Economic Review May 2009

Revision of Electricity Tariffs: Economic Implications for Lesotho

The increase in the electricity tariffs during the month of May 2009 will ensure that the utility company remain financially viable in the face of increasing operating costs. However, there are concerns on the possible implications, particularly, in light of the unfolding global economic recession.……...

1. Background

It is now normal for utility companies in Lesotho to review their tariffs in April, which is the beginning of the financial year and coincides with the fiscal year. The recent increases in electricity tariffs are occurring at the time when the economy is faced with the unfolding global economic recession that is threatening a sizable number of jobs particularly in the manufacturing sub-sector. In addition, in winter 2008, the country was marked with electricity shortage commonly referred to as load shedding. The recent increase in tariffs may erode some of the gains achieved towards poverty reduction in the country. Hence it is important to understand their implications on economic growth and poverty reduction.

This article intends to review the structure of the electricity sub-sector with special focus on the reforms implemented in recent years under the World Bank financed Privatisation programme. Furthermore, implications of the recent increases in tariffs particularly at the time when the economy is faced with the externally driven recessionary shock, will be highlighted.

2. Overview of Electricity Sector in Lesotho

Electricity sub-sector in Lesotho went through a series of reforms during the period from 2002 to 2007 under the Utilities Reform Programme. The project was financed jointly by the World Bank and the African Development Bank (ADB). The aim of the project was to restructure the sector to be commercially viable while at the same time contributing towards attainment of the development needs of the country. The reforms resulted in the formation of the Lesotho Electricity Authority whose mandate is to balance the interests of all competing wants of different types and groups of electricity sector stakeholders, viz, the Government, Investors, Customers and licensees, among others. In addition, the Lesotho Electricity Company (LEC) was

restructured through an engagement of the management contract. The contract streamlined the operations of the company and placed it on the viable path. One of the key reforms included maintenance of the pricing structure in line with general economic developments. LEC continues to monopolise the transmission, distribution and supply of electricity power in Lesotho. The restructuring period also coincided with the opening of the 'Muela Hydo Power Station. The station significantly changed the structure of the electricity sub-sector since the station is sufficient for the bulk of Lesotho electricity power needs. The station has the capacity to produce the maximum of 72 Mega watts

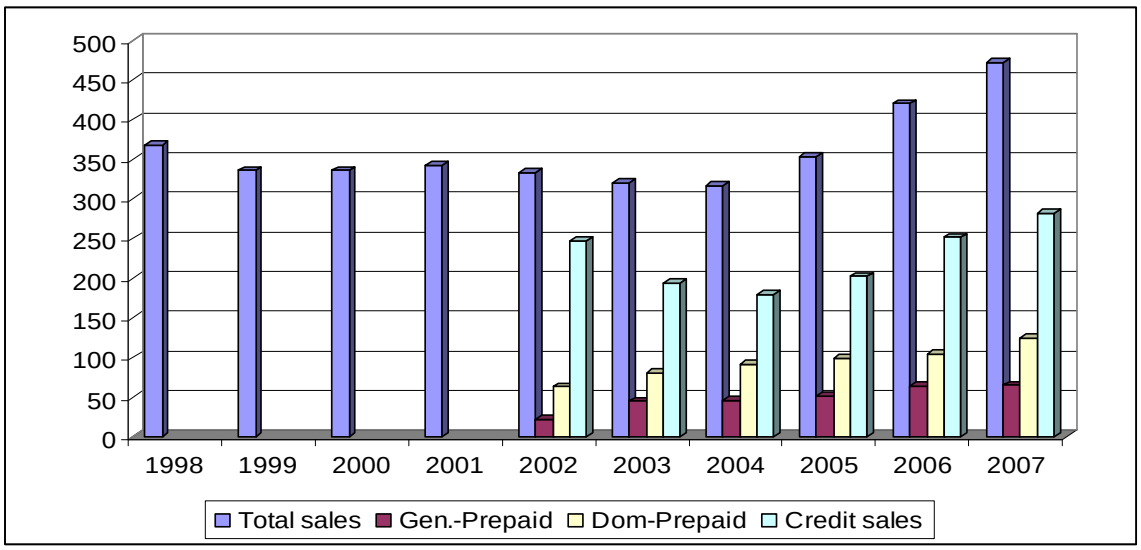
2.1 Electricity Consumption and Production

The reforms implemented also resulted in the increase in the consumption of electricity in Lesotho as more households were connected. The number of customers increased from 277724 in 2003 to 355507 in 2007. In addition, the period was also marked by the rapid expansion of the manufacturing sector, particularly of the textiles and clothing. Figure 1 below shows electricity consumption in Lesotho during the period 1998 to 2007.

