

Private Sector Infrastructure Facility at State Level Project



EXECUTIVE SUMMARY

Provided to the

State Governments of
Andhra Pradesh
Gujarat
Karnataka
Madhya Pradesh
and
Asian Development Bank

By

CPCS Transcom Limited
In association with
Oxford Policy Management
Nathan Incorporated
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15 February 2005

Mr. Cheolsu Kim
Head, Financial and Private Sector
Asian Development Bank
Indian Resident Mission
4, San Martin Marg, Chanakyapuri
New Delhi 110 021

Dear Mr. Kim,

Reference: TA 3791-IND: Enhancing Private Sector Participation (PSP) in Infrastructure Development at State Level

It is with pleasure that I am forwarding to you the final report for the above technical assistance project. I believe that the five volumes attached can form the basis for improved private sector participation in the infrastructure sector in India.

In addition to the main volumes, we have also prepared an Executive Summary which summarises the main report recommendations. We have also structured the recommendations into seven key steps which are needed to enhance state level PSP activity. These seven steps comprise an action plan which can be applied by any State in India.

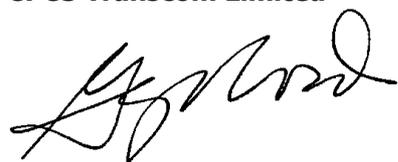
As you pointed out in the tripartite meetings, while the knowledge of how to support PSP activity seems to be fairly widely accepted, following through on that knowledge and implementing the projects is not being done. In the report we have provided a body of material which we hope can assist in that implementation.

While this report is bulky, it was written with the idea of eventually turning it into a reference book for wider dissemination to other state organisations around India. That option still remains. We believe that the concepts and the issues highlighted here, have broader application in other states as well.

In closing I would also like to thank you and your colleagues for your support and help on the project.

Yours sincerely,

CPCS Transcom Limited



W. Greg Wood
Chairman

Executive Summary

E.1 Introduction

The Government of India has for some time believed that more could be done to leverage the infrastructure investments made by the public sector into an expanded role for the private sector. Clearly India is in critical need of improved infrastructure in virtually all fields. Additional private investment, either singly or in partnership with the Government would accelerate the pace of development and potentially inject a degree of improved accountability and management expertise into a critical area of development. In this project we were asked to assist the States of Andhra Pradesh, Gujarat, Karnataka and Madhya Pradesh, in addressing the constraints to increased private sector participation (PSP) in infrastructure development.

The fundamental question was, **“What is inhibiting the private sector from making investments in infrastructure and what can be done to overcome those inhibitions?”**.

Our approach was to work with the organizations in each of the above States to first of all, understand what is being done in each state to support the private sector process (PSP) - what legislation is in place, what policies are prepared, what organizations are available to assist and what process was being followed to help the private sector identify, assess viability and ultimately decide to invest in a project. After much discussion and review, one outstanding fact stood out, namely, that across the States, there was generally a significant lack of bankable projects. Since the private sector is normally very aggressive in finding ways to make money, acknowledging that there were not many “bankable” projects around was surprising.

The remainder of the project was therefore focused on the supplementary question of, **“Why is there a shortage of bankable projects?”**.

The project was divided into a number of streams as follows:

- ❑ The enabling environment – what are the policies, laws, regulations and rules that either inhibit or support PSP in infrastructure investment?
- ❑ The private sector participation process – how are projects identified, evaluated and ultimately developed by the private sector in each state?
- ❑ The institutions - in each state what institutions are either currently involved in making PSP happen or could be involved in making it happen more easily and more often?
- ❑ What role do environmental clearances and social and resettlement approvals play in the process of private sector participation?
- ❑ What factors, such as settlement of disputes or provision of incentives are important to investors and how best should they be handled?

Each of these streams is covered in a chapter in the main volume of the report.

E.2 Context

E.2.1 The Problem

It is tempting to search for a magic solution. I wish we could report that there were a series of clearly defined documents that were missing or a set of regulations or approvals that could be improved and that by doing so we could dramatically improve the availability and quality of projects for investment. **Unfortunately, that is not the case.** In these days of instant communication, conferences, investment tool kits¹ and many competent consultants, we were not able to find any kind of instant fix. However, that in itself is a heartening finding. If we had been able to report that some clever way could be found to dramatically improve the climate for PSP investment, I would hope that the readers of this report would be suitably skeptical.

¹ A very extensive package of private sector investment support material is available from the IFC/World Bank covering many of the same infrastructure sectors as are covered in this project. The webpage address for this information is < <http://rru.worldbank.org/Toolkits/>>.

What we did find was a series of gaps, not all of which are common to all States, that largely fall into the area of PSP process implementation. These gaps describe things that are not being done now, or are being done inadequately and as a result, the pipeline of projects being made available to the private sector is not being kept full.

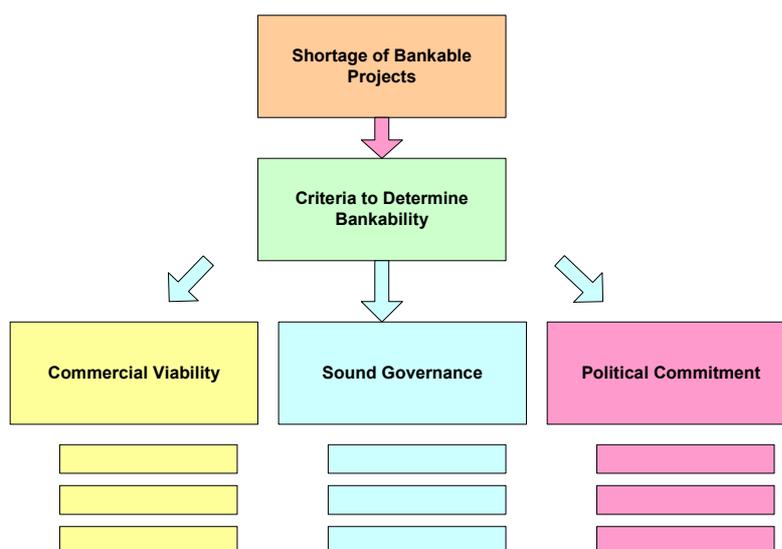
It was instructive, in one of the last tripartite meetings held with the States, when, after presenting the findings of the project to a selection of senior officials from a number of departments of the State Government, one of the officials stated that, “ **Yes, that’s fine but we know all that!**”. The question in reply was, “ **Fine, if that’s the case, then why are there not more bankable projects in this State?**”. The official answered,

“ **Because, while we know what to do, we are not doing much of it. We do not follow through where needed, we do not provide proper support to PSP and we do not provide the funding when and where it is needed to allow those projects to develop!**”.

In a nutshell, that sums up the situation in many of the States. In those States where the process and systems and support are strong, success is being achieved. In those States where there is less commitment to the process, systems and support, then we also see less success.

We have listed three macro criteria for creating bankable projects as highlighted in figure 2.1.

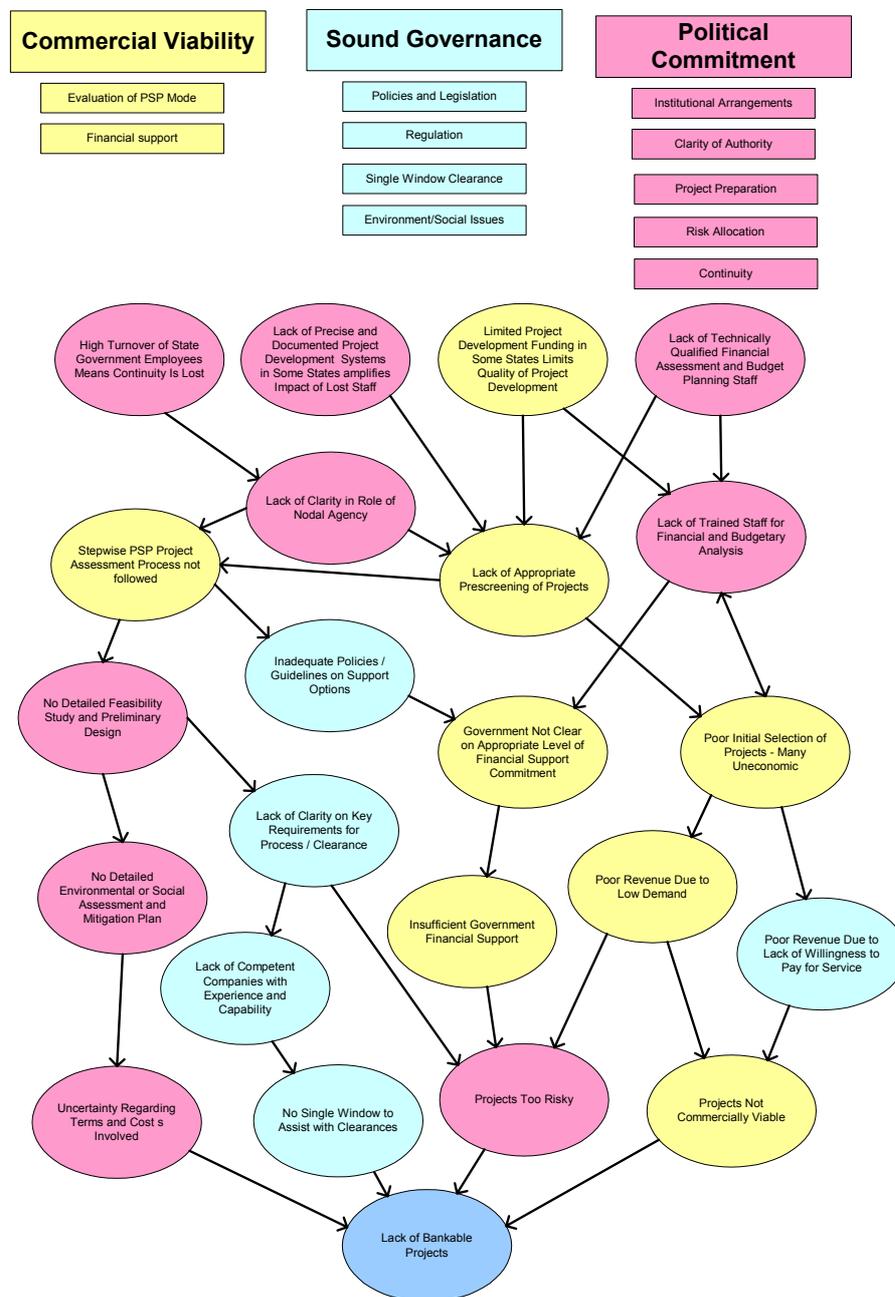
Figure 2.1: Criteria for Bankability



- Commercial Viability
 - Evaluation of bankability and selection of appropriate PSP Mode at early stage;
 - Provision of sufficient financial support to ensure bankability.
- Sound Governance
 - Clear and sound policies and legislation;
 - Separation of regulation from policy and operations;
 - Provision of single window clearance arrangements;
 - Clarification of environmental and social issues.
- Political Commitment
 - Clarity of institutional arrangements and responsibilities;
 - High level political support;
 - Provision of adequate funding for project preparation;
 - Allocation of risks on the basis of those best suited to bear those risks;
 - Continuity of policies and staffing.

None of the States could consistently satisfy all of the criteria to achieve bankability. Some states were better equipped than others on some of the measures. For instance, project gap funding was available to a significant degree in some states and not in others. Institutional arrangements in some states were superior to the arrangements in others. Further, the enabling environment in all states was not an impediment to expended investment. While some improvements were advisable and in a number of instances, were made as part of the output of this project, the bulk of the issues that need to be addressed arise in the other two areas - **political commitment and commercial viability**. The following figure 2.2 illustrates the precedence flow of issues and deficiencies leading to the lack of bankable projects.

Figure 2.2: Precedence Flow of Key Deficiencies that Contribute to A Lack of Bankable Projects



E.2.2 The Proposed Changes

In the above figure should be read from the bottom to the top. In tracing the linkage of issues it is clear that the reasons for lack of bankable projects are a cascade where two or three contributing factors affect an issue which in turn affects something else. While the diagram is a bit complicated, it provides a good indication of the linkages between issues and problems. So what can be done to improve the list of bankable projects? The answer is essentially organization, process and political will and support to move projects forward. We recommend the following seven key steps.

1. Create a Qualified Organisation with the Capability to Support PSP and Evaluate Bankability

While it can be argued that “nodal agency” can be used to cover many kinds of organizations, and that in any case, such an organization is not essential to the successful development of a PSP process, at the same time an effective nodal agency can be a significant driver of PSP in infrastructure. The only one of the Four States with an strongly structured nodal agency is Gujarat. The political and bureaucratic support is apparent and the process focused way that the GIDB approaches PSP stands in contrast to the approach in other states. While Andhra Pradesh has a strong legislative mandate for its nodal agency, it has neither the staffing in place nor the financial support available to make it practically effective. Karnataka has a coordinating unit within the Infrastructure Development Department, but frequent staff turnover and limited mandate to develop projects results in a passive organization, not one actively involved in promoting expanded PSP activity. In Madhya Pradesh, the MP State Industrial Development Commission and the State Road and Bridge Corporation are specialized nodal agencies which have had good success in specific areas – particularly in road development. However this model needs to move to a more generic structure perhaps in the Department of Finance to allow for all areas of infrastructure development expertise to be consolidated in one organization.

We recommend the establishment of a **Private Finance Initiative (PFI) Unit** within the State Department of Finance to evaluate the bankability of potential PSP projects early in the project cycle and to assess the level of financial support that will be required to ensure bankability. The role of the PFI unit is we believe critical to the future success of PSP in the states. Karnataka and MP agree that it should be in the DOF. In Gujarat they have argued that such a unit could well become part of the GIDB. In AP the need is accepted but the location of the unit is still being considered. Such alternative arrangements could be made to work, but the need for the establishment of an effective PFI Unit capability is paramount.

The PFI Unit will have the technical expertise to determine the financial viability of the projects proposed, the relationship of the financial viability to the economic impact of the projects and as a result, the it will be able to clearly recommend to the State Government the level of state support needed to ensure project viability it will also be able to advise on the longer term impact of such support on the state budget and long term commitment. This analysis will allow the PFI Unit to guide the government in its choice of the **most effective PSP mode**. We have provided a draft terms of reference for a supplementary project to help the states establish a PFI Unit as an appendix in Volume 1.

More details about how such an organization can be developed, its role, authorities and linkages to the line departments, the PFI Unit and other affected organizations is outlined and discussed in more detail in Chapter 4 and 5 of Volume 1.

2. Provide a Solid Enabling Environment to Support PSP Activity

The enabling environment in the states is functional, but it can be improved. Providing a clear indication of state intention either through a well crafted policy document or through legislation is to be promoted. We have prepared both example policy statements for the four key infrastructure sectors as well as an example infrastructure law in Volume 3. We also include in volume 3, specific clauses related to PSP activity in the roads sector, ports sector, bidding process and dispute settlement. We believe taken together these policy and legal instruments allow a state to create a private sector friendly approach to PSP in infrastructure development.

We have **not recommended new regulatory bodies** other than for network structures like water and sanitation. Rather we have argued for clarity and specificity in the **concession agreements** with effective **compliance monitoring** through the responsible line department. The line departments have this responsibility. We have recommended training for those departments in contract monitoring and compliance assessment. We have included example concession agreements in Volume 4 based on earlier Indian

examples. These can be used as a starting point for project specific agreements and as supplements to the example templates available through the IFC and World Bank websites.

3. Develop Projects for PSP Using a Tried and Tested Methodology

The project development cycle is not being followed effectively in many cases. We have outlined a standard five step project development process that builds on the international approach. We have seen cases where projects that are not ever likely to be financially viable, remain on the books of the state in hopes of some day finding a sponsor. We have seen cases of excessive delay in development of the projects. Each of these deficiencies is a failure in the PSP project development process. In Chapter 4, we have outlined a clear approach using a **Rapid Assessment Methodology** which will indicate early whether a project is worth further effort or if it is not. We have outlined the responsibilities of the various agencies involved in developing the projects and how they interact in Chapter 5.

4. Provide Development Funding Sufficient to Prove the Merits of Worthy Projects

A clear deficiency is **project development funding**. While "gap" funding is available from various sources to bridge the gap between private sector funding available and the total project cost, it is often difficult to reach the point where gap funding can influence the project closure. State nodal agencies or line departments do not, in many cases, have the funds needed to carry out the required screening, analysis of project viability, environmental and social assessment and securing the necessary clearances, approvals and permits to allow a project to move to developer selection. We found that once a project is ready for PSP and bidding, that the process followed by most states follows international standards. The problem is that in many cases the money is not available to proceed to that point. We have recommended the establishment of a rolling fund to support project development costs for states to allow them to take the key target projects to a point where they can be offered with some confidence to the private sector. For successful PSP projects, the development cost can be recovered from the successful bidder. A terms of reference for the establishment of such a fund is included as an appendix to Volume 1.

