ACEP'S ANALYSIS ON ENERGY SECTOR ISSUES IN THE SUPPLEMENTARY BUDGET

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1.0 Introduction

The 2019 supplementary budget highlights government's assessment of the energy sector challenges, and has proposed measures for addressing those challenges. ACEP sees this as a rehashing of the same issues of which government has been aware of since 2017, as evidenced by various government statements. The difference, however, is that this time, the energy sector bills have crystalized, sending panic waves through government's finances. The most significant challenges facing the energy sector are the excess procurement of power generation systems which the country does not need, and gas; both on Take-or-Pay bases. The effect of this is that government is saddled with huge debt burdens. The measures outlined by the government in the supplementary budget to deal with these challenges need to be examined to determine whether they are capable of addressing the challenges and will not end up creating further problems in the future. In line with ACEP's commitment to supporting the process of finding sustainable solutions to the energy sector challenges, ACEP presents below our independent analysis of the key issues in the supplementary budget.

2.0 Energy sector debt accumulation

The horizon of debt recurrence in the energy sector, from any objective assessment, threatens the socio economic development of the country. Unfortunately, this has not been an event. ACEP is on record to have cautioned government on many occasions, since 2015, of the catastrophic commitment to more power than could be reasonably projected to be the demand for the country. At the same time, gas supply commitments were generated on wrong assumptions which ACEP has extensively written on.

2.1 Power Sector

The subscription to many unwarranted Power Purchase Agreements (PPAs) has resulted in excess dependable capacity which the budget recognises to be about 1900 MW. This is consistent with the excess capacity of the World Bank's projections in 2017. This has created a situation where about 60% of the take-or-pay capacity sits unutilized which translates to a debt burden of $500 million a year for the Ghanaian tax payer according to the budget. The Minister stated that the contracts were inherited, hence an admission that the problems are not new. This raises questions as to government's delay in taking action since January 2017. ACEP observes that not much urgency was attached to addressing the issue until it reached a crisis point.

The key measure proposed by the Minister is to convert all Take-or-Pay contracts to Take-and-Pay contracts effective August 1, 2019. This means government has taken a unilateral decision to suspend its obligation of the terms of the Take-or-Pay contracts. Needless to say, this will amount to a breach of government's contractual obligations under the affected PPAs with potential judgment debt liabilities. Of course, ACEP estimates that abrogating some of the take-or-pay contracts and incurring the resulting liability will still be cheaper than sticking with the Take-or-Pay obligations for the duration of the PPAs. If this is also the position of government, a better way would have been to communicate with the companies its decision before making a public announcement.

Other measures proposed by government to deal with the excess capacity include increasing power exports and increasing productive uses of electricity through industrialisation. On the increase of power for exports, ACEP is of the opinion that the market is largely limited for the quantum of excess supply the country is faced with. Three major reasons account for this conclusion:

a. **The excess capacity is bigger than the total power needs of Togo, Benin and Burkina Faso who are the primary targets of Ghana**: In those countries access to electricity is very limited; 35%, 29% and 20.3% respectively. Total electricity consumption from these countries is about 1034MW which is significantly below their installed capacity of 2478MW. Significantly, the transmission infrastructure to extend electricity in those countries remains a medium to long term aspiration, defeating Ghana's short-term projections for export of power, while it continues to pay for capacity charges.

b. **Price competitive advantage from Nigeria and Ivory Coast for the sub-regional market**: Nigeria and Ivory Coast export cheaper power in the sub-region. While Nigeria sells to Benin between 6-7 cents/kwh, that of Côte d'Ivoire is about 10 cents/kwh. To the contrary, Ghana's generation cost averages 12-15 cents/kwh. This reduces the available market to Burkina Faso, and marginally to Benin and Togo where Ghana has infrastructural advantage.

c. **Medium to long term generation dynamics in the targeted countries**: The countries Ghana expects to export electricity to, have medium to long term plans to generate their own electricity. In some instances, donor programmes such as the Power Africa Programme of the United States of America has initiated plans to accelerate access through off grid solutions and installation of thermal plants. Therefore, Ghana cannot hope on taking advantage of increases in access in those countries in the long run. Again, with consistent decline in the price of solar which has higher yield in the Sahel regions, high cost of electricity in Ghana will struggle to compete with solar, which can be deployed quickly for small to medium scale firms.

