Strategy to revitalize PPPs in India

India’s infrastructure deficit continues to persist despite the relative catch-up in recent years. The Asian Development Bank, in its report titled “Meeting Asia’s Infrastructure Needs”, has estimated that $4.36 trillion is needed to fix India’s infrastructure deficit by 2030. That entails more than $300 billion of spending every year for the next 13 years, as compared to recent spend rates of $120 billion per year.

Much of this has to come from the private sector, but weakening economic growth and the debt overhang problem have constrained both the capacity and flow of private investment in asset creation. Even the successful awards in roads, rail, airports and other infrastructure segments have been mired in implementation challenges, affecting the private sector’s capacity to invest afresh. Broad estimates indicate that the private arm of public-private partnerships (PPPs) will need to contribute at least $90 billion every year for the next 10 years, entailing a potential borrowing of at least $55-60 billion a year. That is quite a large sum for the stretched balance sheets of lenders and investors.

The difficult circumstances have prompted the government to step in and increase public expenditure on infrastructure but by all counts the private sector will need to play a key role. India’s debt-to-gross domestic product ratio is relatively high (65%) and with already stretched finances, the government’s ability to fund new assets will remain constrained.

It means that the government has to hit the reset button on PPPs to address core issues. Three aspects need immediate attention—restructuring PPP contracts through an objective process, broadening and deepening access to long-term credit and tightening procurement processes and timelines. On the first, it is noteworthy that many of the base contracts were drawn up in a different era. That has changed, with disruptions in many forms overtaking every sector. It has become impossible to foresee factors that would have a significant impact on the performance over a long-term contract period. The Kelkar committee recommendations in 2015 are worth reflecting on. These are not matters of negotiation of terms; deep changes and redrafts of concession contracts would be needed based on evolving asset risk profiles, market conditions, technology impacts, investor appetite and bankability.

On credit, the situation has aggravated sharply, with the non-performing assets (NPAs) of domestic lenders mounting. While the international credit and financing market is an avenue, high-quality sponsors and assets remain few. The dearth of bankable projects has contributed partly to the financing challenge, but the inability of project development and procurement agencies to adopt fairer risk-sharing principles and take on contingent financing obligations has contributed equally. The Kelkar committee report has commented vigorously on this and if we indeed want private investments at scale, it is perhaps time to define objective rules of the game.

Poor project preparation also remains an issue. Without adequate preparedness and appropriate risk allocation, large capital pools remain out of access. Bonds have worked very well overseas as a source of project finance, given their relative advantages over commercial bank debt, but the corporate or municipal bond market in India is still not deep enough to support long-term credit and refinancing commitments, unless backed by sovereign guarantees, which are difficult to come by. High project risks, poor entity rating and regulatory uncertainties also make yield-based structures difficult to implement.

Market making assumes greater significance in this context. Financial institutions like India Infrastructure Finance Co. Ltd and the National Infrastructure Investment Fund (NIIF) should lead the market-making role by securing foreign capital and providing equity support to critical infrastructure projects. These are imperative considering the government’s current logjam in cleaning up the balance sheets of public sector banks and making them creditworthy again. Raising $165 billion annually for the next decade looks infeasible otherwise.

Finally, elongated timelines due to lack of institutional capacity in the project-award process have been hurting. Single-window clearance has rarely worked and inability to resolve disputes during the implementation stage quickly has been a big deterrent for high-quality investors. The whole value-for-money principle that favours PPPs over traditional public sector procurement is defeated with time and cost overruns resulting from delayed pre-development and procurement activities. As a case in point, the Navi Mumbai International Airport (NMIA) transaction took nearly a decade to complete from the time the first master plan was prepared and three years to identify the successful bidder after the tenders were invited.

Experience reveals that strong leadership can make a big difference. The Delhi Metro is a good example of how projects can and should be implemented. It had to deal with all kinds of issues typical of large projects—land acquisition, utility shifting, rehabilitation of displaced land owners, migrant workers, construction and engineering challenges, procurement risks and multiple stakeholders—and still came out on top. The same quality of leadership is required for all mega projects, whether implemented by the government or its agencies or by the private sector, and needs to be nurtured and encouraged.

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