of Namibia commissioned a study to review and analyse electricity tariffs in Namibia. One of the most surprising results from this study was the fact that electricity tariffs vary significantly from one Local Authority (and Regional Council) to the next.

There are several reasons for these variations but one of the key drivers is the fact that Local Authorities (LAs)[1] and Regional Councils (RCs) increase the price of electricity above the cost of supply with the purpose to cross-subsidise other municipal services.

This process of over recovery by LAs and RCs, which is referred to as an LA surcharge, has been practiced for many years. However, the fact that it has been done without sufficient oversight or regulation has resulted in a situation where LAs/RCs have been able to set the price of electricity without significant oversight. The fact that different LAs impose different electricity surcharges is a major contributor to vastly differing electricity tariffs across Namibia.

In 2004 the ECB commissioned a study to further investigate the practice of LA surcharges. There are several reasons why the ECB called for such study namely:

- The first was that the current practice of setting and applying LA surcharges has the potential to expose electricity consumers to monopoly power abuse. The ECB has the mandate to regulate electricity tariffs in Namibia and it was felt that the process applied by LAs/RCs should be subject to the ECB's oversight.
- The second reason was that the introduction of Regional Electricity Distributors (REDs) brought the practice of LA surcharges into sharp focus. LAs felt that the establishment of REDs could potentially cut them off from a major source of revenue, which again could affect service delivery. The study was therefore used to determine the size of the LA surcharges. The results from the study would assist the ECB to put mechanisms in place to ensure that LAs' financial positions are not adversely affected.
- The third reason was that the ECB intends to move the electricity supply industry (ESI) into a position of more cost reflective tariffs and where tariffs are better balanced and harmonised across the country. This will help to restore equality and fairness in the price of electricity for the different customers regardless of where they are located in Namibia.

THE DETERMINATION OF LOCAL AUTHORITY SURCHARGES

It was determined that an LA could potentially qualify for four different revenue streams after having agreed to participate in a RED. These revenue streams all have different characteristics including purpose, level and duration. The four revenue streams are discussed below:

Asset Compensation charges

The purpose of this charge is to fairly compensate the LA for any outstanding loan obligations including loan redemption and interest payment. Any outstanding loan (whether internal or external) which has been taken out for the sole purpose to create electricity related infrastructure has been included in the analysis. Ideally the outstanding interest and loan amounts as well as the payback period should be taken from the LA's loan schedule. However, when such information was not available, the amounts were calculated using the LA's ring-fenced information. Once the amounts are determined it will not change (e.g. increase with inflation or adjust with interest rate fluctuations) until the loan has been repaid. The RED will have no further Asset Compensation obligations once all the loans have been repaid.

Service Level charges

The Service Level charge actually consists of two components or charges. The first, and more significant, is the charge that a RED will pay an LA for the purchase of agreed services such as using the LA's cashiers. The services and charges will be defined in a Service Level Agreement (SLA) between the RED and the LA. The establishment of SLAs is an entirely voluntary process between the concerned parties (the buyer and the seller).

It was felt strongly that there should be a mandatory service charge to compensate the LAs for overhead costs that will remain in the LA after the REDs have taken over the responsibility for electricity distribution. After some careful thought, and taking into account the needs of the LA as well as the needs of the RED and the electricity consumers, the ECB decided to include a Transitional Service charge.

The purpose of this charge is to partly compensate the LA for certain overhead costs that will not fall away soon after the establishment of the RED. The ECB, after reviewing the accounts submitted by the LAs, decided to include the following cost elements into the Transitional Service charge:

- Indirect Salaries & Wages;
- Security Services
- Council Fees; and
- Travel & Subsistence (for support staff only).

The Transitional Service charge will be adjusted with actual inflation but will be phased out over three years. The phasing out will be structured as follows:

- In the first year after RED creation the charge will be 67% of the calculated total amount;
- In the second year the charge will be 33% of the total amount; and
- In the third year it will be 0%.

It must be remembered that the LA has the responsibility to re-engineer its business model as soon as possible after the RED has taken over the responsibility of electricity distribution. Hence, the Transition Service charge period has been kept short, not least as an incentive for the LA to conclude and implement its restructuring plans (including entering into SLAs with the RED) as soon as possible.

