

# FREE POWER A Step Backward!

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# INTRODUCTION

Power is a critical infrastructure for economic development and for enhancing the quality of life. Since Independence, India has made significant strides in expanding the power capacity, and spreading the use of electricity to villages and towns. However, it is a matter of great concern that our annual per capita electricity consumption at about 400 kwh is still one of the lowest in the world. Compare this with China at about 850 kwh and over 12,300 kwh in USA, and an average of over 1400 kwh in the middle-income countries.

India has, thus, a very long way to go to catch up with China and middle-income countries, leave alone the advanced countries like USA in expanding its power consumption. But more importantly, our medium term Objective of ensuring electrification to all villages and to all households in the coming decade seems almost impossible to attain. But this is not surprising. Witness the fact that the annual growth of capacity creation in the power sector has slowed down to 3.6% during the last nine years (1995-2004) - almost at half the growth rate achieved in the previous decade (1985-95). Even in absolute terms, on an average annual basis, we have been increasing power capacity at the rate of just about 3400 MW in recent years compared to an impressive performance of about 4200 MW per year during 1985-90, and the current need for addition of at least 8,000 to 9,000 MW per year. This sharp slowdown

*"Free Enterprise was born with man and shall survive as long as man survives".*

— **A. D. Shroff**  
1899-1965  
Founder-President  
Forum of Free Enterprise

in power development has been an inevitable outcome of series of handicaps and adverse factors affecting this vital sector of the economy for well over a last decade. All these are well known, as well as comprehensively deliberated and documented in a number of official and non-official reports and studies. But just to recall the principal reasons of India's continuing long-term poor record in the power sector, let us highlight the following problem areas:

- Inadequate power generation capacity
- Lack of optimum utilization of the existing generation capacity
- Inadequate inter-regional transmission links
- Frequent power cuts and local failures, attributed largely to ageing of distribution and transmission network
- Large-scale transmission and distribution losses and leakages
- Lack of grid discipline
- Skewed tariff structure – cross subsidization of certain consumers, especially the agricultural sector
- Slow progress of rural electrification
- Inefficient use of electricity by the end consumers
- Lack of autonomy of State Electricity Boards (SEBs) and political interference in their working
- Regulatory institutions yet to make their desired

and positive impact in the operational framework, planning and improvement of investment outlook

For an economy aspiring to achieve real GDP growth of 8 % per annum, it is imperative that India's power generation as well as consumption expands at a still faster pace, probably at the rate of at least 10 to 12% per annum. This is undoubtedly a very tough and challenging task. Admittedly, the Union Ministry of Power has developed appropriate strategies, and a blueprint to deal with various vexatious problems mentioned earlier. However, the critical missing link is in terms of implementation of these strategies. Also, given the fact that the power sector is a concurrent subject under our Constitution, the States have to play a much greater role in implementing power reforms, and building up confidence of the private sector in undertaking new power projects. For, the fiscal constraints of both the Center and the States make the task of public sector driven investment activity in power increasingly difficult. The combined revenue and fiscal deficits of both Center and States continue to be persistently high, and in 2003-04, these were of the order of over 6% and 9% of GDP, respectively. Witness, also the continuing deterioration in the financial performance of SEBs, leading to their anticipated commercial losses of Rs.21,698 crores in 2004-05. This is primarily attributable to annual gross subsidy of Rs.33,797 crores estimated for the same year.

In the ultimate analysis, the basic problem faced by the power sector is the gap between user charges and the

cost of supply. Despite reform efforts, the gap between the cost of supply and average tariff has actually worsened over the recent years from a level of 23 paise in 1992-93 to about 110 paise in 2001-02. Revenues dropped from 82.2 % of costs to 58.6% during the same period. Such financial burden has affected the capacity of SEBs to undertake new investments, be it in generation, transmission or distribution. Needless to stress, making rapid progress in the power sector has become such an urgent necessity that India would otherwise lose a momentum to build a competitive fast growing economy, and making the best of opportunities that liberalization and globalisation have unleashed in recent years.

Unfortunately, we have been wavering and delaying power reforms even after the Electricity Act 2003 has come into effect after years of discussions. The recent disturbing development relates to the New Common Minimum Programme of the ruling United Progressive Alliance, which has declared that this Act will be reviewed. There are conflicting signals on what such a review would imply. In all probability, there would be, once again, endless deliberations on the role of regulatory authorities, the structure of power tariffs, subsidy available to agriculture sector and the need for extension of time given for the reorganization of SEBs. Already, some of the States (for example, Andhra Pradesh, Tamilnadu, Maharashtra) have announced free power for the farmers. Such continuing populist stance is going to be counter-productive, and unnerve any private sector investment initiatives, whether domestic or foreign.

