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Indian consumers can bear higher power tariffs

At a seminar on the Indian power sector organised in New Delhi today, CRISIL Infrastructure Advisory outlined two themes. Based on an analysis of the growth in income and the spending patterns of Indian households, CRISIL Infrastructure Advisory believes that Indian consumers do have the capacity to bear higher power tariffs. The ability of the system to tap into this paying power would determine the power sector's viability in future. Secondly, with domestic coal production virtually stagnant for the last 4 years, the Indian power sector will increasingly rely on expensive imported coal in future, making tariff increases inevitable.

Over the second half of the previous decade, power tariffs in India grew by under 5% p.a. Against this, per capita income grew by 13.4% p.a. while household expenditure grew at 10.6% p.a. Consequently, the share of energy expenses in Indian households declined for the first time in two decades, during this period. Power tariffs have also lagged inflation. **Says Roopa Kudva, Managing Director and CEO, CRISIL, "This indicates that Indian consumers can bear higher tariffs, and policy makers may have more flexibility to increase tariffs than they are currently exercising. Had power tariffs been hiked to keep pace with other household expenses, power utilities would have earned additional revenue of about Rs.950 billion in this period. Instead of making aggregate losses of Rs.870 billion, they would have made an aggregate profit of Rs. 80 billion."**

CRISIL Infrastructure Advisory also highlighted issues relating to fuel costs. Indian coal production has remained stagnant in the last 4 years at 400-440 million MT. The power sector's reliance on more expensive imported coal therefore doubled from 7% of coal-based power generation in FY 2007 to 15% in FY 2012. Imported coal is priced at 1.6 times domestic coal and typical transportation cost for imported coal is 1.5 times that for domestic coal.

As fuel prices grew rapidly, and tariffs did not keep pace, state-owned distribution utilities incurred huge losses. Aggregate accumulated losses of Indian utilities are estimated at over Rs.2 trillion as at end FY12. About three fourths of these losses were incurred over the last five years and these were funded mainly by borrowing from banks and financial institutions.

CRISIL Infrastructure Advisory identified some reforms that can address this situation. **Says Razak Khatri Director, CRISIL Infrastructure Advisory, "The key reform would be to devise a mechanism to enable an automatic pass through of fuel price increases to power tariffs."** The problem of delays in payment of subsidies by state governments to utilities can be addressed by setting up an appropriate escrow mechanism operated by the Reserve Bank of India to ensure timely subsidy payments. Utilities must be required to disclose their circle-wise technical and commercial losses along with the improvement targets for each circle. **"Further, we must effectively harness our coal reserves by formulating mining policies that incentivise timely development and production by mine licensees,"** adds Mr. Khatri.

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