5. Offer a Single Window Agency Approach to Approvals to Serve the Developer

India is renowned world wide for the quality and structure of its Civil Service. However, as with many other countries the steps needed for clearance, approvals, permits, and agreements are many and detailed for any private sector investor. While many of the clearances that are the Governments responsibility should be handled prior to the involvement of the private sector, for the unsolicited bids or even for competitive bids, a significant body of approvals will remain the responsibility of the developer. We recommend strongly the creation of a **single window clearance process** to assist the developer. We lay out the recommended outline of how that process can work by involving the key line departments, the nodal agencies and the developer into a team to move smoothly through the approvals and clearance requirements. The coordination of the single window clearance process we see as a natural role for the nodal agency.

6. Provide Corporate Memory and Capacity Through Systems and Training

A generic problem is turnover of key staff. All agencies with whom we have worked in this project have had key senior staff transferred or otherwise lost during the first year and a half of this project. The loss of continuity to the private sector partner is of significant import. Commitments made verbally may be lost. Working relationships and trust will be lost. Knowledge of systems and procedures will often be lost. This is not a problem that can be overcome within the confines of this project. It is a more comprehensive issue for the governments as a whole. However, some steps particular to this PSP area are possible. First is the establishment as noted above, of a clear system for processing and developing PSP initiatives. The more structured the process can become, the easier it is for new people to pick up the threads of a project dropped by the departing officials. Second, we recommend training modules, seminars, use of consultants who maintain longer term knowledge of the projects and availability of documents like this report for general review by incoming officials to help overcome the staff turnover deficit. In the action plan in chapter 8 of Volume 1 we recommend a number of specific training and capacity building activities.

7. Capacity Building within Indian Industry

Development of PSP is still in its early days in India. Other countries have had a longer time to develop both institutional capacity within government as well as industry capacity. For many of the sectors, the private sector does not yet have enough PSP experienced to move aggressively into infrastructure development.

Such experience needs time to develop. The road sector is the best example of this. At both the national level and the state level, smaller scale projects using either the Annuity Based BOT or the Capital Support BOT have been applied. Projects include tolled bridges, two lane widening and more recently, significant new construction. But the process has allowed the industry to develop along with the institutional capacity in the governments. While the ports sector and the roads sector now have a reasonable body of capable domestic companies able to take on expanded roles in PSP, the other sectors such as urban transit and water and sewerage lag behind and will require a stepwise approach which builds initially on operation and maintenance contracts as a way of allowing the industry time to become familiar with PSP activity.

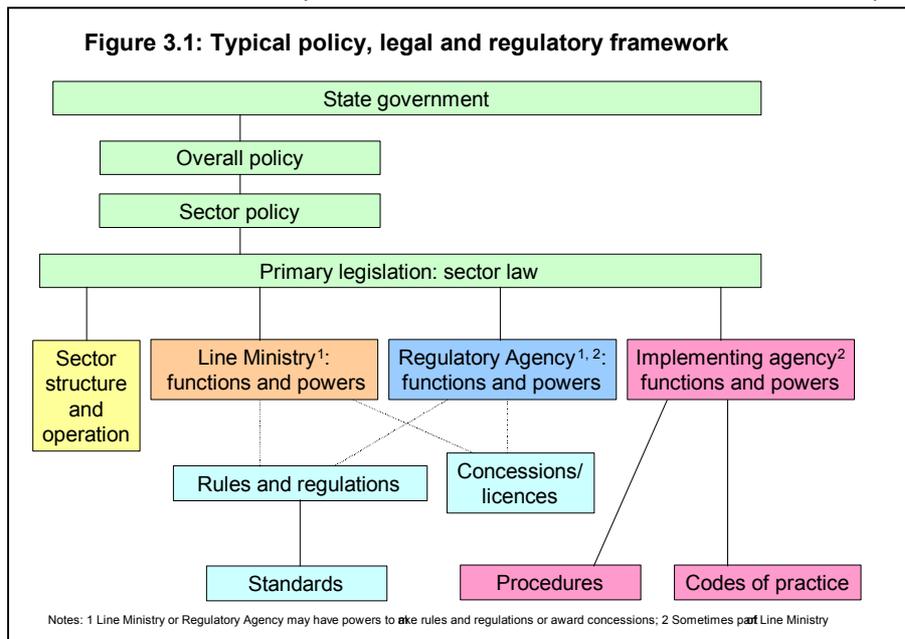
We believe that taken together, the above steps can significantly improve the quality and the throughput of PSP activity in the Four States. We also believe that the above steps can be used as a guide for other states who have less developed PSP programs than do the four target states.

In what follows of this Executive Summary we fill out more extensively the above points following the basis structure of the main report volume.

E.3 The Enabling Environment

E.3.1 What is the Regulatory Framework?

While the regulatory/enabling environment in all states is not the key impediment to increased private sector investment, it remains a key area of focus. While we recommend additions to policy, legislation and regulation



for some sectors, the current status of these instruments combined with the flexibility of normal contract law exercised through the concession agreements provides sufficient flexibility and support to the private sector to allow most normal investment. This is born out by the fact that investment has occurred in all states in most of the key infrastructure areas. Further work in these regulatory/enabling environment areas will assist in creating an atmosphere of practical support for private investors and any

improvements will increase confidence in the seriousness of the respective governments, but of themselves, these changes will not significantly increase the level of bankable projects presented to the private sector. They will simply improve the atmosphere and make the marketing of investment for each of the states more credible.

The GOI has taken some initiative in this regard recently. For example, it has enacted the Electricity Act and it is in the process of developing a Gas Act with similar scope. However, a systematic effort is needed to cover all sectors that have been opened up to private participation. This might be achieved sector by sector or on a multi-sector basis. Since this review is focused on what States can do to support increased private investment, the changes recommended to the regulatory/enabling environment are directed to the state level. Where possible we have tried to keep those changes within the framework of existing or planned legislation or regulations.

Without the appropriate policies and laws needed to reassure the private sector of the Government's commitment to PSP, uncertainty over how private investment will be treated will certainly diminish investors' interest in so investing. The regulatory framework is normally the cornerstone upon which all other parts of the investment scenario stand.

We must take into consideration the various individual elements (Figure 3.1) that together define this regulatory framework, albeit none of them will have the same importance in all the infrastructure sectors under review or in all the four Project States.

E.3.2 Policy Framework

Policy refers to the general principles by which a government, or a government body, is guided in its management of public affairs. Policy, or parts of it, can be made public in the form of a written statement.

Policy, in the context of this TA programme, includes both the overall policy regarding PSP in infrastructure (such as the State Infrastructure Policy, December 2000 issued by the Government of Andhra Pradesh) and sector specific policy (such as the Karnataka 'Policy on Road Development', 1998).

We have specifically provided draft policy statements for the four key sectors, namely, roads, ports, urban mass transit and water and sewerage in volume 3. While these policy statements reflect the conditions prevailing in one or other of the states, they are meant to reflect the structure and intent of a typical policy statement in each of the key areas.

E.3.3 Legislative Framework

The Constitution of India divides legislative power over various subjects, including infrastructure sectors, between the Central Government and the States, with moreover the creation of areas of concurrent jurisdiction. Thus, the Central Government has power to legislate over airports and UMT by railway, the State Governments over state roads and water supply and sewerage, and both Governments have concurrent power to legislate over power, minor ports, and SEZs (but central legislation takes precedence in the event of conflict).

The (primary) legislation in respect of an infrastructure sector often includes provisions for intended sector structure, operation, and ownership as also the functions, powers and duties of relevant ministries, regulatory agencies and implementing agencies. Of particular importance are the powers to award (and revoke) concessions or licenses and to provide subsidiary legislation.

While policy is important to allow the Government of the particular State to lay out specifically, its intention and direction for a specific area, to the investor it is preferable to have that intention and direction formalized in a law. This removes the easy whimsicality of policy change across governments and requires a more careful assessment of the policy/law if change is contemplated and ultimately enacted.

We have provided in Volume 3 a draft (generic) law for guiding private sector investment in infrastructure which is based on the existing laws in Gujarat and Andhra Pradesh. While it is based on the existing laws, we have taken what we believe are the best parts of each, added supplemental material and provided a more comprehensive dispute settlement provision. The draft can therefore act as a starting point for PSP legislation in any state.

E.3.4 Regulatory Framework

Structure

All states have laws, legislation and regulations in place for various sectors, albeit not all. Regulators have been established for the telecom (TRAI) and the electricity (CEA) sectors at the GOI level and these have been successful in enhancing scrutiny of public service providers. In other sectors, including airports, national and state roads urban mass transport, water/sanitation and ports (save for tariff setting), agencies that manage the industry often have a major role as service providers which are in a position to compete with the private sector by virtue of their dual role. It is therefore important in all states to keep the responsibility for policy, operations and regulation separate. While regulation is certainly important, we have tended to err on the side of less rather than more. An independent regulator should be the exception, not the rule. If at all possible, it is our position that regulation through the concession or contract process is often preferable to setting up and staffing of an independent regulatory body. **In the main report therefore, we recommend regulation at the minimum level necessary to protect the investors and the public.**

For specific projects, the regulatory framework comprises:

- the contractual agreements between the government and the developer; and

- regulatory bodies to which the developer's activities are subject.

The contractual arrangements are specific to the project, while the regulatory bodies typically cover all operators that fall under their remit. Such regulatory bodies may be those responsible for monitoring general laws and regulations (eg health and safety), or those specially established for the economic regulation of the sector (eg the State Electricity Regulatory Commissions). This report addresses two essential questions about this generic regulatory framework for the four priority sectors under this TA programme (ie the road, minor ports, UMT and water supply and sewerage sectors):

- what should be included in the contractual arrangements; and
- whether there is a need for a special independent regulator.

Concession agreements

To address the first question, we have considered what should be included in a concession agreement in each of the four sectors, and have prepared example concession agreements in Volume 4. While the toolkits noted above provide a very broad guide to setting up generic concessions, we have relied on existing concession agreements specific to India as our starting template for the example agreements in Volume 4. By and large, these example agreements are consistent with what is being done elsewhere in the world. In preparing the draft concession agreements in Volume 4, we have therefore focused our attention on those areas where we believe improvements can be helpful in limiting disagreements in the future, and areas where improved wording can enhance compliance with concerns over the environment and resettlement.

All concessions are regulated through the contractual arrangements, and we recommend that new independent regulators should only be established if there are special reasons. Well-drafted concession agreements provide a clear and explicit regulatory framework for both parties, while independent regulatory bodies introduce a degree of subjectivity and uncertainty. The incorporation of detailed and specific rules in concession agreements reduces the need for regulatory discretion, and concession agreements can deal with most of the issues that are party specific.

While many aspects of a concession are transaction or sector specific, several key principles related to the award, design and monitoring of concessions are substantially identical across sectors. There is thus a set of core issues or topics that must be dealt with in most concession agreements. These include:

- Allocation of Risks between the Parties
- Price Setting
- Price Adjustment
- Allocation of Responsibilities between the Parties
- Specific Performance Targets
- Penalties and Bonuses
- Performance Guarantee, Insurance and other Security Rights of Public Authority
- Duration, Termination and Compensation
- Force Majeure and other Unforeseen Changes
- Dispute Resolution

That said, it is important to note that there is no standard concession agreement. Since these are contracts between two parties, they necessarily must be negotiated clause by clause. The resulting agreement is always unique to the particular situation faced by the specifics of the project. For instance, responsibility for policing, for revenue collection, for unrelated use of land attached to the concession and so on are all areas where special conditions or special agreements are likely. Model/example concession agreements are therefore used by the participants as checklists to ensure that all the issues have been addressed during the negotiation to the satisfaction of the parties.

The effectiveness of the regulatory framework provided by a concession agreement is firstly dependent on the **quality of the agreement**, and secondly on the **monitoring of the agreement**. For example, the pricing rules must be applied, the concessionaire's behaviour must be monitored to ensure compliance with pricing,

quality and other obligations, and decisions must be made on the application of sanctions for non-compliance. We recommend in Chapters 4 and 5 of Volume 1, the creation of a dedicated unit within the relevant line department to ensure proper supervision of concessions and to conduct any residual public sector functions. This would facilitate the development of expertise and may contribute to the development of professional norms that could strengthen resistance to ministerial direction. In this connection, it might in some instances be necessary to engage the services of highly qualified professionals as outside consultants.

Special independent regulators

We have recommended that **an independent regulator should be established for the water and sewerage sector**. We have recommended that the other priority sectors should be regulated by concession without the establishment of a special regulator, although we acknowledge that circumstances could arise in which a public passenger transport regulator may be justified to regulate UMT and other forms of urban transport.

Objectives

The objectives, which we consider should guide the choice of scope and form of regulation, are:

- ❑ Efficiency²;
- ❑ Equity;
- ❑ Practicality;
- ❑ Transparency.
- ❑ Accountability;
- ❑ Reduction of regulatory risk.

These objectives are discussed in more detail in Chapter 3 of Volume 1.

Single or multi-sector

The effectiveness of regulatory agencies is largely determined by the factors already mentioned, but there are some differences between single and multi-sectoral agencies. Broadly, the advantages of the sector-specific regulatory agencies approach are that it:

- ❑ Provides more industry focus and specialisation.
- ❑ Lessens concentration of regulatory power.
- ❑ May be more conducive to innovation.
- ❑ Allows comparison amongst regulators and hence pressure to improve regulatory performance. However, taken to extreme, this may lead to populist approaches such as seeking to regulate user charges down leading to unrealistic rates of return.

In contrast, the advantages of the multi-sector regulatory agencies approach are that it:

- ❑ Facilitates learning across sectors. This is important for new agencies.
- ❑ Reduces the risk of capture by the industry.
- ❑ Reduces the risk of political interference, as a multi-sector agency is likely to be more distant from individual line ministries than is a single sector agency.
- ❑ Facilitates consistent approaches to regulation across sectors.
- ❑ Allows resource savings. This is important not only in terms of financial resources but also in terms of human resources as regulatory skills are in short supply and take time to develop.

² Output performance measures are indicators of what the public experiences and cares about (e.g. in the water sector, drinking water quality, quality of effluent discharges to the environment and the like); input performance measures are simply any other indicators which, if met, may (or may not) help achieve the desired output performance (e.g. type and quantity of raw water or sewage treatment and extent of filtration used).

We lean towards multi-sector regulatory agencies, because, at this early stage in the development of independent regulators in India, we place greater weight on the need to reduce potential political interference, to make best use of scarce regulatory resources and to behave consistently, than on the need for regulatory focus or concerns about excessive regulatory concentration. However, we do not have strong views and would not rule out sector-specific regulatory agencies either, immediately, or at a later stage when justified by the regulatory workload.

E.3.5 Sector Recommendations

While the project initially covered eight sectors, in consultation with the States and the ADB project staff, the scope of cover was tightened to focus more heavily on those sectors most likely to be developed in the States, notably, roads, ports, water and sewerage and urban mass transit. In the main text, the other sectors are covered, but in less detail.

