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Assembly elections: Parties are promising 'free' power. Who will bear this cost?

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NEW DELHI: The promise of free or subsidised electricity in poll-bound states is giving enough fodder to political parties in the run up to assembly elections to be held in the next few months. Seven states are going to polls this year, of which five – Uttar Pradesh, Punjab, Goa, Manipur and Uttarakhand – will witness assembly elections in the first half of 2022 while Himachal Pradesh and Gujarat will hold elections towards the end of the year.

Earlier this week, Samajwadi Party president Akhilesh Yadav made his first major poll promise ahead of the 2022 Assembly election in Uttar Pradesh by promising to provide 300 units of electricity free of cost to households as well as free electricity for irrigation to farmers if voted to power. Just days later, the Uttar Pradesh government announced a 50 per cent cut on

farmers' electricity bills for running their tubewells. The move would directly benefit over 13 lakh users in rural and semi-rural areas.

Data from Crisil research shows agri-linked consumers account for 15 per cent of the total consumer base in Uttar Pradesh

"UP has 5 state discoms and amongst them Paschimanchal Vidyut Vitran Nigam (PaVVNL) and Dakshinanchal Vidyut Vitran Nigam (DVVNL) have the highest share of agri consumers at close to 20%. With free power, typically in the past, most discoms have increased rates for industrial consumers sharply to partially cover up for these losses and also end up reporting net

losses. This deteriorates their financial situation resulting in sharp increase in debt," said Hetal Gandhe, director, Crisil Research. Thus begins the vicious cycle of higher state government support and delay in payments to creditors.

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24% agri-linked power users in Punjab

Similarly, power freebies are being doled out in Punjab ahead of assembly elections which are slated to be held in March 2022. In Punjab, agri-linked consumers account for 24% of total consumers. Free power to farmers constitute 70% of total subsidies, free power to Scheduled Caste, backward caste and BPL families constitute 14 per cent of the total subsidies while subsidised power to industrial consumers constitutes 16% of total subsidies, as per data analysed by Prayas Energy Group.

Punjab also has a history of making high subsidy commitments and delaying payments to discoms. This impacts Punjab State Power Corporation Limited's (PSPCL) already precarious finances. Not only has the Punjab government waived power bills of those having electricity connection of up to 2 kW, a move that will put a burden of Rs 1,200 crore on the state exchequer, but in May 2021 the government also announced a cut of 50 paise to Re 1 per unit for domestic power consumers in the state. Point to note: Since assuming power in 2017, the Congress government has defaulted on paying subsidy dues every year. It has coughed up a power bill of Rs 10,000 crore already, which has to be paid to PSPCL. And with chief minister Charanjit Singh Channi's announcement of more sops, the subsidy bill for the current fiscal has touched Rs 20,016 crore, of which the government has so far only paid Rs 7,800 crore.

How does the freebie work?

A sizable chunk of electricity is supplied to farmers and households at a fraction of the cost, and sometimes even free. The

state government directs the power distribution company (Discom) to charge a low or zero tariff to these consumers, but promises to reimburse the discom for it. But most states either don't pay the difference or delay these payments, which is why discoms are always in losses or under debt.

Now, the discoms need to make up for at least a part of these losses, and they do so by charging more for power from industries and businesses. But despite several restructuring attempts and cross-subsidies, many discoms now have outstanding dues of between six and 12 times their monthly bills.

"Offering free or subsidised electricity to 'vote banks' achieves the short-term goal of winning elections. In the long term, it erodes the financial viability of the electricity distribution sector. This is not a problem of discom inefficiency but rather a problem of political expediency," said energy expert Akhilesh Sati in an ORF report titled 'Discom reforms in India: Why the inefficiency narrative is inadequate.'

Who bears the cost of these freebies?

Consumers in Delhi enjoy free electricity up to 200 units a month, which means several citizens get zero monthly bills. In Tamil Nadu, users get up to 100 units of free electricity consumption. If an elected government wants to keep a poll promise of reduced or free electricity, it has to compensate the power distribution company for the difference.

