Uday: A Federalist Success Story

Electricity distribution has been disastrously managed over the last three decades and in 2015 was on the verge of absolute collapse. Under-priced power, operational inefficiency, broken equipment, rampant theft and political meddling had resulted in distribution companies (discoms) hoarding losses of Rs 4 trillion on their books. They were incurring damages of Rs 0.60 per unit of power sold, had outstanding receivables of Rs 0.96 trillion (almost a fourth of revenue) and were losing 25 per cent of their output to Aggregate Technical and Commercial (AT&C) losses, a proxy for theft. Most discoms were bankrupt and unable to generate cash even for routine expenses. Banks refused to extend working capital loans and generation companies, which were collectively owed Rs 1.3 trillion, were threatening to cut off supplies. Few would remember that at one point interim court orders and desperate pleas by politicians were the only reasons households were still receiving electricity in some states. In short, the situation amounted to what is generally described as a nightmare.

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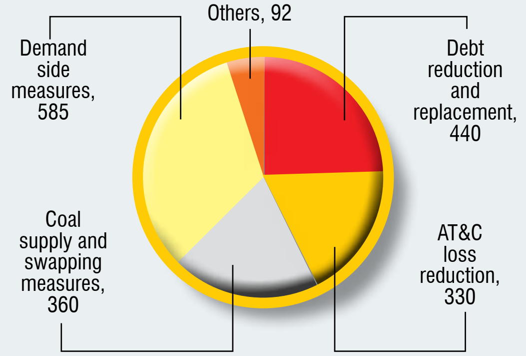
Distribution, in India's constitution, is a sector that falls under state control and therefore not amenable to central diktat. In 2012, the Government came up with a programme called the Financial Restructuring Scheme (FRS) to fix the problem but failed in the absence of state buy-ins given the broken nature of centre-state relations at the time. Subsequently, in 2015, the current administration launched Uday, which to begin with improved upon the terms of the FRS, but more importantly, was sold effectively to the states in a backdrop of more positive federalist relations. A dozen signed up within six months and as of November 2017, a total of 31 states had entered its fold.

Uday: terms of reference

Under Uday, state Governments are to assume 75 per cent of the accumulated losses of their discoms and issue state development loan (SDL) bonds in lieu of these. The proceeds are to be given to the discoms in a mix of equity and grants. The SDL bonds would be priced at G-sec plus 0.75 per cent, which is lower than the interest rate currently being charged to discoms on their debt (~12 per cent pa). The balance debt of 25 per cent would be re-priced at base rate + 0.1 per cent or securitised in the form of state Government-backed discom bonds and offloaded in the market. In this manner, discoms' overall debt would be reduced with high cost loans replaced by lower cost ones together with some equity. Once the balance sheets are cleaned up, any future losses incurred by the discoms will be borne 50 per cent by the state Government. This should align their interests and incentivise governments to manage their discoms better (e.g. by allowing correct pricing of power and investing in equipment and technology) or so the logic goes.

Estimated savings through Uday
(Rs billion)



Source: Towards Ujwal Bharat UDAY: The Story of Reforms, presentation by Ministry of Power, November 2015

On its part, the central government would provide funding support to participating states to beef up their distribution systems (transformer upgradation, metering, consumer indexing, GIS mapping, etc). They would also be supported with measures like additional coal supply at reduced prices, low cost power from NTPC and demand reducing measures such as LED bulbs, energy efficient appliances, etc. States were given targets for shrinking distribution losses, pricing electricity to eliminate under-recoveries, installing metering and transformer equipment and, ultimately, turning profitable by 2018-19. If both state and central Governments do everything they are supposed to, discoms could achieve savings of an impressive Rs 1.8 trillion over the implementation period.

Progress so far

Progress so far has been reasonable. The most visible bit is the issuance of state Government bonds intended to write off 75 per cent of discom debt. Of the Rs 2.7 trillion to be restructured, bonds worth Rs 2.3 trillion have already been issued implying a healthy appetite in the financial markets. This has led to savings of around Rs 160 billion in interest costs in FY17, a figure that will rise considerably in FY18 as state Governments transfer bond proceeds as grants to their discoms and the full year benefit of de-leveraged balance sheets is realised. In terms of under-recovery on the sale of power, the average gap between cost and realisation has dropped by about 50 per cent from Rs 0.60 per unit to Rs 0.35 per unit. This is credible and was made possible by reducing the costs coupled with tariff hikes. Ten of the largest states have raised power tariffs by higher percentages than they were required to for FY18 and some others are likely to follow. In total, 25 states have announced revised tariffs although unsurprisingly not all have implemented them yet.

The all-important statistic, AT&C loss, currently stands at an average of 23.2 per cent across states. This is a marginal improvement over the pre-Uday level of 25 per cent but still short of the target 20.8 per cent set for FY17. One reason is the problem of shoddy billing. Prior to Uday, discoms' average billing efficiency was below 80 per cent i.e. over a fifth of sales were not even billed, due to lack of metering or monitoring. To fix this, discoms need to invest in meters, new connections, audits, GIS mapping and consumer indexing.

An initiative designed to undo three decades of mismanagement without the benefit of a diktat-based solution will take time to deliver results. In view of this, the successes achieved under the Uday programme are not insignificant.

At a softer level Uday has some success. It has for instance promoted a spirit of both cooperation and competition amongst states. Those that achieved targets in certain areas have come forward to share their experiences and the federal Government has sought to institutionalise this practice. The publication of state rankings on the Uday portal has promoted a healthy degree of competition amongst states to outdo each other.

In conclusion: much to be done but progress is steady

It seems logical that an initiative designed to undo three decades of mismanagement without the backing of a diktat-based solution will take time to deliver results. States have to be persuaded rather than compelled to fall in line and, given the nature of India's political fabric, this is a perennial challenge. In view of these factors, the successes achieved under the Uday programme are not insignificant. As the results of early initiatives begin to bear fruit, states are likely to increase their efforts and under a central Government that has demonstrated a strong sense of cooperative federalism, this should lead to improving outcomes in the years ahead. ■

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