

## **THE NEED FOR COMMERCIAL VIABILITY OF UTILITIES**

### **Suggestions for the 13<sup>th</sup> Finance Commission**

Most government owned utilities such as state water works, public transport companies and electricity distributors have run up huge losses and, therefore, debts. Much of the new expenditure of the Central and State Government on these utilities goes in financing these debts/losses so that capital improvement expenditure or expenditure on human capital generation is totally neglected. As a result service quality and availability suffers. As these services form the backbone of a nation's consumer and producer economy it is necessary for these utilities to rethink their strategies for production, administration and pricing.

Commercial viability is the need of the hour and steps should be taken to move in that direction. Commercial viability implies that these state utility companies should make a profit which when ploughed back into service production and delivery would imply a wider consumer net and better quality services. If the operation of these public sector utilities is judged by the criterion of commercial viability then a change in the mindset of the managers of these utilities can be achieved as they would become more accountable for their decisions.

As these enterprises are currently running huge losses a transformation to becoming "profit making" cannot be made overnight. However, certain policy changes to improve the situation and achieve commercial viability can be made:

- 1) Administrative hierarchies need to be further simplified and reduced: This means that the bureaucracies associated with these companies should be trimmed to a functional minimum through minimization of new hiring.
  
- 2) Bureaucratic procedures for getting clearances should be simplified so as to not only provide relief for the consumer but to ensure a slimmer and more commercially viable bureaucracy and to avoid unnecessary variable expenditure

- on stationary and administration. Single window system clearances (if already not in place) should be adopted universally.
- 3) Losses incurred in the process of provision of the service should be reduced to a minimum. This is especially true in the case of the electricity and public transport companies which have run up huge losses so as to put their own sustainability as well as the fiscal health of the state governments at risk. Much of these losses can be ascribed to theft. Better monitoring is needed so that such theft can be cut down drastically.
  - 4) Pricing policies need to be reworked. Politically populist measures of providing free services to certain segments of the population (such as farmers) are fiscally damaging. These segments should be encouraged to pay for services as this stimulates conservation of resources and ensures fiscal viability, even if such payment finances only a portion of the average cost of providing these services.
  - 5) In order to ensure commercial viability and reduce wasteful expenditure the government should undertake schemes to educate local politicians/legislators and bureaucrats in expenditure management. Such educational courses can be provided with the help of relevant NGOs and multilateral international organizations such as the World Bank and IMF and used to build consensus among politicians about the need for and mode of cutting wasteful expenditure.
  - 6) The objective of commercial viability has to be reconciled with the universal service obligation (USO) of utilities. Each sector requires a different approach. For example, in telecommunication the profit making nature of private enterprises implies that they can contribute a certain small but significant proportion of their revenues to a USO fund which can then be used by the public sector utility provider to meet USO requirements. Setting physical targets for private telecom operators (in terms of say number of public telephones) in regions that do not provide them with sufficient economic returns has not had the desired result.

In the case of electricity provision more flexibility should be introduced in efforts to meet USO requirements. The most economic method should be the preferred method. In remote/mountainous areas the government can take recourse to encouraging local small generation (use of generators or mini-hydel projects) instead of trying to connect these areas to the main grid. The government should also introduce metering of power consumption in rural areas, at least for large agricultural consumers. This would reduce the expenditure on the Universal Service Obligation.

In the case of public transport there are huge losses due to theft and negligence. These should be minimized. When city transport is turned over to the private sector it can be done on a regulated basis with sectors coming up for bidding and only one operator allowed in each sector (so that breakneck competition within each sector is prevented). Each sector can be serviced by various classes of buses – ordinary buses catering to the less affluent and luxury/convenience buses catering to the richer sections of society. Exclusive bus lanes which are not administered by the usual traffic light system would ensure that buses would move much faster than private transport. Better mobility and seating comfort would imply that the more affluent sections of society would switch to public bus transport in the relevant categories. With these sections of society willing to pay a premium for bus transport (or metro transport) private mass transport companies can be required to transfer a portion of their revenues towards the USO fund. This fund can then be operated by the government public transport companies to meet the USO in rural passenger transport.

- 7) Many public sector utility providers have huge estates. A suitable estate policy for deriving income from these estates should be worked out. Such incomes can help to meet the objective of overall commercial viability even after meeting USO requirements.

- 8) Tariff rules in which the tariff increases (though discontinuously) with household consumption are already in place. However, these tariff schemes should not be designed arbitrarily but should be based on willingness to pay surveys and companion surveys of household income.

The quantity of services or output which can be provided by a utility is often fixed in the short run because of resource constraints and fixity of capital assets. Systematic incorporation of the information from willingness to pay and income surveys into the design of an optimal tariff scheme will go a long way towards recovering the true cost of these services.