Roads

The road sector is reasonably well served in India with extensive use of concessioning at both the Central Government and State Government level. The concession agreements used for investments in the road sector are well established and cover a variety of types of private sector investment. Some of the agreements are now quite mature and in some cases the concession period is reaching its final stages. While more consistent treatment of commercial issues in the draft Acts currently under development in the Project States would be attractive to the private developers, it has not overly impeded investment to date. In fact, the road sector is one of the bright areas for PSP in India and is likely to be one of the key areas for expansion of investment in the future. The following are some observations and conclusions regarding the existing road policy, legislation and regulatory framework in the four Project States:

- ❑ The road **policies** of all the Project States, except Madhya Pradesh, should be updated to ensure the provision of a high quality, well maintained, safe and efficient road network and to facilitate the upgrading of the road infrastructure by introducing tolls or direct user charges where possible. The revised roads policy developed for Karnataka can be used as a template for updating the roads policies in the other Project States.
- ❑ All the Project States, except Karnataka, should adopt general highway **legislation**, based on the guidelines issued by the GOI for a Model State Highway Act. Such legislation should most definitively incorporate the provisions with regard to tolls and PSP, as discussed earlier in connection with the draft highway legislation for Gujarat and Madhya Pradesh. For Karnataka, "terms and conditions" under subsection (2) of section 19-A of the Act should be prescribed and detailed implementing rules be framed regarding the types of participation permitted, the incentives that may be offered, and the types of State Support that may be provided.
- ❑ Andhra Pradesh and Gujarat should create a road fund for road development and road maintenance, as already proposed in Karnataka and currently under consideration in Madhya Pradesh.
- ❑ A comprehensive **concession contract** should be the primary regulatory instrument. In this regard, the draft concession agreement provided as part of this TA programme may be considered for adoption by the Project States. A special unit, potentially within the State transport department could be created to ensure proper supervision of concessions and other contracts with the private sector.
- ❑ The road sector in India has been innovative in its use of annuity based BOT structures. The annuity BOT together with the capital support BOT are the two most common styles of PSP in the sector. A recent review by the ADB has recommended further development of the annuity BOT model to include toll collection and retention by the operator as a contract enhancement and transfer of risk to the private sector. We agree with this suggestion and we recommend that the States review this option as a means of enhancing PSP in state road development.
- ❑ Creation of an independent **regulatory body**, for the sole purpose of regulating toll roads and the private party operating them, is not justified at present, as tolls are specifically fixed in the concession agreements and there very few road concessions to supervise in any of the four Project States.³

³ As far as we are aware, Karnataka is the only Project State considering the establishment of a separate road regulatory institution, though Madhya Pradesh is considering establishment of a State Highway Authority. Some suggest that the Karnataka State Highways Authority (KSHA) could be strengthened and could function as regulatory institution, until a critical mass of road concessions have been granted when a separate regulatory institution could be created. We understand that the

To summarise, we note that the road sector is reasonably well served in India with extensive use of concessioning at both the Central Government and State Government level. The concession agreements used for investments in the road sector are well established and cover a variety of types of private sector investment. Some of the agreements are now quite mature and in some cases the concession period is reaching its final stages. While more consistent treatment of commercial issues in the draft Acts currently under development in the Project States would be attractive to the private developers, it has not overly impeded investment to date. In fact, the road sector is one of the bright areas for PSP in India and is likely to be one of the key areas for expansion of investment in the future.

Ports

The following are some observations and conclusions regarding the existing port policy, legislation and regulatory framework in the three maritime Project States:

- ❑ Several states have taken initiatives to improve port capacity and performance. However, the strategy to achieve the policy objective has not been thought through and progress so far has been halting and ad hoc. There is no concerted move to speed up the privatisation of all port services. Adequate attention has not also been paid to strengthen the support infrastructure such as land and rail connections and to streamline administrative and customs procedures. The way forward is for the states to develop an integrated approach for the commercialisation and privatisation of port services. One possibility could be to give the implementing agency, such as the maritime board or the ports department, a program approval for implementing the entire master plan, rather than the current approach of project-by-project approval for private participation by the State Government, reducing thereby bureaucratic delays in PSP approvals.
- ❑ The port **policies** of all three maritime Project States should be updated in a permissive manner to allow all forms of PSP.
- ❑ Any specific ports **legislation** being considered for Andhra Pradesh and Karnataka should delineate clearly the functions, powers and duties of policy, regulatory and implementing institutions, as well as set out, in detail, basic guidelines for PSP in port management or operations.
- ❑ Of the three States, only Gujarat has comprehensive **regulation** with regard to PSP in the port sector. Gujarat is now proposing to separate the service delivery and development functions from the regulatory functions through the creation of two separate Authorities. However, the draft Acts prepared by the State would have to be suitably amended, before such separation of functions can be achieved.
- ❑ However, in general we believe that the **concession agreement** can form the primary regulatory instrument for ports. No economic regulation normally need be contemplated. Instead, each port should be free to fix its port dues and charges, within the framework of the draft scheme for regulating minor port fees and tariffs suggested in Chapter 3.
- ❑ A State-wide Maritime Board with a dedicated PSP unit could be established to monitor the concession (based on receipt of audited performance reports provided by the concessionaire) and to conduct any residual public sector functions.

Urban Mass Transit

The following are some observations and conclusions regarding the policy, legislation and overall regulatory framework for the UMT sector in the three Project States that have plans for UMT:

None of the Project States have UMT **policies**, though a Draft National Urban Transport Policy has been proposed to guide future action in the urban transport sector at both the national and state level. It is recommended that policy directions expressed in the draft UMT Policy, prepared as a template for application in the Project States, be implemented by the State, directly or through its institutions.

- ❑ There is need for enactment of comprehensive legislation, which includes provisions to deal with PSP in UMT. Accordingly it is recommended that state UMT law be enacted [by end 2005] and rules regarding price and quality of service developed thereunder [by end 2007], and further that State Governments work with the GOI to promote development of a national UMT law.
- ❑ We note that UMT is best regulated by concession and does not itself warrant establishment of a regulator, unless sufficient PSP has been achieved to provide an appropriate workload. In this regard, the draft concession agreement provided as part of this TA programme may be considered for adoption by the relevant States [by end 2004].

KSHA is chaired by the additional chief secretary and, being separate from the KPWD, might provide some comfort to concessionaires in dispute with the KPWD.

- Independent Municipal Transport Authorities (IMTA) could be established for the major urban areas when justified by the level of PSP, which is unlikely before significant PSP in urban buses. We understand that Andhra Pradesh is considering separating the PPT services in Hyderabad and placing them under a Hyderabad Transport Authority (this would include the buses operated by APSRTC, the MMTS and the Metro (if and when constructed)), and establishing a Hyderabad PPT Regulator to deal with tariffs, route planning, integration, service frequency and the like.

Water and Sewerage

Privatisation of water has been attempted in several States in India, but it has proven difficult to set tariffs that meet costs and to avoid wastage of water. This is clearly an area of keen interest to the States as evidenced by the number of initiatives underway. The regulatory/enabling environment does not exist in water supply and sewerage sector to ensure that the cost of investment can be recouped through user charges, nor is there the political will to ensure that such cost-based tariff structures are implemented. India, however, is not alone in this situation. Other jurisdictions have experienced the same limitations with much the same result. The problems of balancing costs and charges, and of efficient management and leakage, indicate that PSP in the near future is likely to be mainly in the form of operation and maintenance contracts. The following are some observations and conclusions regarding the existing water and sewerage policy, legislation and regulatory framework in the four Project States:

- As part of this TA programme, we have prepared a draft consolidated water supply and sanitation policy for Karnataka (Volume 3), which brings together the various policies for the sector and seeks to address their gaps.⁴ This draft policy may be applied in the other Project States with appropriate modifications. The key objective of this draft policy is to ensure provision of quality water and sanitation services to people that want them and are willing to pay for them and to ensure provision of basic water and sanitation services to all. As none of the project states has such a well-developed water supply and sewerage policy, we believe the above policy for Karnataka can be adopted by the other project states *mutatis mutandis*. Changes will be necessary for all the other project states to reflect the differences in their water supply and sewerage implementing institutions and their plans for regulatory institutions.
- Water supply, sewerage and solid waste management are subjects, which are to be local responsibilities based on State legislation under the 74th Amendment to the Constitution adopted in 1992. Even before the passage of that Amendment, the States had generally enacted legislation that gave authority over water supply and sewerage to municipal corporations under the relevant Municipal Corporation Act. Later, special water and sewerage boards were established at the State level to carry out those functions, while solid waste management remained with the municipal corporations. In addition, each State has a State Pollution Control Board established under the national Water (Prevention and Control of Pollution) Act, 1974, which now has been given similar authority over air pollution. Environmental Assessment aspects remain state-level responsibilities and are well defined in SPCB documentation.
- Given the above, we suggest that a state water law be enacted that includes:
 - Priorities and policy concerning multiple uses of water (potable, industrial, irrigation, electricity generation, navigation etc)
 - Functions, powers and duties of policy, regulatory and implementing institutions.
 - Co-ordination amongst policy and regulatory institutions.
 - Rights of policy, regulatory and implementing institutions.
 - Rules concerning economic regulation, including charges for water and waste water services.
 - Rules concerning quality of service regulation, including reference to standards.
 - Rules for construction, operation and maintenance of the water system, and specific rules for PSP in each such aspect.
 - Rules for monitoring and enforcing economic and quality of service regulation, including penalties for failure to comply.

⁴ The draft policy takes into account the GOI's National Water Policy, 2002, the Government of Karnataka (GOK) Karnataka Ground Water (Regulation for protection of sources of drinking water) Bill, 1999, the GOK State Water Policy, 2002, the Second Karnataka Rural Water Supply and Sanitation Project (Jal Nirmal Project), the GOK Urban Drinking Water and Sanitation Policy, 2003, and the iDeCK Strategy and Implementation Plan for Urban Drinking Water and Sanitation Sector, draft Report, September 2003. The full text of this policy can be downloaded from the project web page.

- We suggest that the water law be as comprehensive as possible to provide greatest comfort to a potential private investor.

Of the four states, only Gujarat has made significant progress on independent water sector regulation⁵. Consultants to the GIDB have prepared a draft regulatory structure for the urban water sector.

Given the potential for monopoly abuse and the need for public health and environmental controls, we consider that regulation is necessary across all services in the water and sewage supply chain:

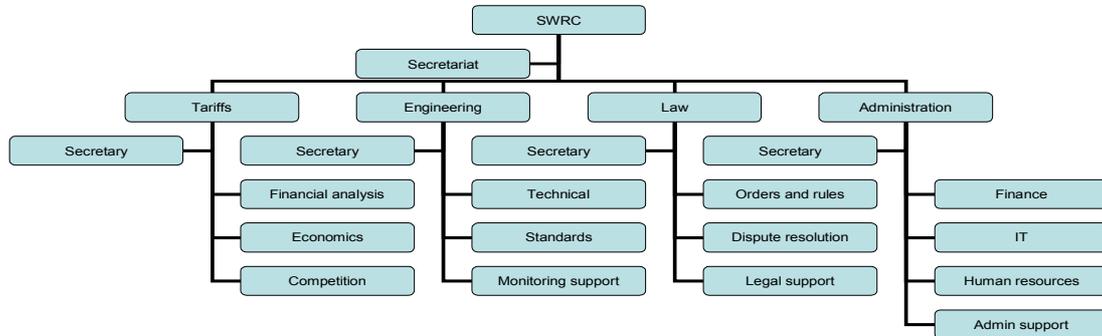
- To control access to the sector (through the competitive award of concessions) to ensure only appropriate qualified reputable firms can provide service.
- To control the price and quality of service:
 - (i) Economic regulation will be required for both water and waste water services for all customer classes.
 - (ii) Technical regulation will be required for setting and enforcing quality standards concerning coverage, water pressure and related matters.
 - (iii) Standards for raw water quality and for waste water discharges are well established in every state and are administered and enforced by the SPCBs, ideally with participation from river basin representatives to help with enforcement.
 - (iv) Public health regulation will be required for setting and enforcing quality standards for drinking water.
 - (v) Customer service regulation will be required for both water and waste water services and for all customer classes.

We suggest that a comprehensive concession contract be the primary regulatory instrument. As part of the output of this TA programme, therefore, we have prepared a draft concession agreement for the sector, outlined in Volume 4.

In Figure 3..2 we set out a suggested high level organisation structure for a **state water supply and sewerage regulatory commission** (SWSSRC) modelled on the AP Electricity Regulatory Commission. It includes:

- The Regulatory Commission comprising a Chairman and two members.
- Secretariat reporting to the Commission and responsible for convening meetings of the Commission and the Advisory Committee, maintaining records, co-ordinating with directorates to provide necessary information for the meetings of the Commission and following-up on customer complaints.
- Four Directorates reporting to the Commission:
 - (i) **Tariffs.** Responsible for economic regulation including setting and monitoring tariffs and promoting competition.
 - (ii) **Engineering.** Responsible for technical regulation including technical licensing and setting and enforcing standards.
 - (iii) **Legal.** Responsible for all legal matters including drafting of orders and rules, dispute resolution and imposition of penalties.
 - (iv) **Administration.** Responsible for monitoring and ensuring timely progress on all important decisions of the Commission and providing financial, IT, human resources and administrative support

Figure 3.2: High-level organisation of State Water Supply and Sewerage Regulator



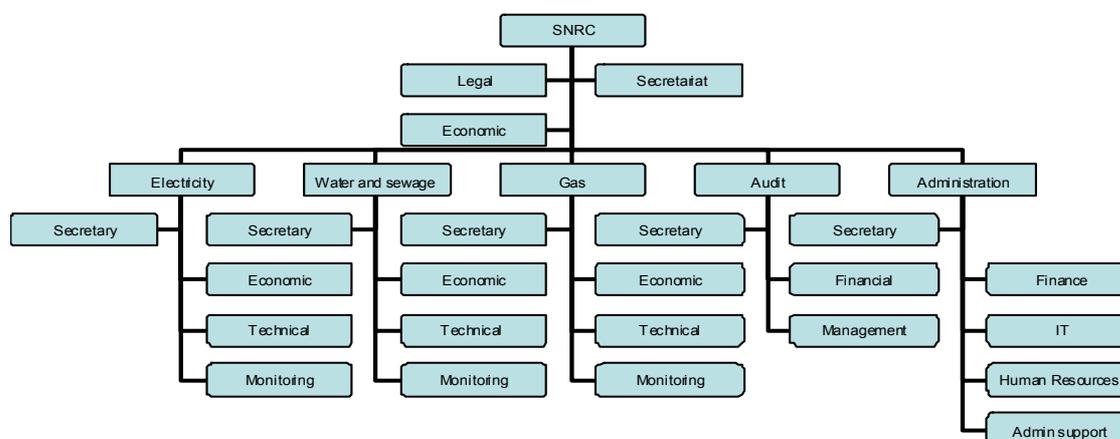
As an alternative, in Figure 3.3, we set out a suggested high level organisation structure for a **state network regulatory commission** (SNRC) incorporating electricity, water supply and sewerage and gas modelled loosely on the New Jersey Board of Public Utilities (NJBPU). It includes:

- ❑ The Regulatory Commission comprising a Chairman and two members.
- ❑ Three Offices reporting to the Commission:
 - (i) **Legal.** Responsible for all legal matters including drafting of orders and rules, dispute resolution and imposition of penalties.
 - (ii) **Economic.** Responsible for advising on policy and analysing and recommending on general economic and competition issues, including user charges (in close co-ordination with the relevant directorate).
 - (iii) **Secretariat.** Responsible for convening meetings of the Commission and the Advisory Committee, maintaining records, co-ordinating with directorates to provide necessary information for the meetings of the Commission and following-up on customer complaints.
- ❑ Five Directorates reporting to the Commission:
 - (i) **Electricity.** Responsible for economic regulation including setting and monitoring tariffs and promoting competition and technical regulation including technical licensing and setting and enforcing standards.
 - (ii) **Water supply and sewerage.** Responsible for economic regulation including setting and monitoring tariffs and promoting competition and technical regulation including technical licensing and setting and enforcing standards
 - (iii) **Gas.** Responsible for economic regulation including setting and monitoring tariffs and promoting competition and technical regulation including technical licensing and setting and enforcing standards
 - (iv) **Audit.** Responsible for financial and economic efficiency auditing of the regulated utilities.
 - (v) **Administration.** Responsible for monitoring and ensuring timely progress on all important decisions of the Commission and providing financial, IT, human resources and administrative support

Again it does not include a directorate for customer service unlike the NJBPU.

A SNRC can be formed by enhancement of the SERC with consolidation of the existing tariffs and engineering directorates to form the power directorate and addition of extra directorates as water supply and sewerage and gas become subject to its regulatory control.

Figure 3.3: High -level organisation of State Network Regulator



E.4 Fast Tracking the PSP Process

In most PSP there is the need for government financial support to compensate for insufficient returns and risks to private capital to achieve financial closure. In spite of low, inaccurate, or unknown financial internal rates of return (FIRRs), state governments have continued to “market” or “keep alive” a shelf of investment projects in the hopes that private investment would appear. In several cases, state governments entered into a Memorandum of Understanding or other tentative agreements with developers without determining the FIRR and whether the project was bankable. As some of our case studies show, some projects were successful in attracting private investment, but financial closure for these projects did not occur without substantial direct government financial support in the form of loan guarantees, equity contributions, or other government funding. We conclude that more effort is required in the early phases of the Project Cycle to assess project bankability and the extent of government financial support required for financial closure and to select the appropriate mode of PSP, in order to avoid wasting scarce government capital and human resources on projects that will eventually wither away. This is in accordance with best international practice for PSP projects, and is followed in countries such as the UK, Ireland, Australia, and South Africa.

