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FAILURE OF PUBLIC-PRIVATE-PARTNERSHIP IN INDIA

Shubh Soni

Research Assistant, Observer Research Foundation

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In the popular American TV series West Wing, an outgoing Chief of Staff is asked by a philanthropist how she would spend US\$ 10 billion to improve the lives of the people in the developing world. She responded by saying her answer was too boring. On further probing she replied highways - because without highways it becomes difficult to get medical supplies to rural hospital.

The purpose of this anecdote is not to stress the importance of highways or infrastructure development; there is global acceptance on that aspect. It is to stress on the word boring. As discussed during the conference, infrastructure i.e. 20th century basic and critical infrastructure, requires large capital upfront, has a long gestation period, and the returns on investment aren't “high” but stable.

On the political front, this means political parties merely seeking re-election would rather invest resources elsewhere. For the private sector, the risks attached just doesn't make projects viable. Thus, as was pointed during the proceedings of this conference, PPP in India can be viewed as a wedding, with lavish parties, which brings excitement to this rather boring sector.

It is now widely accepted in India that the past decade of experimenting with the PPP model to build infrastructure was largely a failure. The fact that a large number of infrastructure projects have their official status as either incomplete or stalled not only confirms this reality, but is also a significant contributor to the country's sluggish growth of the economy, and the inability to sustain high growth rates.

PPP Failure in Numbers

Before exploring the reasons for the failure, it is important to understand the enormity of the situation. According to the Economic Survey of India 2014-15, the stock of stalled projects has risen at an alarming rate, particularly in the private sector. Manufacturing, mining and electricity, in that order, have had the highest stalling rates in the last few quarters among all sectors. In fact, estimates suggest that for every 100 rupees of projects under implementation, 10.3 rupees worth of projects were stalled, and the number for private sector stood at 16. Analysis of the infrastructure sector showed that the electricity had a particularly large number (and total worth) of stalled projects in both public and private sectors. As of quarter three of the financial year 2014-15, 80 projects were stalled in the electricity sector (75 in generation and 5 in distribution), and 54 of these 80 are in fact private. And it is here that the failure of PPP is becomes apparent – almost all the projects in electricity under the “private” category are actually public-private partnerships, which affects the public sector directly (Ministry of Finance, Government of India, 2015). The other problem area in infrastructure is roads and highways – current Union Minister for Surface Transport & Shipping stated back in 2014 that “as many as 189 projects with a cost of Rs. 1,80,000 (US\$ 27 billion) crore are stuck” and that “PPP mode is not possible now” (PTI, 2014).

As a result of these stalled projects, India faces today what the Economic Survey terms “The Balance Sheet Syndrome”. Corporate balance sheets in India continue to be over-extended and the debt to equity for Indian non-financial corporates has been rising at a fairly alarming rate over time (Ministry of Finance, Government of India, 2015). This trend is particularly alarming as the public sector is exposed to corporate risk in the form of public private partnerships, and lending by the public sector banks. In fact, unlike many other countries with high debt to equity ratios currently, India’s debt is almost exclusively financed by public sector banks. This has translated into high and rising non-performing assets for these banks (Ministry of Finance, Government of India, 2015).

This situation where the corporate sector is running high debts which are predicated on financing by the public sector banks, has reinforced the impact of stalled projects on growth rates by making it more and more difficult for banks to finance ongoing business activity, let alone new investment. Thus the crisis in the banking sector is both a driver and a consequence of the failure of the PPP model in infrastructure.

Reasons for PPP failure

The Property Right Theory in New Institutional Economics is a good point to start when discussing the failures of the PPP model in infrastructure in India. This theory states that besides the good itself, the value of “Property Right” needs to be considered – i.e. the right to use, the right to change, the right to make profit or losses, and the right to transfer (Geraldi, J., 2007).

Coase in 1988 had argued that “(i)n order to carry out a market transaction, it is necessary to discover who it is that one wishes to deal with, to inform people that one wishes to deal and on what terms, to conduct negotiations leading up to a bargain, to draw up the contract, to undertake the inspections needed to make sure that the terms of the contract are being observed, and so on. These operations are often extremely costly, sufficiently costly at any rate to prevent many transactions that would be carried out in a world in which the pricing system worked without cost.” (Gerald, J., 2007). These costs are referred to as Transaction Costs and it has been well recognized, infrastructure projects, with their long time horizons, bring with them even higher transaction costs.

The two biggest transaction costs faced by the infrastructure sector in India are dispute resolution, and land acquisition – the first is often a result of the second. Infrastructure projects are fraught with disputes that cause inordinate delays due to slow resolution processes. Arbitration awards are almost invariably appealed against, resulting in long drawn out disputes that often last 3 to 10 years. As per available data, over Rs.21,000 crore (US\$ 3.2 billion) worth disputes involving 870 cases are pending for resolution in the Road sector alone, involving both PPPs and public funded projects. The number of disputes in the PPP projects has shown a significant increase from 56 cases (involving Rs.803 crore) in 2013 to 116 cases (involving Rs.11,580 crore) in 2015. Absence of a clear and fast dispute resolution mechanism is increasing cost of projects and deterring investors’ sentiments (NITI AAYOG, 2015).