Local Authority surcharge

The purpose of the LA surcharge is to continue providing financial support to the LAs and RCs after the establishment of the REDs. The initial charge is based on the actual difference between revenue and costs as reflected in the ring-fenced electricity accounts. It was found that several of the LAs and RCs in fact have and still are making losses on the sale of electricity. For practical reasons the LA surcharge for these entities are deemed to be nil.

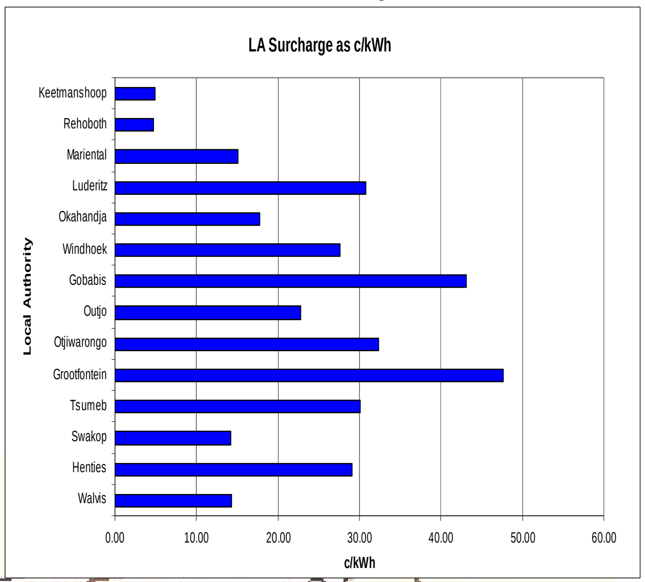
RED Dividends

As shareholders in the RED, LAs and RCs will qualify for dividend pay-outs when the RED is profitable and declares a dividend.

ALLOCATION OF LA SURCHARGES

A question which arises is whether all customers in a RED will pay the same LA surcharge or whether each customer will pay the LA surcharge relevant to its Local Authority until it is decided how LA Surcharges will be treated in future. MME, MRLGH&RD, and the ECB will consult with all LAs/RCs on this very shortly through a national workshop.

Each customer will pay the LA surcharge which has been calculated and approved for the area where he or she lives. It is also believed that electricity customers will be able to put pressure on their respective LAs/RCs to lower the LA Surcharge once it is transparent. Currently the ECB is arguing that the LA Surcharge should be reflected as a separate item on the customers' electricity bill.



ECONOMIC IMPACT OF LA SURCHARGES AND OTHER CROSS SUBSIDIES

Both the GRN and the ECB have stated that the electricity industry should move towards more cost reflective tariffs. The presence of LA surcharges (which is a form of cross subsidy) will prevent the industry from fully reaching this objective. The challenge that many decision-makers wrestle with is to find the correct balance between the economic benefits of cross-subsidies and the economic distortions that they create.

In light of the fact that electricity costs will rise significantly over the next few years in Namibia (and the region), primarily due to massive new investments required in generation and transmission infrastructure, the ECB is concerned about the impact that LA Surcharges have on electricity prices and the consequent impact on customers and the economy as a whole.

Most leading economists are in agreement that cost reflective tariffs (without any cross-subsidies) are the best way to achieve long term economic efficiency. The reason for this is that it will result in the optimum allocation of scarce resources.

Any deviation from cost-reflective tariffs, such as the introduction of a levy or surcharge, is likely to result in (or permeate) sub-optimal economic efficiencies. Does this mean that the electricity industry should do away with all forms of cross subsidies? Ideally the answer is yes. However, we do not live in an ideal word and certain trade-offs may be necessary. Policy makers and regulators must balance conflicting objectives such as the need to have tariffs that:

- Promote economic efficiency;
- Keep electricity affordable to the poor;
- Stimulate economic growth; and
- Support the economic viability of the industry.

There should be no doubt that the key principle of cost reflective tariffs must underpin the basis for tariff design. However, cross-subsidies may be retained in the tariff for two reasons:

- Firstly, an immediate removal of cross-subsidies may lead to a sudden and socially unacceptable tariff adjustment; and
- Secondly, Government may adopt certain social or economic policies to cross-subsidise specific segments of the economy (e.g. prices to rural and low-income consumers). In this case, cross-subsidies may be a feature of electricity tariffs in the long-term.

[1] Local Authorities constitute municipalities, town councils and village councils.