GS Mains Daily Answer Writing

Week 7 Day 2

Model Structures

1. Highlighting the issues associated with power discoms in India, discuss whether privatizing discoms can help in this regard. (150 words)

Model Structure

Introduction

- India became the third largest electricity generator in the world. However, the discoms i.e. power distribution companies, continue to be faced with following issues:

Main Body

- Operational inefficiencies due to huge technical and commercial losses (AT&C) at 21.4% which are primarily caused by power theft, poor payment collection procedures, and inadequate tariff hikes.
- Increasing open access transactions: Big commercial customers who pay higher tariffs are engaging in private power purchase through open access i.e. directly buying from the suppliers bypassing discoms.
- Lack of political will and transparency in dealing with phasing out of energy subsidies for the consumers.
- Decline in demand during lockdown: Revenue of discoms have fallen due to halt in commercial activities while domestic users pay lower tariffs.
- Increased Power Purchase Cost: After the one-time measures under UDAY, the power purchase costs have now increased by 5 per cent in the first nine months of 2018-19. Further the input costs of coal and freight have gone up.
- Indebtedness: According to the PRAAPTI portal, power producers' total outstanding dues owed by discoms rose over 47% year-on-year to Rs. 1.33 lakh crore in June 2020.
- Financial incompetence: DISCOMs have delayed payments owed to solar and wind energy developers making investments into the sector extremely challenging.

Privatization of discoms is being seen as a measure to revitalize discoms due to following reasons-

- Past experiences: There are sufficient case studies when private players have been proved to run cash strapped discoms successfully via more efficiency, increased revenue and improved consumer services. For e.g. the AT&C losses in Delhi after the privatization in 2002 has been brought down from a high of 53% to around 8%.
- Operational autonomy: Due to improved network efficiency and lack of political interference.
- Operational efficiencies: Privatization will eliminate issues such as payment delays, power cuts, and lack of market-based electricity pricing and stimulate economic activity.
- Generating private sector appetite: Amongst Indian and international investors, various PPP models will be tested and it will also provide confidence to larger states and utilities to undertake privatisation based on improvements achieved.

Conclusion

- However, privatization of discoms needs to be accompanied by other measures such as providing autonomy to regulatory bodies; cooperative federalism between centre and state; reinventing the revenue model of discoms which should be conducive to the growth of rooftop solar and open access power.

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2. The Union Budget 2021 has proposed setting up a National bad bank to restore banks' health. Critically discuss the idea for ameliorating the banking sector's stress. (250 words)

Model Structure

Introduction

- A bad bank is an entity that acts as an aggregator of bad loans or non-performing assets (NPA's) and purchases them from across the banking sector at a discounted price and then works towards their recovery and resolution
- The bad bank is similar to an Asset Reconstruction Company (ARC), where they absorb these loans from the banks and then manage them to recover as much amount as possible.

Main Body

- Arguments For Bad Banks
    - Providing Lending Leverage to Banks: The benefits of bad bank include the recovered value, and significant lending leverage because of three factors:
        - Capital being freed up from less than fully provisioned bad assets.
        - Capital freed up from security receipts because of a sovereign guarantee.
        - Cash receipts that come back to the banks and can be leveraged for lending, also freeing up provisions from the balance sheet.
    - International Precedent: eg. The US implemented the Troubled Asset Relief Program (TARP) after the 2008 financial crisis, which helped the US economy after the subprime crisis.
    - Revival of Credit Flow Post-Covid: Some experts believe that a bad bank can help free capital of over Rs. 5 lakh crore that is locked in by banks as provisions against the bad loans.
- Arguments Against Bad Bank:
    - Structural issues in banking sector will not be resolved by creation of bad bank
        - Not a Panacea: It is argued that creating a bad bank is just shifting the problem from one place to another.
    - Tight Fiscal Position: It's difficult to gather needed funds
    - There is no clear procedure to determine at what price and which loans should be transferred to the bad bank.
    - Moral Hazard: Former Governor of the reserve bank, Raghuram Rajan believes that setting up a bad bank may also create moral hazard problems among the banks that would enable them to continue with their reckless lending practices, further exacerbating the NPA problem.

Conclusion

- Therefore, a bad bank is a good idea, but the main challenge lies with tackling the underlying structural problems in the banking system and making reforms to improve the public sector banks.