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A GANGRENOUS WOUND THAT COULD BLOCK INDIA’S ECONOMIC RECOVERY

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

Reforms in the power sector are urgent if the country is to eliminate distortions that keep the economy below its potential

Ever since it returned to power with a thumping majority this summer, the government of Prime Minister Narendra Modi has been dealing with interruptions to rosy straight-line projections. A cyclical economic downturn exacerbated by continuing banking sector issues, a severe contraction in automobile sector demand, and, most recently, a seven-year low in industrial output appear to have jolted the government.

Even as the government scrambles to respond to this slowdown, structural impediments to long-term growth have been festering. One area where the wounds threaten to turn gangrenous is in the power sector. India’s power sector is a mixed tale of positive and negative developments over the last 10 years.

Electricity is critical to fulfilling the growth aspirations of a developing economy. It fuels industry, agriculture, and, consequently, consumer demand. India has made impressive strides in the power sector over the last 15 years. It is now the third-largest producer and consumer of power in the world. To mix some metaphors, with an installed capacity of 350 gigawatts (GW), India is a global powerhouse. With an annual electricity production estimated at about 1,300 billion units, India’s power generation has been growing at approximately 6-7% a year over the last 10 years, keeping pace with real gross domestic product (GDP) growth. Installed capacity has been growing faster than GDP at nearly 11% per annum over the last decade. India has diversified sources of power, with thermal coal/gas constituting 66%, nuclear 2%, renewables 13%, and hydro power 19% of installed capacity. The renewables component is growing rapidly with both solar and wind expected to generate 175GW of power by 2022.

The power sector in an economy is typically broken into three segments: Generation, transmission and distribution. These three segments and power trading are regulated in India under a consolidated and modernized Electricity Act of 2003, which was promulgated during the tenure of former prime minister Atal Bihari Vajpayee. It is a landmark regulation that opened the way for the power sector to keep pace with a fast-growing economy by bringing competition to the generation and distribution segments. Generation was fully de-licensed and distribution by private companies was permitted under license for rural and urban areas. The Act of 2003 catalysed power generation in the country, including for captive power plants.

Believe it or not, India has an overall surplus of power in terms of generation today. The real trouble is that this power is not available where and when it is needed. Geographically, the north and north-east of the country are short of power, particularly during peak periods. Jammu and Kashmir, for instance, has a 20% deficit both for normal and peak periods, and Uttar Pradesh is chronically short of power. At the same time, capacity utilization for thermal plants measured by plant load factor (PLF) has been declining. This decline in PLF arises from a combination of non-availability of fuel, surplus capacity/inadequate demand in geographical pockets, and competition from other sources of power.

The transmission and distribution segments are in much deeper trouble. Growth in transmission capacity and investment, particularly for inter-regional movement, has fallen short of the requirement. Distribution companies (discoms), most often owned by the states, are deeply indebted to banks and have also accumulated accounts payable to upstream companies. The central government's Ujjwal Discom Assurance Yojana (UDAY) scheme has been a mixed success, with some relief of the debt burden borne by discoms and moderate performance improvements in transmission and distribution (T&D) losses.

If the power sector is to play its role in India's growth, a nuanced set of reforms is now required. The generation side requires reforms that encourage environmental sustainability and a focus on the quality and reliability of electricity. With the renewable share increasing, we need greater emphasis on balancing power sources to overcome the variability of renewable electricity supply. The transmission sector requires investment and the ability to get projects completed. The distribution sector needs radical reforms such that bad debts and accounts payable are dealt with "shock and awe" rather than in drips. Broken balance sheets cannot be fixed incrementally. Looking ahead, state electricity regulatory commissions that govern discoms should be able to set and raise tariffs as necessary. Like with cooking gas, the smarter way to provide subsidies is by removing price interventions for agriculture and residential consumers, and making direct benefit transfers instead. This would eliminate distortionary pricing and level the playing field between sectors.

If these issues continue to fester, power will become a major impediment to India's growth prospects. Commentators have begun to spew untruths about 5% GDP growth being the new normal. That will become a truism only if we do not address structural issues that hold us back, such as those in the power sector. According to a World Bank report, if distortions in the power sector are reduced, we could add up to 4% to our annual growth rate. Delivering on that idea would certainly be one way to retain the balance of power in future elections.

P.S.: "The past cannot be changed, the future is yet in your power"—Anonymous.

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