

BloombergBusinessweek

News From Bloomberg



India's Potato Prince Gets Free Power as Grants Spur Blackouts

By Andrew MacAskill and Kartikay Mehrotra on September 04, 2012

<http://www.businessweek.com/news/2012-09-04/india-s-potato-prince-gets-free-power-as-grants-spur-blackouts>

Jang Bahadur Singh Sangha wears Armani clothes and lives in an eight-bedroom house, a lifestyle afforded by income from his family's 5,000-acre farm in India's Punjab. Yet Sangha doesn't pay a cent for the state-generated power that helps irrigate his fields.

Sangha, 44, is an unintended beneficiary of a vote-winning initiative that grants farmers free power irrespective of income. Designed to help small farmers in the northwest state, where the average holding is 4 acres (1.6 hectares), the practice has saddled the Punjab electricity board with \$3 billion in losses since 2005, curbing investment in a network failing rich and poor with blackouts as long as 16 hours a day.

Punjab is an extreme example of how populist politics undermines the expansion of power infrastructure in India, where farmers pay on average 13 percent of the true cost of electricity, according to a 2011 study by Yale University. The result is a system so dysfunctional that 400 million people have no access to the national network, India suffered two grid collapses this summer, power cuts force government workers from offices early and companies have to build their own generators.

"Politicians who don't understand the economics of free power are compounding the problems facing Indian growth and deterring investors," said Hari Das Khunteta, who until July 31 was the finance director of the state-run Rural Electrification Corp., India's largest lender to electricity transmission and distribution companies. "Our democracy imposes a price that means we lag rivals like China."

Revenue Starved

India spends \$6 billion annually in meeting the promises of free or cheap power made by ballot-chasing politicians, according to The Energy and Resources Institute, which helps run rural development programs. That's more than it invests in either healthcare or higher education.

The largesse starves utilities of revenue, limiting the power they can buy from the national grid, which then reduces the incentive for power generators like NTPC Ltd. (NTPC) to build new plants. That's thwarting India's bid to increase by about half its existing generating capacity of 206.5 gigawatts in the next five years.

The resulting blackouts curtail growth in Asia's third-largest economy by as much as 1.2 percentage points annually, according to India's Planning Commission. They have forced its biggest companies, including Reliance Industries Ltd. (RIL), to invest \$29 billion to date in private generating plants.

Acknowledging the importance of the subsidy for poorer farmers, Sangha says he would rather pay for power.

Potato Prince

"This is doing much more harm than good," said Sangha, who calls himself India's "Potato Prince" on his website and has a degree in agricultural science from Cornell University. "When you give something away for free, people overuse it and it leads to neglect."

While the blackouts in July were triggered by India's mismanagement of power sales to states rather than insufficient electricity, the outages in more than a dozen regions underscored the risk to an economy that is growing near its slowest pace in three years. The situation is exacerbated by the government's failure to stop citizens stealing power by illegally hooking up to transmission lines and losses from obsolete equipment, which together account for about 30 percent of the county's generated electricity.

Indian Prime Minister Manmohan Singh, who is seeking \$247 billion in power-sector investment to curb the nation's 9 percent peak demand deficit, has called for regional leaders to end the electricity subsidies, branding them "populist gimmicks" in a 2005 speech. He has been ignored.

Universal Practice

All India's farmers, who account for 235 million people or about a fifth of the country's population, are entitled to receive subsidized electricity. Governments in three states -- Punjab, Andhra Pradesh and Tamil Nadu -- have been giving them free power to run irrigation pumps.

In a sign of the strain the giveaways impose, the latter two states have the biggest power deficits of all India's regions even after more than doubling their generating capacity since 2005. Punjab, which has increased its capacity by 51 percent in the same period, has the country's fifth-biggest peak shortfall.

The state's power secretary, Anirudh Tewari, defends the policy of free power as a necessary fiscal evil. He says Punjab is trying to keep agriculture profitable for an impoverished majority of its 1.1 million farmers and help feed India's 1.2 billion population, which has grown by nearly 18 percent over the last decade.

