

# Impact of regulatory reforms in india



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Trace the Institutional Changes in the Sectors of Electricity, Telecom and Urbanization with the Coming Up of Regulatory Reforms

## INTRODUCTION

All economic reforms in modern India were the result of the financial crisis that occurred in 1991. Prior to this, India followed a state-led development strategy. Under this regime, most utility firms were public monopolies with their function carried out indirectly by the government. Late 1980s saw the deterioration of the state-led markets. From a fiscal deficit of 5% of Gross Domestic Product that existed in 1975-80, the figure fell to 10% of GDP in 1985-90. The deterioration slowly snowballed into a balance of payments crisis in 1991, when the Gulf war added to the existing woes of the government. The government secured an emergency loan from the International Monetary Fund (IMF) by pledging 47 tonnes of India's gold reserves that was airlifted to the Bank of England. However, IMF placed certain conditions in exchange for the loan. These conditions included liberalization of trade, privatization of industries and opening up of the nation to globalisation. Dr Manmohan Singh, under the premiership of Mr Narasimha Rao, undertook extensive reforms in the industrial structure of the nation.

This assignment focuses on the reforms and its effects in three sectors- the power sector, the urbanisation sector and the telecommunication sector. The former two have achieved partial success while the latter is an example of a very successful reform. We consider each of these separately below:-

## THE POWER SECTOR

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The power sector was the first sector to undergo privatization post the 1991 balance of payments crisis. This reforms in this sector faced partial success. This is mostly due to the political aversion that this sector garners with privatization. The fear of defeat in political election keep governments from undertaking full-fledged reform, even in the face of heavy losses and poor quality output.

The sector practices a dual-subsidy system, which gives subsidy to both consumers and producers. Consumers mostly include agricultural farmers. The irony of this lies in the fact that in the Indian agricultural scenario, the farmers who are able to afford farm equipments that run on electricity (like electric mortars used for irrigation) are wealthy farmers. Such subsidies are especially high in states with powerful agricultural lobbies. Other industrial consumers established captive units for their power generation. This was especially true for states with poor utility performance and high losses in transmission and distribution.

This conflict of interest- political interest versus liberalization motive of the government has led to an uneven reformation and restructuring of this sector. Private sector today commands 36 percent of the total power generation capacity currently installed, while the state governments and central government own 37 percent and 27 percent respectively.

The reform process that initialized in 1991 can be categorized into three phases. The first phase witnessed the amendment of the 1948 Electricity (Supply) Act. With this, private players could enter into long-term contracts with the state utilities for the supply of power as independent power

producers (IPP). Privatization was restricted to the generation of power and was not extended to the distribution. Rather than a restructuring sector, the amendment merely aimed at expanding the capacity of the sector.

The second phase comprises state initiatives in restructuring the State Electricity Board, establishing independent regulators and privatization of distribution. The sector's main source of loss is in the distribution process. However, this problem has not yet been solved. The only reforms in this respect are through back-door initiatives that could not be formalized due to the fear of political fallout. Private participation is still concentrated in the generation process and liberalization of tariff-rate for electricity has been unsuccessful.

Major initiatives were taken by three states- Orissa, Andhra Pradesh and Delhi. Orissa and Delhi both lacked strong farmer lobbies. Orissa, being a very poor state, lacked rural electrification and thus, had very few wealthy farmers to influence the political scenario. Delhi, on the other hand, was a metropolitan city with negligible farmer population. The scenario in Andhra Pradesh, however, was different.

Orissa was the first state to take up a strong initiative to privatize and corporatize the power sector. It also undertook tariff reformation and establishment of an independent regulator. It aimed to create an apolitical field for decision-making process of the sector. This would gain the confidence of private investors. However, despite the noble motive, the Orissa model failed.

Andhra Pradesh, citing heavy losses and poor infrastructure, under the Chief Ministership of Chandrababu Naidu, took up similar reforms. And the efforts proved fruitful. During the span of 1999-2005 the state witnessed dramatic changes. The sector was differentiated into distinct entities- generation, distribution and transmission, each managed separately. However, in the elections of 2004, political unpopularity put the privatization process on hold. Subsequently, Mr Naidu lost the elections, and the reforms were reversed.

