Power Sector Solutions Brief - 1

Synopsis

- Pakistan needs a 7-9% GDP growth.
    - FY25 target of 3.6% is much better than contracted 0.2% in 2023, 2.4% in 2024 and is estimated to reach 5% in 2027.
- That is not enough
    - 49.6 percent of Pakistan's population is female, while 50.4 percent of the population is male and has increased to 241.49 million with an annual growth rate of 2.55% per 2023 census
    - Is projected to reach 263 m by 2030 and 383 m by 2050
- Achieving 7-9 % GDP growth requires an economic turnaround
    - Taxing the untaxed
    - Transfer of responsibilities to Provinces
    - Upgrade of agriculture sector
    - Accepting our decades of mismanagement and learning from it
- The reaction post budget is just icing on the cake
    - GOP will need to hold stead and appreciate that *turnaround requires time, patience, and endurance but with no hopium narrative*
- Continuity of disruptive measures and reform battle critical to
    - Reduce GOP expense, circular debt, pension liability, PSDP to essentials
    - FY24 Debt to GDP ratio 70% and external debt to GDP ratio of 26% (FY 23 32%) target of 50% and 15% by FY2030
        - Optimizing foreign debt servicing of $20.82bn FY23 to $16.94bn FY24 to equivalent of remittances by FY27; by reducing principal (Total Loans at 130.502 USD bn in Jun 2024)
        - Debt servicing was Rs 8.3tr FY24 and will be Rs 9.78tr FY25 out of Rs 19.8tr budget outlay
        - Reduction in debt of Rs. 68.9tr at end of FY24 (domestic Rs47.16tr FY24 and Rs 38.81tr FY23 raised primarily via PIBs and Market Treasury Bills) and Rs 79tr in FY25
- Circular debt containment
    - Rebasing of tariff: electricity and semi annual adjustment in gas prices and provision of subsidy by Provinces, from USC (Rs 60bn) and BISP (Rs 598.71bn FY25 vs Rs 471 billion FY24)
- Reducing Rs. 1.67tr/$6 bn owed by Public Sector Enterprises.

- Ease of business, encouragement of FDI, execution of a competitive market approach and without GOP running businesses has to become norm and requires

- To provide space for improving social indicators without blaming or hiding behind IMF diktat with initial focus on education standards upgrade and skills development
    - Undertaking changes in Energy sector post 18th amendment
    - Developing a competitive environment with uniformity of pricing initially by province for first 2 years to allow working out the challenges in way of expeditious implementation of deregulation.
    - Deregulation of energy (Generation, Transmission, Distribution and Retail in the power, fuel and gas sectorial) is an essential action inclusive of building a strong regulatory environment
- Understand that there is no Magic Wand for Energy Sector Solutions
    - Sector is venerable to shocks due to international events
    - Large change management projects have to start somewhere.
    - Status quo or ostrich approach is not an option
    - Success is not Static but Evolves and
        - We need to learn from the past but always aim higher
        - We must keep pushing the boundaries
        - And learn new methods to stay ahead.

Transformation requires patience and judicious measures

a. Immediate Measures aim is to Optimize Electricity tariff to 8-9 cents

   i. Contractual and Other Measures to reduce Capacity Charge

      - Expedite deferment on payment by two years for K2-K3 pending due accrual of interest payments for the deferred payment.
        - Awaits NEPRA approval per its last Industry Report
        - Has implications on below
      - Undertake pending review to increase Debt Tenor, total or partial reprofiling, interest rate on loans, ROE % and denomination
        - GOP IPPs, followed by Private Sector and then CPEC IPPs
        - Committee has been set up to seek 5 year relaxation to 2041 (cost $1.22bn) in repayment of $15.4bn debt (relief of Rs 2-3 per unit)
      - Assistance for conversion of imported coal plants coal projects (Sahiwal, Port Qasim, and Hub) to Thar coal
        - The transition could save Pakistan more than Rs. 200 bn a year in imports, translating to a decrease of as much as Rs 2.5 per unit in the price of electricity eventually
        - MoF to Facilitate: Local and Panda Bonds for $1bn capex funding by SECMC and Project Developers, $4-5bn for refinery upgrade projects and conversion cost of $50m
      - Measures to tighten loop holes, review status and benefit of implementation of previous negotiations and learning to be implemented for contracts of next phase of IPPs
        - GoP close out with its own IPPs left out of negotiations round with local IPPs subsequent to MA report
      - TOR of Forensic Review of IPPs In Public and Private Sector
        - Confirmation of Compliance with PPA Commercial Terms; ROE, Capex, IRR, Storage, Fuel Payments, Financing and Loan Terms vs Actual including role DFIs and Banks including fund cost
        - Fairness in obtaining least cost coal procurement process and corrective steps required
        - Upfront tariff determination basis by NEPRA and role played by Developers and EPC/Suppliers
        - Delay in removing system constraints by DISCOS and NTDC
        - Violations of merit order by CPPA-G, delay in providing excess power to KE and allowing it to operate expensive FO units
        - Delay in Implementation of CTBM and measures taken to activate competitive trading on PMEX

- Undertake working of IPPs Termination Cost versus Cumulative Capacity Payment till expiry of Term including review of past exercises undertaken, if any
  - Net of Capacity Payment paid and due till expiry of Term
  - Impact of extending/reducing PPAs with initial focus on low generation and dispatch units of KE, GENCOs and FO plants
  - Delaying IPP plans based on revised IGCEP 2024-2034
- While in parallel, exercising caution and prudence in execution
  - Draft IGCEP highlighted need of $66 bn and TSEP $10 bn investment (by GOP/under P3) over next 10 years
  - Keeping in perspective that China was invited by us to invest under our Power Policy and protected returns were offered to all and not just to China. They came when most denied to invest in Pakistan.
  - Plants under CPEC and other IPPs are front-loaded (as a norm) as loan payoffs are in first 10-12 years vs 25/40 years plant life.
- In 2000, a number of companies applied for IPP LOI but were rejected since Pakistan had surplus power.
  - We then experienced massive load shedding (from 2005 till about 2016) up to 20 hours a day having impact on GDP and investment. A number of textile companies left for BD
  - We may see same 2027 onward and may experience load shedding, low GDP, joblessness as FDI dies out due to 3rd or 4rth time renegotiation of sovereign contracts
- Reko Diq award was wake up to impact of breaching agreements
  - The shock would be more severe for IPPs
  - It has required post confidence building measures
- The petitions in SC are devoid of legal contraventions, donot prioritize Pakistan First, are based on APTMA's political narrative, FPCCI playing on emotions without impact caused by subsidies, zero rating regime, retention of export proceeds facility to them, long term implication of immature recommendations that will push country over the precipice from
  - Cancellation of Power Policies, PPAs & IPPs Nationalization
  - It is norm to pay capacity payments and ignoring that in other countries, power plants do run from 0 to 10% capacity
  - Increasing hydel and RE will expose consumer negatively due intermittency, higher capex and without additional capex in storage and base load capex cost of Nuclear and Gas on tariff
  - The fact that GOP owns 50% of generation capacity and not all are owned by private sector IPPs. Fiscal weakness causes devaluation impacting tariff although of benefit to exporters