The process for PSP project development can be divided into five stages which together we refer to as the Project Cycle. The stages are:

- ❑ Project identification: the generation of initial project ideas and an initial shelf of projects.
- ❑ Evaluation of PSP mode: project screening leading to a decision on whether the project is suitable for PSP, and, if it is, the appropriate PSP mode. An important factor that is considered at this stage is the amount of government financial support that is likely to be required in order to ensure the commercial viability of the project and whether the government can afford this support.
- ❑ Project Preparation: more detailed engineering and cost data that are input into a comprehensive financial feasibility analysis and preparation of bidding documents. The extent of the engineering and details of the cost estimates will depend on the particular PSP tendering process selected for the project.
- ❑ Private developer selection: qualifying bidders, determination of award criteria, bidding process, evaluation and selection, negotiating with first placed tenderer, finalisation of project documents and contracts.
- ❑ Project Implementation: final clearances/approvals and financial closure, followed by implementation of the project.

E.4.1 Selecting the Appropriate PSP Option using a Rapid Assessment Methodology

The second stage in the project cycle – the Evaluation of PSP Mode – is what is missing. We suggest a “Rapid Assessment” approach for this stage, which is the initial evaluation of PSP projects and conceptual level of

technical inputs. It should be conducted at the second stage in the Project Cycle, namely the Evaluation of PSP Mode.

The purpose of the Rapid Assessment is to select the appropriate PSP option for a project, and to ascertain an “order of magnitude” estimate of state government financial support required, if any. It is done prior to final engineering design and a detailed financial feasibility analysis. The Rapid Assessment relies on conceptual, but adequate, project cost and revenue data to make reliable judgments about a project’s economic and financial viability. Pre-feasibility studies should be undertaken in sufficient detail to allow for a reasonable preliminary estimate to be made of the project’s economic and financial returns. The level of engineering should be sufficiently detailed (up to around 25-40%), to capture potential design elements that can significantly increase costs and radically affect the economic and financial returns. The exact level of “conceptual” and “preliminary” engineering design will depend on the nature of the project, and ultimately is a matter of judgement.

Based on best international practice for PSP initiatives, we recommend that the following criteria are used to select PSP projects and evaluate the appropriate PSP Mode:

- ❑ Impact on the budget;
- ❑ Value for money – to ensure that the state receives the highest return for its financial support;
- ❑ Risk allocation – to ensure the appropriate level of risk transfer to the private sector.

The criteria should be applied as follows:

- ❑ Impact on the budget to the State Government involves the calculation of the FIRR and the extent of government financial support, including equity contributions and their equivalent (such as land transfers), loans, loan guarantees and other contingent financial liabilities; tax incentives; indirect costs (such as improvements to roads, water supply or other related infrastructure), etc.;
- ❑ Value for money is essentially concerned with comparing the full whole life costs of provision through a PSP project with provision by the public sector, taking full account of the transfer of risks to the private sector and other relevant factors. Sophisticated ways of making such calculations have been developed (eg in the UK), but we recommend that the assessment should initially be kept as simple as possible in the States;
- ❑ Risk allocation between the public and private sectors, covering technical, design, completion, operational, regulatory, legal, project revenue, planning approvals, and other risks. This analysis forms part of the value for money assessment.

The range of potential PSP modes is wide, and is illustrated in table 4.1 for each of the four sectors: roads, ports, UMT and water.

Table 4.1: Range of PSP / PPP Options Appropriate for India in 2004

PSP/PPP Option	Asset Ownership	Operation and Maintenance	Capital Investment	Commercial Risk	Duration	Roads	Ports	UMT	Water and Sanitation
O&M Service	Public	Shared	Public	Public	1-2 Yrs	Green	Green	Green	Green
Management Contract	Public	Private	Public	Public	3-5 Yrs	Green	Green	Green	Green
Lease	Public	Private	Public	Private	8-15 Yrs	Green	Green	Red	Red
Annuity Based BOT	Public	Private	Shared	Public	20 Yrs	Green	Green	Green	Green
SPV or Joint Venture	Public	Private	Shared	Shared	20 – 25 Yrs	Green	Green	Green	Green
Concession	Public	Private	Private	Private	20 – 30 Yrs	Green	Green	Red	Red
Capital Support BOT	Public	Private	Shared	Private	20 – 30 Yrs	Green	Green	Red	Red
BOT/BOOT	Shared	Private	Private	Private	20 – 30 Yrs	Green	Green	Red	Red
Divestiture	Private	Private	Private	Private	Indefinite	Red	Green	Red	Red

The following points highlight the form of PSP mode that is likely to be the most appropriate in the four sectors.

Roads

- ❑ District roads / Low volume – O&M only;
- ❑ Major District/State Highways – Annuity BOT or Capital Support BOT;
- ❑ High Volume State Highways / National Highways – Lease/Concession/SPV/BOT.

Ports

- ❑ Multi-use Minor Ports – O&M/Management Contract or Lease of Existing Terminals;
- ❑ High Volume Minor Ports – Terminal Lease/SPV/Concession;
- ❑ High Volume Single Use – Lease/Concession/BOT/Disinvestment.

UMT

- ❑ O&M, Management Contracts;
- ❑ SPV/Joint Ventures and Annuity Based BOT on Some Lines.

Water and Sewerage

- ❑ O&M, Management Contracts (best option at the moment)
- ❑ SPV/Joint Ventures and Annuity Based BOT for some applications like bulk water
- ❑ Future potential to grow into leasing or concessions but not yet.

E.4.2 The PFI Unit

We recommend the establishment of a PFI Unit, preferably in the Department of Finance, to take responsibility for the Rapid Assessment. The PFI Unit would evaluate the amount of government financial support required, and, in those cases where it is in the Department of Finance, integrate its activities with the annual budget process. It would thereby be in the best position to judge whether the level of government financial support can be afforded, or whether other PSP modes should be investigated to reduce the financial burden on the State. The two main decisions coming out of the Rapid Assessment would be the appropriate PSP mode, together with a realistic estimate of the financial support that will be required to ensure a bankable project. The project would only proceed to the next stage, Project Preparation, if the estimated level of government financial support can be afforded in budgetary terms.

The Unit would be trained in the Rapid Assessment technique, but would not be expected to be responsible for the whole exercise. In particular, the agency responsible for the project (eg a line department) should be responsible for collecting and assembling the information and data required for the Rapid Assessment, using consultants and advisers as necessary. The role of the PFI Unit would be to ensure that the Assessment is made to a consistent standard in all cases, and to help determine the appropriate PSP mode and the level of financial support required from budgetary resources.

State Recommendations for PFI Units

We further suggest that a full review of the options and implications needs to be undertaken prior to the full establishment of a PFI Unit in each State. We have included as Appendix D a draft Terms of Reference for the establishment of a PFI Unit. We believe that the development of such a unit is of significant importance to the Four States and we further believe that a careful and measured development of the unit is justified as outlined in the Appendix D document.

Our specific recommendations for a PFI Unit in each State are as follows:

- ❑ **Andhra Pradesh:** the GoAP considers that any PFI Unit capability should be located in the APIA rather than in the Department of Finance. This option has particular merit if the Infrastructure Projects Fund is established as provided for in the IDEA. In this situation, the APIA should create a PFI type unit to manage the Fund, and the unit could report to the APIA rather than the Department of Finance so long as the Fund has a funding source that **is totally independent of the GOAP budget and will not require a GOAP guarantee.**

- ❑ **Gujarat:** the GoG believe that the analytical capability of any PFI Unit should be in the GIDB rather than the Department of Finance. We accept this arrangement so long as satisfactory arrangements can be made for co-ordination with the Department of Finance so that budgetary issues are taken into account as appropriate. This question can best be addressed during the detailed planning for the establishment of the PFI Unit.
- ❑ **Karnataka:** Organize a PFI Unit under the Secretary of Budget and Resources Division, Department of Finance within the FPAC. Expand the role of the FPAC (or other unit within the Department of Finance, if this is not appropriate), to include Multi-Year Financial Planning, and link the PFI Unit's PSP Project evaluation process into the GOK's annual budget and Multi-Year Financial Planning Process.
- ❑ **Madhya Pradesh:** If there is to be a substantial expansion of PSP activity, the Madhya Pradesh Infrastructure Investment Fund Board (MPIIFB) might be expanded into a PFI Unit. However, the GOMP would prefer in this situation to establish a separate PFI Unit. We believe that the decision made between an expanded MPIIFB and a separate PFI Unit is not critical as long as the unit is in the Department of Finance.

E.5 Creating a Capable Nodal Agency - Conditions for effective institutions and good governance

We believe that there are three broad conditions that determine the effectiveness of any institutional arrangements for PSP in infrastructure, each of which is discussed below in turn:

- ❑ Sustained political commitment
- ❑ Clear responsibilities during the project cycle
- ❑ Single window agency for clearances.

E.5.1 Sustained political commitment

PSP projects are not easy to implement. Generally, there are many policy decisions to make. Most projects require approvals from multiple line departments and other public sector bodies. The larger projects especially take a long time to bring to fruition. Without sustained political commitment over the full project cycle, projects are likely to fail, whatever institutional framework is in place.

The main lessons for the four States are:

- ❑ The institutional framework should directly engage support at whatever political level is required to resolve problems and remove obstacles in a timely manner. For larger projects, the implication is, in most cases, that the institutions charged with implementing PSP projects should be seen to act with the support, and the ultimate authority, of the Chief Minister.
- ❑ There must be continuity throughout the project cycle. During the course of the relatively short duration of our project, we have experienced numerous changes in staff at the senior level in all States. If the general practice of rotating senior officials every three years or so takes place in the middle of a the project process, it is essential that arrangements are put in place for effective handovers, so that progress on each PSP project can continue in a seamless manner. In some important cases it may be necessary to retain key staff in particular posts for longer than normal, in order to ensure that critical phases of project development and implementation are not compromised. Our experience on this project suggests that the changes in senior staff are not seamless, and that the lack of continuity is a major problem that needs to be addressed.

E.5.2 Clear responsibilities during the project cycle

The second condition for effective institutional arrangements is that, at each stage in the project cycle, clear and transparent arrangements are made as to:

- ❑ The specific organisation that is responsible for taking particular actions or decisions;
- ❑ Who each organisation is accountable to; and
- ❑ Effective arrangements are made for accountability.

It is also important to avoid potential conflict of interest difficulties. Regulatory issues should be separated from policy and operations; and during the project cycle, there should be a division of duties between the party giving

the approval, the one carrying out the negotiations and project analysis, and the party engaged in contract monitoring (even if all these duties are within a single line department).

The institutional frameworks for PSP in infrastructure vary around the world, and there is no single "ideal" framework. Each country has its own existing institutional structure and traditions, and the appropriate framework for PSP has to take account of such factors. What is important is a clear delineation of responsibilities, the separation of responsibilities where appropriate to ensure good governance, and effective arrangements for accountability.

E.5.3 Single window agency for clearances

Our third condition for effective institutional arrangements is that there should be a single window agency for all clearances, approvals and consents required by the selected developer. Delays in approval, circuitous approval processes, and overly complex requirements for approval, result in project delays, and can ultimately cause a project to fail, as well as providing additional opportunities for rent-seeking. Part of the solution to this problem is for the nodal agency responsible for project preparation to obtain some of the clearances during the preparatory phase. However, many clearances will remain to be obtained by the developer.

It is important to clarify that the recommendation for establishment of a single window clearance process does not mean that one body will be giving all approvals. It rather means that one body will act as a coordinating agency for the private developer to assist in ensuring that the approvals are processed and cleared in a timely and open way.

The key principles for a single window agency are:

- ❑ clear responsibilities are assigned for monitoring progress in the clearance process,
- ❑ there is a regular reporting of progress against an agreed timetable, combined with clear lines of accountability; and
- ❑ the reporting goes up to a sufficiently high level to ensure that the necessary actions can be taken to remove unnecessary blockages or bottlenecks.

We also recommend that the Single Window Agency should establish a complaints office to which the developer can bring any allegations of irregularities in the clearance process.

E.5.4 Institutional Recommendations for Each State

Our specific recommendations for each state are summarised below:

Andhra Pradesh

The APIA was established in 2002, but is not being utilised effectively. Since it has wide powers of benefit to the PSP process, we recommend that it should be retained and utilised.

There are a number of useful functions that the APIA could perform in the short term to expand the role of the private sector in developing the State's infrastructure, in particular:

- ❑ The GoAP should request APIA to commission a study by consultants to identify the infrastructure projects that are appropriate for implementation through PSP over the next five years, working closely with line departments and other public bodies. The APIA would organise the study and provide the forum within which a consensus can be built on the way forward.
- ❑ The recommended PFI Unit might be established in the APIA, particularly if an Infrastructure Projects Fund is established, and if that Fund has a funding source that is totally independent of the GOAP budget and does not require a GOAP guarantee.
- ❑ APIA should continue to play a supporting and facilitating role during project preparation, providing specialist expertise where required, or helping to remove bottlenecks in formal meetings of the Authority or in informal meetings.
- ❑ Rules should be issued under IDEA, 2001, setting out the procedures for the bidding process to ensure full transparency and fairness, and providing for the establishment of a committee to manage the bidding

process. The role of the APIA should be to monitor consistency in application of the Rules, and to recommend any improvements.

The number of organisations with lead responsibility for project preparation should be limited as far as practical by using APIIC where appropriate, and building up special units only if there is expected to be a pipeline of PSP projects in a sector.

The provisions in the AP Industrial Single Window Clearance Act, 2002 should be used to provide a Single Window Agency for infrastructure PSP projects, so long as the Act is proving to be successful in achieving timely and effective clearances and approvals in cases where it has been used so far.

The initial professional staffing required in the APIA to fulfil the functions set out above is 3-4 in addition to the CEO. If the PFI Unit were to be in the Department of Finance it may initially only require a staff of one technical expert until the level of PSP activity increases.

Training requirements are set out for the PFI Unit, nodal agencies involved in project development (APIA, line departments etc), contract monitoring units, and to increase general awareness.

Gujarat

The GIDB is a well established body that has devoted considerable time to commissioning studies of potential PSP projects. The real test of GIDB's effectiveness will be whether this work results over the next year or two in an increased flow of PSP projects reaching the implementation stage.

GIDB's draft Rules (on which we have commented separately in Volume 3) should be finalised and issued as soon as possible.

We support the proposals in the draft Rules for the establishment of a Committee (PBAC) to guide the private developer selection process. The Rules on the bidding process should be applied to all PSP projects, not just those above the thresholds for submission to GIDB (see Volume 3, item 2 for how this might be achieved).

The GIDB should play a strong consensus-building role to ensure that the outcome of the Crisil study is wide agreement on the PSP projects that should be pursued.

The GIDB should change its project cycle to include the Evaluation of PSP Mode stage between project identification and project preparation, and should establish a PFI Unit to conduct Rapid Assessments at this stage. Preferably the PFI Unit should be in the Department of Finance, but we accept that it might be in the GIDB (which is understood to be GoG's preference).

The GIDB should perform the single window agency role and should also establish a complaints office.

The PFI Unit might start with a single technical expert trained in the Rapid Assessment methodology until the level of PSP activity justifies more.

Training requirements are set out for the PFI Unit, nodal agencies involved in project development, and contract monitoring units.

Karnataka

The GoK's approach to PSP in infrastructure has been largely reactive, but we have discussed with the GOK some specific proposals for increasing the level of PSP through a more proactive approach. A new infrastructure policy has been under preparation by the GOK, but we have not seen it and our recommendations may therefore be subject to change when the new policy is issued.

A more proactive approach should start with a study by consultants to identify the infrastructure projects that are appropriate for implementation through PSP over the next five years, working closely with line departments and other public bodies. The study should be commissioned at a high government level and might be organised by KIDD.

A PFI Unit should be established in the Department of Finance.

Rules should be issued by the GOK (under the general law on PSP in infrastructure recommended in Chapter 3), setting out the procedures for the bidding process to ensure full transparency and fairness, and providing for the establishment of a committee to manage the bidding process.

There may be scope for rationalising the institutional arrangements for project preparation so that the number of organisations with primary responsibility is limited to a manageable number.

An effective single window agency should be established in the case of all PSP projects and a complaints office established.

The PFI Unit might start with a single technical expert trained in the Rapid Assessment methodology until the level of PSP activity justifies more.