Overall consumption increased from 2.0 per cent in 2001 to 12.5 per cent in 2007, growing at an average of around 3.0 per cent a year a decade from 1998.

The introduction of the prepaid system in 2002 saw ''domestic prepaid'' increase from 63.4 GWh in 2002 to 124.8 GWh in 2007. "Domestic prepaid" accounts for about 27 per cent of the total electricity sales. However, credit sales continue to constitute the larger share at 59.6 per cent. This is partly because the industrial consumers prefer credit buying to prepaid.

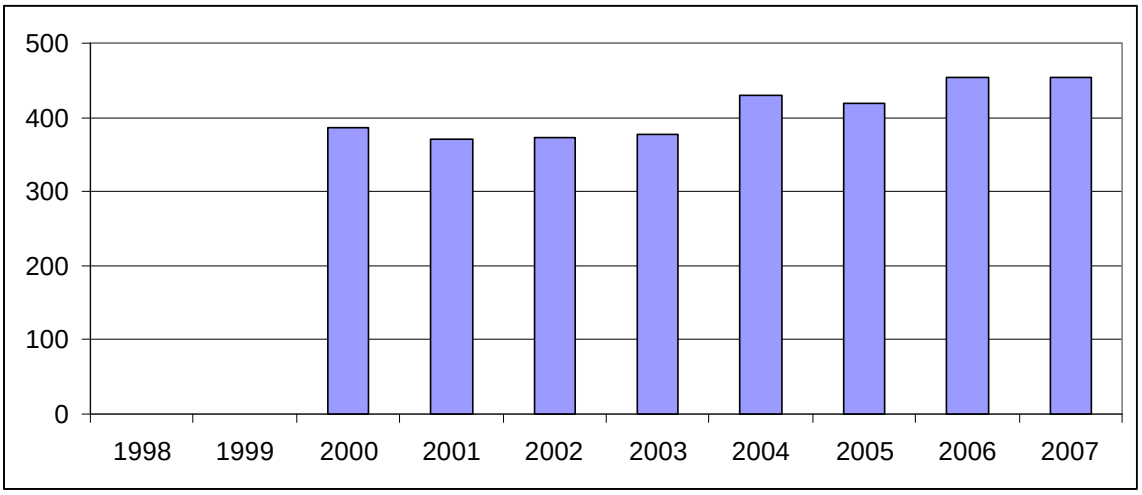
Figure 1. Consumption of Electricity in Lesotho (Gigawatts)



Source* : LEC *and LHDA

Figure 2 below presents electricity production at 'Muela Hydro power during the period 2000 to 2007. Electricity production rose from 386.4 GWh in 2000 to 454 GWh in 2007. An average of 95 per cent of 'Muela production is sold to LEC for distribution in Lesotho.