'Major Expense'

"The country relies on these farmers to put food on its table and without that subsidy India's food security would be in jeopardy," Tewari said. "It's a major expense. But the challenge to find the resources lies with the finance department, not mine."

In Punjab, blackouts have curtailed the work day for civil servants. Government employees were told in summer to work between 8 a.m. and 2 p.m. without a lunch break and not to use office air conditioners, even as summer temperatures hit 45 degrees Celsius (113 degrees Fahrenheit).

Manpreet Singh Badal, the state's ex-finance minister, who was fired and expelled from the ruling Shiromani Akali Dal party in 2010 after criticizing the government's handling of the economy and its growing debt, says that Punjab's delivery of free power threatens to bankrupt the state.

"We simply cannot afford to carry on with this policy without running our finances into the ground," Badal said in a phone interview from Punjab's state capital, Chandigarh. "Your state education suffers, your health education suffers, your anti-poverty program suffers."

Political Response

Political leaders argue that reducing subsidies would put poor farmers out of business. Punjab's agricultural sector, which grows 12 percent of the nation's wheat and rice from just 1.6 percent of India's geographical area, expanded at half the national average over the last five years.

"There is wastage, both in financial and material resources, but without the subsidy some of India's poorest farmers become even poorer," said Vijay Paul Sharma, a professor of agriculture at the Indian Institute of Management in Ahmedabad.

Financial burdens already have led about 3,000 Punjabi farmers to commit suicide in the last nine years, an average of almost one a day, according to a report in the International Journal of Management & Business Studies published this year.

A 30-minute drive from Sangha's farm, 43-year-old Radhesham, who like many Indians uses only one name, supports his family by growing cabbages on a four-acre plot. While he welcomes the free power, he's critical of the erratic supply that leaves him sleeping in his fields so he can turn on the irrigation pump when there is electricity.

Nighttime Work

"We are forced to work in the dark because this is the only time we get reliable power," said Radhesham.

Free power has another damaging effect: rich farmers use it to pump water across large tracts of land, sending aquifer levels plunging and putting water out of reach of their less well-off counterparts, according to a Columbia University study led by Shama Perveen released this year.

Punjab's water table has been falling 0.4 meters (1.3 feet) annually and nine out of 10 farmers have had to deepen their wells during that period, the study found.

While reducing power subsidies can save water it also cuts into farmers' income, Yale University's Reena Badiani and Katrina Jessoe wrote in a report published in March 2011. A 10 percent cut in the electricity discount would lower groundwater extraction by 4.3 percent and farm revenues by 13 percent, they concluded.

Gujarat Model

Gujarat is one state where subsidized power for farmers hasn't been allowed to hollow out public finances. Distribution companies there are permitted to pass along rising electricity prices to residential and industrial consumers, offsetting losses racked up by the state's farms.

India's Power Minister Veerappa Moily said on Aug. 29 that the government is considering legislation allowing all state regulators to more freely approve tariff hikes.

Since 2001, Gujarat's Chief Minister Narendra Modi has appealed to voters with a simple pledge: you pay and we'll make sure the lights stay on.

Over the past decade, Gujarat has raised power generation capacity more than five-fold and claims to be the only state in India to have a surplus of electricity. Modi's state is now a favored destination for many of India's top manufacturing companies, including Tata Motors Ltd. (TTMT)

Second Term

In Punjab, even as citizens and businesses struggle with daily blackouts, the Akali Dal party has continued its policy of doling out free electricity. During state elections this year that saw the party elected for a second straight term, it promised to expand the program by granting free power to 1.5 million of the state's poorest families.

"Eventually there has to be a debate around whether you want free power and no power, or whether you want to pay and have stable power," said M. Govinda Rao, a member of Prime Minister Singh's economic advisory council, a panel that produces periodic reports to aid government policy making. "There is a feeling among many states that good economics makes bad politics."

To contact the reporters on this story: Andrew MacAskill in New Delhi at amacaskill@bloomberg.net; Kartikay Mehrotra in New Delhi at kmehrotra2@bloomberg.net

To contact the editor responsible for this story: Peter Hirschberg at phirschberg@bloomberg.net

