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NOTE NO. 6 – MAY 2006

GRIDLINES

Sharing knowledge, experiences, and innovations in public-private partnerships in infrastructure

Lifting constraints to public-private partnerships in South Asia

The way toward better infrastructure services

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For countries in South Asia, bridging gaps in infrastructure is key to achieving goals for growth and poverty reduction. Over the years governments have underinvested in infrastructure assets and especially in maintaining them. Private investment has also been limited. Today policymakers increasingly recognize that public-private partnerships in infrastructure offer the most promise for developing infrastructure and improving services. How to ensure that such partnerships can succeed? Act on critical policy, regulatory, and institutional reforms, pay close attention to the design of transactions, and tackle key constraints to private participation.

Countries in South Asia face a dual challenge in infrastructure: many households and businesses lack access to services, and those that do have access suffer from unreliable and poor-quality service. Power cuts and shortages impose huge costs on consumers, with the biggest burden on industry and poor people. No city in the region has water available 24/7. Choked sewerage and sewage-polluted water systems pose serious health hazards. Neglected maintenance of roads causes congestion, many accidents, and excessive wear and tear on vehicles. And congested ports and poorly maintained highways hamper trade. Short of resources to meet the demand for infrastructure, governments are evaluating options for involving the private sector.

Modest private investment in South Asia

South Asia has relatively low levels of private participation in infrastructure. In 1990–2004 the region's 224 infrastructure projects with private participation attracted about US$55.4 billion in investment commitments, far short of commitments in the leading regions of Latin America and East Asia (figure 1). India accounted for much of that activity, with 152 projects and US$42 billion in investment (76 percent of the total), followed by Pakistan (16 percent) and Bangladesh (4 percent).

Investment flows in the region remained mostly steady over the 15-year period, by contrast with the steep declines seen in 1997–99 in East Asia and Latin America as a result of currency and economic crises (figure 2). Indeed, investment flows in South Asia have been gradually rising since 2000 and surpassed investment in East Asia in 2004.

Most private investment in South Asian infrastructure has gone to telecommunications and power generation. In telecommunications the introduction of competition in fixed and mobile services and the partial divestiture of government-owned companies brought investment commitments of US$27 billion in 1990–2004. Annual investment grew to a peak of US$4.4 billion in 1997, driven mainly by mobile service licenses granted by India.

In the electricity sector governments awarded 104 projects to the private sector during the period, bringing investment of US$24 billion (mainly for independent power producers, or IPPs). Annual investment peaked at US$4.6 billion in 1996 with the award of several IPPs in India and Pakistan, then declined sharply as some of these IPPs went into distress.

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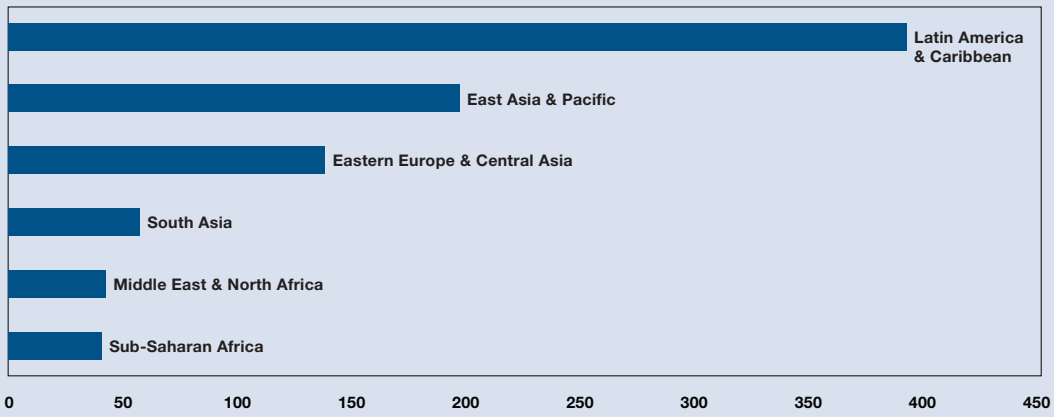
Helping to eliminate poverty and achieve sustainable development through public-private partnerships in infrastructure

FIGURE 1
South Asia lags far behind the leaders



Source: World Bank and PPIAF, Private Participation in Infrastructure (PPI) Project Database.

