

User Fees and Political and Regulatory Risks in Indian Public-Private Partnerships

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Good quality infrastructure services have to be paid for, either by the users as user charges or by the government through explicit subsidies. The recent dismantling of toll booths in the country is increasing the political and regulatory risks in public-private partnership projects, as user fees as a revenue source dry up and there is no commensurate increase in government subsidy.

A recent newspaper headline states “No Toll’ Sparks Concerns over Future PPP Projects in Maharashtra” (Prasad 2015). The article goes on to say, and rightly so, that Maharashtra’s recent decision to scrap tolling at some roads and exempt cars from paying toll at many other projects has sparked concerns over the future of projects under the public-private partnership (PPP) mode in the state and triggered fears that other states may also follow such a populist stance. The Delhi-Noida Toll Bridge (DND Flyway), for example, is also afflicted by a similar malaise.

This explicit resistance to paying user fees in the road sector has come to the fore recently, but in other infrastructure sectors like power and water distribution, such resistance has been prevalent for long and is manifested in high aggregate technical and commercial (AT&C) losses or high non-revenue water (NRW), respectively. Low or non-existent tariffs in water and power distribution sectors are justified in the name of affordability for poor households. However, very often, since the poorer households are not connected to public supply, they do not get the benefit of below-cost supply of basic infrastructure services. For example, the Delhi Jal Board has only 1.6 million metered connections and about 0.5 million unmetered connections for the over 5 million households in Delhi, implying that the vast majority of the poor households are not connected to piped water supply. So, keeping user charges low in the name of the poor may be a misleading stance. In fact, it is well established that consumption subsidies (or low user charges) should be replaced with connection subsidies for improving both efficiency and equity in provision of such services.

User fees (say, water charges) are also strongly opposed by stakeholders who

may have become used to getting infrastructure services free. Infrastructure user charges, in such cases, raise political heckles, and governments, who depend on these constituencies for votes, have an interest in keeping these charges non-existent (or low, through regulators, giving rise to regulatory risk). Disallowance of the cost-recovering level of tariffs earns political brownie points and the losers ultimately are the users who would not have access to good quality infrastructure services.

Resistance to User Charges

The problem of resistance to paying user charges is not unique to India. Private water and sewerage projects and power distribution projects that have failed across the developing world encountered problems as a result of opposition to needed price increases, and opposition on principle to the private sector providing these “essential” services. Most countries see power and, in particular, water being priced well below costs. Though the private sector may bring in efficiencies, in terms of reducing costs and increasing revenue collections, the initial gap between revenues and costs may be too large to bridge with politically feasible price increases. Gassner et al (2007), in their review of the performance of public and private utilities, highlight scarce evidence of increase in consumer prices for private water utilities, while Andres et al (2006) find limited evidence of an increase in prices of privatised electricity distribution companies. The overall scant evidence of a price rise subsequent to private participation suggests difficulties in increasing prices in these politically sensitive sectors across the world (Pratap 2011).

However, the underpricing and political difficulties in raising user charges does not mean that there is no room for improvement in the way these charges are collected. For example, in the road sector, a common electronic toll system for the whole country would be ideal and would ensure against long lines of vehicles at toll booths and consequent wastage of time and fuel. The Government of India has already decided to

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implement the Electronic Toll Collection (ETC) system on pan-India basis by 2015. The ETC system is already operational on the Delhi–Mumbai arm of the Golden Quadrilateral.¹

Infrastructure services should be paid for, either through user charges or from the budget. User charges are essential for remunerating investors in toll-based infrastructure projects. If the user charges have to be below cost of provision of these services,² the government should provide explicit subsidies. Otherwise, there would be problems as exemplified by the high rate of private infrastructure project failure for the water and sewerage sector, where 6% of the projects have failed accounting for 21.6% of investment in the sector.³

User charges add to investment in that a new revenue stream is created where none existed earlier (for example, toll roads collected Rs 13,236 crore in 2013–14),⁴ and can have environmentally benign effects. Since the very rationale of inducting the private sector in most instances is the resource crunch of governments, creation of an additional revenue stream facilitates the creation of additional infrastructure, and thus addresses the issue of infrastructure deficit in the country. The Central Ground Water Board imposes no charges for extraction of groundwater, which is partly responsible for the depleting groundwater levels across the country. Imposing a volumetric water charge would be environmentally benign.⁵ User fees are an elegant solution if set on the basis of objective principles like toll rates being determined on the basis of wear and tear caused to the road surface, with trucks being charged higher tolls than cars.

People who have got used to receiving infrastructure services free (say water, power and roads) may take recourse to direct action (preventing providers from charging tolls, as in the DND Flyway), adding to political risks faced by private infrastructure projects. Regulators may also be setting user fees below costs, as in the power distribution sector. These political and regulatory risks would be reflected in a higher risk premium charged by the investors, thereby increasing costs and decreasing the cost

competitiveness of the Indian economy. Let us discuss each of these risks in turn.

Political Risk

Political risk includes expropriation, non-convertibility and non-transferability. Not allowing concessionaires to charge agreed user fees effectively amounts to expropriation of assets.