Training requirements are set out for the PFI Unit, nodal agencies involved in project development, contract monitoring units, and to increase general awareness.

Madhya Pradesh

The PSP institutional arrangements in Madhya Pradesh are relatively simple compared with the other three States, because the scope of PSP in infrastructure has been more limited. The main PSP activity has been in the road sector, for which the institutional arrangements are effective, and capacity building is being addressed by another ADB funded project.

If there is the political will for an expanded PSP programme, we recommend that the GOMP should follow other successful international examples by focusing on the Department of Finance for co-ordinating and organising such a programme. Since the MPSIDC/RBC is a major sectoral nodal agency, the Department of Finance could also work through those agencies to undertake the review of projects suitable for an expanded program.

An expanded PSP programme should be launched with a study by consultants to identify the infrastructure projects that are appropriate for implementation through PSP over the next five years, working closely with line departments and other public bodies. The study should be commissioned by the Cabinet and might be organised by the Department of Finance.

Project preparation should be the responsibility of the line department, although many of the responsibilities might be delegated to a project or sector nodal agency, as is the current practice in the road and SEZ sectors.

Rules should be issued by the GOMP (under the general law on PSP in infrastructure recommended in Chapter 3), setting out the procedures for the bidding process to ensure full transparency and fairness, and providing for the establishment of a committee to manage the bidding process.

An effective single window agency should be established in the case of all PSP projects and a complaints office established.

If the PFI Unit is separate from the MPIIFB, it might start with a single technical expert trained in the Rapid Assessment methodology until the level of PSP activity justifies more.

Training requirements are set out for the PFI Unit, nodal agencies involved in project development, contract monitoring units, and to increase general awareness.

E.6 Environmental and Social Issues

The assessment of environmental and social issues in the context of PSP activity centers on an assessment of the following questions:

- ❑ Is the environmental and or social legislation which governs the development of infrastructure projects in India and particularly in the States, consistent with the standard required by the International Financial Institutions?
- ❑ If the legislation governing these aspects is adequate, is it effectively applied by the State Governments?

- ❑ Is there a difference in the application of the legislation and guidelines as between those projects funded through the Governments or those funded by the private sector?
- ❑ In those areas where there appear to be deficiencies, what are the logical steps to be taken to address the deficiencies?

E.6.1 India's EC Process Versus ADB's Environmental Safeguards Guideline

India's EC process and the ADB's environmental safeguard guidelines are similar in terms of the steps involved in EA as well project pre-classification (Table 6.1). All ADB projects fall into one of three classes. Similarly, under existing Indian regulations, projects fall into three categories: those requiring a full EA, an abbreviation or summary EA and no EA. The existing EA notification has a list of projects requiring full EA.

In many respects the Indian EA process is considerably more onerous and consequently more thorough. For example: in order to properly include any sensitive sites, EA study boundaries must extend 7-10 km from a project site or along both sides of a linear development. Further, for a full EA, India requires that primary field data be collected for at least 2 seasonal periods. No such requirements exist with the ADB.

In relation to best practice, information disclosure during both the ADB's and India's process is somewhat restrictive, with full documentation and data release not mandated for either system, and little guidance on the type and quality of information to be provided. The Indian process does identify a summary of the EA, while the ADB's guidelines do not.

While this TA was being undertaken (for which the environmental task was to identify a streamlined EC process for PSP-type projects) the MOEF was completing its comprehensive EA process streamlining exercise, funded by the World Bank. While the new EC process is not law yet, it will likely become the required procedure within the near future. It has very clear benefits and extensive application to this work.

The reengineering of India's EC procedure, will significantly improve its flexibility and precision. The new EC process will permit a more exact identification of the potential impacts, then tailor the EC process to that project, through web-based screening exercises. The EA notification will include a much longer list of projects and their classification, helping PSPs identify environmental pitfalls from a very early stage.

Table 6.1: Comparison of Government of India (GOI) and Asian Development Bank (ADB) Environmental Safeguard Procedures

Key Steps and/or Outputs	GoI	ADB
Project Classification	+++	+++
Project Scoping and Screening	++	+
Description of existing environment and bounding	+++	+++
Assessment of alternatives	+	++
Analysis of Impacts and Definition of Mitigative Measures	+++	+++
Preparation of Environmental Management Plan (EMP)	++	+++
Mitigation costing	+	++
Preparation of Environmental monitoring program to match mitigative actions	++	+++
Compliance Monitoring follow up	+	Almost never
Public consultation and Information disclosure <ul style="list-style-type: none"> • Full EIAs • Lesser EAs 	+++ +	+++ +++
Environmental Clearance double checking process via the CFE and CFO requirements	+++	None
EIA review and provision of written decisions, including conditions etc.	+++	+++
Adequate air, water, noise standards	+++	+++

Scale: - absent, + = minimal, +++ = Very Good

Details of the revised approach are outlined in Chapter 6 and a revised checklist for environmental screening and assessment is presented which complies with the revised MOEF procedures.

In summary, the process mandated by the MOEF and followed by the States is both comprehensive and largely comparable to the process required by the ADB for those projects using ADB funding. Given that the ADB process is only applied when the domestic process is in some way lacking, in India the MOEF process and guidelines apply in virtually all situations.

Further, since the guidelines apply to all projects irrespective of the source of funding, both Government funded and private sector funded projects are treated exactly the same. No special consideration needs to be added to the standard guidelines to address PSP issues.

E.6.2 Recommendations

The following are recommendations coming either from the states themselves or were inferred by the consultants based on the weeks of interviews and discussions with state officials:

- ❑ MOEF's streamlining work will bring considerable clarity and simplicity to the EC clearance process. Until this becomes law, investors are urged to use the scoping form and classification tables taken from the MOEF study and adapted for this work to define the environmental risks and EA needs of their proposed project.
- ❑ Investors should also make use of ECOSMART's Environment Information Centre to help assemble relevant and technically credible datasets needed for environmental screening and future EIA.
- ❑ The authority for providing environmental clearances and EIA reviews should be divested to the state level, provided that the state meets basic institutional capacity skills as exemplified by AP, Karnataka and Gujarat. Only projects extending across state borders and where national lands are involved, should have central government involvement.
- ❑ All maritime states need to work towards encouraging the central government to transfer clearance powers to the state DOE⁶, instead of the Ministry of Shipping and the State Public Works Department.
- ❑ For AP, Karnataka and Gujarat it will be important to streamline the ports-development environmental clearance process and prepare a step-by-step guide to Environmental Clearance for Port Development.
- ❑ MP needs to make its entire clearance process more accessible and can do this by using AP as a template.
- ❑ The cost of environmental screening and obtaining environmental clearance sufficient for the project to begin will vary depending on who is initiating the project. If the project is unsolicited and initiated by the private sector, the process of obtaining environmental clearance will be the responsibility of the investor. If the project is being prepared and presented to the private sector for investment by the Government, then the obligation to ensure environmental clearance for the project will be with the Government.
- ❑ All nodal agencies should prepare a summary guide on the EC process in their state, listing key agency contacts, the names and contacts for qualified consultants, public sector environmental expertise and web sites for specific environmental data and information, such as MOEF's Environment Information Centre.

Capacity Building

Flowing from the above, we have recommended an environmental issues training program as applied across the spectrum of organizations involved in development of PSP projects. Details of the training program are included in Chapter 6.

E.6.3 Social Impact Assessment and Resettlement

In contrast to the environmental area, the situation regarding state approach and treatment of social impact assessment and resettlement issues is much more confused and in evolution. The application of policy in the treatment of social impact issues at the State level often only considers the legal obligation of the State under the Land Acquisition Act. This is often administered as a bureaucratic exercise and does not involve extensive consideration of aspects other than primary land purchase. The Government of India has been working since 1992 on the formulation of a national resettlement and rehabilitation (R&R) policy for project-affected families

⁶ The request for transfer to state authority was officially tabled with the central government by all maritime states (collectively) more than a decade ago. To date this has not been acted on.

(PAF)⁷. The policy is a set of broad guidelines and executive instructions, and represents a minimum level of support for project-affected families.

The national R&R policy targets projects that displace significant numbers of people, namely 500 families or more in plains areas or 250 families or more in hilly areas, DDP blocks and areas mentioned in Schedules V and VI of the Constitution of India. The proposed rehabilitation grant and other monetary benefits are applicable to all project-affected families whether belonging to the Below Poverty Line (BPL) or non-BPL categories. Elements of the policy include:

- ❑ Loss of agricultural land or cultivable wasteland is compensated with land-for-land up to a maximum of 1 ha of irrigated land or 2 ha of non-irrigated land or cultivable wasteland, subject to the availability of government land in the district. Each PAF that has lost agricultural land also receives a one-time grant of Rs. 10,000/ per ha for land development and Rs. 5,000/ for agricultural production.
- ❑ Loss of houses is compensated by the allotment of a homestead site of 500 m² in rural areas and 75 m² in urban areas. BPL families also receive a one-time grant of Rs. 25,000/ for house construction. Basic amenities and infrastructure are provided at resettlement sites.
- ❑ Financial assistance to help PAF to relocate and re-establish livelihoods includes shifting allowances (Rs. 5,000/), and construction of cattle sheds (Rs. 3,000/) and shops (Rs. 10,000/).
- ❑ "Loss of livelihood" financial assistance packages based on the Minimum Agricultural Wage (MAW) are provided to all PAF that lose all or significant portions of their land, as well as landless agricultural labourers and non-agricultural labourers.
- ❑ PAF that are members of tribal groups receive additional benefits, including financial assistance for loss of customary grazing and fishing rights; higher benefits if they are relocated out of their district; and, continuation of reservation benefits at resettlement sites for tribal PAF and Schedule Castes (SC) who enjoy those benefits in the affected areas.
- ❑ The policy establishes procedures for a participatory Review and Monitoring Committee and a Grievance Redress Cell at the project level. The former comprising representatives of SC/ST and women living in the affected area and other elected officials will monitor and review the implementation of the R&R plan or scheme. The latter under the Chairmanship of a Commissioner for Resettlement and Rehabilitation will hear grievances of PAF.
- ❑ In the case of inter-state projects, the Central Government is the competent authority for R&R. A National Monitoring Committee monitors and reviews the R&R implementation.

E.6.4 State R&R Policies and Legislation

State governments have the power to legislate concerning the acquisition of land for public purposes, and to establish state-wide policies for resettlement and rehabilitation of project-affected people. Among states included in the PSIF II loan program, existing legislation and policies have been developed in the context of specific donor-funded water resources and road projects, and applied to other situations at the discretion of the government.

The Government of Andhra Pradesh (GoAP) is currently in the process of formulating a state-wide policy that will apply to all development projects regardless of source of funding⁸. The Irrigation and CAD Department (I&CAD) is responsible for this initiative, including consultations with a range of line departments, government agencies, NGOs and other stakeholders.

The proposed AP R&R policy advocates a rights-based, participatory approach to the identification of entitlements, as well as procedures for planning and implementation of compensation and livelihood restoration strategies. The key principles of the proposed policy are that project-affected people (PAP) should be fully involved in the preparation of the R&R plan, and entitlements and strategies to assist AP to restore livelihoods should reflect their priorities and preferences.

Together with the above national policy, the AP Policy currently offers the best state level structure for dealing with PAP.

⁷ In February 2004, the former Government announced the imminent adoption of the R&R policy as part of its elections platform (Hindustan Times, New Delhi, 26 February 2004). The following is based on this proposal.

⁸ Source of information: Meeting on 10 Feb. 2004 with K. Raju, I.A.S., Secretary to Government (Projects), Irrigation & C.A.D. Department.

E.6.5 IL&FS Resettlement Policy Framework

The IL&FS resettlement policy framework is applied to all PSP projects financed through the PSIF II loan facility. The policy framework is based on the IL&FS 1995 Environmental and Social Report (ESR), and accepted by the ADB during appraisal of the PSIF II loan. The IL&FS policy framework endorses the following objectives:

- ❑ address the legitimate concerns of relevant stakeholders, especially persons affected by the project;
- ❑ avoid or minimize resettlement due to land acquisition through appropriate technical and management measures, involving the affected communities;
- ❑ ensure protection of marginalized and vulnerable groups, including the economically and socially disadvantaged, the elderly, women, children, physically handicapped and indigenous people; and,
- ❑ ensure responsible resettlement and rehabilitation of affected persons through sustainable livelihood options that at least restore, if not improve, their standard of living.

Compensation and rehabilitation packages encompass seven categories of entitlement: losses of land; structures; livelihood, trade or occupation; access to common resources and facilities; and, standing crops and trees. They also include losses during transition of displaced persons or establishment; and, losses to host communities.

- ❑ Compensation for loss of agricultural land should be based, to the extent possible, on the principle of land-for-land. In the event of the unavailability of land, cash compensation should be based on replacement value. Any difference in the value of acquired land between the market value as determined by the Land Acquisition Act and an agreed replacement value will be paid as resettlement assistance.
- ❑ Compensation for loss of homestead land and housing will also be based on replacement value. A family losing housing will receive alternative housing that meets minimum national housing standards, or cash compensation if the family prefers self-relocation. Compensation for commercial structures should ensure that the family's source of income is not adversely affected.
- ❑ Rehabilitation packages should be provided to enhance social conditions in project areas and meet the objectives for social development.

The policy framework also makes provision for full consultation with and disclosure to affected people; implementation of a grievance redress mechanism; and, R&R monitoring and evaluation.

E.6.6 Framework for Social Resettlement Awareness Building and Training

Since this area is still being developed and there is a general lack of awareness at the state level of how and what can and should be done, it is an area where longer term awareness building and training will provide solid improvement. We propose a framework for social resettlement training to encompass the scope of information necessary to inform the PSP project development and implementation process, as well as providing an approach that is tailored to the needs of different participants in the target sectors and States. Training programs should be developed and adapted to the social resettlement issues of different sectors and the policy and institutional conditions in each State, using a modular approach to achieve the following:

- ❑ Senior management of nodal agencies and line departments that promote, facilitate or undertake PSP projects as well as project managers and other technical staff involved in these projects should receive training that encompasses a) existing legislative and policy framework and b) the issues, roles and responsibilities for social resettlement issues in PSP projects. These are encompassed in the first two modules below.
- ❑ Project managers and, where relevant, designated competent authorities in nodal agencies and line departments involved in PSP projects as well as personnel of the Revenue Department responsible for land acquisition require training to ensure a comprehensive, consistent approach to the application of the Land Acquisition Act and other activities related to the acquisition and compensation for titled land assets. This is encompassed in the third module below.
- ❑ Project managers and relevant staff of nodal agencies and line departments involved in the preparation of PSP projects prior to negotiation of concession agreements require training on the planning and implementation of resettlement and rehabilitation activities. This will enable them to carry out prepare feasibility studies and DPR and/or manage consultants engaged for these activities; facilitate all activities required to meet the State commitment to provide the concessionaire project land free of encumbrances;

and, monitor the concessionaire to ensure compliance with State policies. These issues are encompassed in modules 4 and 5 below.

- Private developers, consultants and NGOs involved in PSP projects should also be included in training programs, particularly to enhance the capacity to integrate social resettlement issues in PSP project.

E.7 Incentives for Private Infrastructure Investment: General Considerations

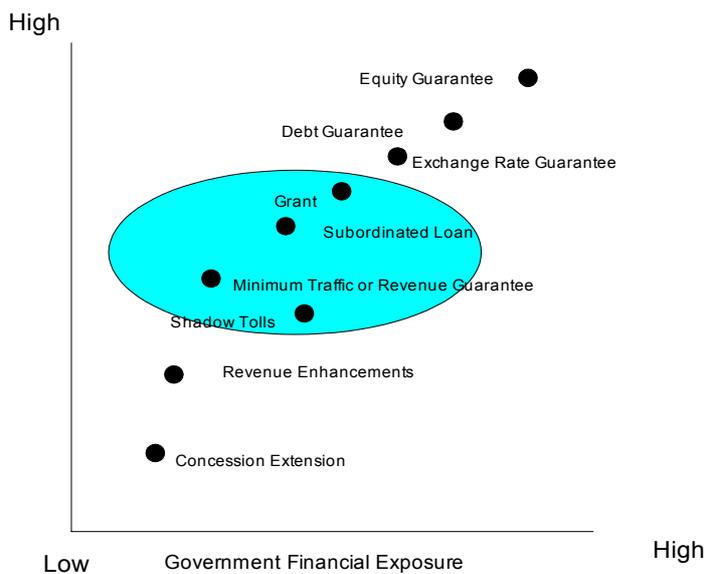
E.7.1 The Case for Incentives

Incentives can be broadly defined as actions, arrangements, or commitments on the part of governments that serves to minimize risk or enhance returns to an investor. Several countries have used incentives to attract private investment characterizing such investment as a source of economic development and modernization, income growth and employment.

