<u>"FINANCIAL EXPRESS" OF OCTOBER 014</u>

<u>"Coal Reform and related issues" by S L Rao</u>

The Supreme Court cancelled 214 coal block allocations, (except to central government owned undertakings, and the ultra mega power projects awarded on competitive bidding). It asked all coal block allotees to pay Rs 295/ per metric tonne of coal extracted to date. It gave the government the option to have a committee of retired Supreme Court judges to propose a different allocation method.

Instead, government has itself come out with an Ordinance for e-auctioning the mines. It deals with the issues arising directly out of the cancellations. No existing allotees will have a right to retain the mines allotted to them unless they win it back in the auction. They have no right of first refusal. Allotees who had used illegal means to get their allotments cannot participate in the e-auction. All must pay to a Claims Agency to be created by government, the fee of Rs 295/ per tonne. A floor price will be fixed for each mine to allow for investments made by the earlier allotee be recovered. If the earlier allotee loses the mine in the auction, the end plant (power, steel, cement) can if he wants, be auctioned so that the investor gets his money back since the plant cannot operate without the coal. There will be might be some allotees who invested in good faith who will lose out.

Some commentators have condemned the Ordinance as inadequate. They miss the point. It is a first step. But government should have announced the further steps. Here we try to forecast the plan of which the Ordinance is only the first step.

It must be understood that the procedure laid down by the Ordinance will increase coal prices significantly to allow for a return on the cost of capital invested in the auction price. Another important fuel for power plants, natural gas, also has had its prices have increased by about 50%. Both coal and gas are essential inputs ofr power generation. Their prices will certainly increase power generation costs.

Other users like cement and steel who operate in free markets can competitively allow increase end product prices. But power tariffs are

determined by state electricity regulators. They may or may not allow the increased costs of fuels to be passed through in full to the buyers of power.

In principle, the power sector has become financially unviable because it has not passed on all costs to buyers. Instead the real prices have been hidden by subsidies and cross-subsidies. These have burdened government deficits, and corporate accounts. The method adopted by the Ordinance will add substantial costs to power generation. Some staggering of increases in consumer prices would have buffered the shock to buyers.

The raising of gas prices for producers will improve the revenues of producing companies, especially ONGC (and thus of government). Reliance has to wait till it meets earlier supply projections. Surely government will also change the bidding process for oil and gas exploration and production to enable more overseas companies to bid for them. If there are many explorers and producers, more gas produced, with end prices left to competition in the market, and an overall regulator watching to ensure that there is no rxploiation of buyers, there will be more production to benefit the economy.

The same logic must apply to deregulated coal as well. The Ordinance enables governemtn to allow producers to commercially exploit the coal, i.e., to trade in coal. This will benefit consumers. Using the Energy Exchange for trading in coal (or gas) will ensure that the trading is done under transparent conditions.

Government has also decided that petroleum product prices will now vary with imported crude prices. Stoppage of subsidies by government will reduce government deficits and enable market conditions to determine prices. In the case of coal the Supreme Court cancelled all licenses except for government companies and two ultra mega power projects (in production). Commendably, government has announced an e-auction method for auctioning these coal mines. Those who have used illegal means to get the licenses are excluded from bidding. Others are divided into user sectors- power, steel and cement. Coal mines will be identified for each sector. Hopefully they will be in the vicinity of the user plant. This will not be easy and some might suffer.

There is to be an Authority to lay down the rules for the e-auction and also to determine the floor prices for each mine, taking account of the sunk costs incurred by the developer. It is necessary that the reserves, the over burden, the time required to start production, the reforestation and resettlement needs, etc, must all be determined and announced.

Coal India is an unreliable and inefficient producer of coal. It has been weak in determining reserves in coal mines. The auction price is a capital cost and will have to be factored into the coal prices and that of the products which it is used for. If al the present user of the coal mine is not a successful idder in the auction, it the user plant can also be auctioned by government. When government exercises the power under the Ordinance to allow commercial use of private coal mines, Coal India will have competition in the market. It may not be nimble enough to withstand it, unless it has entrepreneurial maangement.

Instead of a one-time Authority for these specific issues, it would have been better if an independent statutory Energy Regulator had been created. This Regulator could have transparently and independently dealt with the auction process and issues, and later with the monitoring of production, productivity, adherence to supply contracts, coal prices, related power prices, power plant productivity, etc.

Power prices are subject to populist and political considerations. For many consumers today prices are zero or well below costs. There is no compulsion on the state governments and regulators to take auction prices into account. The Forum of Regulators must now be asked to agree, and perhaps a suo moto order might come from the Electricity Tribunal.

The Modi government must have a complete plan for Energy Reforms. The Ordinance ensures that coal mines do not shut down on the cancellation of licenses by the Supreme Court. Other steps must follow. This government is market oriented and is for far less state control. Doubtless, an Energy Regulator must be part of the Grand Plan for the energy sector. So must be the ultimate objective of getting rid of the curse of the Energy sector in India, namely the nationalization of coal and the state control over oil and gas exploration, production, utilization and pricing. Government should go out of all power generation and distribution. We need strong and independent

regulaton to ensure that quasi-monopolies and oligopolies do not exploit the market. The Nobel prize in Economics to Tirole gives a strong theoretical basis to the idea that strong and transparent regulation can make even non-cpmpetitve markets beneficial to consumers. (1167)