Delhi government undertook similar reforms despite the political stakes being high. It set up the Delhi Electricity Regulatory Commission (DERC) in 1999. However, the privatization arrangements constrained the DERC. The regulator lost control over performance targets, since they were based on bids and included in the privatization contracts. The Delhi government wanted uniform tariff for all power companies. This proved to be a disincentive to achieve efficiency in performance. The lack of information for efficient tariff setting, minimal experience and capacity of the regulator was exposed before the powerful companies like Tata Power and Reliance power, eventually leading to its failure.

The third phase of the reform process saw the enactment of the Electricity Act of 2003 by the central government.

The reform process can be called a partial success. A number of states have successfully reduced losses in transmission and distribution. These states include Andhra Pradesh, Tamil Nadu, and Punjab. However, supply remains of poor quality in many other states. Electricity theft is a major concern.

There have also been revelations like that of the mini-steel plants of

Maharashtra that had systematically stolen power. The Coalgate scam is another such scandal. Many other such business interests have benefitted through such practices. Other entities enjoy generous terms from the government like subsidies, tax exemptions etc.

## URBANISATION

Recognizing the need for decentralization, Government came up with the 74<sup>th</sup> Constitutional Amendment Act. This Act lay down the composition of municipal planning committees. This was done to empower local self-governance through urban local bodies (ULBs). Urban areas face an altogether different dimension of problems arising out of limited resources and spaces, in the face of ever-increasing population. Local self-governments can prove to be more efficient by involving the concerned people and addressing their specific problems. The responsibilities of urban planning, slum up-gradation, water supply, etc. have been assigned to ULBs through the Act. However, the motive of decentralization of the government has not been very successful since the amendment failed to establish ULBs as a constitutional obligation. As a result, its implementation and success level have differed widely across states. Many more reforms are needed in this area to ensure overall efficiency in governance.

One of the major drawbacks of the Amendment is that it does not make provisions for adequate revenue base of the ULBs. The allocation of revenue is left to the respective state governments, most of which have failed to transfer functions, resources and funds for the effective functioning of the ULBs. One of the primary sources of revenue for ULBs is property taxes.

However, improper documentation facilitates loopholes in the collection of these taxes, thus lowering the revenue base of the ULBs further. Categories of property tax exemptions should be thoroughly reviewed. The Finance Commission, both at the centre and state-levels must give grants and loans to the ULBs based on their performance. In the face of low resource base, alternative financial instruments are used, like tax-free municipal bonds. The interest rates of these bonds must be linked to the market rates. Provisions must be made for more diversified instruments, like infrastructure bonds, etc.

The 74<sup>th</sup> Amendment Act rightly considers ULBs as the solution to the problem of water supply and sewerage services. These are mostly provided by inefficient public monopolies. The functions of managing and maintaining the water supply, sanitation and town planning are better left to the local bodies. Given sufficient staff, they will be able to carry out these civic functions more efficiently, and therefore must be the primary function of a local body.

A number of constitutional amendments can help improve the efficiency of the local bodies. There is a dire need for these bodies to be held accountable for the provision of basic services. Provisions must be put in place to ensure timely elections to major posts of the bodies, including the Mayor. Proper delegation of authority must be made between the Mayor and the Commissioner. The Mayor should be made the Chief Executive of the municipal body. Additional grants must be provided to the ULBs to improve their staff capacity. All mega projects must be implemented having consulted all stakeholders. Proper compensation and rehabilitation must be

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provided in case of land acquisition. Public-Private Partnership must be encouraged in the better deliverance of services in each sector. PPP could be a solution for conservation of environment and its resources, by setting up of treatment plants and landfills. Also, in the urban transport sector, private operators could be roped, through competitive bidding process. This would lead to improved efficiency.

Overall, the lack of political consensus, both at the state and the municipal level has been the major cause of the failure of the Act in most states.

Without obligatory enforcement, revenue base and a general unwillingness to privatize services, decentralization remains an objective only on paper.

Further administrative and structural reforms are needed to implement the concept of decentralization.