A major part of the high AT&C losses in India at 27% is accounted for by electricity theft and giveaways. The problem is partly political in that many political parties look the other way (to cultivate constituencies) when consumers steal electricity. This is a case of ensuring compliance with the rule of law, and it is possible to bring down the AT&C losses drastically when the rule of law is ensured. The case in point is the experience of Tata Power Delhi Distribution Limited (TPDDL), which was able to reduce the AT&C losses to 10.6% in 2012–13 as compared to the opening loss level of 48.1% in 2001–02 (on the eve of privatisation) (Delhi Electricity Regulatory Commission 2014c). So, if the government wants to bring about major improvement in the viability of the power sector, it needs to enforce the rule of law and take strict action against electricity theft, thereby shaving off a substantial portion of the AT&C losses.

New risks have also emerged, and toll booths are being dismantled in Maharashtra and some stakeholders have forcefully prevented levying of tolls on the DND Flyway for limited periods. This, again, is a law and order issue and best dealt with by the government through enforcement of the law of the land. Once the government has entered into a contract with the private sector, allowing the private sector to toll the road for the concession period, the onus is on the government to enforce the contract. For example, it has been asserted that there should be no toll on the DND Flyway as the company has already made enough money from the project (Sinha 2014). However, as long as the public party has entered into a contract guaranteeing 20% after-tax returns on the total project cost and an escalation clause that links toll rates to the consumer price index for non-manual workers, as

in the case of the DND Flyway, it has to be enforced. If it is felt that the terms of the DND Flyway contract with the Noida Authority are flawed (which the author believes to be so), there always is the judicial remedy of terminating the contract in public interest. However, during the subsistence of the contract, it would have to be honoured and the necessary toll increases as per the concession contract enforced.

Regulatory Risk

Since many of the infrastructure services are provided in monopoly settings, there is a requirement of tariff setting by independent regulators, whose mandate would include setting remunerative tariffs for enabling provision of such infrastructure services, while preventing monopolistic exploitation of the users. However, independence of regulators is crucial here and this does not happen in practice in India (in the road sector, though, there is no regulator and tolls are set on the basis of the National Highway Fee (Determination of Rates and Collection) Rules, 2008).

Tariff risk is the most important regulatory risk and refers to the risk that regulators may not enforce cost-recovering level of tariffs. Regulators may not be willing to allow full cost recovery partly because of their mandate and partly because of political interference. An example is the Delhi Electricity Regulatory Commission (DERC) decision implementing a power purchase adjustment charge (PPAC) on consumers of an average of 4.7% on 13 November 2014 (Delhi Electricity Regulatory Commission 2014a), and withdrawing it within a day (Delhi Electricity Regulatory Commission 2014b) till it received complete information from various power generators on fuel prices. As a result, the private distribution companies in Delhi have petitioned the Central Electricity Regulatory Commission that they cannot pay the new higher power supply rates as they cannot pass them on to consumers through the PPAC (*Times of India* 2014). These regulatory flip-flops reduce business confidence, raise regulatory risk and are a major hurdle for private participation in infrastructure.

The situation is quite precarious in the power sector. The entire power value chain is serviced through revenues garnered in the electricity distribution segment, where the average tariff continues to lag behind cost of supply for power distribution companies. Though the Electricity Act (2003) is clear about making the electricity tariffs cost-reflective,⁶ it has not happened in practice. Though, recently, the electricity tariffs have gone up disproportionately in some states, the gap is still quite wide at Rs 0.81/kWh of electricity supplied in the country (Government of India 2014). This has led to an unsustainable situation of increasing commercial losses in the distribution segment adversely having an impact on even the power generation and transmission segments. While the high level of AT&C losses is partly responsible for this outcome, the predominant role of low electricity tariffs is also fairly well established.

What Can Be Done

One of the established principles of optimal risk allocation is that risk should be allocated to the party that has more control over the risk factor. Using this principle, political risks should be assigned to the government, which should have the responsibility of upholding the rule of law and not allow goons to take over toll booths. Similarly, regulatory risk can be mitigated by making regulatory institutions truly autonomous; it is no coincidence that all infrastructure regulators are headed by ex-government officers too eager to tow the official line. The selection of the regulators and the regulatory processes needs to improve for an improved credibility.

NOTES

- 1 Lok Sabha Unstarred Question No 618, answered on 26 February 2015, Sixteenth Lok Sabha, Government of India.
- 2 After the Delhi power distribution privatisation, the tariffs for households consuming below 200 units of electricity per month is subsidised, and the difference between tariffs and cost of supply to this market segment is paid explicitly by the Delhi government to the private providers as subsidy.
- 3 World Bank-Private Participation in Infrastructure database, viewed on 30 December 2014, <http://ppi.worldbank.org/>
- 4 Lok Sabha Unstarred Question No 802, answered on 27 November 2014, Sixteenth Lok Sabha, Government of India.

- 5 Adequate surface and groundwater resources are major facets of a society that is in sync with the environment. Part of the reason why groundwater is depleting rapidly is that there is no charge for extracting it. If water is priced, less water would be extracted and consumed, and this would be environmentally benign. Even when there is a charge for water, it is a flat rate for a household. Volumetric water charges would make households consume less water and thus promote environmental sustainability.
- 6 Section 61 of the Electricity Act (2003) states that "The Appropriate Commission shall, subject to the provisions of this Act, specify the terms and conditions for the determination of tariff, and in doing so, shall be guided by the following...that the tariff progressively reflects the cost of supply of electricity."

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