Floundering Public-Private Partnerships
Some Suggestions

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Public-private partnerships are floundering in India, mainly due to the opportunistic behaviour of the private sector partners, regulatory uncertainty, and poor value-for-money to the government. What can be done to salvage the situation?

The views expressed are personal.

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As per the Private Participation in Infrastructure Database of the World Bank,[1] India is second among the developing countries, both by the number of public-private partnership (PPP) projects, as well as the associated investments – 725 PPP projects accounting for an investment of over Rs 15 lakh crore. India has made the adoption of PPPs in infrastructure the default option, resulting in an increasing trend in the private sector's contribution to total infrastructure investment – from a quarter of the total infrastructure investment in the Tenth Plan period (2002-07) to a third in the Eleventh Plan period (2007-12), which is expected to rise up to half in the Twelfth Plan period (2012-17).

However, everything is not sanguine with the PPP regime in the country. About a year ago, *The Economist* (2012) published an article on the difficult times faced by several trophy PPPs, including the Delhi International Airport Limited, the Delhi Airport Metro Express, and the Tata Mundra Power Generation project. Things have deteriorated since then and the Delhi Airport Metro Express project has reverted to the public sector while the Tata Mundra project is being renegotiated at great cost to the public sector.

Opportunistic Behaviour

Recent months have seen a culture of renegotiations pervade the country. On 15 April 2013, the Central Electricity Regulatory Commission (CERC 2013a) gave relief to the Tata Mundra project for the unprecedented rise in the price of imported coal and in the process compromised the sanctity of the bid. This relief was sanctified by the Deepak Parekh Committee, which recommended an increase in agreed electricity tariff by Rs 0.59 per unit of electricity (CERC 2013b). In the process, the next three bidders for the project became competitive and have a legitimate grievance that if this relief was forthcoming, why was it not on offer at the time of bidding.

The reason given for recommending a rate increase was the "unprecedented" and "unforeseen" increase in the price of imported Indonesian coal and the requirement that contracted prices have to be benchmarked to the prevailing coal prices. However, this was not the first instance of Indonesia unilaterally abrogating contracts and so was not "unprecedented" and should not have been "unforeseen" (Pratap 2013a). When Tatas had willingly taken 55% of the risk of the increase in energy charges, which was instrumental in their winning the bid, this decision of CERC will only encourage more opportunistic bidding. The demonstration effect of the relief is visible and other ultra mega power projects have lined up at the doors of CERC for getting similar relief (*Hindu Business Line* 2013).

Even solar projects like Rajasthan Sun Technique Energy (Reliance Power), Diwakar Solar Projects (Lanco Group), and Godawari Green Energy (Ispat) are seeking higher tariffs saying that the data on solar radiation provided by the government was faulty which has led to lower generation (*The Economic Times* 2014).

Over three dozen road projects (including the GMR-promoted Kishangarh-Ahmedabad highway project, credited with committing the highest ever premium payment to the National Highways Authority of India, NHAI) are stalled or stressed for a variety of reasons, including drying up of debt financing, aggressive bidding, problems related to land acquisition and environment clearance, traffic overestimation, etc. Some proposals have been mooted to alleviate these problems, including rescheduling the premium payments,[2] revenue shortfall loan from the government, etc. While some of these proposals are as per the Concession Agreement, like the revenue shortfall loan proposal (ibid), others are in the nature of renegotiations as they go beyond what is provided in the Concession Agreement.

Once contracts are made renegotiation-friendly, as they are sought to be made now, the whole PPP programme in India will grind to a halt as there would be no sanctity of bid, and watchdog agencies like the Comptroller and Auditor General (CAG) and the Central Vigilance Commission (CVC) will legitimately question the relief. All events would become "unforeseen" and demand for relief would become routine to be dealt with in a routine manner as "relief for unforeseen events" has explicitly been included in the model concession agreements (MCAs) to be signed between the government and the winning bidder.

Regulatory Uncertainty

Private investors face considerable regulatory risk, manifested as tariff risk, which is the risk that the regulator will not enforce the cost-recovering level of tariffs. As a result, there is a loss of Rs 1.07 per unit of electricity sold in India and there is an annual loss of Rs 60,000 crore in the power distribution segment.

Besides the tariff risk, there are also issues with regulatory capacity. In the context of the Delhi Electricity Regulatory Commission (DERC) proffering contradictory statutory advice to the Delhi government over a space of six months about the financial position of the Delhi power distribution companies and the need for tariff increase,[3] the Delhi High Court (2011) had observed the following about the DERC in 2011:

> ...the Commission has to function with responsibility, intellectual integrity, consistent objectivity, and transparent functionalism appreciating the essential nature of the regulatory body. We emphasise on intellectual integrity and transparent functionalism as we are totally dissatisfied with the way the Commission has proceeded with the manner of (tariff) determination.

Regulatory risk would have to be mitigated by strengthening the regulatory institutions through providing for impartial selection, appointment and removal of their members and by making them accountable to Parliament and the people. Autonomous and transparent functioning would also add to regulatory credibility and reduce regulatory risk.