This is the message that the comes out loud and clear from a very comprehensive and insightful article written by Mr. Harish Budhlani. We hope the concerned policy making authorities are listening!

-Editor

**Post Script** - As we were about to finalise the printing of this booklet, there has been a news report on the Planning Commission's very candid observations on the National Electricity Policy. Among other things, it points out that this draft policy document fails to address core issues relating to the development of the power system, based on optimal utilization of resources such as coal, natural gas, nuclear substances which are materials, hydro and renewal sources of energy.

It is also reported to have been critical of the fact that the draft policy fails to identify any specific policy initiatives that would address the key problems that the power service faces, viz., competition in the sector, shifting away from the cost plus pricing regime, removing bottlenecks to open access, handling the legacy of existing contracts, raising the level of redundancy in generation, transmission and distribution, and so on. We strongly believe that there has to be a holistic approach and an integrated framework to the National Electricity Policy.

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HARISH BUDHLANI

**Introduction:** Power Sector problems, mainly high transmission and distribution losses including power theft and pilferage since 1980's, gradually wiped out the financial resources of the State Electricity Boards (SEBs). As a consequence, the annual losses reached a whopping Rs.30,000 crore, leaving SEBs with no hope of survival. Power Sector Reforms were therefore initiated during early 1990's – discussed, debated and reviewed from time-to-time, finally delivering 'The Electricity Act-2003. This Act provides the legal framework for "development of the power system – including generation, transmissions and distribution – based on the optimal utilization of various resources.....".

The most important provisions of the Act are – Regulatory Commissions at both the Centre and States level (CERC / SERCs) to determine fair and affordable tariffs for all, gradual reduction and abolition of "all subsidies and cross-subsidies" and deterrent punishment against power thefts, defaulters, etc.

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In fact, the backbone of Power Reforms was a consensus agreement of all Chief Ministers with the Prime Minister to stop free power to consumers and to charge at least 50 paise per unit to reduce power wastage and to bring in some accountability. Unfortunately some States have started renegeing their commitments and backstepping by announcing 'free power to farmers for short political gains. This article discusses various aspects and possible alternatives for this popular but unfair and unpractical step.

**Background:** After independence, as a secular, socialist and democrat country, India needed rapid development of agricultural and industrial sectors to increase food production and create employment opportunities for the huge population. To achieve this objective, it was necessary to augment the installed power generating capacity, which at that point of time was a meagre 1,340 MW. A well planned drive launched during late 1950's saw establishment of many SEBs, which took up this great challenge to energize lacs of households, millions of pumpsets and small industries during the fifties and sixties. In fact, this was a performance-meter for a number of SEBs. In about two decades, self-sufficiency was achieved in food and fertilizer production and also many small-scale industries were established. Those were the days when people felt proud to work hard for the national development. The increasing success perhaps resulted in some degree of complacency creeping in, alongwith selfishness of some politicians, bureaucrats and other people with influence and power. After 1980's, these people treated SEBs as self-owned

cows, sucking them out till the last drop of milk through 1990's. The theft and pilferage of electricity came rampant and almost all SEBs that did such a commendable work during first two decades, became financially bankrupt and without proper metering, it became routine to show all unaccounted losses including power theft, as agricultural consumption – so that the financial and other aspects could be covered up.

The power consumption for agricultural sector of 15-16% during 1960's and 1970's, increased to over 35-40%, thus pushing SEBs further down in their operational and financial performance. As a consequence, power reforms initiative became inevitable, resulting in the enactment of Electricity Act-2003. Among other things, the Act provides for deterrent punishment against power theft and also gradual reduction and elimination of all subsidies as well as cross-subsidies so that the power sector runs on commercial principles.

The enactment of the Act has taken a very long time – almost a decade for convincing the State Chief and Power Ministers as well as political parties that without this action, SEBs and power sector will not survive.

**Chronology of Events:** With this background, let us discuss chronologically various points:

- ▶ All SEBs did an excellent work for the initial period of 20/25 years in spite of free and subsidized power given to the weaker sections, as long as the same was within a manageable level of 15 to 20% of total consumption or sales.

