MISSION POSSIBLE

- A lot needs to be done to better the infrastructure

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From darkness to light

Our infrastructure has not grown or improved. This causes severe delays in every economic activity, with serious adverse impact on economic growth. Infrastructure investments are usually large and act to stimulate the economy and employment. They have not done so for the last three years.

The power sector has suffered the most. Liberalization of power began in 1994, when private investment was permitted in generation. In 1998, liberalization was allowed also in power transmission and distribution. The central electricity regulatory commission was created in 1998. Commissions for each state (in some cases for groups of states) followed. Convinced that it had created the enabling conditions, the government awaited substantial private and foreign investment. Unaccustomed to attracting private investment, the government did not realize that mere opening of the sector was not enough. None of the enabling environment was simplified.

The ‘reforms’ did not stimulate the power sector. A major constraint was the irrational belief that electricity should be available to all, and to those who could not afford it, at below the cost or even free. This became a populist political ploy.

The telecommunications sector, especially mobile telephony, was virgin soil. It benefited itself and the consumer the most when it was opened to private investment. But the huge sales values of Spectrum provided opportunity for scams by bureaucrats and politicians. This messed up the sector’s profitability for some years.

The public-private partnership model was an imaginative way to minimize government investment in developing infrastructure (in ports, airports, roads, metro rail). “Viability gap funding” was to meet the shortfall in expected revenues. The government paid a fraction of what it would otherwise have invested. However, the contracts were not fully thought through. There were loopholes. The need for many government approvals delayed project execution. Delays in approvals led to cost escalation, unbearable in low margin, high investment projects. Other *force majeure* factors and changes in law (for example, tax rates) also made many quotations unviable in execution.

The power sector has been deteriorating every year since ‘reforms’ began, with severe shortages of power, load-shedding, frequency and voltage fluctuations, large-scale thefts of power, submissiveness of state electricity regulatory commissions to their governments, and growing losses of the state-owned distribution enterprises. The year 2012-13 has been the worst for the power sector, as for other infrastructure sectors. In power, tariffs have mostly remained low because of trading, and financial constraints prevented SEBs from buying power. Below-cost supplies to farmers and low-income groups have distorted price structures and diverted state government funds to power subsidies. Stranded capacities of gas and coal-based generation plants amounted to around 50,000 megawatt. New investments in power generation and distribution have almost halted, especially from the private sector. Intra-state transmission has also had poor investment.

Many contractors have withdrawn from road projects. Reliance, the first private entrant in building metro rail, has withdrawn from the Delhi airport metro and may withdraw from the Mumbai metro project. The ambitious Bombay sea-link project is abandoned, leading to growing misery for the Mumbai traffic. The ambitious freight corridors have yet to take off. Special economic zones are mostly failures. There are many other such infrastructure projects which have either been abandoned or are about to be abandoned.

Power has severe shortages of gas and coal. Coal India has reneged on supply commitments, as has Reliance on gas. The inability of some distribution enterprises to pay bills has led to decline in plant loads in some generation plants. Transmission constraints to the South have limited the amount of trading with the South. Distribution enterprises have invested poorly in repairs and maintenance. Maintenance, postponed to make way for political demands before elections, has damaged plants. Similarly with generation, where postponed annual maintenance has led to deterioration in the health of plants. Regulators at the state level have constrained the finances of distribution enterprises by holding back required tariff increases, freezing some expenses as regulatory assets and making unreasonable demands for lower tariffs. Regulators do not monitor and evaluate their charges.

Tariff bids are called for every 25 to 30 years (‘levellized’ tariffs) for projects in power, roads and other infrastructure projects. Forecasting of revenues and costs for 30 years is poor. The government has also been a poor forecaster.

Aggressive low bids by private bidders are common. A large order book helps raise equity funds, but the bids soon make the projects unviable. Careful evaluation by lender banks and other institutions, especially because of the high debt equity ratios for infrastructure projects, could avoid problems. But lenders lack scientific methods for checking forecasts, and are superficial in evaluation. Lenders now face considerable rise in poor quality assets.

Reform initiatives in coal have made the nationalized Coal India commit to meeting a portion of the shortfall in its committed coal supplies with imported coal. Prices of domestic and imported coal are to be pooled. Another ‘reform’ is the setting up by CERC, of committees to consider changes in levellized tariffs for ultra mega power projects by using imported coal. Any price increase will certainly be appealed to by failed bidders and customers in the power purchase agreement. The UMPPs thus may remain stranded for many more years.

For gas, the ‘reform’ has meant a doubling of prices. There is no certainty that the market can bear those prices.

For power distribution, ‘reform’ has meant an offer of around Rs 1,20,000 crore to SEBs to clean up their losses. This follows the Rs 40,000 crore given to them some years back for restructuring loans. There is no compulsion to privatize as there is in Delhi.

Some key actions are needed. In power, even if coal is not denationalized, coal mines should be allotted transparently to private operators, and tough regulations put in place for production, productivity, cost, time lines and so on. No financial support should be given to SEBs unless there is a credible time-bound move to privatize, *à la* Delhi. Coal and gas suppliers must meet commitments at earlier agreed tariffs. Coal should be imported by generating plants, perhaps through a Coal Exchange, which could be a part of the Energy Exchange. The appellate tribunal for electricity should have severe penal powers.

All roads and metro projects should have floor prices below which bids will not be considered. These should be determined independently. For all projects (including those for power) the bid period must be reduced from 25 to 30 years to 12 to 15 years — the period that projections are required by lenders. All bids should state the assumptions made (demand forecasts, exchange rates, raw material costs, interest rates and so on) and provide for adjustment if they change beyond a stated point.

India also needs a unified energy regulator, with benches for power, coal and so on, sitting together when the issues impinge on each other. Selection and staffing of the commissions should be done independently and its membership not confined to retired bureaucrats. Younger and expert technical people, economists, finance experts, legal experts, should be members. Bids should be for a maximum of 15 years. All regulatory laws should have mechanisms allowing the commissions to renegotiate prices even for closed contracts, under certain conditions and determined within a time frame. Some uncertainties that could trigger the mechanism are — when imported coal goes up in price, the rupee exchange rate collapses, interest rates rise and so on. Or, a new law must specifically address renegotiation of signed contracts under these conditions. A national Energy Exchange should trade freely in domestic and imported fuels (such as coal and gas). Penalties should apply to government departments that delay clearances beyond a committed period (for land, environment, forests and so on). Similar penalties on bidders who fail to complete projects on time should apply, provided the changes suggested earlier are put into practice.

There is hope for a better infrastructure. Can we rely on politicians and the bureaucracy to do the right things?

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