The answer to regulatory uncertainty is not to usurp their authority as is being done by the MCAs. In India, we have a hybrid regulatory system with the MCAs coexisting with independent regulatory institutions. MCAs seek to standardise contracts – they provide transparency, predictability and consistency in risk allocation between the public and private sectors. Thus, decisions are made objectively and expeditiously. While MCAs may be made more sustainable when backed by independent regulators, the Indian MCAs seek to usurp the authority of the independent regulators, as in the case of setting tariffs. For example, the CERC has an explicit mandate to regulate tariffs of generation companies, which is being usurped by providing for the mechanism of fixing tariffs and its escalation in the newly approved MCAs of the Ministry of Power (2013).

Poor Value for Money

For PPP projects to be sustainable, they should provide clear value for money (VFM) to the government because the starting point for many PPPs is the resource crunch faced by governments. The UK and Australia are major developed country markets implementing PPPs on a large scale. The UK experience suggests that PPP projects deliver average savings of 17% compared to traditional public sector delivery (Arthur Andersen and Enterprise LSE 2000). In the case of Australia, the corresponding number is estimated at 9% (Fitzgerald 2004).

However, VFM analysis of PPP projects is not a requirement in India, which is a serious lacuna. Research shows that returns that Indian PPPs produce for the government are marginal at best (Pratap 2013b) and the much-maligned build-operate-transfer (annuity) model in India is producing better returns compared to the much-favoured build-operate-transfer (toll) model in the case of the National Highways Development Programme (Phase I) projects. This calls for a reassessment and possibly mid-course correction of the PPP programme in the country.

Even the UK has recently done a mid-course correction by incorporating the private finance initiative (PFI) liabilities in government accounts, introducing minority shareholding of the government in PFI projects to augment transparency and enabling sharing of gains, and announcing new arrangements for approval of major projects to strengthen scrutiny and control (HM Treasury 2012).

Another serious flaw with the PPP regime in India is the recent move to separate the construction and operation and maintenance (O&M) phases of the PPP project cycle and concessioning them to separate companies. This would negate whole life costing, which is a major driver of value for money from PPPs (Arthur Andersen and Enterprise LSE 2000).

Some Suggestions

The objective of any review of the Indian PPP policy should be to uphold the sanctity of the PPP contract, create more regulatory certainty, and increase the value for money from PPPs. The increasingly shriller demand for renegotiations in India, as elsewhere, is generally based on opportunistic behaviour on the part of the private sector. The answer to this opportunistic behaviour is not renegotiations, but to cancel bad projects and retender them to the private sector in a transparent manner. While this would be time consuming and could also reduce the inflated premia generated for the public sector, it would incentivise more realistic bidding. Commercial discipline and the "freedom to fail" are a major part of the rationale for turning to the private sector (Pratap 2011). Therefore, allowing bad projects to fail should be an acceptable option if we want less opportunistic and more realistic bidding from the private sector.

One of the frequently cited reasons for seeking renegotiations is traffic overestimation. To ameliorate traffic risk incidence on the private concessionaires in the road sector, the government may consider introducing a new bidding parameter: least present value of revenues (LPVR). Under this bidding parameter, the user fees and discount rate are predetermined and the concession is awarded to the firm that bids the least present value of toll revenue. The concession ends when the present value of actual toll revenue is equal to the winning bid. This bidding parameter substantially mitigates traffic risk in that the concession period will automatically lengthen in case of actual demand being less than projected and vice versa. The LPVR mechanism also allows for fair compensation if parties wish to terminate the contract early. This bidding parameter has been used in Chile (e g, Santiago-Valparaíso-Viña Del Mar toll road).

The answer to regulatory uncertainty would be to strengthen the regulatory institutions rather than seek to undermine them by usurping their role. This can happen by taking action aimed at augmenting their autonomy while making them more accountable.

Then there should be a requirement of value for money calculation at three stages – at the appraisal stage (to decide whether it is worth going for the PPP option), at the operation stage (because the promised benefits may not materialise as in renegotiated contracts), and finally, at the end of the contract period (to compare the actual value for money with the projected). To further improve PPP project performance and VFM as also transparency, the concession agreements should be in public domain. This will enable all interested parties to monitor the project, which should improve performance and VFM. The direct liabilities created by PPP projects (as in annuity projects)[4] should also be reported in the budget, which would provide a level playing field to all procurement options for provisioning public services.

NOTES

1 Private Participation in Infrastructure Database, viewed on 6 January 2014 (ppi.worldbank.org).

2 Premium is the annual upfront revenue that concessionaires promise to pay to National Highway Authority of India, which increases by 5% annually during the contract period.

3 On 30 June 2010, chairman, DERC conveyed to Delhi government that the three private Delhi discoms have a surplus of Rs 3,577 crore that needs to be adjusted through a downward tariff revision in FY 2010-11. On 15 December 2010, DERC sent "Statutory Advice" to Delhi government acknowledging the resource crunch being faced by Delhi discoms and calling for a tariff increase.

4 NHAI (2013). As per the report, 51 BOT (Annuity) projects have been awarded involving a total length of 3,547 km at a total project cost of Rs 30,287 crore. The periodic annuity payments for these projects is Rs 3,097 crore.

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