

STRENGTHENING PUBLIC PRIVATE PARTNERSHIPS AT THE STATES

With a need to attain fiscal consolidation, Government of India and various state governments are encouraging private participation in provision of infrastructure services. The total investment requirement of the infrastructure sector in the 11th five year plan (2007-2012) has been estimated at USD 494 billion and it is envisaged that USD 147 billion would be in the form of private investment. The Public-Private-Partnership (PPP) model of development of infrastructure is being encouraged which provides for better risk allocation.

At the central government level, as per the study of the PWC, 231 PPP projects are under various stages of implementation covering areas like roads, power, ports, airports, urban infrastructure etc. In the states also various PPP projects are under progress in areas like roads, health, SEZs, ports, Information Technology and power.



This indicates that PPP model of infrastructure development has gathered steam both at the central and state levels. Thus, PPP has gained acceptability and private sector participation is increasing.

Deficit in infrastructure could emerge as a binding constraint on overall economic growth and there is a need to accelerate the pace of investment in infrastructure sector. In particular, as infrastructure projects which are capital-intensive, have long gestation period and involve inter-governmental involvement, there is a need to strengthen the central-state relationships.

At the same time, it should also be noted that there is inter-regional disparity in the level of infrastructure development as well as in acceptance of PPP as a means of improving infrastructure services. Some states like Andhra Pradesh, Tamil Nadu, Karnataka, Gujarat and Maharashtra have moved ahead in increasing availability of infrastructure and have encouraged PPP, while in other states the progress is still to gather momentum.

Analysis of state government finances has revealed that many of the states have moved ahead in the path of fiscal correction. Some of the states have enacted Fiscal Responsibility Legislation (FRL). Some states have built up surplus cash balances in the recent period particularly due to tax revenue buoyancy and also due to improved devolution of finances from the central government. Such resources could be profitably utilised in providing infrastructure services. In particular, adoption of PPPs could help channel such resources optimally and also provide for increased private sector participation.

However, the major impediments to building infrastructure assets in the states relate to three levels viz., institutional, organizational and project specific

(a) Institutional : Need for Infrastructure Development Act

At the institutional level, states are constrained by not having

appropriate law which could facilitate faster clearance of infrastructure projects and which could also reduce the risks. Lack of legislation and absence of clear policies and framework for implementing PPP projects in infrastructure leads to time delays and increases transaction costs. It would be useful if states could evolve proper law for infrastructure development. The Gujarat Infrastructure Development Act could be taken as a benchmark. The act provides framework for private sector participation in financing, construction, operation and maintenance of infrastructure projects in the state. The sectors covered by the act are within the ambit of the state government.

The act provides for the following:

- ▶ Fair and transparent mechanism for selection of developers through competitive bidding or direct negotiations
- ▶ Delineates the extent of project support available to the developers
- ▶ Ensures protection of public interest
- ▶ Takes care of the interest of the developers and lenders.

For instance, as per the Act, competitive bidding for a project would be achieved by issue of public notice inviting expression of interest. The Expression of Interest (EoI) would be examined at the pre-qualification stage and successful qualifiers would be required to submit their financial and technical bids. While evaluating the proposal, factors like lowest bid in terms of present value of user fees, highest revenue share to state government and lowest subsidy element would be considered.

The state in turn, could provide assistance in the form of participation in equity upto 49%, provide subsidy, make available senior or subordinate loans, conferment of development rights in respect of any land etc.

It would be useful, if other states enact similar legislation to speed up implementation of infrastructure projects.

(b) Organisational: Lack of capacity

Lack of capacity amongst the state governments is a major constraint in promotion of PPPs at the state level. The lack of capacity is three levels viz., (i) administrative levels hampering identification and preparation of PPP projects; (ii) at the political level without consensus about promotion of PPPs to meet infrastructure gaps; and (iii) private sector capacity to implement PPP projects. Besides, in many states there is low trust between private and public sector, resulting in improper allocation of risks.

Capacity building needs to be focussed upon in respect of:

- ▶ Formulation of PPP policy and guidelines
- ▶ Development of regulatory framework
- ▶ Setting up of dedicated PPP cells
- ▶ Funding and resources for developing and structuring projects
- ▶ Evolving legally and financially sound model procedure from conceptualisation to implementation of infrastructure projects
- ▶ Developing framework for arriving at economic viability
- ▶ Evolving Model documents in a range of infrastructure sectors
- ▶ Dealing with unsolicited proposals (Swiss Challenge model).

