PROGRAM INFORMATION DOCUMENT (PID)
CONCEPT STAGE

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Operation Name	DPL Rajasthan Reform for Power Sector Financial Sustainability
Region	SOUTH ASIA
Country	India
Sector	Transmission and Distribution of Electricity (100%)
Operation ID	P157224
Lending Instrument	Development Policy Lending
Borrower(s)	GOVERNMENT OF INDIA
	Department of Economic Affairs, Government of India North Block New Delhi India 110001
Implementing Agency	Energy Department, Government of Rajasthan India
Date PID Prepared	January 5, 2016
Estimated Date of Appraisal	February 28, 2016
Estimated Date of Board Approval	November 22, 2016
Corporate Review Decision	Following the corporate review, the decision was taken to proceed with the preparation of the operation.

I. Key development issues and rationale for Bank involvement

Lifted by lower oil prices and prospects for implementation of critical structural reforms, India has become the world's fastest growing large economy. Growth in real GDP (market prices) increased from 5.1 percent in FY13 to 7.3 percent in FY15 before moderating slightly to 7.2 percent in the first half of FY16. While the momentum was initially supported by private consumption (average growth of 6 percent during FY13-FY15), it has more recently benefited from a pick-up in investments (4.6 percent in FY15 and 5.8 percent in H1 FY16 vs. an average of 1.3 percent in the preceding two years). Non-farm activities continue to be the major drivers of growth. While trade and transport services still make the largest contribution to growth, manufacturing, construction and real-estate services have gained prominence and their combined contribution to growth increased to nearly 55 percent in FY15 from 45 percent in the previous two years.

Growth is expected to accelerate further, albeit modestly, driven by a pick-up in investments. In the near-term, India is relatively well-positioned to weather the global volatility. India has low trade exposure to China, while Indian financial markets (local bond markets in particular) are fairly closed. India's considerable foreign exchange reserves (9 months of retained imports) provide additional buffer. In the medium-term, however, the Indian economy is not immune to a slowdown in global demand and heightened volatility. India requires some measure of foreign capital inflows to finance both fiscal and current account deficits and ultimately the investments needed to spur growth. China's slowdown and its reverberation in the global economy has led to further deterioration of the already weak export outlook. Although India may be able to achieve fast Gross Domestic Product (GDP) growth without export growth for a short period (as suggested by the low year-to-year correlation between exports and GDP growth), sustaining high rates of GDP growth over a longer period will require a recovery of export growth.

During the previous decade, Rajasthan's economy grew at 7.9 percent and poverty declined more rapidly than the national average. Rajasthan is the sixth most populous state and the seventh largest economy in the country. Despite large desert expanses, its economy grew faster than the all-India average and registered an annualized growth rate of 7.9 percent during 2004/05-2014/15, above the national growth of 7.6 percent.[1] Economic growth was much more effective at reducing poverty in Rajasthan than at the all-India level during 2005-2012 – one percent increase in growth was accompanied by 1.75 percent decline in the poverty rate, compared to the all-India responsiveness where similar growth resulted in 1.06 percent in decline in poverty.[2] The state's poverty rate declined by 19.7 percent (from 34.4 percent) to 14.7 during 2005-2012, while the all India poverty rate declined by 15.3 percent to 21.9 percent – resulting in a lower concentration of the poor in Rajasthan. The Government aims to make Rajasthan a powerful, developed and prosperous State by 2020 (Vision 2020), with a targeted economic growth rate of 12 percent.

Electric power supply in Rajasthan has expanded and improved over time, but is now facing considerable accumulated financial challenges. Rajasthan has a household electricity access rate of about 67 percent in 2011 (and with a target to provide 100 percent access by 2019) and better energy availability compared to most other States. However, a combination of high generation costs, inefficiencies in the distribution sector and an accumulation of long-delayed tariff adjustments, resulted in several years of continuing losses requiring substantial financial support from the State. Unlike other Indian States, Rajasthan has not curtailed power supply to reduce financial losses in the sector. Distribution utilities have been increasing their borrowings to cover financial deficits over the years, while at the same time maintaining power supply. As a result, Rajasthan's distribution utilities have now accumulated unsustainable levels of debt and exceedingly costly debt servicing obligations. Financial institutions are therefore now reluctant to extend further financing to the distribution utilities. A broad financial

[1] For comparison, all-India GDP growths have been calculated using the 2004-05 series.
[2] Poverty measured using the Tendulkar poverty line.

restructuring accompanied with structural and operational reforms is now needed to secure the availability of power in the State.

The situation in Rajasthan is not unique, though the size of the problem in the State is the largest. Across India, the weakest link in the value chain is distribution, wherein DISCOMs in the country have accumulated losses of approximately Rs. 3.8 lakh crore and outstanding debt of approximately Rs. 4.3 lakh crore (as on March 2015), with interest rates upto 14-15%. Financially stressed DISCOMs are not able to supply adequate power at affordable rates, which hampers quality of life and overall economic growth and development. Efforts towards 100% village electrification, 24X7 power supply and clean energy cannot be achieved without performing DISCOMs. Power outages also adversely affect national priorities like “Make in India” and “Digital India”. In addition, default on bank loans by financially stressed DISCOMs has the potential to seriously impact the banking sector and the economy at large. Due to legacy issues, DISCOMs are trapped in a vicious cycle with operational losses being funded by debt.

