

"Infrastructure at Crossroads"

Review of Gajendra Haldea's book

There aren't many books to be found in India that are written by bureaucrats on economic policy. A few that are available have been authored by ex-bureaucrats in the form of memoirs, mostly about their own personal and professional journey.

To find a book by an author who is still part of the government is indeed unusual. To have him or her speak plainly on the issues of the day, and be critical of the ways of the government, even more so.

But Gajendra Haldea is not your typical bureaucrat. He has not followed the path of most of his fellow IAS officers which is: do not rock the boat, avoid controversy at all costs and do not disagree with your bosses.

He has been more than willing to express his views in public fora, including media. He has often opposed positions taken by powerful ministers and secretaries. He has even filed a petition in court, against the Delhi government, on the manner of privatisation of power distribution.

Instead of taking the "joint secretary-to-additional secretary-to-secretary path", with all the trappings of "power", he has chosen to spend his time in organisations like NCAER and the Planning Commission (a place where IAS officers go after they retire) to work on position papers and policy formulation.

In the process, he has made more of a contribution and had more of an impact than his peers. He has helped draft the Electricity Act, written the model concession agreement for road projects (and other sectors), and standardised the qualification and bidding process

and documents for PPP projects.

Even as a young joint secretary in the Ministry of Finance, he fought tenaciously against the guarantees being provided to fast-track power projects, ensuring that the contingent liabilities of the Indian government were reduced.

There are many who question the "perfectionist" approach of Dr Haldea. Perfect, they say, must not become an enemy of the good. So let us accept what is "good". His answer: one must ensure that the good is at least good enough.

There is no doubt that Dr Haldea's insistence on diligence, detail and standardisation has sometimes led to delays in the short run but it can be argued that these also provide the proper foundation for long-term development.

It is also true that his stand on these issues has prevented many corrupt ministers from going ahead with grandiose projects and contracts loaded in favour of particular companies.

For these reasons, the views of the man known as "Mr Infrastructure" will be of high interest to anyone involved with Indian infrastructure. Here is our take on the book...



process in the power sector and why it has not borne fruit. The fourth section is even more specific, dealing with the privatisation of power distribution in Delhi. The fifth section describes the challenges and the tasks ahead, and also offers some thoughts on the way forward.

The most satisfying sections are the first and the last, along with the prologue and the epilogue, which are more "big picture" and strategic in perspective.

The middle three sections of the book are a collection of articles published in newspapers from 2000 to 2011. Because there is more than one article on many topics, there is a bit of repetition. Some of them are also "dated" but, happily, the author has provided a postscript with each of those, giving an update on developments since the publication and his own take on them.

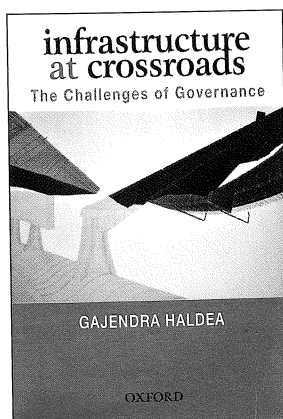
Key themes and arguments

The book analyses infrastructure development in India over the last two decades, identifies the key deficiencies and offers both general principles and specific courses of action to remedy the situation. It is, therefore, both analytical and prescriptive. Here are the key themes and arguments....

Importance of private participation:

The key reason for the infrastructure deficit is the unwillingness of the public sector to let go. Wherever private investment and competition are introduced, the services improve and the tariffs decline. Wherever the public sector continues to monopolise, the service quality does not improve while the tariffs increase.

Governance: The most important challenge is governance of infrastructure services. Manufacturing and other sectors of the



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Structure

The book is divided into five sections. The first section is an analysis of where things stand, in each sector, and identifies the key challenges. The second section, to a large extent, is an analysis and commentary on what has gone wrong. The third section focuses on the reform

Indian economy have been freed from the “licence raj” but the infrastructure sectors are governed by the “contract raj”. Politicians and bureaucrats are reluctant to give up control, given the magnitude and scale of infrastructure projects and the resulting opportunities for graft and profiteering.

As a result, growth in the infrastructure sectors has lagged behind that in other sectors. The only exceptions have been telecom and aviation (airlines), which have grown dramatically, simply because they have been thrown open to competition.