(c) Project specific issues

Social acceptance of the infrastructure project to be implemented will have to be ensured. This would require that the fee structure to be charged on the users of the facility/service should be viable and it should not impair social inclusion. The contracts should be equitable and proper framework should be in place with regard to management and regulatory oversight.

The key challenges in this respect are:

- ▶ Selection of land and acquisition thereof
- ▶ Rehabilitation and resettlement of affected persons
- ▶ Projects should be bankable
- ▶ Project structuring should attract quality bidders

(d) Issues in land acquisition

Land acquisition has emerged as a major impediment to implementation of infrastructure projects. In particular, the issue relates to land selection and acquisition. In many cases, views have been expressed that the compensation paid to the displaced persons were inadequate. Although the Land Acquisition Act 1894 is a central legislation, land is a state subject. State governments have framed their own law under this act and in various cases, the R & R policy has also been evolved.

The main issues in land acquisition at the state level relate to:

- ▶ Absence of guidelines to provide compensation to land owners with unclear title
- ▶ Lack of uniformity in calculation of replacement cost
- ▶ Inadequate capacity of the revenue department to carry out surveys for land acquisition as per the requirement of the project
- ▶ Lack of funds to finance land acquisition

At the state level, there is need to computerise all land records so that they are easily accessible and updated regularly. Moreover, the project developers are dependent upon the district administration for land acquisition. Among the priority of the district administration, land acquisition, more often, ranks lowest. As the project implementer is wholly dependent upon the district administration, delays in land acquisition would transform into delays in project completion. This, in turn, can affect the revenue streams and impact on the repayment of the loans granted. States should take suitable corrective action in this regard.

(e) State Support Agreement

The Model Concession Agreement for roads provide for State Support Agreement (SSA). The agreement, inter-alia, provides for support of the state government for access to project site and operations thereon by the concessionaire; provision of all permits; provision of infrastructure facilities like water, electricity, telecom etc. The availability of such agreement improves the project implementation efficiency. However, in some of the states, the provision of SSA is unduly delayed with the result private investors are unwilling to take up any projects.

Recent reports indicate that in case of one state, despite extension of the date for final submission of bids for various infrastructure projects, private sector developers have not shown

much interest. This indicates the need for an enabling environment where as sovereign, the state governments should fulfill their role and share the risks in an appropriate manner.

(f) Attitudinal issues

PPPs involve different stakeholders with differing mindsets. While the private partner wants the speed of award of contract and better returns, the government agency awarding the project is more process-driven and needs multiple approvals. Government agencies are also driven by policy objectives of welfare of the users, social inclusion and affordability of the charges/tariff.

The differing perceptions about the project and its outcome places the partners in a PPP project sometimes in adversarial position. This, in turn, results in low trust between the partners. It is imperative that both partners remain flexible and understand each other's position.

Ideally, the state should concentrate on the risks in the public domain, while the private sector should bear risks relating to construction and related aspects.

(g) Lack of pipe-line projects

In many states, the project pipe-line is dry and many projects which have been identified and evolved, they may not be bankable. The key to successful bidding of any PPP project is the robustness with which it has been prepared. And the responsibility for preparing a good, biddable project, lies with the sponsoring agency.

State agencies responsible for project preparation, therefore need to strengthen project preparation activities including technical feasibility, demand analysis, financial modelling, environmental and social issues. The sponsoring agency should also take quick decisions after pre-feasibility is completed. More important, states should designate a single department as the nodal agency for implementation of projects, instead of the current practice of multiplicity of departments which often work at cross-purposes.

(h) Steep rise in input costs

Keeping with global trends, there has been a steep increase in price of inputs. For instance, the price of steel which was Rs28,254 per tonne in April 2006 has gone up to Rs53,500 per tonne in April 2008. Prices of cement and bitumen have also shown significant increase during this period. As these inputs form 35 to 40% of the construction costs, the total cost are likely to escalate further. Although in the case of road projects, the toll charges are linked to Wholesale Price Index (WPI), the absorption of the costs of construction by the project proponent could become burdensome. **With interest rates also heading north, the cost escalation would further reflect in the overall project cost. Innovative methods need to be evolved to address such issues.**



Item	April 2006 (in Rs.)	April 2008 (in Rs.)
Steel/tonne	28,245	53,500
Cement/bag	199	265
Bitument/tonne	15,990	25,140

Source : Business Line

Promotion of PPPs at the state level is imperative as the development of infrastructure could well address the issue of inter-regional disparity. The experience gained by some of the states in implementing infrastructure projects under the PPP model offer valuable lessons for other states to emulate.