Figure 2. Electricity Production by 'Muela Plant

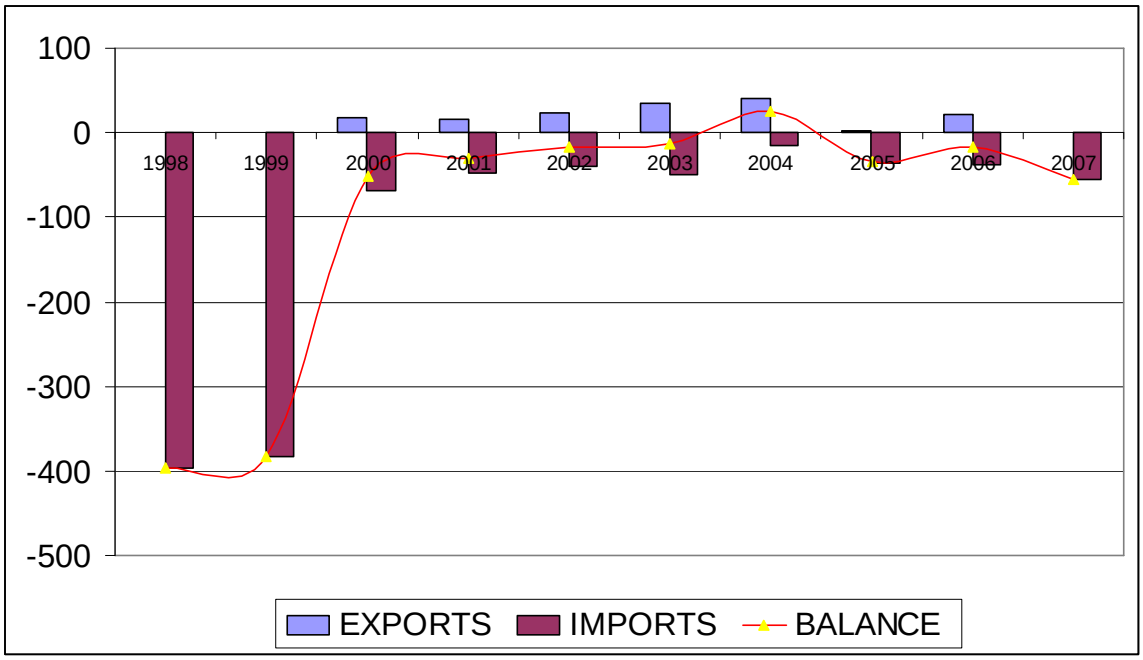


Source* : LEC *and LHDA

2.2 Electricity Imports and Exports

Figure 3 below presents electricity exports, imports and trade balance during the period 1998 to 2007. It can be seen that the coming into being of 'Muela had a significant structural change in the trade in electricity between Lesotho and South Africa. The coming into effect of 'Muela Hydropower Station in 2000 reduced Lesotho's imports of electricity significantly. Electricity imports declined from 397.1 GWh in 1999 to 68.9GWh in 2000. Although Lesotho remains a net importer of electricity, on average it exports 65.1 GWh per year. It should be noted that in 2004 Lesotho had a net exporter position. The net importer position mainly occurs in winter times when the demand for electricity is generally high. In 2008, when there was general shortage in electricity in the region, Lesotho had to resort to load shedding as there were limits to the amount of imports available in order to cover up consumption of electricity domestically.

Figure 3 : Imports and Exports of Electricity



Source*: LEC *and LHDA

3. Structure of New Electricity Tariffs

As discussed, the electricity sub-sector in Lesotho is regulated by the Lesotho Electricity Authority (LEA) whose mandate is to ensure that the needs of electricity system operators and those of the consumers do balance. For the electricity operators, the regulator has to see that the electricity company earns a reasonable rate of return on their investment for provision of good service. For the consumers, LEA has to ensure that they get good quality service at just and reasonable prices. Operators in the sector are required to apply for any changes in the pricing structure and LEA is responsible for the determination of LEC application for a tariff increase. Table 1 below presents the increases in LEC energy charges in 2008/2009 and 2009/2010. It is important to note that LEC effected two revisions in 2008/2009.

The tariffs for both Industrial and commercial users registered the highest average increase of 10.7 per cent in 2009/2010 compared 23.6 per cent in the previous revision. The tariffs for general purpose which includes churches, schools and health centers, as well as domestic and street lighting registered an increase of 9.1 per cent. The current hike in the tariffs for "general purpose" is higher than the past year's increase of 2.2 per cent, while for the domestic purpose the increase is 2.1 percentage points higher. On the other hand, street lighting which registered 14.1 per cent from the previous year declined by 5.0 percentage points to 9.1 per cent this year. Looking at all the tariff increases, it can be observed that the commercial and industrial electricity tariffs are higher than those of other customer categories.

Table 1: Approved LEC Energy Charges for 2008/09 Fiscal Year

Customer Category	2008/09 energy charge (M/kwh)	2008/09 energy charge (M/kwh) Revised	2009/10 energy charge (M/kwh)	% changes 2008/09	% changes 2009/10
Industrial HV	0.0848	0.1048	0.1160	23.6	10.7
Industrial LV	0.0934	0.1134	0.1254	21.4	10.6
Commercial HV	0.0848	0.1048	0.1160	23.6	10.7
Commercial LV	0.0934	0.1134	0.1254	21.4	10.6
General Purpose	0.6800	0.6950	0.7580	2.2	9.1
Domestic	0.5675	0.6125	0.6650	7.9	9.1
Street lighting	0.3200	0.3650	0.3983	14.1	9.1