State governments either subsidise or take over the debt of Discoms. Case in point is the Ujjwal Discom Assurance Yojna (UDAY) scheme when state governments floated bonds to retire the debt of Discoms. The second option is cross-subsidising, which means they raise the price of power for other consumers like businesses and industries. But what really happens in majority of the cases is that power distribution companies incur massive losses.

What happens if there is a delay in subsidy payments?

Data analysed by Prayas Energy group, shows that subsidies to electricity distribution companies (DISCOMs) form 10% to 30% of the aggregate revenue requirement of DISCOMs in various states. "Delays in subsidy payments result in increased working capital borrowings for DISCOMs to meet operational expenses. This puts additional stress on cash-strapped DISCOMs. If

subsidies are not committed or paid in time, the impact on DISCOM finances will be substantial and will necessitate periodic bailouts in the future", said research analyst Nikita Das.

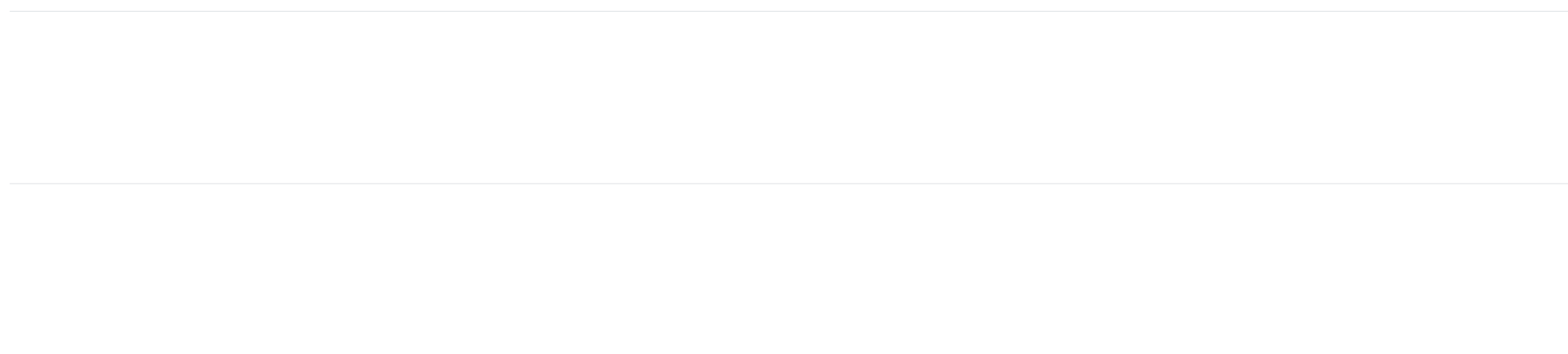
The amount owed to power generation companies is only rising each month

Discoms owed a total of Rs 1,15,904 crore to power generation firms in January 2021, according to portal PRAAPTI (Payment Ratification And Analysis in Power procurement for bringing Transparency in Invoicing of generators). In January 2022, the total overdue amount, which was not cleared even after 45 days of grace period offered by generators, stood at Rs 1,01,357 crore as against Rs 99,650 crore in the same month a year ago. The overdue amount stood at Rs 99,981 crore in December 2021.

Discoms in Rajasthan, Uttar Pradesh, Jammu & Kashmir, Telangana, Andhra Pradesh, Karnataka, Madhya Pradesh, Maharashtra, Jharkhand and Tamil Nadu account for the major portion of dues to gencos, the data showed.

Total overdues to Gencos by Discoms in poll-bound states

All figures in Rs crore



Of the five states that are going to polls in the first half of 22, discoms in Uttar Pradesh owe the maximum amount to power generating companies.

Why discoms bleed money

"The manifesto announcements favored political parties and the power sector was used to attract voters. The significant issues like lower tariff rates, subsidies, higher Aggregate Technical & Commercial (AT&C) losses, Higher Transmission and Distribution (T&D) losses, bills recovery efficiency, elimination of Average Cost of Supply (ACS) and Average Revenue Realization (ARR) gap, higher receivables and payables days, higher operation and management (O&M) cost need be solved. Until these root causes of the problem are not eliminated without political parties' interest, this circle of low performance shall prevail. One after one new scheme for the financial viability of discoms will be needed," said Kamaljit Singh and Simmi Vashishth in a study titled "Impact of Poll Promises and Political Interference on Financial Performance of Power Distribution Companies in Haryana."