There is also the question of honouring contracts. It has been experienced that in large number of cases, the project authorities do not discharge their contractual obligations in a timely manner which imposes additional costs on private sector participants. There is also lack of enforcement of the contractual obligations to be discharged by the Concessionaires (NITI AAYOG, 2015).

The issue of Land Acquisition is at the heart of the country’s development predicament, with projects in any and every sector facing enormous challenges with regards to land. A number of the problems are self-generated- till 2013 the land acquisition processes followed a law passed by the British in 1894 which meant successive Centre and State Governments had the power to behave like colonial overlords, and they did. The 2013 Act, seen as a much needed improvement over the one passed in 1894, however had numerous pitfalls and did not address major concerns of both industry and land. In a nutshell, the act neither benefits industry, nor the farmer, but only the bureaucrats.

And was highlighted in the deliberations during this conference, the laws that exist are often not implemented. For instance, tendency to award projects before obtaining clearances and the requisite land for the project. This has delayed projects’ cash flows and put developers and banks under stress.

There was a suggestion from within the deliberations that it might be easier to split infrastructure projects into smaller units to ensure more efficient implementation. Small however is a very relative term. In India for instance land ownership is often fragmented and when land acquisition takes place, the government has to negotiate and/or displace a large number of people – this could be for the smallest of projects but the impact on lives is large just because of land fragmentation.

The third transaction cost which has hindered private participation is risk assessment and allocation. Discussions around this subject often centre around how much risk the private sector should/can take and how the private sector must lay down the perceived risks. This narrative however often discounts the fact that there are certain risks that the private sector just cannot foresee. An Indian example helps explain this point - in the state of Maharashtra, a political party decided that paying toll for a road was against its ethos. It started breaking down booths, and beating toll officials to a pulp.¹ This is a scenario the private sector is just not equipped to perceive, or manage (TNN, 2014).

Corruption

Thus a partnership which is formed between the private and public sector, where the private sector takes on large amounts of debt (that too from public sector banks), is unable to perceive and manage risk and as a result the public sector takes that burden, coupled with weak institutional capacity to enforce legislation and a delayed justice delivery system, corruption, rent-seeking, resource extraction, is bound to happen. India is a classic case of private sector companies entering into these projects merely for these reasons.

Role of Private Sector

This is not to say the private sector doesn't have a role to play. Private investment in 21st century infrastructure – which is based on internet based technologies – has the potential to revolutionize the way Indians live. The internet sector already employs 4-5 lakh people, and the e-commerce sector is expected to create 15-20 lakh jobs by 2018 (Boston Consulting Group, 2015). And, it is not just this sector which stands to benefit from state of the art cyber infrastructure – the knock off effects on other sectors can potentially add 20-30% or about \$550-\$1000 billion to India's GDP. The benefits of advancements such as mobile internet, cloud computing, internet of things, and advanced geographic information systems (GIS) can potentially provide health care services to 400 million people, facilitate financial inclusion of 300 million, and improve agriculture yield by 15-60% (McKinsey Global Institute, 2014).

How does the public sector raise finance? How should it be disbursed?

India's bilateral relations with the east-Asian giants Japan and China will be critical in accessing funds for infrastructure development. Japan has already pledged significant resources, the most recent being its role in modernising 400 Indian railway stations as part of the Indian government's bid to invest USD 140 billion in the sector (PTI, 2015). Additionally, India's active participation in the Asian Infrastructure Investment Bank (AIIB) and the New Development Bank (NDB), will also be two prominent sources of infrastructure finance in the coming years.

On how it should be disbursed, India should allow its State governments and even third tier governments to access funds from these channels. Decentralized decision making can be the key to efficient and effective utilization of resources.

Sustainability

The word sustainability has been deliberately left out of this paper. During the first day of the conference two important points were brought up regarding sustainability in infrastructure developed – first that “in the long run, sustainable projects are cheaper” which is why we should go for them; and the second one that “sustainability is like an insurance policy” without which we might face disaster. While both these points are true, they do not take into account the fact that the richest 14% of the world's population have a mean life expectancy of 84, while the poorest 34% live for only 36 years on average (Pogge, 2012). In this context, asking the bottom 34% to think of long-term essentially means asking them to make sacrifices for benefits they wouldn't live to witness – a thought inherently immoral. It also must not be forgotten that the 'original sin' of fossil-fuel led industrialization was committed by the now developed countries – and these countries continue to live a consumption based lifestyle which is just not 'sustainable' (the total per capita coal consumption of OECD nations in 2014 was 1,100 watts, compared to 635.1 of Non-OECD countries).

It would be counter-productive for the developing countries to not take part in the green-transition the world is witnessing as these countries are most vulnerable to the adverse impacts of climate change. However, the developed world must take on the onus of leading this transition; leadership which has thus far not been forthcoming - eighteen civil society groups in a study titled “Fair Shares: A Civil Society Equity Review of INDCs”, found that the national declarations of the developed world have failed to impress, while the commitments developing countries such as India have exceed their 'fair share' of emission cuts (SEI, 2015). In this context, Sustainable Development Goals, which are going to be used as progress indicators for the developing countries, must be accompanied by Sustainable Lifestyle Goals, which would measure the efforts made by the developed world in combating climate change, and their contributions towards a more sustainable planet.

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