IIFCL welcomes its new director

Mr N Balasubramanian, ex-Chairman & Managing Director, Small Industries Development Bank of India (SIDBI) has been appointed as one of the Directors of the company. Mr Balasubramanian holds a Masters degree in agriculture and has completed PGP in Management from the Indian Institute of Management, Ahmedabad. Prior to his joining the SIDBI as Deputy Managing Director, he worked with Bank of Baroda for over 35 years. He has exposure in the areas of corporate lending, international finance, treasury operations, infrastructure financing and asset liability management. He was also a Member of the Working Group on Micro and Small Scale Enterprises and Agro and Rural Industries for the 11th Five Year Plan constituted by the Planning Commission.

IBA issues circular on suggestion of IIFCL

IIFCL which is co-partnering banks and financial institutions in promoting infrastructure development in the country has been emphasizing on the proper monitoring of the the projects financed. The exposure of the banking system to infrastructure sector is around 9 to 10% of net credit which is expected to increase significantly in the next 5 years. This underlines the need for close monitoring.

Acting upon the suggestion of IIFCL, Indian Banks' Association has issued a circular to all the Member Banks . The circular, inter-alia, highlights the unique nature of infrastructure projects and the modalities for monitoring. Among the checks banks have been required to ensure are: the project has all the required clearances/approvals, assessment of any escalation in cost by the lead bank, availability of regular information to all the participating institutions about the progress by way of Lenders' Independent Engineer Report, the draw downs are as per schedule, compliance with the terms of sanction, monitoring of escrow account, implementation of environmental and social safeguards framework, and whether land acquisition has been complete.

IIFC (UK) Ltd commences operations

Subsequent to its incorporation in UK on the 7th February 2008, IIFC (UK) Ltd, the wholly owned subsidiary of IIFCL has commenced operations from 10th April 2008 after inauguration by the Hon'ble Finance Minister, Shri P Chidambaram. The function was attended by over 250 participants and received wide coverage in the domestic and foreign media.

In his welcome speech, Mr S S Kohli, Chairman & Managing Director, IIFCL stated that the establishment of IIFC(UK) Ltd is the fulfillment of the announcement made by the Hon'ble Finance Minister in the Union Budget 2006-07. The Company would be borrowing from the Reserve Bank of India foreign currency upto a maximum of \$ 5 billion in several tranches and provide foreign currency loans to meet the import requirements of Indian companies developing infrastructure. The loan would be solely for meeting capital expenditure outside India.

Hon'ble Finance Minister Shri P Chidambaram in his inaugural speech stated that the Indian economy is humming with activity and it has the potential to achieve 8 percent plus growth in the next two decades. This, he said, would keep India in the second



spot on the list of rapidly growing economies and the pressure on infrastructure would increase. Finance Minister stated that the infrastructure deficit in the

country should be treated as a cause for celebration of India's growth story. Finance Minister commended the performance IIFCL has achieved in the short span of 2 years and stated that for any one dealing with IIFC (UK) Ltd, it would be a "win-win" situation as the operations of the subsidiary would not only help building of infrastructure in India but also promote exports from other countries

The event was attended by senior functionaries of banks including SBI, PNB, BoB, UTI, Citigroup, Standard Chartered, HSBC, ABN Amro, Bank of America, Depfa Bank, and UBS, reputed investment banks (Lehman Bros, Morgan Stanley), IL & FS, consulting firms, private equity firms like Blackstone and 3i, legal firms, representatives of Indian industry, industry associations, UK government agencies, leaders of the Indian diaspora, officials from Indian High Commission and local and foreign media.

Ms. Sharon Bamford, Chief Executive of UK India Business Council welcomed IIFCL's decision to establish its subsidiary at London and hoped that the initiative would strengthen Indo-UK trade and business relations and help promoting exports from UK. Prof. Lord Meghnad Desai, Professor Emeritus, London School of Economics viewed that the Government of India's decision to establish IIFC(UK)Ltd with the objective of providing loans to meet capital requirements of infrastructure projects was a step in the right direction.