Banks need directors on discoms, and must be tough

With 5 of the 7 major states that account for the bulk of power sector losses in various stages of getting on board the government's ambitious financial restructuring plan, the chances of success look better than at any time in the past—Punjab, sadly, has opted out and the Oriental Bank of Commerce chairman is on record saying Rajasthan and Uttar Pradesh are yet to confirm their final participation. What makes the chances of success better than, say, at the time of the Montek Singh Ahluwalia panel's one-time settlement of dues a decade ago, is that this time around, the banks are going to do the monitoring. If banks show more resolve than they have shown in the past, as in the case of Kingfisher for example, they will nominate directors on the boards of the state electricity boards, and they will drive change. The government also has other checks and balances such as the need to put prepaid meters for all large consumers as well as defaulters and deadlines for tariff hikes, but driving meaningful change in a sector where losses have risen from R26,400 crore in FY09 to R70,000 crore in FY11 and a projected R1,16,000 crore in FY13 (13th Finance Commission) is going to take some doing.

It is true most state electricity boards (SEBs) have made large tariff hikes in the last 18-24 months—56% in the case of Delhi, 37% for Tamil Nadu and West Bengal, 30% for Kerala and some like Andhra Pradesh have proposed a 42% hike in FY14 while Tamil Nadu which has large losses has proposed a much smaller hike. But this has to be seen in the context of several of these states doing nothing for a long time. In the case of Rajasthan, for instance, the 23% hike followed a period of 6 years in which no hikes were made. Indeed, at an all-India level, tariffs are around R1.1 per unit lower than cost—so that's a hike of 30% that's required at an all-India level and much higher at the level of various states. And, the way power costs have been rising, the future hikes will be much steeper given the higher costs of capital of new plants as well as the higher costs of imported coal.

Apart from the burden that hiking tariffs significantly will place on the political system, especially in an election year, there are the other costs of the restructuring package. As the Shunglu committee pointed out after looking at SEB accounts for between 2005 and 2010, a sum of R77,000 crore had been shown as “other current assets”—this is the amount of subsidies that the state governments had promised to pay the SEBs, but didn't have the money to pay. As part of the restructuring programme, SEBs/state governments have to pay all outstanding energy bills of up to March 2012 within a few months. Since state governments will have to, after 2-3 years, take on half the SEB debt by way of bonds—the other half will have to be restructured by banks with a moratorium—this will put a big burden on them. Under the plan, this extra fiscal space will be provided to them by the next Finance Commission. A lot will, however, depend on how the economy fares—while central tax devolution to states rose 17.7% in FY09, this fell to just 14.1% in FY13 as the economy tanked. Whether the restructuring works has to be seen, but while the political class has less at stake in an election year—most states have preferred to go in for load shedding instead of tariff hikes—the banks are in serious trouble if it doesn't.