In theory, the case for incentives arises when a free market economy or an economy without active interventions from the government results in a less than optimum supply of infrastructure services. Incentives may be economically justified in some cases, where market imperfections impede investors from earning a normal return on their investments. These could arise due to a number of factors. Characterized as these sectors are by increasing returns to scale, they tend to be natural monopolies and hence even in the absence of entry/exit regulations, capital flow in such sectors is limited.

In addition, investments in these sectors carry higher risk premiums, as these investments are usually lumpy and irreversible and have long pay-back periods. Thirdly, several infrastructure services are characterised by their non-completive nature as quasi-government services and may require active government interventions to bring market forces to bear on those services. There exist additional, indirect benefits - technology spill-over and other positive externalities - which are not captured by private returns and may result in levels of investment that are sub-optimal. In the specific context of developing countries, the government is usually constrained in its access to external finance, so attracting private investment becomes a strategy for financing economic growth.

While financial incentives may distort financial clarity, they are also sometimes essential to closing the deal. The investor is interested in minimising risk and therefore those incentives that bring his risk to a manageable level are attractive. By comparison the Government is interested in minimising exposure to financial cost. The intersection of these interests for any project is the point where the deal can be struck. A schematic of the relationship between risk and exposure is as shown diagrammatically below.



Reference: Private Financing of Toll Roads, Fisher and Babbar, RMC Discussion Paper Series 117

We have highlighted above the strong recommendation for establishment of a PFI Unit within the Department of Finance to essentially determine what kind of PSP is appropriate for a given project, what level of potential funding by the Government through financial or other types of incentives is appropriate, and how does that level of support impact on the longer term budget and finance capacity of the Government.

The sensible determination of incentives remains a critical step in that process. In Volume 1 we review the situation in India by infrastructure sector and by state in terms of how best to address the need for enhanced and expanded PSP activity. The discussion is too detailed and voluminous to paraphrase here. However, the fundamental argument for incentives is worth noting.

In any infrastructure sector, development whose primary purpose is to expand and enhance the opportunities for economic and social development, there is always an economic value and a financial or use value. The financial or use value can be equated to the financial return on the investment as noted above in the discussion of the FIRR. Equally, the economic value can be equated to the total social and economic good which derives from the investment. It is always larger than the financial return. The incremental difference between the financial return and the economic return represents the financing gap. It is that gap that can be best filled by the sensible application of incentives to the developer. Incentives are not a gift. They are not a reward for the developer. They are simply the sharing of the cost of the investment to allow for an equitable sharing of the benefits from the investment between the private sector and the public sector.

E.7.2 Incentives for Private Infrastructure Investment: Consultations with private sector

During the TA we consulted directly with a number of private sector organisations involved in infrastructure investment in India regarding the use of incentives for investment. The key comments are as follows.

Complexity and ambiguity

It is important that the contractual arrangements should be unambiguous and responsibilities of various agencies and parties are laid out clearly. At the same time it is important that enough flexibility and consultations are provided for the document is finalized so as to adequately reflect the concerns of all stakeholders, including the private sector.

Residual value of projects

One issue that needs to be addressed is the issue of residual value of the asset, particularly in BOT or concession type of contracts. While most contracts require such assets to be transferred to the government at the end of the contract at zero value, these assets could clearly be valued positively as most such contracts involve large investments that have a useful life much beyond the life of the contract itself. While there was a view that such issues could be addressed within the frame of the contract's financial design, particularly when the investor is carrying out the financial feasibility analysis, it was felt that some such provision would help in improving the viability of such projects. Such a provision would also help to ensure that the assets would be maintained effectively. These are currently being addressed as part of the contract in terms of minimum maintenance standards in the contract. Such a provision would also ensure that user charges are more reasonable by improving the viability of the project. This would also imply easier step-in by new operators in case of failure of the operator making the project viable even for the new operator.

Tariff setting

In terms of tariff, while the need for independent regulation is articulated for several reasons, it is also necessary to ensure the public acceptability of the PSP process. Tariff setting processes would also vary considerably across sectors and hence a differential approach is suggested. In addition, while guaranteed payments reduce risk premiums considerably, there is also a case for other financing mechanisms to be continued in parallel to the extent these are feasible. For instance, while the annuity scheme has been successful in the roads sector, there is clearly a role for tolling in cases where traffic levels allow at least part recovery of the project cost. The need for adopting hybrid or innovative approaches to structuring the projects was stressed. In addition, tariffs should be set at reasonable levels to ensure acceptability. Since acceptability is determined essentially in consumer perception and would vary across infrastructure sectors, this would imply differential potential for PSP in different infrastructure sectors or the need for financial or budgetary support, at least in the initial periods. It was pointed out that for these reasons, the potential for viable tariff setting is higher in sectors such as ports where the consumers are mostly other business entities than in sectors such as roads and, particularly, water.

Dispute resolution issues

Investors stressed the importance of effective provisions in the contract and mechanisms for dispute resolution. It was pointed out that often while interpreting the contract by the parties, particularly the government at the operating level the spirit or context of the original contract is overlooked. This results in adversarial interpretation and positions and leads to avoidable recourse to the dispute resolution process. It was also pointed out that the arbitration process is often marred by long delays in appointments of arbitrators etc. leading to loss of value in the contract.

Consistency and legitimacy issues

It was pointed out that while changes of government are inevitable in a democracy, these should not be occasions for review (and sometimes threats of termination) of ongoing contracts. Greater transparency and wider consultation were suggested as possible palliatives in this regard. However, it was stressed that commitment of government across all political parties was paramount. In the absence of such a commitment from the government towards the regulatory reforms program, even the institutions of independent regulation would not be effective.

Importance of consistency and commitment to the provisions of contracts was highlighted in the context of cases where government gone beyond the contractual provisions to capture the upside in returns retrospectively. It was pointed out that contracts should be well-designed so that they provide a clear basis for the investor to carry out the financial analysis, and yet have provisions to progressively share in returns so that resentment against any windfall gains does delegitimise or politicize the contract.

Independent regulation and other such mechanisms that provide some legitimacy to the PSP process are important for private investors. Such a step would be taken to indicate to private operators that some legitimacy in the process can be perceived and communicated to the government and civil society groups, hence minimizing opposition to private investment. Another mechanism here would be strategies such as revenue sharing arrangements and ceilings for tariffs. However, there is a fear in strategies such as revenue sharing that while the government would want to share the higher revenues while not take part in the downsides. Nevertheless, such changes should not be retrospective and should be only taken into account only for new projects.

Role of Union and State Governments

Since several incentives are provided for by the Union Government, there is a case for the Union Government to consult and collaborate with the state governments to make the incentive structure more effective. The state governments also have a role in developing projects in terms of feasibility studies, etc before the project comes for PSP. This would ensure that the project costs are lower as also are risk premiums.

It was specifically pointed out, in the context of the liberalization of the ECB norms by the central government that the schemes for tax or financial should not have the effect of discriminating against smaller investors. Other than suggestions from one large investor about guaranteed return on equity, no specific suggestions came out about the adequacy of the current fiscal and financial incentives or the need for providing new incentives of this type.

Credibility in Guarantees

Government guarantees become more credible when backed with dedicated financing such as the case for the annuity scheme for road sector being backed by the cess on fuels. In the absence of such funds, guarantees are not perceived as adequate and a substantial risk premium is seen to attach to them. A point was in this context, in the absence of such funds, in case of default in payment, the processing to enforcing payment out of the consolidated fund of the government can be very time consuming and costly.

E.8 The Road Map for More Effective Infrastructure Investment

This chapter deals with the practical steps that we recommend for each of the States individually to help improve the climate and the process for private sector investment in that state. While the recommendations are specific to each of the states, they may also be generic and can equally apply to any of the four states or to any other states in India. In what follows we deal with each states separately and deal with the various issues following from what are listed in Chapter 2 as the key constraints on PSP. To allow for a sense of the importance of each issues, we also provide a timetable and schedule for implementation which indicates where we feel the attention should be focused. While this timetable is indicative of the schedule of recommended action, many of the recommendations are open ended and may require some years to achieve, as for instance passing of new legislation.

E.8.1 Generic Recommendations for Application to All States

Policies and Legislation

As we noted, many policies now exist at the State level. However, some are out of date and some need to deal with emerging issues. The process of setting and updating policy will never be complete. As governments change, policy also changes. So it is a futile task to hope that all policy will always be written down and clear to all who wish to work within it. However, some guide can always be provided.

Our recommendations are based on the review carried out in Chapter 3 and supported by the more detailed census of policies and legislation provided in Volume 2. Most of the actions in relation to policy and legislation are State-specific and are covered under each State accordingly, but a few are generic:

- A coordinating agency, needs adequate trained staff, financial resources and a clear set of implementing rules, model concessions or other agreements and clear procedures for application, in order to effectively promote private sector participation.⁹ The draft concession agreements included in Volume 4 provide a solid foundation for this standardisation. These draft concession agreements should be used as examples for future development of concessions in each state.
- A conciliation and arbitration clause as outlined above in chapter 8 should be inserted in any of the concession agreements prepared for the infrastructure sector in the four states. We have included it in the draft concession agreement templates. The recommended clause takes into account the provisions of the IDEA and the GIDA and is structured to work within those provisions;
- Example sectoral specific policy statements have been developed in the major focus areas. While States may not need to update their policy in every case, the example policy statements can be used as templates to ensure that investor specific provisions are included at the sector level in State policies.

Regulation

In general we recommend minimum regulation, and regulation through concession agreements where possible. As noted in chapter 3, we do not recommend that the States develop a separate regulatory body for any of the sectors with the exception of Water supply and sewerage, and possibly for public passenger transport if there is PSP in UMT and in other modes of public transport (eg buses) to warrant such a regulator.

We do not consider that there is any need for a public passenger transport regulator in any of the States at present, but we have given our outline proposals for such a regulator in the event the situation materially changes.

For water we consider, on balance, that network regulators should be established at state-level by extending the existing SERCs to cover the water sector as well. These network regulators would be responsible for economic, technical and customer-service regulation. However, we recognise that some states may prefer to establish a stand-alone water regulator given the particularly sensitive and complex issues in the sector.

Specific action plans for establishing water regulation are set out separately for each State.

The PSP Process and Capacity Building

We identify five stages in the Project Cycle for PSP projects: Project Identification, Evaluation of PSP Mode, Project Preparation, Private Developer Selection, and Project Implementation. The second stage, Evaluation of PSP Mode, is critical in removing one of the main constraints on increased PSP activity in the States, namely the shortage of bankable projects. At this second stage in the Project Cycle, it is essential to select projects that are both worthwhile and will attract private sector interest.

We recommend that a Rapid Assessment methodology should be used at this stage, and the establishment of a PFI Unit in the Department of Finance to take responsibility for the Rapid Assessment. The PFI Unit would evaluate the amount of government financial support required, and integrate its activities with the annual budget process. The two main decisions coming out of the Rapid Assessment would be the appropriate PSP mode, together with a realistic estimate of the financial support that will be required to ensure a bankable project. The project would only proceed to the next stage, Project Preparation, if the estimated level of financial support can be afforded in budgetary terms.

⁹ Standardised concession agreements for all four sectors have been prepared and are available for download on the webpage.

¹⁰ Standardised concession agreements for all four sectors have been prepared and are available for download on the webpage.

We also suggest that states consider preparing Multi-Year Financial Plans to demonstrate the long term budgetary impact of PSP projects with other government capital expenditures required to support social and economic development. Our specific proposals are set out for each State separately.

Institutional Strengthening

There is no “right and wrong” institutional structure for PSP in infrastructure. The choices are generally between a **centralised** model with a dedicated unit responsible for managing the whole of the project cycle for selected projects; a **line department** model without any specially constituted central agency responsible for PSP across multiple sectors; or a **hybrid** of the two. Andhra Pradesh and Gujarat have adopted hybrid models, while Karnataka and Madhya Pradesh essentially have line department models.

Whatever model is chosen, there are three broad conditions that determine the effectiveness of the institutional arrangements:

- ❑ Sustained political commitment
- ❑ Clear responsibilities during the project cycle
- ❑ Single window agency for clearances.

We have assessed the arrangements in each State against these conditions, and have set out our main proposals for each State below.

Environment

- ❑ MOEF’s streamlining work will bring considerably clarity and simplicity to the EC clearance process. Until such time as this becomes law, investors are urged to use the scoping form and classification tables taken from the MOEF study and adapted for this work, to define the environmental risks and EA needs of their proposed project;
- ❑ Investors should also make use of ECOSMART’s EIC to have them assemble relevant and technically credible datasets, needed for environmental screening and future EIA;
- ❑ Investors should use Tables 6.1 and 6.2 on this document to help guide them through the EC clearance process
- ❑ The authority for provide environmental clearances and EIA reviews should be divested to the state level, provided that the state meets basic institutional capacity skills as is exemplified by AP, Karnataka and Gujarat. Only projects extending across state borders and where national lands are involved, should have central government involvement;
- ❑ All maritime states need to work toward encouraging the central government to transfer clearance powers to the state DOE¹¹, instead of the Ministry of Shipping and the State Public Works Department;
- ❑ For AP, Karnataka and Gujarat it will be important to streamline the ports-development environmental clearance process and prepare a step-by-step guide to Environmental Clearance for Port Development.
- ❑ Costs and responsibility for environmental clearance will rest with the Government for those projects initiated by the Government. For projects initiated by the private sector, costs for environmental clearance will be with the private sponsor. After construction begins, environmental issues related to implementation will be the responsibility of the investor. Costs for subsequent post construction environmental compliance and certification of compliance will be to the account of the investor.

Resettlement and Rehabilitation

- ❑ All states should review the Andhra Pradesh guidelines on R&R with a view to adopting those or similar guidelines;
- ❑ The current IL&FS policy is being applied to all applications coming forward under PSIF II. The IL&FS policy will continue to mirror the ADB standards and guidelines. All states should review that policy and apply it’s requirements to all projects which are now being developed for possible PSIF II support;

¹¹ The request for transfer to state authority was officially tables with the central government by all maritime states (collectively) more than a decade ago. To date this had not been acted on.

- Consistent with the State specific recommendations to create steering committees to direct the development of PSP projects, we also recommend that an R&R committee be established to oversee the application of State policy regarding R&R. This will overcome what is now perceived to be a lack of interest in this key area of concern;
- This TA has developed a Land Acquisition and R&R checklist for States. All States should use the checklist to guide them in applying the IL&FS policy as above;
- Costs for land acquisition will remain with the Government. Costs for resettlement and rehabilitation under future expanded guidelines will normally be to the account of the investor. However, in most cases the Government will need to take a lead in this area and in many cases costs incurred may be a pre-requisite for obtaining private sector participation in the project. This may then be considered an incentive provided by the Government to attract private sector involvement.

Incentives

As was noted earlier, much of the problem with PSP in India is a shortage of bankable projects. This may be overcome by moving toward more PPP projects or O&M projects. In these cases the Governments will need to become active partners in the development and financing of the project.

- It is important to ensure that the States have the flexibility to implement a full range of incentives across all the target sectors. We have discussed in detail the types of incentives that are potentially viable in chapter 7. We urge all States to ensure that they have the necessary flexibility to apply these incentives if it is shown that they are critical to the success of the private initiative.
- A draft terminology for incorporation of incentives in enabling legislation is included in the draft legislation prepared for MP and Karantaka and as an amendment for the Gujarat GIDA. APIA legislation already contains a flexible incentives clause.

E.8.2 State Specific Recommendations

Following the preparation of the Draft Final Report and its circulation to the States, a final round of tripartite meetings were held in the states to discuss the recommendations and the response of each state to those recommendations. A summary table for each state is presented as Table 8.1-4.

Andhra Pradesh

While the APIA, through the IDEA has significant power to mobilise and commit resources for PSP development, in reality, due to limited staff capacity, no independent funding and serious concern within the Chief Secretary's Office about maintaining line department control and accountability, the Secretary, Industries Department is seen as the focus and control point through which this PSP activity must move. This includes any consideration of setting up an independent PFI Unit. While there was general agreement on implementation of many of the recommendations, the Secretaries also indicated that many of the recommendations were consistent with activity already being undertaken. The Secretaries stated that while the knowledge of how to promote PSP seemed well understood in the state, the deficiency was in implementation, follow through and human capacity. The APIA at the time of the tripartite meeting had recently seen the resignation of the Chairman and shortly thereafter the resignation of two of the key senior administrative staff so in many ways it was an organization in name only.