Further, government is proposing increasing productive uses of power to spur industrialization. While the proposal is laudable, the cost of electricity remains a major hindrance for achieving this target. Considering that industrial use has the potential to quickly absorb the excess capacity, the following measures require urgent consideration:

a. **Suspension of Value Added Tax (VAT) on industrial consumption of power to boost demand**: The VAT on industrial consumers is a significant disincentive to power consumption. Suspending the tax has the potential to improve liquidity of businesses to reinvest more on expansion. This could also be a rebate for start-ups who want to enter into production.
b. **Aggressive policy to increase consumption**: The situation requires deliberate policy to map out existing potential consumers of the excess power at a cost below the average tariff. For example, VALCO should be encouraged to operate at full capacity with subsidised power, sourced directly from the generators. ACEP estimates that subsidizing VALCO's power consumption is cheaper than paying capacity charges for unutilised power plants. This is also applicable to high power-consuming industries.

2.2 Natural Gas

The take-or-pay issues plaguing the power generation sector equally apply to the gas sector. Ghana has contracted for about 750mmscf of gas per day (mmscfd) by 2023. About 640mmscfd of the contracted gas volume is on a take-or-pay basis. By 2023, gas demand is projected to be between 450mmscfd and 550mmscfd creating an excess supply of 200mmscfd to 300mmscfd. The minister indicated that from 2020, the country will be facing extra gas supply charges of between $550 million and $850 million. The estimation of the gas volume is the most conservative the government has issued in recent past on gas supply and demand scenarios. This time, the high case scenario for industrial consumption (i.e. fertilizer production, bauxite extraction etc.) appears discounted to create realistic assumptions dictated by the contextual realities.

According to ACEP's projections, supply of gas from domestic oil and gas fields is in line with government's projections of demand of 450mmscfd to 550mmscfd by 2023. This includes supply from the Jubilee/TEN fields (which is not on a Take-or-Pay basis) and Sankofa fields, as well as about the WAGP. It would appear therefore that the 750 mmscfd quoted in the supplementary budget includes LNG imports of about 250mmscfd to 300mmscfd; the excess which government is very much concerned about. By implication, government's estimated excess capacity charges can be avoided if all LNG contracts are cancelled. ACEP recommends the cancellation of LNG imports because of the following reasons:

1. Ghana has enough domestic sources of gas from existing fields to meet current and projected needs.
2. There are new gas discoveries that have the potential to increase domestic gas production beyond 450mmscfd. This includes ENI's Akoma discovery.

3.0 ESLA revision

The government has proposed to increase the Energy Sector Levies by GHp 20 per litre for petrol and diesel and GHp 8 per kg for LPG. The increases are attributed to inflation and depreciation of the Cedi. This has made it impossible for government to realise its intended 24 percent value of the ex-pump price of fuel to improve the poor balance sheet of the power sector utilities. While the need to bridge the financing gap is understandable, ACEP believes that increasing energy sector levies for this purpose is unsustainable in the short to medium term. Inflation and currency depreciation are macroeconomic issues that require robust fiscal policies, the absence of which consumers would consistently suffer the consequences if the current proposition is maintained. Government must fix the debt accumulation challenges along the energy sector value chain, particularly the generation and distribution chains.

Conclusion

Events in the energy sector have influenced much of the adjustments made in the supplementary budget. These are mainly debt accumulation resulting from Take-or-Pay contracts and inefficiencies in the energy sector value chain which have also contributed to debt among the utilities. The government is faced with the challenge of meeting energy needs at sustainable costs, and has proposed various measures.

On Take-or-Pay contracts with PPAs, ACEP is of the view that government should not unilaterally convert the contracts. Also, the market dynamics within the sub-region do not support increased export of power from Ghana's excess generation capacity. LNG imports are not needed considering Ghana's current and potential domestic gas production capacities. Cancelling LNG contracts will therefore eliminate the looming costs of excess gas by 2023. Finally, addressing energy sector debt challenges in a holistic manner is the most sustainable way of relieving citizens of excessive tax burdens.

SIGNED
EXECUTIVE DIRECTOR