In transport, private participation has been concentrated in ports and highways. India, Pakistan, and Sri Lanka awarded 17 port development projects in 1990–2004, attracting about US$2.2 billion in investment commitments from both national and international players. In highways only India has succeeded in raising private investment (about US$1.6 billion), through innovative financing models and limited build-operate-transfer (BOT) projects.

Private investment in water supply and sanitation has been negligible, and attempts to award water concessions in India, Nepal, Pakistan, and Sri Lanka have met with little success. Some private sector involvement has been introduced under service contracts, but the most recent attempts to award management contracts to improve services have been stalled in India (Delhi) by strong opposition from stakeholders and in Nepal by political crisis.

Encouragingly, local and regional investors and operators are beginning to play a larger role. As some traditional international operators have retreated from large infrastructure projects, new players have emerged to fill the gap. While developed country investors accounted for 34 percent of investment in 1998–2003, in the last four years of that period their share declined to just 18 percent. After more than a decade of experience in infrastructure, local and regional investors are now better positioned to invest in the sector. In rural and remote areas small-scale private service providers can also play an important role in meeting needs.

Bangladesh, India, and Pakistan are all working to catalyze PPPs for infrastructure

Partnering to improve services

Driven by governments' objective of raising additional resources, most private participation in South Asia has been in greenfield projects. Indeed, 83.5 percent of the projects awarded to the private sector in 1990–2004 were greenfield operations. The rest were port concessions and divestitures in telecommunications and power.

Governments have a wide variety of options for partnering with the private sector, however—in ways that bring not only new resources for infrastructure but also knowledge and experience for sustained improvements in service delivery. The models for public-private partnership (PPP) range from management contracts to affermages, leases, concessions, and divestitures.[1] To select the one that best fits local needs and circumstances, a government must first be clear about the objectives of private participation. Another key factor in the choice is optimal allocation of responsibilities and risks between the public and private partners.

The governments of Bangladesh, India, and Pakistan have all initiated new policies and measures to catalyze PPPs for infrastructure development. In the transport sector, where ports, airports, highways, and railways are mostly owned and operated by the federal government, there is renewed interest in encouraging private participation. Governments are exploring BOT projects and other innovative models for using subsidy support to improve the viability of projects. In water and electricity governments are likely to adopt performance-based management, affermage, and lease contracts for utilities. In these

businesses the biggest constraint is lack of political will and public consensus on the role of the private sector. For all PPP programs the most critical elements for success will be the commitment of and coordination among different levels of government.

What to do? Minimize constraints

How quickly public-private partnerships can be implemented will depend on whether governments adopt the right policy, regulatory, and institutional reforms. To ensure that such partnerships can succeed will require tackling several key constraints.

Building consensus for PPPs

There is little consensus among stakeholders on the benefits of involving the private sector in infrastructure, especially in power and water utilities, in part because of ideological opposition and in part owing to limited experience with private participation. Moving ahead successfully with PPP projects in the medium term will require continued efforts to build awareness of the positive experiences with PPPs, hold consultations with policymakers and other key stakeholders on the range of options for PPPs, and address stakeholders' concerns up-front during the planning and design stage.

Moving toward cost recovery

Prices for infrastructure services in South Asia generally cover only a small share of the costs. Public and political opposition to involving the private sector often rests on concerns about price increases and exclusion of the poor. To be politically acceptable, a move toward cost recovery is likely to be gradual and must be accompanied by efforts to reduce inefficiency. In addition, the design of PPP projects should include innovative ways to deliver subsidies to the poor.

To ensure that PPP projects are viable, governments may need to provide some funding during the transition to full cost recovery through user charges. The Indian government's "viability gap fund" subsidizes up to 40 percent of the capital cost to improve commercial viability and facilitate private participation.