Free electricity announcements lead to subsidy dependency for the distribution utilities from their respective state governments. "With the free power policy as seen currently as well as highly subsidised power tariff rates to agriculture category & some sections in residential category across most states and given the fact that cost of power supply has increased, overall absolute level of subsidy requirement for the distribution utilities has gone up over the period and is estimated at about Rs 1.3 lakh crore for the current financial year, comprising at about 16-17% of the discoms' revenues. As a result, timeliness and adequacy of subsidy release from the state governments towards the utilities remain extremely important from their cash flow perspective," explained Girishkumar Kadam, Senior Vice President & Co-Group Head - Corporate Ratings, ICRA Limited.

State finances are strained thanks to these subsidies

"Free electricity would stress the state's finances and the implications of this would be carried forward for years. Owing to the constrained finances the state would incur lower developmental expenditure which would have ramifications for the future economic potential of the state," said Kavita Chacko, Senior Economist, CareEdge, a rating agency.

The finances of all the states have been strained in FY21 owing to the pandemic. Barring Manipur, the other 4 poll bound states

witnessed a revenue deficit in FY21 (as per revised estimates). For FY22, barring Punjab, the other 4 states have budgeted for a revenue surplus. In the first 8 months of FY22, Punjab and Uttar Pradesh have recorded a revenue deficit.

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All figures in Rs crore

Rs crs	Gross revenue deficit(+)/ (-) surplus : FY21 (Revised Estimates)	Gross revenue deficit(+)/ (-) surplus: FY22 (Budget Estimates)	Apr-Nov'21: Gross revenue deficit(+)/ (-) surplus
Goa	133	-59	
Manipur	-810	-1,550	-358
Punjab	20,730	8,622	6,842
Uttar Pradesh	13,160	-23,210	2,378
Uttarakhand	3,080	-115	-996

TOI Table: CMIE

Moreover, the promise of free or subsidised electricity would further strain the finances of the power distributing companies in India (Discoms.). These companies do not generate electricity themselves but rather purchasing them from someone else and just supplying it to the final consumer. Examples include Tata power, BSES Yamuna, BSES Rajdhani and Reliance infrastructure.

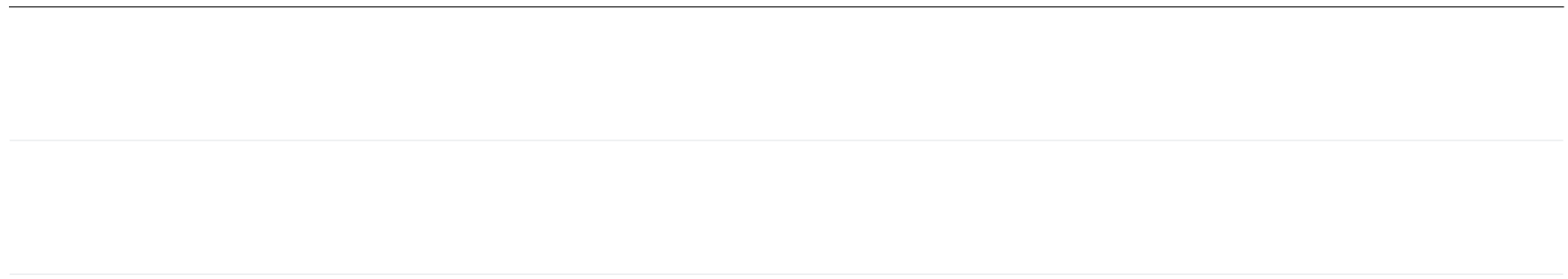
"Given the state govt's financial constraints the payments to DISCOMs would get delayed and the DISCOMs would have to resort to borrowings.It would also delay payments from DISCOMs to generating companies, adding to the already sizeable overdues to Gencos," said Chacko. It would also result in higher electricity costs/tariffs for the industrial and commercial segment as they cross subsidise agriculture and households, said Chacko.

