For Immediate Release

Reforming Sri Lanka's Electricity Tariffs: Principles for a Sustainable Future

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We welcome the opportunity to comment on Sri Lanka's proposed electricity tariff revisions. Effective tariff design must account for three intrinsic characteristics of electricity:

1. **Homogeneity**: One megawatt-hour (MWh) of electricity—regardless of whether it originates from coal, hydropower, or renewables—is identical in energy content.
2. **Non-storability**: Electricity must be consumed as it is generated; the high cost of storage necessitates real-time balancing of supply and demand.
3. **Time-varying costs**: The cost of supplying electricity fluctuates daily, influenced by the generation mix, fuel prices, and network losses.

Tariff Structure and Tariff Levels

The current tariff structure in Sri Lanka comprises multiple user categories, including domestic, General Purpose/Government, Industrial/Hotel, and Religious/Charitable institutions, each with their own rate schedules. Tariff levels vary both across and within these categories, leading to cross-subsidies and inconsistencies.

The proposed reforms present an opportunity to rationalise the tariff structure. Consumers using the same commodity under similar conditions should pay comparable rates, with only one justified differentiation: a lifeline tariff for low-income domestic users. This principle supports equity while ensuring cost recovery.

Tariff levels must be aligned with the full economic cost of supply—including generation, transmission, distribution, and system losses. Without such alignment, the sector faces underinvestment, rising debt, and operational inefficiencies. Overly subsidised tariffs for select user groups have historically led to financial imbalances and discouraged energy efficiency.

Best Practice Principles in Tariff Design

Drawing on international experience, we recommend the following guiding principles:

- **Cost-reflective pricing**: Tariffs must transparently account for generation, transmission, distribution, and losses.
- **Non-discrimination**: Users consuming the same service should face the same prices, except where explicit, targeted subsidies apply.

- **Time-of-use (TOU) tariffs**: Pricing should vary by time of day to reflect real-time supply costs and promote demand-side responsiveness.
- **Regulatory clarity**: The regulator should focus on pricing that ensures cost recovery and long-term sector sustainability. Redistribution and affordability concerns should be addressed via fiscal policy—ideally through direct cash transfers.
- **Minimisation of cross-subsidies**: Social objectives must be funded transparently via public budgets rather than embedded, opaque tariff distortions.

Comments on Proposed Tariff Revisions

1. **Amalgamation of Bulk User Categories**
   We recommend consolidating user categories such as Industrial/Hotel, General Purpose/Government into a single bulk user class. Electricity is a homogeneous product; differential pricing between, for instance, a banquet hall and a hotel is unjustifiable when both host similar events. Likewise, a restaurant in a mall pays a higher rate than one in a hotel, despite identical energy usage patterns.

Preferential tariffs for "industry" unfairly disadvantage new economy enterprises such as IT and BPO firms, while incentivising energy-intensive industries with limited comparative advantage. This distorts resource allocation, encourages overconsumption, and undermines competitiveness.

2. **Removal of Special Tariffs for Religious and Charitable Institutions**
   These institutions should be brought under the standard domestic or commercial categories. Special concessions are best provided through direct fiscal support, not through tariff distortions that undermine transparency and equity.
3. **Consolidation and Extension of Time-of-Use Tariffs**
   The “Rate 1” category for bulk users should be eliminated, with TOU pricing applied universally across bulk consumers. Uniform tariffs flatten important price signals and discourage efficient load management. TOU tariffs encourage load shifting, optimise system use, and reflect the actual cost of supply.
4. **Lifeline Tariff as the Sole Subsidy**
   A well-targeted lifeline tariff remains the only justifiable tariff-based subsidy. Current domestic tariffs impose disproportionately high costs on high-usage households, effectively subsidising commercial and industrial users—an inequitable and inefficient arrangement.
5. **Consideration for Remote Work and Efficiency**
   Higher domestic tariffs risk discouraging remote work, which can reduce transport-related emissions and congestion. Tariff design should avoid penalising such socially beneficial behaviour and consider broader economic impacts.
6. **Reform of Solar Net Metering**
   The current one-for-one offset mechanism for rooftop solar does not account for the

time-of-day value of electricity. Best practice dictates pricing solar generation based on the timing of generation and consumption, improving integration of distributed energy and supporting grid stability.

7. **Movement Toward Spot Market Pricing**
   Sri Lanka's reliance on variable renewable generation necessitates more dynamic pricing. Introducing spot market pricing for bulk users—similar to Singapore's Energy Market Company—can enhance efficiency, better match demand to real-time costs, and reduce forecasting risks.

Transparency and Incentives

Transparency is essential to maintain public trust and support. The Ceylon Electricity Board (CEB) should be required to publish quarterly reports detailing:

- **Generation costs**: Disaggregated by plant, including fuel, labour, maintenance, and capital costs, with justifications for deviations from least-cost dispatch principles.
- **Network costs**: Including transmission and distribution.
- **Overheads**: Covering administration, billing, metering, and customer services.

Procurement contracts—particularly for coal and oil—should be publicly disclosed to discourage inefficiencies and corruption.

Incentive Structures

Public ownership must not breed complacency. We advocate performance-based incentives to reduce technical and commercial losses, improve service quality, and enhance operational efficiency.

Types of losses must be clearly classified and addressed:

- **Technical losses**: Incurred in the grid, transformers, and substations.
- **Commercial losses**: Arising from theft, faulty meters, or billing errors.
- **Collection losses**: Due to non-payment or delayed payments.

All losses must be quantified and minimised before being considered in tariff setting.

Additional Observations

- **Differential Tariffs and Economic Efficiency**
  Discriminatory pricing misallocates resources. When tariffs are too low during peak periods, consumption exceeds optimal levels, increasing system costs. Conversely, excessive off-peak pricing deters usage or shifts demand inefficiently.
  Cost-reflective pricing leads to better demand management and investment decisions.

- **Regulation vs Fiscal Policy**
  The regulator's core responsibility is to ensure cost recovery and efficient pricing. Social equity and redistribution should be managed through fiscal tools—such as targeted subsidies or cash transfers—not by distorting electricity tariffs.

Conclusion

The Public Utilities Commission of Sri Lanka (PUCSL) should adopt a tariff reform framework that:

- Eliminates discriminatory pricing, retaining only the lifeline tariff for low-income users;
- Implements TOU tariffs widely and advances towards real-time pricing for bulk users;
- Requires full cost transparency and independent audits of CEB operations;
- Funds social objectives through direct, transparent fiscal transfers, not hidden cross-subsidies.

These reforms are essential to ensure the long-term sustainability of the electricity sector, attract much-needed investment, and align Sri Lanka with global best practices.

About Advocata Institute

The Advocata Institute is an independent think tank based in Colombo, advocating evidence-based economic policy reforms, market liberalisation, and institutional improvements to promote sustainable economic growth in Sri Lanka.

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