Improving transparency

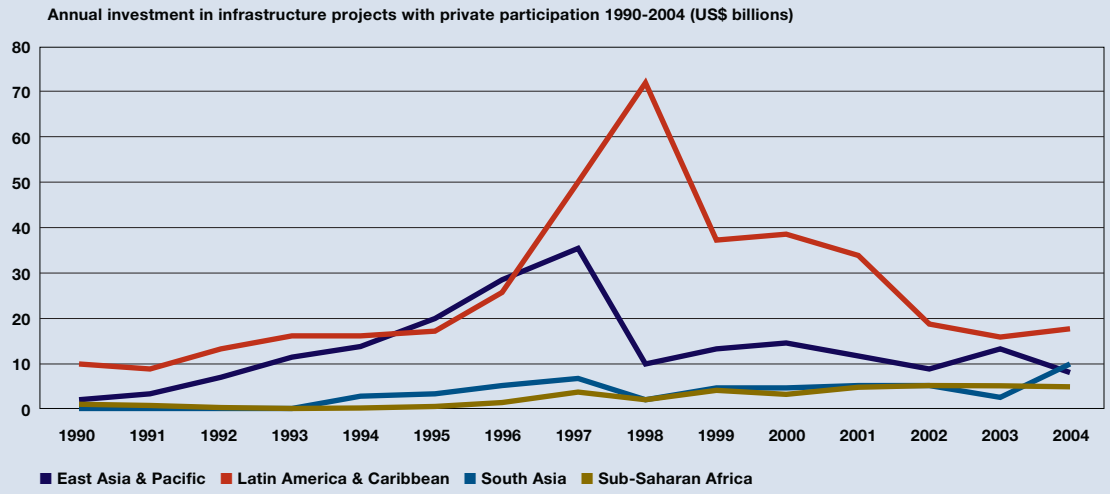
Several South Asian IPPs awarded on the basis of memoranda of understanding in the 1990s attracted criticism and went into renegotiations. The award of mobile and fixed line telecommunications licenses in India in 1993 and 1995 encountered delays and lower investor interest because of a lack of clarity on bidding criteria and the evaluation process. These problems point to a need to ensure that governments' procurement policy encourages competition and transparency for all stakeholders. It should make the objectives of transactions explicit, use well-defined selection criteria, and be designed to achieve fair, cost-effective, and timely outcomes.

Enhancing government capacity

Wide-ranging institutional structures have evolved across the countries of South Asia to help procure private provision of infrastructure. But sector

Critical to success is government commitment to easing the constraints to private participation

FIGURE 2
But investment trends in South Asia are steady and rising



Source: World Bank and PPIAF, Private Participation in Infrastructure (PPI) Project Database.

ministries and their agencies tasked with developing PPP projects generally have limited capacity to design and implement those projects, particularly in assessing commercial issues, allocating risk, and managing procurement.

To address this constraint, several countries pursuing broad PPP programs have set up dedicated, cross-sectoral professional units to support their implementation, with responsibilities ranging from disseminating information and preparing guidelines to designing and implementing transactions. These units can guide and complement the efforts of line ministries and provincial governments in developing frameworks for PPPs, methodologies for evaluating PPP options and associated fiscal costs, standard contracts, guidance on managing the bid process, and monitoring and evaluation tools.

Fostering effective regulation

Private investors' perception of regulatory risk in South Asia has been among the main factors limiting their investments in infrastructure. The region's experience with independent regulators in power and telecommunications has been mixed. Concerns have often arisen about lack of clarity in roles, high levels of discretion, and uncertainty in regulatory rules. To counter such concerns, clear separation of policy and regulatory functions and an institutional framework that fosters independent and effective regulatory oversight are critical. To enhance the effectiveness of regulatory institutions, their autonomy, accountability, and independence should be written into law. Also a priority is technical assistance to build regulatory capacity.

Easing financing constraints

Financing infrastructure projects is a challenge in South Asian countries, where financial markets are shallow and there are limited options for financing long-term projects. To ease financing constraints, key priorities include developing longer-term bond markets; developing investment policies and regulatory guidelines that encourage banks, insurance companies, pension and mutual funds, and other financial institutions to participate in financing infrastructure projects; and encouraging the use of innovative financing instruments to mitigate lenders' risks. To help close the funding gap, the governments of Bangladesh, India, and Pakistan are establishing facilities to provide long-term finance for infrastructure projects.

Moving forward

South Asian governments have set ambitious targets for expanding access to services and improving their quality. Meeting these targets will require the right policy, regulatory, and institutional reforms. As governments move forward with PPP programs, the factor most critical to success will be their commitment to minimizing the constraints to private participation. Options for PPPs should be evaluated through a comprehensive approach that includes an assessment of their benefits, risk allocation, affordability, and value for money. Building confidence among stakeholders will also be important, and that can best be done by successfully implementing some PPP projects in the short term and demonstrating efficiency gains. But to achieve all these objectives will require strengthening institutional capacity to design, implement, and monitor PPP transactions.

Note

1 The definition of PPPs varies. In many countries PPP programs center on projects for services traditionally provided by the public sector, have the private sector bear significant risks, and also assign either substantial risk to the public sector or a major role in purchasing services.

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