Source: Lesotho Electricity Authority (LEC)

Figure 4: Average Electricity Tariff increase and Average Inflation Rate (2007-2009)

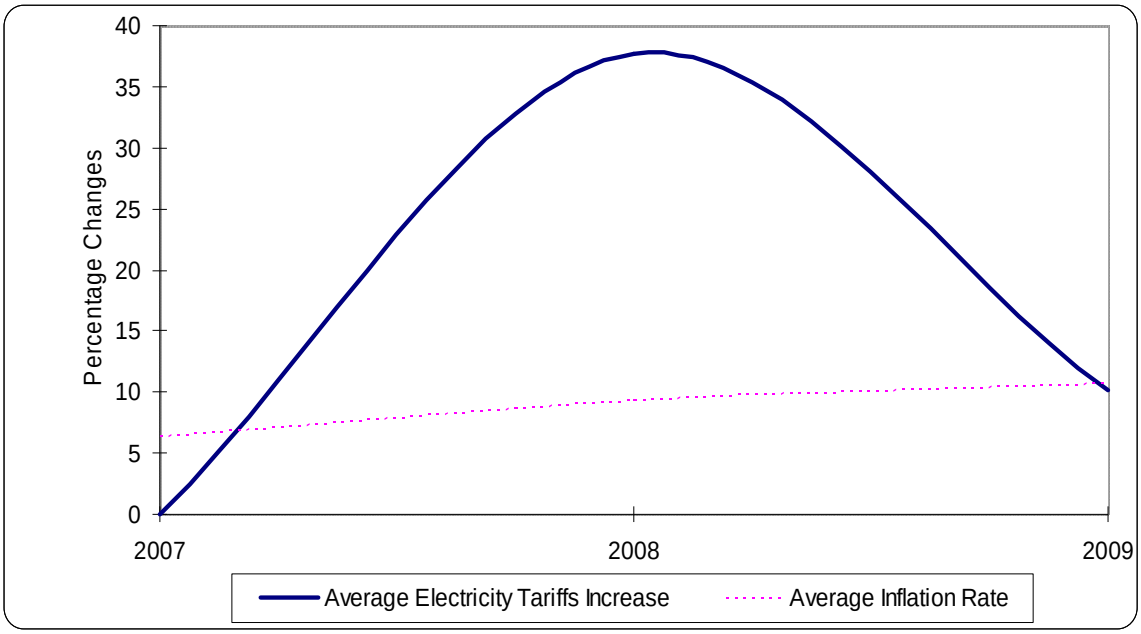


Figure 4 above presents the average inflation rate and average electricity tariff increase during the period 2007/2008 to 2009/2010. The comparison is important since inflation is believed to be the benchmark for increases in the prices of services. Price revisions in line with inflation developments ensure that the commercial entity is viable. On average, the tariff increased by 10.0 per cent in 2009 as compared to 37.7 per cent in 2008. It should be noted that the hump in 2008 reflects two increases effected in May and November. The increase in 2008 was above average annual inflation while in 2009 it was in line with the annual average inflation rate of 10.7 per cent registered in 2008/2009 financial year.

4. Implications for the Lesotho's economy

The recent increase in electricity tariffs is likely to have negative effects on the manufacturing sub-sector. The cost of electricity plays an important role in the country competitiveness. In the textile and clothing industry, Lesotho in the Sub-Saharan Africa competes with Mauritius, Madagascar, South Africa, Kenya and Swaziland. It is important that we compare Lesotho's electricity tariffs with our competitors. The negative implications may be aggravated by the unfolding global economic recession which is having an adverse impact on the key sectors of the economy. The recent tariff increases could put a brake on the economic growth momentum of the country as the long-term competitiveness of the country's exports is eroded both regionally (SADC) and internationally. The loss of competitiveness will result from increased cost of doing business in the face of increased electricity prices. The impact is more pronounced in manufacturing and mining sub-sectors and a number of jobs have already been lost in the sub-sectors due to the current global financial crisis. Thus the recent increase in tariffs may exacerbate the already vulnerable situation as electricity is an important input in these sub-sectors.

