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Why Importing LNG for Power is Not a Good Idea

About IPR

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Some days ago, the National Electric Power Regulatory Authority determined upfront tariff for power generation based on imported Liquefied Natural Gas. Policy makers seem to have learned nothing from the past. With energy price in decline, we had hoped that government would put the power sector on a sustainable path of development. We now see that it is business as usual in Islamabad. Pursuing the same strategy each time and expecting a different result is the sign of policy making with the head planted firmly in the sand.

The current chaos in electric supply is the result of reckless policy followed in the 1990s. Coddled investors and expensive fuel mix have brought us to this pass. In similar fashion, producing power from LNG is the wrong approach. The price of LNG is no different from fossil fuel. This is complicated further by the policy of upfront tariff. Upfront tariff guarantees returns to the investor and places no constraint on them to be efficient. The investor can source fuel from any source and at any price. She can use any technology even one that is not productive. The parameters for the power plant remain open. All costs are passed through to the consumer while the power producer receives an assured return.

The 1994 policy did that and we ended up with a structure for the power sector that is clearly unsustainable. It is too expensive for this economy to sustain and along with high line losses and weak governance, it has become hard to manage. Upfront tariff also means that price of power is not the result of a competitive process rather the result of approximating costs often from a single source. The 2002 power policy corrected some of the more egregious provisions of 1994. It introduced cost plus tariff as well as competition among producers. The government, so far, prefers to rely on upfront tariff for LNG.

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Secrecy surrounds import of LNG. Even NEPRA's tariff for LNG power production was based on an assumed cost for fuel. We can take its assumption of USD 12/mmBTU as the best information available about the possible price for LNG. News reports suggest that we may have over paid for the 147,000 cubic feet LNG bought recently from the spot market. Even if subsequent import price were somewhat lower, the price would be no different from the current price per mmBTU for furnace oil. High fuel cost is one reason for the current travails of the power sector. The price at which we buy LNG would transmit to the cost of power production. Linked to the price of crude, as we understand it to be, the cost of LNG power would be as volatile as that produced from furnace oil. It would leave the power sector equally vulnerable. In essence, imported LNG holds no benefit for the economy. In fact, it is fraught with risks of the sort that has brought the power sector to its current jumbled state. Its only benefit is that it allows government to show that it is doing something to solve the power crisis.

A number of other policy and governance factors affect performance of the power sector. Poor governance leads to high line losses and revenue leakage, which is about 30% of sales. The government is unable or unwilling to fix this loss. Institutional structure of the sector needs change as in its current form, operations and monitoring of performance is weak and ineffective. Tariff policy is skewed and circular debt is high. Almost every unit of power sold carries subsidy. All this has led to circular debt, a euphemism for unpaid bills that is one of the main factors behind load shedding. Additional generation capacity would face the same structural flaws and lead to the same losses. That is why Chinese partners want upfront guarantees from the government. They insist that government must settle all dues in time.

It is as important to fix the present confusion and disarray to make the sector viable as it is to increase power generation capacity. Investment is viable only if the system generates enough liquidity to pay for itself.

In the last couple of years, the government has tried different approaches to increase power supply. It has spent over a year planning new production from imported coal. In recent weeks though, coal has taken a back seat to LNG. Who knows what the power production 'flavour of the week' would be in the coming days. The Chinese President is due to visit Pakistan soon and enthusiasm for coal may yet surge ahead again. While all this plays out the Pakistani people suffer and the economy falters.

The best advice to the government is to get the power sector house in order. Its management in government represents trench warfare among ministers. This shows up in fragmented decision-making. There is no one to take stock of the big picture of flawed policy, crumbling institutions, and broken governance. Increase generation by all means, but try also to fix the fractured sector. And in the short term, allocate more domestic gas for power production. It would do well to study the possibility of imported piped gas from Iran in the coming months and, if you must, go for imported coal rather than LNG. Producing power from LNG will be as risky as our decision of the 1990s to produce power from fossil fuel.