

POWER POLITICS: PROPOSED CHANGES IN THE ELECTRICITY ACT

Relevant for: Indian Economy | Topic: Infrastructure: Energy incl. Renewable & Non-renewable

A few months before the next general election, the Central government has proposed a set of changes to the Electricity Act 2003. The amendments seek to enable a market transformation in electricity. The link between political power and electrical power is widely known; promises around electricity access, price and quality are important political currency.

However, the expenditure of scarce political capital on this issue is puzzling. The amendments will be hard to get through Parliament (an earlier 2014 effort failed) and voters will not see an immediate impact. What is the political rationality of this effort? Who are the winners or losers from these amendments?

Bringing in competition and choice in supply for the final consumer has long been an aim of electricity reform and remains central to these amendments. The idea is that while a single public utility will run the wires through which electricity flows, multiple supply licensees (both public and private) will be allowed to compete for consumers. The intent is that the discipline of competing for customers will lead to improved supply and lower bills. However, the global track record on this approach is far from definitive.

While an earlier 2014 reform effort proposed mandatory and time-bound implementation of these reforms, and therefore was resisted by States, the current amendment allows them discretion on the timing of implementation. The combination of time discretion and the improved presence of the ruling coalition in State governments may facilitate passage this time around.

If it does, India could have an electricity distribution sector with pockets of competition for wealthy consumers in a sea of monopoly inhabited by the poorest. Private suppliers could cherry-pick profitable locations and consumers; the state-owned incumbent supplier will be left with the obligation to serve low-paying consumers.

This need not be bad, if there were a mechanism to support the second group. This currently happens through 'cross-subsidy' from wealthier customers, but this is also being changed under the amendments. This leaves only the possibility of direct support from States. If these transfers are not forthcoming, or late, the cash-starved incumbent supplier will be locked into a cycle of poor quality of service for its customers who have no 'exit' option, leading to more bill evasion, and further financial deterioration.

The amendment (along with changes in the National Tariff Policy) aims to get the price right — a long-standing aspiration — by capping cross-subsidies at 20% immediately, and eliminating them within three years. The cross-subsidy surcharge on open access customers — the fee that holds back customers from leaving the grid — would be eliminated within two years.

There is a compelling rationale for these changes — India has among the highest electricity tariffs for industry, which bears the burden of low-performance and losses among other consumers, impacting their global competitiveness. However, this shift could be highly disruptive if the profit-making side is allowed to flee, without devising a transition pathway for the loss-making side of electricity.

Perhaps because of these political sensitivities, the proposed approach to eliminating cross-

subsidies is complicated. Subsidies will not be allowed across consumer categories like industry and agriculture, but will be allowed across consumption categories — big consumers can subsidise small ones. Big industrial consumers will see no effective change, although small business consumers will escape payment of subsidy.

The more significant change is abolition of the cross-subsidy surcharge, which will open the flood gates for large consumers to migrate through 'open access' to cheaper sources and avoid paying any subsidy. In short, cross-subsidy will become load-based subsidy, but the load available to pay that subsidy will be allowed to escape.

Where is support for poorer customers to come from? The amendment recognises the need to subsidise the poor, but mandates this be done through direct benefit transfers. However, identifying and targeting beneficiaries remains a challenge. Moreover, with these changes, the mechanism of support for poorer customers will shift from the electricity customer to the taxpayer. Cross-subsidies are certainly distorting. But the solution requires the electricity sector to assert its claims for support in competition with several other possible uses of state funds, introducing political uncertainty.

The proposed legislation makes subsidy to the poor the collective responsibility of the States and the Centre, which has so far been only the responsibility of each State. Notably, the Centre may have access to enhanced tax revenues from electricity because it stands to gain from additional tax revenue from profitable new wires companies and private suppliers. Thus, the Centre could become a new fulcrum of redistribution from wealthy areas in wealthy States, to needy customers that are concentrated in a few States.

While this may be a pragmatic fiscal strategy allowing redistribution across States, it also has undeniable political implications. It provides greater control to the Centre and limits the States' and regional political parties' capability to make electoral use of electricity pricing. The politics of power prices will shift from sub-national to national electoral politics. In an electoral context where the battle lines may be drawn between the ruling coalition and strong regional parties, this is worth noting.

Moreover, the amendments have other centralising dimensions. The amendment proposes a reformulation of the selection committee for State regulators, from a majority of State representatives to a majority of Central representatives.

The Centre will also gain more oversight on capacity addition, through the requirement of detailed project report submission to the Central Electricity Authority. There is no doubt that State performance has been poor on both fronts. But the amendments reflect a clear choice of solution: re-direct responsibility to the Centre instead of fixing the process in the States.

Many generating companies have been in the news recently due to decreasing demand for their power and consequently their stranded assets. The amendments potentially provide comfort to them at the expense of distribution companies. Specifically, they mandate that suppliers sign power purchase agreements (PPAs) to meet the annual average demand, ostensibly to ensure 24x7 power for all, which will be subject to review and compliance measures.

The challenge of low demand for existing power is undoubtedly an issue. However, the logic of this move is curious; disincentives to serve poor customers rather than availability of power is the real obstacle to 24x7 power. The gain to generators could come at the cost of customers, who, through the PPAs signed by supply companies, have to ultimately bear the risk of uncertain load growth, prices and migration.

The amendments include many other provisions, notably around making the Act more up to date with regard to renewable energy, which is a worthy objective. In terms of the big questions, it places its bets on more competition, subsidy reform, a steering role for the Centre and throwing a lifeline to generators.

There is no doubt the status quo is unsatisfactory; India's electricity sector remains beset with problems. Yet, the amendments leave quite unclear what happens to those left behind by distribution reforms and by efforts to help out generators. Disruptive change in Indian electricity may be needed, even inevitable. But the amendments risk placing the cost of disruption on the backs of the poorest, and shifts the potential for ameliorative measures to the hands of the Centre, rather than the States.

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