## TELECOM SECTOR

Prior to 1991, the entire functioning of the telecommunication sector was reigned by the Department of Telecommunication (DOT), which served as an executive wing of the Government of India. This department served as the policy-maker, service-provider and regulator, all in one. These powers were conferred upon the DOT under the Indian Telegraph Act of 1885. This automatically implied a regulation bias in favour of the government monopoly. In the late 1980s, Prime Minister Rajiv Gandhi had unsuccessfully attempted to bring in private players in this sector. The balance of payment crisis of 1991 made the then Prime Minister Chandra Sekhar to reorganize the DOT. Subsequently, an Athreya committee was set-up to devise a plan to privates this public monopoly. Despite the support of the Prime Minister's



office and the Ministry of Finance, the DOT opposed the Athreya recommendation of separating the regulatory and policy-making role from the service-provider. This recommendation was aimed at providing the private players with a fair playing field. The only recommendation that the DOT accepted was the opening up of value-added services to private investment. These value-added services included cellular mobile services, audio and video text messages, video-conferencing etc. This move proved to be a mistake for DOT considering the tremendous growth of cellular services that followed in the later years.

The Government appointed N. Vittal as the secretary of the DOT, against the wishes of the department. This appointment was aimed to bring about a through reform of DOT from within. This reform came in the form of the National Telecom Policy (NTP) of 1994, which allowed basic telecommunication services to be opened up for private investment. However, this was a reform only in paper, since implementing this would require some structural changes that were not addressed by the NTP. Only the GSM mobile technology witnessed an influx of private investment. Another drawback of the NTP was that it ignored the need for a separate regulator. DOT fiercely opposed the corporatization of its role as a service-provider. There was a clear conflict of interest between the Prime Minister's office and the DOT. However, the DOT managed to keep its monopoly powers intact by getting N. Vittal transferred.

Following this, the DOT steered policies in areas that it still had jurisdiction over, in ways that would deter privatization. Firstly, private players were in a disadvantageous position with regards to the domestic and long-distance

services. DOT used these services to subsidize its local operations, an advantage that private players did not have. Telecom licenses were distributed by the DOT through a bidding process where the license was allocated to those who bid the highest rather than to those with better operational capabilities. These unreasonably large bids were additional costs to the private players that the DOT did not have to incur. This gave DOT a cost advantage over the others. DOT also placed interconnection rates for cellular services. Since the cellular service network was very small in comparison to DOT's network, the private cellular service providers now found it difficult to survive in the telecom market. However, the Supreme court in order to solve the deadlock between the DOT and the Prime Minister's office, and to keep a check on the DOT's predatory policies, it suggested the incorporation of a regulatory body that would have the power to keep a tab on the telecom services provided by the DOT. Subsequently, the Telecom Regulatory Authority of India (TRAI) was established by the Narasimha Rao's Government in 1996.

However, this was not enough. Loopholes still persisted. TRAI could only resolve disputes between service-providers and not between the licensor and the service-provider. Also, the power to issue or cancel licenses was still the jurisdiction of the DOT. Prime Minister Atal Bihari Vajpayee set up a Telecom Dispute Settlement Appellate Tribunal (TDSAT) to keep up the interest of the private players.

In 1997, the government service provider MTNL wanted to enter the cellular service. However, this was opposed by the Cellular Operators Association of India, who demanded that MTNL too should pay a license fee since it

functioned more as a corporate house than as a governmental entity. This dispute was taken to the TRAI which ruled in favour of the private investors.

In Vajpayee's second term of office, he tried to curb the monopoly power of the DOT by modernizing the telecom sector. Subsequently, a National Task Force was constituted which went on to break the monopoly of DOT over long-distance telecommunication (a service provided by VSNL until then) and provision of internet service. An inter-ministerial group was set up that successfully implemented the National Telecom Policy, 1999. It also amended the TRAI Act. The service providing division of DOT was corporatized into Bharat Sanchar Nigam Limited, BSNL, thus separating the role of the service-provider from the role of policy-maker. Tata Group of Industries bought the shares of the now-privatized VSNL.

NTP gave higher jurisdiction to TRAI than to DOT in the regulatory field. DOT would now have to consult TRAI in matters of issuing licenses. All disputes between the service-provider and the licensor (the DOT) would now be dealt with by the Telecom Dispute Settlement Appellate Tribunal. Only Supreme Court had higher appeal than the TDSAT.

Another controversy erupted in the telecom sector soon after. The National Telecom policy of 1999, allowed for the use of code division multiple access (CDMA) technology with the facility of wireless in local loop with limited mobility (WLLM). The license for this was given away at a much lower rate than for regular cellular services. This was done to improve telecommunication network in the rural areas of the country. However, Reliance Infocomm, one of the beneficiaries of the policy, violated the license

condition. This exposed the incapability of the regulator and the appellate tribunal to curb the monopolistic urges of the private sector. Following this, more reforms were introduced to empower the regulator to deal with such troubles.