‘COMMENTARAO’ IN ‘THE TELEGRAPH” OF APRIL 1 2015

“Public-private partnerships have not worked” by S L Rao

__India has for 44 years since independence been a “socialist” country. This meant that public ownership was considered better for society. Private ownership was profit seeking. Profits were not held to be in the public interest. They meant exploitation of a very large and poverty stricken population. So private investors were rigidly controlled by government and taxed heavily to make a more equal society.

Simultaneously, many schemes gave free or cheap goods and services to the “poor”. These policies to divide a small GDP cake into more equal parts, led to poor economic growth, inhibition of enterprise, tax evasion on a large scale, corruption, favours given to crony business persons, monopolies and oligopolies, with market dominance leading to consumer exploitation, and growing differentials in living standards.

In 1991 enterprise was given a freer role in the economy with the abolition of industrial and most import licensing. There was a flurry of private entrepreneurship. New manufacturing capacity was created. Competition between multiple players in the market gave the consumer superior quality and lower prices. The opening of the economy to imports further benefited consumers.

Public sector monopolies, especially in infrastructure, were also challenged by private entries allowed into telecommunications, electricity generation, transmission, distribution and trading,, oil refining, airports, ports.

The removal of ceilings on industrial capacities, technology imports, removal of limits on compensation to all and particularly employees with special skills, resulted in efficiency improvements and cost reductions in many private enterprises. However, state owned enterprises remained unchanged, continuing under government ownership and bureaucratic control.

As the economy grew with this liberalization of markets, manufacturing and imports, there was a galloping demand for fresh capital for increasing production. Sources for capital were largely domestic. Despite high domestic household savings, and growing corporate profits and savings, there was a shortage of capital. A good part of the savings went to government run insurance, provident, pension and gratuity funds. Government owned and financed development finance institutions that lent long term capital converted into commercial banks after the economic liberalization. While foreign investment grew significantly especially in equity and debt, it was a fraction of the needed capital.

Long-term debt of companies was increasingly financed by commercial banks, mainly from their short-term deposits. Inevitably the cost of capital for investment was high compared to China and many other countries. Indian manufacturers were not competitive in overseas markets. India was an exporter of raw materials, not much of manufactures. There were other constraints to manufacturing in India: the numerous government permissions and frequent inspections, widespread corruption, restrictive labour laws that forced employers to restrict permanent employment in favour of contract labor that could be laid off in case of a demand downturn, the constraints on free movement of goods because of varying indirect taxes, environmental regulations and interminable wait for government go-aheads, in addition to state government bureaucracies holding up projects. Infrastructure projects inevitably suffered time and cost overruns. Bank loans became sticky. .

One answer was for government to participate with private enterprise with capital. In some cases government couls speed up clearances. Partnerships between public and private investments (ppp) in infrastructure projects required large investments. Their focus was on-power plants and power distribution, roads, ports, airports, metro rail. All these projects required large tracts of land, many times in irrigated and inhabited areas. Thousands of farmers had to be persuaded to part with their lands for compensation. For many whose livelihoods came from working on the land, alternative skills had to be developed and gainful employment found. Considerable resettlement and rehabilitation of people was required. In most cases there were adverse environmental impacts that had to be

mitigated. Roads, airports, ports, had to be built to bring in raw materials and fuels.

Public sector companies (like the Power Finance Corporation and the National Highways Authority of India) were tasked to get these initial clearances. The private party, it was hoped, would spend minimum time and capital locked up in developing the projects. Government would be a financial partner in addition to dealing with these preliminaries.

In some projects where tariffs were felt inadequate to allow an adequate return, government developed the idea of "viability gap funding". Bidders were to forecast tariffs for the next 25 to 30 years. Taking account of other incomes that might be permitted-advertising, from land development, etc- the bidder was to quote forward tariffs for the period (with escalations), and how much financial support he would need from government to build the project. Whoever quoted lowest, got the project, if other conditions were met.

In the event. What was a brilliant solution to moving forward in building infrastructure, was on the whole a failure. No project was without delays. There were many reasons: land acquisition became delayed, resettlement and rehabilitation took negotiations and time, environmental groups lobbied governments to delay or refuse permissions, in addition to problems of weather, geology, etc. Government's desire to offer projects that had got major clearances, with only construction and operations remaining, was not achieved. This led to the private developer having his capital locked up, his technology providers and equipment suppliers screaming for payments even though the project was not ready for them, and the payback period beign extended.

What was worse was that the economic assumptions did not hold. Power plants based on imported coal found that the coal prices were much higher than assumed in their power tariff commitments. Bidders for roads were so aggressive that they found their quotes unsustainable, and many abandoned their projects. Forecasting was poor-of future road traffic for tolls, advertising revenues, land development revenues, railways taking interminable time to approve under and over bridges over railway lines, etc. Fuel availability especially gas became very

uncertain. Coalmines allocated for ultra mega power projects got mired in controversy. Barren land given cheap for port development (as for Mundra port) and on which the developer lavished expenditures on hinterland development, had political charges against them for being “crony capitalists”. This was because the land values soared after the investments by the developer. Thus infrastructure peojects, and the subset of ppp’s suffered time and cost overruns. They could not service bank loans. Capital adequacy of banks declined.

So is there hope that ppp’s can work? Yes but there are big “if”s. Our bureaucracies and politicians at all levels should be tamed to deal with all clearances in a timely fashion. There should be a coordinated approach to such clearances so that related clearances are given together. There must be compensation to the developer who suffers because of delayed clearances. Tariffs should not be quoted for longer than required by financiers for financial closures. Land acquisition should be simplified-a very difficult task with so many political parties with interests in creating problems. Land required for projects should be minimal and not result in vast surplus lands as is the case with so many projects over the last 70 years. The contracts must be so designed that they take account of eventualities like unforeseen cost increases. or imported coal-based power projects. There must be agreement on what is to be done if assumptions on forward interest or exchanger rates are proven wrong. A There must be a far wider reservoir of capital for long term investments, as in many other countries. This should include long term savings in insurance, gratuity, provident and pension funds. Government guarantees might be required. Clearly our administration needs much reform before India is ready for ppp’s. (1295)

---

1. Strong public sector capacity to identify, structure and monitor projects.
2. 2. Private competence to design, construct and operate

3. Community participations
4. Financing and commercial viability
5. Risk sharing
6. Social inlcudsion'
7. Substainability