Discom bailout

Lacking the power of reforms

The new bailout plan is unlikely to change the incentive structure and ensure healthy functioning of discoms

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If FRBM targets have to take into account discom finances, the recommendations of the 14th Finance Commission on taking extended deficit and debt as target variables should have been implemented

The accumulated deficits and debt of states' power distribution companies (discoms) are in the news once again and any observer who has analysed the fiscal restructuring plan (FRP) implemented in 2013 will not be surprised. In fact, the Union government has been coming out with periodic bailout plans such as Accelerated Power Development and Reform Programme (APDRP) and Revised APDRP. A careful analysis shows that these periodic oxygen infusions were essentially to ensure regularity in the payments to the power generators or to ensure repayment to lenders. These reforms fell much short of remedying irrational pricing, reducing transmission and distribution losses or improving regulatory governance. As the cost of power purchase by discoms steadily increase—and with the regulator not allowing increase in tariffs—deficits and debt continued to mount. While some discoms tried to limit the damage by simply resorting to power outages for long hours, those which could leverage, resorted to borrowing and accumulating debt. In none of the restructuring plans implemented so far, there is any evidence of improving the electricity service to the consumers is evident. Households had to either embrace darkness or have had to look for more expensive options. Similarly, industry and commerce have had to depend on expensive captive power generation to continue their activity. From newspaper reports, there appears to be another attempt at bailing out power utilities, and from these reports, it appears that it is yet another attempt to oxygenate the lenders and power generators, and that the hope of better electricity supply to the consumers will remain a mirage.

There have been repeated attempts to bail out states' power distribution utilities. The APRDP was initiated in 2000-01 to improve their financial health and to improve the quality of supply. The Union government agreed to contribute 50% of the project costs, half of which was in the form of loans and the remaining 50% to be borrowed by the respective states from institutions like PFC and REC. This failed to take off as the states were not willing to contract 75% of the amount as loans. In 2008, the Union government came out with the R-APRDP which had two components. The first was the introduction of information technology to generate the baseline data, energy auditing and for consumer services. The second was to address the issues relating to power distribution, the key being reduction in power losses. The programme was to be financed through loans to be converted into grants on successful achievement of the targets fully in the case of the first part and up to 50% in the case of the second. As this too did not take off, the FRP for the discoms was implemented in October 2013 which entailed converting 50% of short-term liabilities into bonds by the respective states and restructuring of the remaining 50% by the lenders with a moratorium of 3 years. The action plan to bridge the difference between the average cost and average revenues of the discoms was also introduced by providing incentive to reduce the AT&C losses by rationalising the tariffs and reducing the transmission and distribution losses. As a part of the programme, the government of India promised grants equivalent to the value of additional energy saved by reducing the AT&C losses beyond what was prescribed, 3% per year in the case of discoms having more than 30% losses and 1.5% in the case of the rest. Furthermore, the Union government agreed to reimburse 25% of the bonds/special securities issued by the state governments.

The FRP too, like the earlier bailout plans failed to take off. Although the eight states—Andhra Pradesh, Bihar, Haryana, Jharkhand, Rajasthan, Tamil Nadu, Telangana and Uttar Pradesh—which accounted for 80% of the accumulated debt adopted the plan, they failed to meet the performance criteria. Thus, the situation continues to be grim, with the outstanding debt of discoms estimated at more than ₹4 lakh crore, increasing by ₹60,000-70,000 crore every year. This is one of the factors contributing to the deterioration of asset quality of state-owned banks, whose NPAs are estimated at 5.2% of their lending portfolio.

The details of the new bailout plan are not yet available. According to the available reports, the proposal envisages the states issuing bonds to the lenders cover over 80-100% of the debt of the discoms. To facilitate this, it is proposed to relax the FRBM targets by 0.25 percentage point and provide interest subvention to the states by 3-4 percentage points to limit the interest rate at 9%. It is not clear whether the Union government will reimburse the difference to the banks or the banks will be asked to take yet another haircut. If the latter option is taken, given their large NPAs, it would be like giving a haircut to a bald man! The remaining debt should be repaid by improving the finances through rationalising tariff and reducing transmission and distribution losses. If the states default on the agreed terms of bond issue, the Union government would cut their tax devolution. I hope this is not true for this can raise serious questions of Constitutional propriety as the tax devolution recommended by the Finance Commissions, once accepted by the government, cannot be pre-empted for any payments.

Where does the proposal leave us? Indeed, this may improve the balance sheets of financial institutions, particularly state-owned banks. Perhaps, this may also improve the plant load factor and finances of electricity generating companies. Unfortunately, this is unlikely to change the structure of incentives to ensure healthy functioning of the discoms, nor are consumers likely to get better supply of power. In fact, consumers' interest was never a consideration in any of the bailout plans. As already mentioned, many discoms have been containing losses not by improvement in their functioning or increases in tariffs but simply by resorting to outages for long hours. The consumers' interest has not been in the regulators' radars. Many discoms were not allowed to charge rational tariffs because of ineffective regulators acting as lapdogs of the states rather than independent watch dogs. Meddling with the fiscal deficit targets to facilitate the bailout gives a clear signal that fiscal austerity can be easily be given up from time to time. If indeed targets need to be adjusted to take into account the finances of discoms, the advisable route should have been to implement the recommendations of the 14th Finance Commission to take extended deficit and debt as the target variables. This would force the discoms to make audited accounts available to the state. Relaxing the targets in ad hoc manner will send wrong signals on the seriousness of FRBM.

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