Discoms have been saddled with losses over the years

DISCOMs have been saddled with losses over the years and their losses are expected to have increased since the onset of the pandemic given the lower power demand from the industrial and commercial sector. The aggregate losses of 115 DISCOMs evaluated by PFC in 2019-20 stood at Rs 31,672 crore (Rs.9,103 crore in 2018-19, Rs.27,966 crore in 2017-18). The outstanding debt of the 115 DISCOMs in 2019-20 was Rs 5.14 lakh crore (Rs 5 lakh crore in 2018-19, Rs.4.64 lakh crore in 2017-18).

Aggregate losses of discoms on subsidies received excluding regulatory income and Uday Grant 2019-2020

All figures in Rs crore



Coajpibandh

TOI Chart: PFC

It is not surprising that ICRA has a negative outlook on discoms. Overall financial health of state owned distribution utilities

remains weak, due to fundamental issues pertaining to inadequate tariffs, high level of operational in-efficiencies with higher than allowed AT&C loss levels as well as inadequate subsidy support.

"The cash gap for the discoms per unit sold for the discoms on an overall basis is estimated at about Rs.0.54/Unit sold for FY 2023. Cash gap is a sum of profit after tax, depreciation, UDAY grant and regulatory income divided by units sold. In addition to efforts required for curtailing the AT&C loss levels, timely pass through of cost variations in power purchase cost by the utilities as well as timely tariff determination by SERCs for the utilities remains critical too, given the upward pressure on cost of power supply," said Kadam.

And, given that coal as a fuel contributes about 70% of all India energy generation, distribution utilities remain exposed to an upward pressure on cost of power purchase. In case of upward revision in domestic coal price by 10% and strengthening in imported coal price seen by about 70% since April 2021, the cost of power supply is estimated to increase by about 1.0-1.5% for distribution utilities at all India level. What this means is that any more power sops or subsidies announced by state governments, will put further pressure on discoms.

A Niti Ayogya report on the state of electricity distribution in India also notes that subsidised and sometimes free electricity for agriculture can lead to leakages and high losses for discoms. "Some states, with large agricultural consumer bases such as Rajasthan, Andhra Pradesh, Gujarat, Karnataka, and Maharashtra, have reduced leakages by separating feeders for agricultural use from non-agricultural use. Discoms can significantly decrease their power procurement costs by encouraging the use of solar pumps for agriculture," said the report.

A CRISIL study of 34 state discoms (from 15 states) shows that continuing cash losses is the primary reason for the existing weak credit profiles of state discoms and make structural reforms critical to their sustainability.

"Further, denting the cash flows will be a more than 30% surge in interest cost as discoms take debt largely under Aatmanirbhar Bharat scheme², to repay older dues of generation and transmission companies. This is a higher cost debt with interest cost around 50-100 basis points higher than the average cost of debt of discoms. Debt will also be taken to fund ensuing cash losses and capital expenditure. We expect debt to surge to Rs 5.3 lakh crore this fiscal," said Aditya Jhaver, Director, CRISIL Ratings.

What is the way out of this mess?

For fiscal year 2022, accumulated losses of 30 discoms spread across 9 states accounting for over 60% of power demand are estimated at Rs 700 billion, shows data from Crisil.

"Amid Corona, these losses have gone up from Rs 250 billion to Rs 700 billion between FY20 and FY22. Given the government's latest RLTDs scheme, multiple discoms and state governments have submitted or are in the process of submitting a plan of action. The scheme focuses on funding incentives linked to infrastructural improvements such as network augmentation works, smart metering and compliance enhancements and requires discoms to focus on improving operational parameters like ACS-ARR gaps and hence tariffs revisions. Steps like these will determine the eligibility of the discoms for the Rs 3 trillion scheme. The current freebies being offered by a few states can impact their eligibility for the scheme or need more state government funding support," said Gandhi.