The proposed operation, builds on the Government of India’s Ujwal DISCOM Assurance Yojana (UDAY) and focuses on institutional and operational reforms of the distribution utilities of Rajasthan aiming to restore the viability of the power sector. The Government of India (GoI) has prepared the UDAY program of reforms aiming to address the deficiencies of distribution companies in the country and has made it available to the states. The UDAY program is centered around four initiatives (i) Improving operational efficiencies of DISCOMs; (ii) Reduction of cost of power; (iii) Reduction in interest cost of DISCOMs; (iv) Enforcing financial discipline on DISCOMs through alignment with State finances. In turn, the Government of Rajasthan (GoR) has elaborated a plan of legislative, financial and institutional actions, which are aligned to GoI’s plan and aim in strengthening the governance of the State-owned utilities, assisting with the financial restructuring, and establishing operational performance criteria and incentives for the recovery of the sector. The operation is expected to support these efforts and contribute to reversing the financial degradation of the sector and contribute to long-term stability in the supply of electric power.

II. Proposed Objective(s)

This proposed first loan of a programmatic series of two single tranche operations supports the Government of the State of Rajasthan in its goals of establishing a financially sustainable power sector and improving electricity services. The proposed operation consists of an IBRD loan US$250 million and would support the State Governments’ reforms in the electric power sector, focusing in particular on the performance of companies carrying out the distribution of electricity. The operation would contribute to the comprehensive reform program developed by the GoI and the State government to improve the financial, operational and technical performance of the electricity distribution utilities of Rajasthan.

The program supports the World Bank’s twin goals of poverty reduction and shared prosperity. The Country Partnership Strategy (CPS) for India focuses on assisting lower income states, such as Rajasthan, while recognizing the importance of good quality electricity services to enable economic growth. A reformed power sector will require lower fiscal subsidies in the medium-term and reduced contingent liabilities that will create fiscal space for more poverty-targeted interventions.

Nevertheless, the proposed operation faces substantial risks. Reforms of power sector distribution companies often face significant difficulties, because of the broad social and economic reach of electric power supply, with distribution utilities being the main interface between millions of customers and power supply provision. Resistance to change can be found within the sector, as well as among electricity users, who may benefit from the weak governance and deficient operational practices of the companies. These risks are mitigated by the central and the state government's recent efforts to increase accountability and monitoring of the sector, bold decisions to make sector debt obligations explicit on State budget. A more comprehensive approach –compared to previous reform attempts—including coordinated approaches to reducing overall supply costs, is now underway. The State-ownership of distribution utilities in Rajasthan requires sustained political will, over a number of years, to maintain performance improvements efforts and a focus on restoring financial sustainability.

III. Preliminary Description

The proposed operation would support the GoR's program for the turnaround of the sector. This first operation lays the foundations of legislative changes and institutional reforms to improve the sector's governance, supports the pressing short term needs of the financial restructuring of the sector, and focuses on necessary actions to improve operational performance. The main areas of the GoR program that are supported by the proposed operation are:

(A) *Strengthening the Governance of the Rajasthan Electricity Distribution Sector.* The State's DISCOMs were established in the early 2000s, but their organizational and institutional structures have not followed the modernization and best practices of more successful State owned enterprises in India. Measures in this area will provide more operational autonomy to the utilities, establish targets for reducing the gap between the cost of supply and revenues recovery, and institute more accountability for the performance of key personnel.

(B) *Financial Restructuring and Recovery*. Actions to be supported in this policy area will: (i) address the immediate financial pressures of the DISCOMs by transferring a considerable amount of the debt of the DISCOMs to the State (recognizing its implicit responsibility as the owner of the companies); (ii) bring a more disciplined approach to submissions by the DISCOMs to the regulatory commission for annual revenue requirements and tariff revisions; and (iii) better focus the DISCOMs efforts on increasing transparency and competition to reduce the costs of energy procurement.

(C) *Improving the Operational Performance of Distribution Utilities.* Clear performance targets and agreements between the management of DISCOMs and the GoR will provide the basis for better accountability in the sector. Actions under this pillar will also include better financial management efforts and the initiation of key programs to modernize the monitoring and control of the distribution network, including the introduction of new technologies (smart metering, pre-paid metering program and energy efficiency lighting).

IV. Poverty and Social Impacts and Environment Aspects

Poverty and Social Impacts

A Poverty and Social Impact Analysis (PSIA) of the proposed reform program will be undertaken in support of the proposed operation. The objective of the PSIA is to identify potential impacts of reforms on different stakeholders, with a particular focus on the poor, and to propose mitigation measures in case of negative impacts. A preliminary analysis suggest several potential channels of impact. From the point of view of DISCOM customers, it is expected that the envisioned reforms would lead to a more financially viable and operationally efficient sector, with positive impacts of more and better electricity supply for those who are already connected to the grid, and extension of access to electricity for households and farmers that do not as yet have access to power. Economy-wide impacts on growth and employment can also be expected with the power sector on a sounder footing in the long-run. However, the path to financial viability can also have negative impacts on households through higher cost of power and knock-on effects on prices of other consumption goods, which may require further action by government to protect the poor from the impact of any subsidy reduction.

Environment Aspects

The proposed operation's objectives of improved operational performance and reduction of losses should have a positive environmental impact in Rajasthan. Losses in the distribution system encourage wasteful use of energy and therefore increased emissions from thermal power plants, which in Rajasthan are predominantly coal-based. With reduced losses, the project is expected to contribute to lower carbon dioxide emissions and reduced local pollutants.

V. Tentative financing

Source:		($m.)
Borrower		0
International Bank for Reconstruction and Development		250
Borrower/Recipient		0
IBRD		
Others (specifiy)		
	Total	250

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