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Importance of Cost Reflective Pricing for Utilities

Sri Lanka has had a long legacy of below-cost pricing for utilities such as electricity and fuel to offer 'blanket' type of relief to consumers irrespective of their income level. These concessions took a significant toll on the financial performance of the Ceylon Electricity Board (CEB) and CPC. Liquidity shortages of these State Owned Business Enterprises (SOBEs) were financed by the banking sector and thereby crowded out other productive investments. To secure financial viability of these SOBEs, the Government had to assume a portion of these legacy debts in 2022 and make substantial adjustments in fuel prices and electricity tariffs in 2022 and 2023, in line with cost reflective pricing mechanisms. Since then, both CEB and CPC have been making annual profits. This experience has revealed that though untargeted energy subsidies provided short term reliefs to the public and businesses, ultimately, they had to bear accumulated cost later in the form of high prices for energy, taxes and overall inflation. To prevent this vicious cycle of below cost pricing for short term gains leading to long term losses for

the macroeconomy, continuation of cost reflective pricing is essential. Therefore, deviation from the cost reflective pricing mechanism for utilities is not beneficial for the Government or businesses or the public in the long run. Therefore, rather than extending a 'blanket' type of relief to all through mispricing of utilities, any additional support can be provided to the needy segments of the economy through targeted benefit schemes. Also measures could be taken to enhance operational efficiency and competition while reducing production cost to pass the benefits to the consumer.