Gujarat

Gujarat has been more involved than the other States in this TA project in the sense of asking for more help and information to be developed for that state. Many of the documents included in Volume 3 were prepared as a result of requests for assistance and advice from Gujarat. In terms of the recommendations flowing from the TA, Gujarat has agreed with many of them as noted in the attached table and subsequent follow up comments on the Draft Final Report. While there was strong agreement by the Secretary of Finance with the concept of the PFI Unit, during the tripartite meeting, the staff of GIDB argued that it would make more sense for that capability to be resident in the GIDB. At time of writing GIDB had received the results of a full review of its shelf of projects with the objective of focusing effort on those projects which showed the greatest potential for bankability. The recommendations regarding changes to law, process, policies and rules have largely been accepted. With limited exceptions, the role of GIDB appears clear and the momentum for PSP support is strong.

The defining limitation in Gujarat is essentially capacity to assess commercial and financial viability – for which role we have recommended the formation of the PFI Unit.

Karnataka

At the time of the tripartite meeting in Karnataka, the Secretary of the Infrastructure Development Department (IDD) had resigned to join the Union Government and no replacement had yet been appointed. The IDD Project Management Unit, is led by a Deputy Secretary reporting to the Secretary. While there is generally support for implementation of many of the recommendations from the report within the Karnataka Government, the Secretaries argued that implementation would take some time. Karnataka has also embarked on a full review of its budget and planning function within the Department of Finance and it was clear that the PFI Unit would dovetail nicely with the other work being done in that area. Both the water and sewerage policy and the road policy were developed at the request of the GOK. Recommended additions to the road legislation were also accepted. The key concern in Karnataka remain the passive role of the KIDD and the limited human capacity to play a dynamic role in PSP project development. IDeCK in some ways fills a role similar to that of a nodal agency but as a private sector organization, it remains in a conflict of interest. KIDD needs significant strengthening to enable it to play a more aggressive role in the PSP project development process.

Madhya Pradesh

The tripartite meeting in MP included both the Director of the MP State Industrial Development Corporation / MP State Road and Bridge Corporation as well as the Secretary of Finance Department. The Secretary of Finance agreed with the recommendations regarding establishment of the PFI Unit. There was general agreement with most of the recommendations. The only issue related to the time required to implement them and the limited ability of the MPSIDC to commit the Government to legal or policy changes that fell under other departmental mandates. In MP the work of the State Roads and Bridge Corporation in getting PSP underway in the road sector has been a significant success. However, MP now faces the challenge of making the same impact on other sectors in a state where the population is not large and where industrial development is not extensive. It is likely that PSP opportunities in the future will require significant Government support as was seen in the road sector. The challenge for MP will be to find the potential projects where the commitment of that Government support will provide the attraction that the private sector needs to make good investments.

Table 8.1: Action Plan Checklist for Andhra Pradesh

Recommendation		Action			Timetable for Implementation		
		Agree	Disagree	Requires further Consideration	Months	1-3 years	>3 years
Policies and Legislation							
Ports	Proposed Scheme for Regulating Minor Ports Fees	Yes		Not Critical Now			
Roads	Proposed Additions to Road Legislation	Yes		Under Develop		1-2 Yrs	
	Draft Road Policy as prepared for Karnataka	Yes		Under Develop	Current		
UMT	Draft UMT Policy Prepared for AP	Yes		Will consider	4 – 5 mo		
Water	Draft Water Policy Prepared for Karnataka	Yes		Will consider			
Regulation							
Progress on establishment of Water Regulatory Authority			No	Multisector to be Considered			
PSP Process							
Focus Activity on PSP/PPP Modes with Practical Viability		Yes			Current		
Initiate Full Review and Prioritisation of Potential PSP/PPP Projects		Yes		CCG Group	Current		
Ensure Sufficient Funding for Project Development is Available				Need further consideration of development funding	6 months		
Institutional Strengthening							
Establish a PFI Unit within the DOF			No	Consider within APIA		1 Yr	
Establish a Multisector Bid Co-ordination/Management Committee		Yes		Transparency is key.	As need		
Develop a Single Window Clearance Capability in APIA			No	Line Departments and Commissioner of Industries	Current		
Clarify and Strengthen Role/Capability of APIA		Yes			Current		
Obtain Key Clearances before Tendering		Yes		Line Departments	Current		
Develop Line Department Capacity for Contract Compliance		Yes		Strongly Needed	Current		
Standard Documents							
Apply Key Clauses in Standard Concession Agreements		Yes			Current		

The following table 8.2 highlights the status of commitment and action taken in Gujarat related to the above recommendations. In many areas Gujarat has followed the recommended approach more consistently than have other States.

Table 8.2: Action Plan Commitments for Gujarat

Recommendation	Action			Timetable for Submit/Implement		
	Agree	Disagree	Requires further Consideration	Months	1-3 years	>3 years
Policies and Legislation						
GIDA	Comments on GIDA and Suggested Amendments	Yes		3/05		
	Comments and Amendments to Draft Rules	Yes		3/05		
Ports	Review of Gujarat Ports Policy & BOOT Principles re GIDA	Yes			2 Yrs	
	Comment on Gujarat Maritime Authority & Ports Act	Yes			2yrs	
	Proposed Scheme for Regulating Minor Ports Fees	Yes			1-2 yrs	
Roads	Proposed Additions to Road Legislation	Yes	Submission	3/05		
	Draft Road Policy as prepared for Karnataka	Yes	Submission	3/05		
UMT	Draft UMT Policy Prepared for AP	Yes	National Policy			
Water	Draft Water Policy Prepared for Karnataka	Yes		3/05		
Resettlement	Review Resettlement Policy for AP		Consider			
Regulation						
	Progress on establishment of Water Regulatory Authority	Yes		3/05		
PSP Process						
	Focus Activity on PSP/PPP Modes with Practical Viability	Yes	Consider	Current		
	Ensure Sufficient Funding for Project Development is Available	Yes	In Place	Current		
Institutional Strengthening						
	Establish a PFI Unit within the DOF	Yes	Review Options			
	Develop a Single Window Clearance Capability in GIDB	Yes		Current		
	Obtain Key Clearances before Tendering	Yes		Current		
	Develop Line Department Capacity for Contract Compliance	Yes		Current		
Standard Documents						
	Apply Key Clauses in Standard Concession Agreements	Yes		Current		

Table 8.3: Action Plan Commitments for Karnataka

Recommendation		Action			Timetable for Implementation		
		Agree	Disagree	Requires further Consideration	Months	1-3 years	>3 years
Policies and Legislation							
Enabling Act	Propose Review and Amend Draft Act for PSP			Will review			
Ports	Proposed Scheme for Regulating Minor Ports Fees	Agree in Concept					
Roads	Proposed Additions to Road Legislation	Yes				1-3 yrs	
	Draft Road Policy as prepared for Karnataka	Yes			Under Development		
UMT	Draft UMT Policy Prepared for AP	Agree in Concept		Will review for application	Current		
Water	Draft Water Policy Prepared for Karnataka	Agree				Customisation needed	
Land Acquisit.	Review AP and National Land Acquisition Policy	Agree Concept				1-3 yrs	
Regulation							
Progress on establishment of Water Regulatory Authority		Agree				Needs careful drafting	
PSP Process							
Organise PFI Unit in DOF within PFAC		Agree			Coordinate with US AID		
Role of PFI/PFAC - Impact of PSP on Multiyear Financial Planning		Agree			Coordinate with US AID		
Focus Activity on PSP/PPP Modes with Practical Viability		Agree			IDD review		
Ensure Sufficient Funding for Project Development is Available		Agree			Needs budget allocation		
Institutional Strengthening							
Initiate Full Review and Prioritisation of Potential PSP/PPP Projects		Agree					
Rationalise Project Preparation Institutional Arrangements							
Establish a Multisector Bid Co-ordination/Management Committee		Agree Concept			Departmental Coordination		
Develop a Single Window Clearance Capability		Agree			IDD Review		
Clarify and Strengthen Role/Capability of KIDD				Will review	New Gov't		
Develop Line Department Capacity for Contract Compliance		Agree		Will review			
Standard Documents							
Apply Key Clauses in Standard Concession Agreements		Agree			Many used		

Table 8.4: Action Plan Commitments for Madhya Pradesh

Recommendation		Action			Timetable for Implementation		
		Agree	Disagree	Requires further Consideration	Months	1-3 years	>3 years
Policies and Legislation							
Enabling Act	Propose Review and Amend Draft Act for PSP	Agree				Review and Draft	
Roads	Proposed Additions to Road Legislation	Agree				Review and Draft	
	Draft Road Policy as prepared for Karnataka	Agree		Will Review	Within Year		
UMT	Draft UMT Policy Prepared for AP	Agree		Will Review	Within Year		
Water	Draft Water Policy Prepared for Karnataka	Agree		Will Review	Within Year		
Land Acquisit.	Review AP and National Land Acquisition Policy	Agree		Will Review	Within Year		
Environment	Clarify and Publish Clearance Rules for Environment	Agree		Will Review		Needs drafting	
Regulation							
No major regulatory agencies are recommended							
PSP Process							
Organise PFI Unit in DOF/MPIIFC		Agree				Needs planning	
Role of PFI/MPIIFC - Impact of PSP on Multiyear Financial Planning		Agree					
Focus Activity on PSP/PPP Modes with Practical Viability		Agree					
Ensure Sufficient Funding for Project Development is Available		Agree			Limited financial resources in MP		
Institutional Strengthening							
Initiate Full Review and Prioritisation of Potential PSP/PPP Projects		Agree		Not many candidates			
Establish a Multisector Bid Co-ordination/Management Committee			Non Needed	Bid process good. Will consider advantages			
Develop a Single Window Clearance Capability		Agree			As needed		
Develop Line Department Capacity for Contract Compliance		Agree			As needed		
Standard Documents							
Apply Key Clauses in Standard Concession Agreements		Agree			Current		

E.9 Policy Matrix

The above constraints can be categorised into general constraints and sector-specific constraints. These are summarised in a policy matrix as required by the terms of reference and included in appendix A.

E.10 Recommended Follow Up Support

Flowing from the recommendations which we have made in the main text of the report and as noted in the policy matrix, two areas for further support stand out as essential. These are:

- (i) Institutional development support to states to assist in the establishment of the PFI Units and the linkage of those units to the current nodal/coordinating agencies and to the Department of Finance;
- (ii) Establishment of a project development fund for States on a loan basis to allow for full development of PSP projects with eventual recovery of the cost of project development from the private investor.

We have prepared draft terms of reference for these additional areas of support and included them as appendices in the main volume of the Final Report.

Appendix A: Policy Matrix

Table 1 – Investment Constraints and Broad Measures to Address Them

CREATING A CAPABLE NODAL AGENCY

General constraint	Broad measures	Andhra Pradesh	Gujarat Progress of Implementation During Project	Karnataka	Madhya Pradesh
Shortage of bankable projects due to inappropriate choice of project or mode of PSP, inadequate project preparation, risk identification and sharing and/or absence of sufficient public funding to ensure commercial viability	The root of the problem is inadequate evaluation of the project and PSP mode before proceeding to project preparation, integrated with a realistic assessment of the need for, and availability of, public funding to ensure commercial viability. We recommend that a "PFI Unit" is established in the Department of Finance.	<p>The concept of the PFI Unit has been discussed with the State authorities and broad agreement has been reached on the general way forward. In each state the relative linkage of the PFI Unit with the PSP coordinating agency and the line departments is not yet fixed. These decisions will take time to implement and the exact structure of the PFI Unit in each state will also depend on the specific Department of Finance. In general, we have recommended that the unit be staffed by professional financial analysts who are separate from the current public service rotation. This will allow for better continuity and also for more targeted professional skills.</p> <p>In Andhra Pradesh the IDEA Act gives the APIA sufficient power to undertake most of the activities recommended for the PFI Unit. The APIA is largely none effective at the moment. The Government is concerned about line authority for implementation which currently rests with the Department of Industry. The consultants believe that the DOF may still remain the appropriate home for a PFI Unit but further consultation will be needed for implementation.</p>	<p>The GIDB is the legal authority for implementation and approvals of project development activity. While the functions and the PFI Unit are accepted, the GIDB believes that the staffing should best remain within the GIDB. Earlier discussions with the Principal Secretary of Finance supported the concept and also agreed that some of the functions should best fit within the DOF. These discussions and option review should best be carried out during implementation.</p>	<p>In Karnataka, the current US AID funded "Strengthening of Government" project is working with the Department of Finance to develop better budget planning capability. The recommended PFI Unit would fit very cleanly within the recommended structure being developed by the US AID consultants for Karnataka. We recommend that further discussion take place with the DOF on how best to integrate the recommended functions within the current program.</p>	<p>DOF generally supported the concept of PFI Unit within the DOF. Further discussion on the role, mandate, reporting relationships and linkages with SIDC and RBC as well as other line departments is still needed as part of the implementation process.</p>
Shortage of funding for project evaluation and preparation	State government costs of project preparation might be recovered through the resulting concession agreement, but only if the project is successfully tendered. Otherwise these up-front costs have to be funded by the State budget, or from a specially constituted fund established through some form of taxation or other source of funds.	IDEA 2001 provides for the establishment of an Infrastructure Projects Fund. APIA has prepared proposals for this Fund, but no proposals have yet been approved.	The GIDB has some project development funds available. A full review of "5 year horizon" bankable projects is now underway. Depending on the specifics of the recommended shelf of projects, more support may be needed from the Government.	Currently projects are funded on an ad hoc basis. Most projects are left to the proponent to develop. Karnataka has argued that the private sector should pay these costs. However, for Government fostered and initiated projects, this approach may not be viable. Costs can be recovered from successful bidders but ex post, not ex ante.	This is not yet a critical issue as the scope and level of PSP in infrastructure is relatively low, but could become so if the scale is substantially increased.
Deficiencies at the general level in the enabling environment,	A specific written policy on PSP in infrastructure, supported where appropriate by legislation. The	IDEA 2001 provides a clear framework for PSP in infrastructure, but the implementing rules remain to be finalized and issued.	We have prepared proposed amendments to the GIDA 1999 and the draft Rules 2002, which need to be finalized by the GoG.	A draft State Infrastructure Policy has been prepared, but not yet issued. We have prepared draft infrastructure legislation that should be considered by the GoK	We have prepared draft infrastructure legislation that should be considered by the GoMP and possibly enacted.

