

LCG-Energy Subgroups

Observations on National Strategy for Economic Growth, Poverty Reduction and Social Development

General Comments:

A key message from the LCG subgroup on Energy is that the draft I-PRSP has not done justice to the importance of the energy sector in permitting/encouraging economic growth and poverty reduction. Accordingly, the draft I-PRSP should assess the potential of infrastructure, and particularly energy related infrastructure, in accelerating economic growth and human development, and prioritize the infrastructure (including energy) investment needed to maximize these ends. The draft I-PRSP should also highlight in the text the key policy reforms and financial resources required for development of the needed infrastructure. Furthermore, the draft I-PRSP should suggest ways for mobilizing needed resources for investment in infrastructure, assess the scope for private sector involvement in the provision of priority infrastructure and identify policy measures to encourage private investment in these areas.

For part of Annex 6 to the draft “A National Strategy for Economic Growth, Poverty Reduction, and Social Development (draft I-PRSP)” – suggested write-up incorporating comments of other LCG subgroup members as appropriate

Power Sector: Reliable access to electricity is essential for economic growth and poverty reduction in Bangladesh. Without adequate energy supply there can be little economic development. Quality of life will also be poor in the absence of energy supplies such as for lighting and communications. Yet only 30 percent of the people have access to electricity, which is of poor quality and unreliable in nature. The Government in its vision statement in 2000 has committed to supplying electricity to all by 2020, which translated in the next five-year (FY2003-2007) development program an additional 3,000 MW generation, over 1,500 km transmission lines and 60,000 km distribution lines and associated substations, with an estimated investment cost of over \$3.6 billion over the same period. While there is no question about the huge investment need in the future, it is also clear that without sustained reform, it will be difficult to achieve any results.

The problems of the sector are well documented along with the need for reforms.¹ The sector's financial performance had been poor in the 1990s with the two main utilities – the Bangladesh Power Development Board (BPDB) and Dhaka Electric Supply Authority (DESA) – plagued with system losses and inadequate collections. Investments in maintenance and expansion of the network had been inadequate. When reforms were initiated in 1994, losses in the power system were around 35 percent of energy generated, and collections were below 80 percent of billing. The sector was losing more than \$200 million in cash annually, forcing the Government to transfer resources from its general budget that were badly needed for social sectors, to the power sector.

¹ For example, the lack of institutional capability, poor management systems and procedures, unavailability of long-term domestic capital for financing investments, limited foreign exchange debt service capability of the economy, and institutional weakness in governance, banking, law enforcement, and judicial processes, which are external to the sector but are essential for its proper functioning.

Natural Gas Sector: The potential of the natural gas sector, with its tremendous potential in contributing to the development of the economy, should be effectively harnessed to ensure that it contributes to economic growth, and contributes to poverty alleviation by ensuring that the economic rent is used effectively for the benefit of all. The gas sector remains in a poor condition due to (i) lack of commercial orientation of sector entities, (ii) poor governance, (iii) inadequate financial policies including subsidized tariffs, and (iv) inadequate funding for expansion and operation and maintenance. The financial and technical capability of Petrobangla, the controlling corporation, is weak. Integration of operation and regulatory and policy functions in Petrobangla is also causing serious conflict of interest.

The Government has recently implemented several measures to improve the performance of the gas sector. The Energy Regulatory Commission would enforce the Government's pricing policies for transmission and distribution services, which would *inter alia* enable effective private sector participation. To improve governance, the gas sector corporate entities have been given full financial and administrative autonomy, boards are being restructured through induction of directors from private sector, and market based salary structure is being introduced to attract competent management. The Hydrocarbon Unit would be institutionalized and strengthened with sufficient staff and expertise to assist the Government in policy formulation in the hydrocarbon sector, manage petroleum database, promote acreage to industry, negotiate concessions, monitor companies under contract, and analyze/propose gas production policies and upstream regulation. Consumer prices would be rationalized to eliminate cross subsidy and to offset losses incurred by the sector in purchasing gas from international oil companies (IOCs) at a price aligned to international fuel oil parity price. Decision on export prospects of gas would be taken keeping the national interests in view to ensure reliable supply for economic development by attracting investment from IOCs.

Petroleum Downstream Sector: The petroleum downstream activities, which are normally competitive in nature elsewhere, are very tightly controlled by the government. As a consequence, there are numerous distortions: (i) consumer prices do not reflect changes in international oil prices, and the financial penalties are borne by the state; (ii) little incentives exist for industry participants, and rent-seeking behavior is rampant; (iii) product specifications, safety and customer service leaves a lot to be desired; and (iv) petroleum infrastructure is in dire need of renewal, and country's strategic stocks are limited to 2-3 weeks of consumption.

The Government would foster competition among different industry players by restructuring Bangladesh Petroleum Corporation (BPC), and by deregulating the sector to allow imports of crude oil and petroleum products by the refinery and Oil marketing Companies (OMC), respectively. While petroleum product prices would be ultimately set by the market, a formula-based pricing framework would be introduced in the short-run. Under this framework, domestic petroleum products prices would be set as caps on the basis of import parity, and subsidies (if any) would be made transparent. Energy Regulatory Commission (ERC) is envisaged to provide oversight, but regulate primarily non-pricing matters and externalities.