ELECTRICITY CONTRACTS

Connected renegotiations*Econometrica* **88**, 383–424 (2020)

Weak contract enforcement in the power sector can reduce competition if firms that are politically connected can negotiate electricity rates upwards after award of a contract. However, quantifying political connectedness and measuring its effect on contract renegotiation is difficult. Now, using data from India's 'Coalgate' scandal to identify potentially connected firms, Nicholas Ryan at Yale University shows that renegotiation may lead to larger overall mark-ups for connected winning firms even if their initial winning bids were below cost.

The study uses a dataset of bids and renegotiations from 2006 to 2012 from India's Central Electricity Regulatory Commission and State Electricity Regulatory Commissions. The data showed widespread renegotiations. Ryan then designated all firms that received coal blocks in the Coalgate scandal as politically connected. In the auctions studied, while the contract to provide electricity went to the lowest bidder, firms were allowed to index their prices to fuel prices. Connected firms indexed less of the value of their bids in power auctions, showing more willingness to bear fuel price risk. This allows for greater room for renegotiation in the wake of a fuel price shock. A model of the competitive bids with and without renegotiation showed that contract enforcement (that is, no renegotiation) increased competitiveness, brought down firm mark-ups and reduced production costs. Case studies showed that connected firms were offering power below costs to win contracts, with the expectation of future renegotiations and high mark-ups.

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