Moreover, electricity is an important commercial energy resource used extensively by urban households in Lesotho. At the end of 2007, about 355 507 households had electricity connections. Table 2 below shows the distribution of households with access to electricity. About 39.1 per cent of Maseru households have access to electricity. An increase in electricity tariffs would affect household consumption depending on the size of electricity share in the household budget. Urban households have a larger electricity budget share and as result will be hurt in other categories of the budget. They will have to forgo other items in the budget in order to keep up with the increase. Under these conditions, there is a high probability that the next wage negotiations would be higher wage demands.

In addition, the increase will shift the cost structure in the user sector, thus resulting in a build up of inflationary pressures. The increase in the consumer price level would hurt consumers more as the electricity price hike would have a ripple effect resulting in consumers paying more for other goods such as food and furniture which use electricity as their intermediate goods.

Table 2: Percentage Distribution of Households with Access to Electricity by Region, 2002/03 and 1994/95

Year	Access to electricity	Maseru Urban	Other Urban	Rural Lowland	Rural Foothill	Rural Mountain	Rural SRV	Lesotho
2002/03	Yes	39.1	19.9	2.1	1.1	0.5	2.6	14
	No	60.9	80.1	97.9	98.9	99.5	97.4	86
	Total	**100**	**100**	**100**	**100**	**100**	**100**	**100**
1994/95	Yes	21.4	7.8	1.1	0.7	0.6	0.8	5.6
	No	78.6	92.2	98.9	99.3	99.4	99.2	94.4
	Total	**100**	**100**	**100**	**100**	**100**	**100**	**100**

Household Budget Survey 2002/2003

3. Monetary Policy Operations Report for May 2009

The open market operations (OMO) employed by the Central Bank of Lesotho (CBL) continues to be effective. This is observed in the movement of treasury bills rates compared with those in South Africa, as well as, the level of Net International Reserve (NIR). This initiative enables CBL to maintain the parity between the local currency, Loti, and the South African Rand.

The maintenance of the parity is important to price stability. Hence, the employment of open sale and purchase of treasury bills goes a long way in protecting the currency peg.

The report present economic and operational issues surrounding the monetary policy operations conducted during the review period to assess the success of the operations.

Table 1 below shows that the entire amounts of treasury bills (M50.0 and M11.0 million) announced during the auctions conducted on May 13 and 27 2009, respectively, were ultimately issued. During the review period, the market responded relatively poor to the 91-day treasury bills auction held on the May 27, 2009 compared with the previous auction on May 13, 2009. Competitiveness of the 91-day Treasury Bills auction, as measured by the number of bids received, deteriorated during the review period. The number of bids received during the auction conducted on May 27 fell to 6 compared with 22 on May 13. The number of bidders also declined from 9 to 4 participants.

Lesotho's 91-day Treasury bills rate (discount rate) remained above its South African counterpart by 9 basis points, after a significant drop to 5.96% (176 basis points below SA counterpart) on the May 13.

The margin of interest rate differential between Lesotho's 91-day Treasury bills rate and SA counterpart narrowed significantly to 9 basis points on May 27 from 176 basis points on May 13. This implies that there was a minimal incentive for undesirable cross border transfers of funds between the two countries. Therefore, the Monetary Policy operations undertaken during the review month were successful in attaining their desired objectives of financial stability by maintaining the target NIR level.

Table 3: Treasury Bills Auctions

Type of Security	Auction Date	Maturity Date	Auction Amount (Million Maloti)	Amount Issued (Million Maloti)	Discount Rate (%)	RSA Discount Rate (%)
91-day	***13-May-09***	12-Aug-09	M15.0	M15.0	5.96%	7.72%
182-day		11-Nov-09	M15.0	M15.0	7.38%	7.38%
273-day		10-Feb-10	M10.0	M10.0	8.10%	7.23%
364-day		12-May-10	M10.0	M10.0	7.94%	7.02%
91-day	***27-May-09***	26-Aug-09	M3.3	M3.3	7.60%	7.51%
182-day		25-Nov-09	M3.3	M3.3	7.3%	7.22%
273-day		24-Feb-10	M2.2	M2.2	8.09%	7.06%
364-day		26-May-10	M2.2	M2.2	7.94%	6.84%
Total for reporting period			M61.0	M61.0	-	-

Figure 4: Measuring the Success of Monetary Policy Objectives: Performances of Lesotho 91-day T-bills vs RSA 91-day T-bills