- ▶ As the cost of generation increased, as also the manipulated agricultural consumption reaching above 35-40%, this could not be sustained even after heavy and unfair increase in industrial and commercial tariffs, with their inevitable serious repercussions.
- ▶ It is a fact that the State Governments and SEBs could not control the rampant theft of power, leading the SEBs to a death-bed. Some drastic measures became essential so as to revive the SEBs and power sector through a major surgical operation. It was, therefore, agreed that subsidies must be reduced/eliminated to recover the cost of supply. A provision was made in the Act that, if any government wishes to give subsidies, the government "must pay for the differential cost in advance...." (Clause 65).
- ▶ Unfortunately, power reforms process first started in Orissa, did not succeed due to various lacunae. The T&D losses could not be reduced to increase the revenue and defaulters as well as the problems continued. So much so that the whole decade can be termed as 'decade of experimentation' and failure.
- ▶ Political pressure and farmers' ire in UP, Haryana and Punjab forced postponement / cancellation of metering programmes and free power was given to the farmers. This was recently followed by Andhra Pradesh, Tamil Nadu and now Maharashtra, in spite of the fact that new Act discourages the same strongly.

- ▶ Like SEBs, financial condition of many state governments is also not very satisfactory. For example, Maharashtra is already burdened with debt of over Rs.90,000 crores and this new promise of free power will cost the government additionally about Rs.1,500 crores per year. Where does the government get this money from? It could be by increasing power tariff on other consumers or putting additional tax burden on the common man. Maharashtra Government does not have enough funds even for more important and basic needs like primary and secondary education and providing essential medicines for health centers and hospitals.
- ▶ Going back on the committed reforms mean stoppage of major funds from the World Bank, which will further slow down/stop all proposed improvements/modifications in distribution and other sectors.
- ▶ At present, about 3,000 MW power is used by agricultural sector in Maharashtra, where regular shortage is 1,500-2,000 MW. About 4 lacs pump connections are still pending which will need further 1,500 MW of power. Where do we get this additional power from? There is so much magic wand, so just providing the connections, without adequate and timely electricity will not serve any purpose.
- ▶ Arrears from farm sector have already accumulated to Rs.3,800 crore. When and how this money will be recovered?

- ▶ Readers may think that we are writing this against the interest of poor, hapless farmers, some of whom are driven to extreme step of committing suicides. Not at all. Our point is that, out of Rs.1,500 crores, hardly some 8-10% will benefit small farmers. The rest will actually benefit large and rich farmers.
- ▶ This has been questioned by Mr. Sharad Pawar, Union Agriculture Minister, himself stating that such help must be given to small and deserving farmers only. Farmers in remaining States may also ask for free power all over India and also some 30 lac poor families using minimum power less than 400 units per year for their basic needs. Can we then stop this?
- ▶ While the Chief Minister and the Power Minister have given lame, unconvincing reasons for this political decision, it is interesting that even a senior leader of Shetkari Kamgar Paksh has strongly opposed this decision. He has emphasized that the farmers do not want free and charitable power, but they require reliable power at reasonable price. Since government free schemes never work, such election promises are easily forgotten as soon as the elections are over. Therefore, farmers should get reliable power as per their needs at affordable price. This will give more enduring benefits to farmers, who then will be in a position to claim consumer protection rights by paying for the power.

- ▶ There is going to be an important role for CERC/ SERCs to decide affordable price for all poor and small consumers with minimum burden on other consumers. However, if any government insists on giving free power to farmers or other consumers, the payment has to be made by government in advance as per the SERC orders.

**Other Aspects and Possible Solutions:** Therefore, what could be the possible solutions? Some suggestions are given below:

- ▶ Almost 50% of the farmers still depend on the rain water for their farming, at least in Maharashtra and only about 15% small farmers use pump sets. These people need proper help so that their hardships are reduced. Therefore, charging at least 50 paise per unit for all farmers should satisfy both large rich farmers and poor small farmers, provided that the power quality is assured, so that their crops do not suffer. In Rajasthan, e.g., farmers are paying 90 paise per unit already.
- ▶ State governments can always give financial help to small and deserving farmers on humanitarian ground by reimbursing their electricity Bills. This will be a direct help to deserving farmers with minimal burden on the government, like waiver of interest on the farm-loans amounting to Rs.210 crores but benefiting nearly 30 lac small farmers. By properly maintaining land records, each farmer can be given refund/reimbursement as being already done by the Kerala Government.