CREATING A CAPABLE NODAL AGENCY

General constraint	Broad measures	Andhra Pradesh	Gujarat Progress of Implementation	Karnataka Progress of Implementation During Project	Madhya Pradesh
which deter private investors from bidding for projects	legislation should cover issues such as the processes for implementation, and provision for compulsory conciliation proceedings in dispute resolution. Change in government should not lead to review of ongoing contracts. This should be ensure through greater transparency, wider consultations, and setting up independent institutions. Consistency and commitment to the provisions of contracts is important particularly where government can potentially go beyond the contractual provisions to capture the upside in returns retrospectively.			and possibly enacted.	
Poor quality concession agreement that either deters private investors, or results in difficulties at the implementation stage.	Preparation of suitable standard concession agreements for sectors where PSP is being promoted. Inclusion of suitable dispute resolution terminology in the Concession Agreements.	We have prepared example concession agreements for BOT and Annuity Based BOT for Roads, Ports, Urban Mass Transit and Water and Sewerage. The example concession agreements draw on international experience where little activity has taken place in India (Urban Mass Transit) and in those areas where a body of existing agreements does exist, we have drawn on those agreements. Where clauses from one agreement appear to be beneficial to other sectors, they have been so included in the sector examples. The agreements are meant to be used as guidance in the development of project specific agreements. They are not templates as each project requires a specific tailored agreement structure. Recommended improved draft conciliation and arbitration clauses are included in each agreement.			
Absence of strong institutional arrangements,	Sustained political commitment and monitoring of progress at the highest levels;	We have made a number of recommendations including measures to strengthen the present authority and role	The GIDB is well established, but we have made some suggestions how it might speed up the implementation of PSP, including	We believe that the current institutional arrangements should be simplified, and have made some suggestions for new arrangements	If there is a political decision to increase substantially the scope and level of PSP activity, new institutional arrangements may be

CREATING A CAPABLE NODAL AGENCY

General constraint	Broad measures	Andhra Pradesh	Gujarat	Karnataka Progress of Implementation During Project	Madhya Pradesh
such as overlapping responsibilities, and bureaucratic delays in decision-making	clear delineation of responsibilities throughout the project cycle; and a single window agency for clearances at the project level.	of APIA, and new arrangements for managing the bidding process and providing a single window agency for clearances. The Chief Secretary has directed that a number of the recommended institutional improvements to the APIA be implemented. However staff changes have limited the functionality of the APIA and this problem continues. See item below.	new arrangements for providing a single window agency for clearances. Many of the recommended improvements suggested in the report have been agreed by GIDB and are under consideration or being implemented.	for managing the bidding process and providing a single window agency for clearances. Changing staff at senior level has a strong negative impact on continuity of process. IDEck remains the one consistent voice supporting PSP in the State.	required but for the moment the SIDC and RBC can effectively manage PSP. Meanwhile we have made some general suggestions including new arrangements for managing the bidding process and providing a single window agency for clearances.
Insufficient continuity of staff dealing with specific projects.	Changing the status of key officials to avoid the standard rotation cycle and/or effective handovers to ensure seamless continuity.	This issue is endemic to all States. During the course of this project all four states have had significant staff changes in the nodal agency. This is unlikely to change under the normal Indian Administrative System. However, we have recommended that some positions be considered professional staff who are hired on longer tenure – say 10 years and where the gradual buildup of corporate memory can aid in the development of bankable projects. The PFI Units would fall into this category. It is also critically important to develop systems for processing PSP projects that are not dependent on staff for success.			
Corruption	Some private investors have pointed to this issue as a key impediment to normal project development. It is not state specific and cuts across all sectors.	Two key recommended changes will measurable assist in reducing corruption. First, having a single window clearance process will remove the potential for each decision maker to hold up the progress of a project until he or she is paid. The role of the single window clearance is to place the burden of clearance support on the Government – rather than the private sector. Second, the allocation of increased funding to project development will allow for more competitive bidding by the private sector on projects which have been developed to a mature state. This will dramatically reduce the potential for pressure to be placed on the private investor by elements of the public sector.			
Undeveloped domestic capital markets	Widen the appeal of project finance credit among the commercial banking institutions; and facilitate capital market issuance by non-government issuers.	To date this has not proven to be a major constraint. The State banking system has been providing shorter term funds sufficient to allow for investments to occur at an interest rate of 6 to 7% for a medium tenor loan. The concern is that the ongoing capital borrowing needs of the Governments will eventually crowd out the private sector from the capital market. Much of the adequacy of this market depends on the macro economic policy and fiscal / tax policy of the Governments. The recent change to the National and many of the State Governments makes this a wait and see issue.			
State Government Financial Support	Match the incentives offered to the economic rationale for the investments. As the ratio of the economic return to the financial return rises, the	Incentives support to projects in AP remain flexible. The development of a PFI Unit within the APIA or Department of Finance will allow for much greater analytical	The GIDA limits capital support to 15%. We have provided draft wording to change the limits to allow for flexibility. The PFI Unit analysis will significantly improve the recommendations regarding capital and other kinds of	Incentives support to projects in Karnataka remain flexible. The development of a PFI Unit within the Department of Finance will allow for much greater analytical assessment of the need for and benefits of Government incentives and the	MP has traditionally been flexible in providing State incentives. This has included capital support of up to 50 to 60% of the project budget. This has proven to be a sensible approach so long as the project shows significant

CREATING A CAPABLE NODAL AGENCY

General constraint	Broad measures	Andhra Pradesh	Gujarat Progress of Implementation	Karnataka Progress of Implementation	Madhya Pradesh
	argument for incentives gets stronger. Incentives policy should be flexible to allow for maximisation of economic returns.	assessment of the need for and benefits of Government incentives and the impact of those incentives on the longer term budget of the State.	incentive support to the projects.	impact of those incentives on the longer term budget of the State.	economic return on the public investment. The PFI Unit can better assess the longer term impact of this support on State Budgets.
Environmental Clearance is seen by some investors as an impediment to investment particularly because of the time required and the potential for delay in the project approval.	Distribution of PSP guidelines to investors focusing on the environmental planning steps needed. Secondly quick reference to the MOEF website and use of step-by-step electronic EA guide can go a long way toward avoiding costly delays and constraints. Web site for Private sector investment guide should be considered. Environmental issues, while relatively well defined by the four states, are overlooked by financial institutions, due to a lack of knowledge and expertise. This would include the Min. Of Finance and by extension to private investors. As a result, environmental requirements become expensive and time consuming tag-ons, completed once investors realize that this part of the package is missing and must to be added.	AP has well described environmental procedures, but in electronic and written form, with guidebooks for investors available at the SPCB offices in Hyderabad. AP also had the Environmental Green-Book, a comprehensive reference to all environmental rules and regulations affecting AP. MOEF's project specific guidelines coupled with the new ECOSMART service of IL&FS should facilitate private sector needs	Gujarat has all its environmental procedures in electronic and written form on its website. it is proceeding toward a one stop-shopping approach to environmental clearance.	Karnataka is fully equipped to handle all environmental issues and should have little intervention from Delhi on all issues. MOEF's project specific guidelines coupled with the new ECOSMART service of IL&FS should facilitate private sector needs	Agencies responsible are too insular, and as such information about, but with improvements to website, better communication is taking place.

CREATING A CAPABLE NODAL AGENCY

General constraint	Broad measures	Andhra Pradesh	Gujarat Progress of Implementation During Project	Karnataka	Madhya Pradesh
Environment and water-sewage works require complex clearance	Historically proponents have not taken the time to familiarize themselves with requirements of the states (there are differences among states). The requirement for a CFE and CFO must be well understood	These requirements are clearly described on all state pollution control board web sites and in Chapter 6 of this report. Consultation with the SPCBs involved is highly recommended since, failure to communicate has resulted in refusal of consents by the SPCBs, not because the application was deficient, but because of misunderstanding.			
Social resettlement is not seen by most states as a major concern. Current consideration is limited to land acquisition with only limited consideration of resettlement and rehabilitation.	In January 2004, the Government of India announced a new National Policy on Resettlement and Rehabilitation (R&R) of Project-Affected Families (PAF), 2003. The Union Cabinet has adopted the new policy, in a process that may lead to the enactment of national R&R legislation but further action will depend on the direction of the new national government.	The Government of Andhra Pradesh (GoAP) is currently in the process of formulating a state-wide policy that will apply to all development projects regardless of source of funding. It is anticipated that the GoAP will formally adopt the policy by mid-year 2004. No decision has as yet been taken regarding R&R legislation.	The World Bank-funded Gujarat State Highway Program (GSHP) is the basis of the present R&R policy framework in Gujarat. The GSHP policy framework, formulated in 1999, was based on Government of India (GoI) legislation (EIA notification, 1994), the draft National R&R Policy and the World Bank operational directive on involuntary resettlement. It currently applies to state highway projects, as well as projects in other sectors.	The Karnataka Resettlement of Project Displaced Persons Act, 1987 establishes a legislative framework for R&R for the State. This Act evolved from the World Bank-funded Upper Krishna Project (UKP), in the context of water resource projects for irrigation and power generation. However, as per the Act, if the State Government is of the opinion that it is necessary or expedient in the public interest to do so for the resettlement of displaced people, it may by notification declare that the provisions of the Act apply to any project.	The Madhya Pradesh Model Resettlement Policy, 2002, establishes a framework for resettlement and rehabilitation of people affected by land acquisition. As its title suggests, it provides a model for Government departments and agencies to review and adjust their own policies. The scope of the Policy goes beyond the Land Acquisition Act to identify provisions for land owners and other project-affected people (PAP) to ensure that living standards are improved following resettlement. The Policy has been disseminated to all Government departments and agencies, although there is no mechanism to monitor whether or how the policy is being implemented.
Roads					
Absence of adequate and/or up-to-date road policy and legislation	A suitable road policy, and legislation in the form of a general road and highway act, with appropriate provisions regarding tolling and PSP	The 1997 State road policy should be updated using the revised roads policy we have developed for Karnataka as a template. Consideration should also be given to the adoption of a general highway act, based on the guidelines	The 1996 State road policy should be updated using the revised roads policy we have developed for Karnataka as a template. Consideration should also be given to the adoption of a general highway act, based on the guidelines issued by the GOI for a Model State Highway Act,	The 1998 State road policy should be updated using the revised roads policy we have developed for the State. The Karnataka Highways Act, 1964 should be updated consistent with the updated policy and including detailed implementing rules regarding the types of PSP permitted, the incentives that may	Provisions with regard to tolls and PSP should be incorporated in the Madhya Pradesh Highway Bill, 2001, if this is feasible.

CREATING A CAPABLE NODAL AGENCY

General constraint	Broad measures	Andhra Pradesh	Gujarat Progress of Implementation	Karnataka Progress of Implementation	Madhya Pradesh
		issued by the GOI for a Model State Highway Act, and incorporating the provisions in the policy for tolls and PSP.	and incorporating the provisions in the policy for tolls and PSP.	be offered, and the types of State Support that may be provided.	
Insecure and/or inadequate revenue stream to ensure commercial viability	Options exist to provide for a more secure revenue stream. These options include use of the Annuity based BOT, capital support or Leasing/Concessioneering of existing roads that have defined and observable traffic and toll capture experience.	It is expected that the proposed PFI Unit and added resources provided to the APIA will assist in the development of more bankable road projects in AP. This will also allow for more coherent incentives policy and application.	Gujarat is in the midst of redefining its approach to support of road projects. One option is to pay "Public Service Obligation" support to the toll operator for non tolled traffic. This is a form of shadow toll and may offer an innovative way to extend the financial viability of road PSP.	The proposed State Highway Fund based on cess on fuel and other charges may offer a basis for public / private partnerships in road development. A number of potential projects have been listed for PSP but few have been developed successfully. The Bangalore – Mysore Infrastructure Corridor, currently under construction will be an important test case.	MP has had significant success with road PSP. One of the major factors in the success is significant capital support, smaller projects, local investors and more definable and dependable traffic estimates.
Ports					
Absence of adequate and/or up-to-date port policy and legislation	A port policy that permits all forms of PSP, and legislation as necessary that delineates clearly the functions, powers and duties of policy, regulatory and implementing institutions, as well as set out, in detail, basic guidelines for PSP in port management or operations.	The port policy should be updated in a permissive manner to allow all forms of PSP. If the need arises, a port law for a specific port should be considered that delineates clearly the functions, powers and duties of policy, regulatory and implementing institutions. The draft scheme prepared for regulating port fees and tariffs should be implemented.	The port policy should be updated in a permissive manner to allow all forms of PSP, and to reconcile inconsistencies with the GIDA 1999 and the draft Rules 2002. The draft ports legislation prepared by the State to separate the service delivery and development functions from the regulatory functions through the creation of two separate Authorities should be suitably amended, to achieve such separation of functions. The draft scheme prepared for regulating port fees and tariffs should be implemented.	The port policy should be updated in a permissive manner to allow all forms of PSP. If the need arises, a port law for a specific port should be considered that delineates clearly the functions, powers and duties of policy, regulatory and implementing institutions. The draft scheme prepared for regulating port fees and tariffs should be implemented.	
Lack of commercial viability, particularly for Greenfield ports	Appropriate conditions relating to exclusivity, transport connectivity, funding of breakwaters and/or other issues with a major bearing on viability.	Some development of ports projects for PSP in AP is underway. Detailed analysis of markets and consideration of incentive support may be needed.	Gujarat has had strong experience in port development. Further development is likely. Demand analysis is critical. Land connection is often the critical limiting factor in commercial viability.	Some recent success in port development has been achieved by linking shippers and transport operators into Special Purpose Vehicle Company. This may be a good model to develop further.	

CREATING A CAPABLE NODAL AGENCY

General constraint	Broad measures	Andhra Pradesh	Gujarat	Karnataka	Madhya Pradesh
Urban Mass Transit					
Absence of UMT policy and legislation	Introduction of a comprehensive policy, and enactment of legislation with provisions to deal with PSP in UMT and rules regarding price and quality of service. Further, State Governments should work with the GOI to promote development of a national UMT law.	A comprehensive policy should be introduced, formulated within the overall framework of the Draft National Urban Transport Policy, and based on the draft UMT Policy prepared as a template in Volume 3 of this report. Development of legislation will remain as necessary, with provisions to deal with PSP in UMT and rules regarding price and quality of service.			
Conflicting authority at the GOI and State level, due to GOI responsibility for rail transport (for use of Indian Rail track or new rail extending beyond the municipal boundary).	Consider joint ventures and other forms of PSP which allow the public sector to own the rail infrastructure and other key components.	UMT remains a new area for all states. No stand alone UMT system in the world is fully self financing. Consequently, all new projects contemplated will require PPP. This means that the new PFI Units will need to clearly identify the social and community benefits from the public investment. Incentives are likely to last for some time and will have a significant impact on State budgets. Jurisdiction is also a key concern. Most of the options for Urban Mass Transit will involve track which is controlled by the Indian Railways. The current experience in Hyderabad may offer a useful guide for future developments in other cities.			
User charges highly unlikely to ensure commercial viability	The provision of subsidies, backed by adequate provision in future State budgets.	We believe that the selection of an appropriate form of PSP, and the consequential funding implications, should be carefully assessed by the proposed PFI Unit and approved by the Cabinet, before proceeding with detailed preparation of any specific project proposal. Significant support from the public sector will be needed to make any investment in Urban Mass Transit viable. Experience elsewhere indicates that it is impossible to cover the full cost of capital and operations from the farebox. South American and other Asian cities like Bangkok have provided full capital support for the infrastructure while the private sector provides the vehicles, systems and operations. This is likely the model that can be copied in India.			
Water and Sewerage					

CREATING A CAPABLE NODAL AGENCY

General constraint	Broad measures	Andhra Pradesh	Gujarat Progress of Implementation During Project	Karnataka	Madhya Pradesh
Absence of consolidated water and sanitation policy and legislation at State Level	A consolidated water supply and sanitation policy, and a comprehensive State-wide water and sewerage law, with clearly defined roles with regard to construction, operations and maintenance. This can be based on the National Water Policy 2002.	The draft consolidated water and sanitation policy prepared for the State should be finalised and introduced, and similarly the action plan finalised and implemented. This should be followed by a comprehensive sector law.			
Complex institutional arrangements for water and sanitation with potentially overlapping responsibilities	Start with relatively simple schemes (eg management contracts in urban areas with relatively simple institutional arrangements) before progressing to more complex concession agreements	The Visak Water project is now just beginning operation. Further bulk water projects are likely. Joint public and private participation will be essential to get the projects funded. In water distribution resolution of authority and responsibility will be important. Some form of regulatory control is recommended.	GIDB has already prepared a phased programme for the introduction PSP into the water sector that takes account of the institutional arrangements. Some form of regulatory control is recommended.	Development of water and sewerage projects is likely in the future. Consideration of some form of regulatory control is recommended.	
User charges unlikely to ensure commercial viability, except in a few cases (eg an industrial water scheme)	The provision of appropriately targeted subsidies to a private concessionaire, backed by adequate provision in future State budgets.	We believe that question of subsidies should be carefully assessed by the proposed PFI Unit and approved by the Cabinet, before proceeding with detailed preparation of any specific project proposal. An option for the distribution of water is to begin with efficiency improvement by contracting out operation of distribution systems with efficiency bonus clauses. Gradual expansion of private activity can be then staged. Experience elsewhere (Manila) has indicated that full concessioning of water supply and distribution may not be financially viable for some time, even with higher user charges.			

CREATING A CAPABLE NODAL AGENCY

General constraint	Broad measures	Andhra Pradesh	Gujarat	Karnataka	Madhya Pradesh
User and political resistance to PSP in water and to increases in user charges	Consider PSP schemes under which large efficiency improvements are made without exposure to user charges (eg rehabilitate–operate–transfer), followed by concessions with increases in tariff.	<p>Because of user and political resistance to fully compensatory schemes, implementation should be slow and careful. A strong role for the public sector is recommended.</p> <p>GIDB has already prepared a phased programme for the introduction PSP into the water sector that takes account of the likely willingness to pay of users.</p> <p>Replacing high cost trucked water with less expensive piped water may overcome some tariff resistance. But the process will be slow and will require a continuation of public service obligations for some time in the future.</p>			
Fear of monopoly abuse	Separation of policy, operations and regulation, and the establishment of an independent regulatory agency	Our proposals for the establishment of an independent regulator should be considered, and implemented as appropriate.			