UDAY lacks brightness

Improvement in the finances of discoms is possible only if they reduce costs and increase revenues

The reform of the power distribution sector has received the Cabinet approval. As I had mentioned in my recent column in this paper, this is the fourth attempt at reforming the power sector, beginning with the Accelerated Power Development and Reform Programme (APRDP) in 2000 which was revised in 2008 (R-APRDP) and the financial restructuring programme initiated in 2013. Like the earlier attempts, it posits laudable objectives but falls well short of what is needed to bring about systemic improvements in the distribution sector and ensure uninterrupted power supply.

The reform proposal approved by the Cabinet, the Ujwal Discom Assurance Yojana (UDAY) confirms that the major objective of the initiative is to improve the balance-sheets of the discoms and prevent the stressed assets of the public sector banks and financial institutions that have lent money to the discoms from becoming non-performing ones. In part, improved balance-sheets of the discoms might enable them to buy more power from the generators and improve their plant load factor in the medium- and long-term. With the discoms bleeding—accumulated losses of ₹3.8 lakh crore—and with outstanding debt of ₹4.3 lakh crore (till March 2015), action was needed to revive their financial fortunes.

According to the Cabinet note, UDAY is a "path-breaking" reform and promises "the rise of vibrant and efficient discoms though a permanent resolution of the past as well as potential future issues of the sector." This is sought to be achieved by (i) improving their operation efficiency; (ii) reducing the cost of power; (iii) reduction in their borrowing cost and (iv) enforcing the financial discipline on discoms by linking them with state finances. The operational part of the reform is that the states shall take over 75% of the outstanding liabilities of the discoms, 50% the first year and 25% in the second. These liabilities will not be included in the prescribed fiscal deficit targets for FY16 and FY17. The states will issue non-SLR bonds directly to the banks and financial institutions holding the discom debt at present. The remaining debt of the discoms will be converted into bonds or loans carrying an interest of not more than the bank's base rate plus 0.1%. Alternatively, discoms will issue the state guaranteed bonds at the prevailing market rate which shall be equal-to or less-than the bank base rate plus 0.1%. Finally, future losses will be taken over by the respective states in a graded manner with the increasing proportion of the losses to be taken over by them over the years, starting at 5% in FY18 and increasing to 50% in FY21 to ensure that the states remain significantly responsible for the losses of discoms. The reform is optional for the states.

What is the incentive for the states to adopt these reforms? The only gain is that the existing high-cost loans (averaging an interest rate of 13-14%) of the discoms will be replaced with loans bearing lower rate of interests of about 9-10%. It is not clear who will compensate the lenders, who will bear the the difference between the rate at which banks had lent to the discoms and the rate of interest chargeable to the renewed bonds. It appears, the lenders will have to take the haircut for avoid these loans from becoming "non-performing".

Structural improvement in the finances of discoms is sought to be achieved by improvement in their operational efficiency, reduction in the cost of power and lower interest costs and by aligning the finances of the discoms with the respective state finances. Operational efficiency is supposed to be achieved by compulsory

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smart metering, upgradation of transformers and adopting energy efficiency measures. However, there is nothing in UDAY that requires the adoption of any of these measures. Similarly, the cost of power is supposed to result from measures such as supply of cheaper domestic coal, coal linkage rationalisation, liberal coal swaps from inefficient to efficient plants, coal price rationalisation based on gross calorific value of coal, supply of washed and crushed coal. Indeed, these measures would reduce the cost of thermal power, but that requires a separate set of reforms.

Thus, an improvement in the finances of discoms is possible only when they reduce their costs and increase their revenues. Lowering the cost of generation and procuring power, as mentioned above, requires a separate set of reforms. Irrational pricing and inability to prevent the theft of power are the main reasons for lower revenues. The political decision not to charge electricity to the agricultural consumption and unmetered consumption needs to be tackled and that is not going to be easy. Unmetered consumption does not even give a clear picture of transmission and distribution (T&D) losses. Tackling this, too, is a political problem as the theft of power is often by the politically-connected. In fact, the estimate of 22% transmission and distribution loss is completely unreliable because, in the absence of a proper measure of agricultural consumption, discoms simply overstate agricultural consumption to show lower T&D losses. In fact, many of the discoms do not even care to have updated audited accounts! Another major issue confronting the sector is the ineffective and often, incompetent regulators loyal to the political executive. In most states, the regulators are hardly independent and tariff revisions depend upon political willingness rather than cost factors. Many discoms suffer from the problem of overemployment which only adds to operational costs. In fact, most discoms do not even audit their accounts regularly and we really do not know the true picture of their losses and loans. None of these issues is addressed in UDAY.

The most important issue is how the reform will help the consumers. The Cabinet note characterises UDAY as "…..a path-breaking reform for realizing the Hon'ble Prime Minister's vision of affordable and accessible 24X7 power for all." Can this really happen? Indeed, the proposed reform could prove helpful for cleaning the balance-sheets of the discoms, to some extent, and reduce the non-performing assets of the banking system, but to ensure stable supply of power to the consumers, additional reforms to deal with the structural problems of the sector are called for. There is nothing in the reform that prevents the discoms from resorting to outages for hours together simply to reduce their losses and as long as the price charged is lower than the average cost of supplying power, this will continue to happen. Ensuring that the average price of power sold is higher than the cost of supply requires a separate set of structural, including institutional reforms, and until that happens, it would be too optimistic to presume that the consumers will see an affordable and 24X7-accessible power supply. Furthermore, insulating the bond issue by power discoms from the fiscal targets can prove costly for monitoring their fiscal discipline in the long-term

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