- ▶ Metering and monitoring of power is essential to reduce and eliminate unaccounted power losses (theft and pilferage) and wasteful use of this precious resource. This will also reduce wastage of water, which is getting more scarce day by day, pushing water table deeper and deeper. With free power, farmers have no incentive to use energy efficient motors or use power factor improving capacitors with the motors, resulting in more power wastage.
- ▶ In the consultative high-level meeting of the Chief Ministers presided over by the then Prime Minister, it was agreed to charge nominal 50 paise per unit from all farmers. Now a very senior and powerful leader and Union Agriculture Minister, Mr. Sharad Pawar, will have to take a fearless lead in this matter of national importance and fix a uniform rate between 50 and 100 paise unit from the farmers all over India in consultation with the Prime Minister to avoid political one-upmanship..
- ▶ May be any subsidy amount so saved can be earmarked to improve power supply quality for the farmers and improve availability. Unpractical promises in past for more power have remained pipe-dreams without necessary funds.
- ▶ The benefits of subsidized power should be monitored so that it is available for deserving poor and marginal farmers only. In fact and if possible, rich farmers should actually pay some cess/levy for exclusive benefit of their less unfortunate

brethren. In India, there are innumerable rich farmers and a small voluntary help from them could possibly solve the power shortage problem, if money so collected is used for long term projects.

- ▶ In addition to the present capacity of 1,10,000 MW, we are required to add another 40,000 MW in the 10<sup>th</sup> Plan and 60,000 MW during the 11<sup>th</sup> Plan, involving investment of Rs.700,000 to Rs.800,000 crores. The Act, therefore, provides for privatization of generation, transmission and distribution to attract private funds. This commercial concept means possible competition in the long-run but consumers are unlikely to get cheaper and reliable power as long as power shortage continues.
- ▶ CERC and SERCs have the authority to regulate and ensure fair and affordable tariff to all, but this will depend on their competency and impartiality, as well as independence in operation without political interference. There is already a question mark whether MERC (or any other SERC) can ask utility to stop power supply to farmers, if the subsidy amount is not given by the State Government in advance, as provided in the Act and this may lead to legal entangles.
- ▶ A small incidence is worthwhile to cite here. A SEB had to disconnect power supply to a Civil Hospital for not clearing the pending bill of Rs.1.2 lacs. Can the State Governments pay crores of rupees in advance for free power, as provided in

the Act, if they do not have money to pay such small amounts. If so, can SERCs allow the utilities to disconnect their supply? If yes, how will State Governments face farmers' agitations by blocking the highways, etc., as was done by UP and Haryana farmers for their demands?

- ▶ It is mandatory for the CERC/SERCs to act as per the National Tariff Policy and "that the tariff progressively reflects the cost of supply of electricity....." The tariff based on cost of supply + basis cannot allow 'free power' unless this is fully compensated by the Governments without affecting the interests of other consumers and common man. Assuming average cost of supply @ Rs.3.0 – 3.5/unit, Regulatory Commission will have to be careful in fixing 'fair and affordable' tariff for different consumers.
- ▶ Another possibility is that the private suppliers will be more professional commercial minded and will always prefer more profitable urban and concentrated loads/consumers. SEBs/ state utilities may be forced to take over rural, low-load and less profitable areas, pushing them further down in their financial viability. We have to guard against this danger and correct past mistakes to save the utilities.

**Conclusion:** As mentioned earlier, the Electricity Act 2003 is a well drafted excellent piece of legislation. However, any Act is as good as it is implemented by various agencies. The governments, therefore, have to

play the most important role ensuring that all agencies<sup>1</sup> authorities work professionally and efficiently. If the State Governments continue to play political power games, it will give wrong signals to the authorities, government officials, political parties and leaders to expand their vision, shun the short-sighted approach for this important issue.

The Electricity Act 2003 must therefore be implemented in words and spirit to meet desired objectives. Free power can be conceived only if the power is available in the first place. We must learn from our past mistakes so that the goal of power for all at affordable price can be achieved.

The current half-hearted approach of "two steps forward and one step backward" will not be of any help.

*"People must come to accept private enterprise not as a necessary evil, but as an affirmative good".*

— Eugene Black

## FORUM OF FREE ENTERPRISE

The Forum of Free Enterprise is a non-political and non-partisan organisation started in 1956, to educate public opinion in India on free enterprise and its close relationship with the democratic way of life. The Forum seeks to stimulate public thinking on vital economic problems of the day through booklets and leaflets, meetings, essay competitions and other means as befit a democratic society.

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