Players cannot be umpires: The reform process in the infrastructure sectors has often been led by incumbents, who have much to lose if true reform is achieved. The reform process should be managed by an agency that is both competent to handle complex issues and free of conflict of interest. Otherwise, the players end up being the umpires. Dr Haldea points out that some of the more successful reform efforts were led by “non-incumbents”, whether it was the finance ministry demolishing the licence raj in 1991 or a group of ministers overcoming resistance from the telecom ministry while formulating the National Telecom Policy in 1999-2000.

Regulation: The regulators must also be independent, competent and accountable. The regulation should be light-handed where competition is feasible and close where there are elements of monopoly. What is most important is that in “carriage infrastructure” (airports/transmission/ports/roads), which tend to be natural monopolies, the regulators

The way forward: Key principles

- Incumbent mind-set and conflict of interest are key challenges. They need to be addressed through effective inter-ministerial processes, which are implemented by the finance ministry and the Planning Commission. Participation of other stakeholders such as users, investors and lenders is also critical.
- The effort to build world-class infrastructure must also ensure that the services are both cost-effective and affordable.
- We need a much wider ownership and broader support for systemic reforms in infrastructure, and thus, much greater public awareness and participation.
- Restoring accountability and professionalism are key challenges of governance to address corruption and inadequate delivery.
- We need greater due diligence and ability to anticipate in the governance of the infrastructure sectors.

must ensure non-discriminatory access and reasonable tariffs.

Over-engineering of projects and cost-effectiveness: Dr Haldea believes that many projects are over-engineered and gold-plated. This increases the value of the contracts and thus, perhaps, the payoffs to the overseeing authorities. But the public ends up paying and some projects become financially unviable. The only way to support and sustain large infrastructure programmes is to levy user charges. And to make sure that these are affordable, projects should not be over-engineered.

Item rate versus turnkey contracts: One of the key reasons for time and cost overruns in public infrastructure projects is the practice of “item rate contracts”, where per unit rates are fixed for products and services but there are no caps on quantity or limits on time. He argues that turnkey contracts, where the cost of overruns will be borne by the contractor, are

a much better option but are not often used by the government because it loses “control”.

Cost-plus versus competitive bidding: Cost-plus projects tend to be costlier because there is no incentive for efficiency. They also end up offering inflated returns to project sponsors. Competitive bidding should be the preferred route for infrastructure projects.

Standardisation of the bidding process and documents: The bidding processes and documents must be standardised. Otherwise the agreements will either be drafted by agencies that are not equipped to do so or by potential sponsors and concessionaires, as has been the case in many sectors and states.

Take on the power sector

The Electricity Act was a comprehensive and world-class legislation. But there has been a failure of governance. The two most important elements of the legislation – open access and introduction of competition – have not been implemented, mainly because of resistance from the incumbent players and authorities.

As a result, even after the unbundling of the state electricity boards, we have ended up with an interconnected chain of monopolies, led by a “single buyer” (transco or discom). There is no market that has been created and thus no efficiency gains that have been achieved. We have simply gone from public monopolies to a mix of private and public monopolies. ▀

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Key prescriptions

Power: Introduction of open access and competition in the supply of electricity to consumers.

Highways: Restructuring of the NHAI to enable it to function on business principles, like a Navratna public sector undertaking; encourage adoption of the PPP route at the state level.

Ports: Corporatisation of port trusts and, possibly, their privatisation.

Airports: Private participation in all airports; containment of user charges; separation of air traffic control from the Airports Authority of India.

Railways: Corporatisation; rationalisation of the fare structure; attracting private investment and modernisation of the network and rolling stock.

Regulation: Objective selection of regulators; accountability to legislative assemblies and Parliament.

Gajendra Haldea's sector view: Selected excerpts

Power: The politicisation of SEBs over the years had led to unsustainable tariffs, weak managements, excessive pilferage, and rising losses. In 2003, the Central Government enacted the Electricity Act to create separate entities for generation, transmission, and distribution, respectively, with a view to enabling competition that would improve the services and reduce costs, besides accelerating the flow of investment. However, seven years have passed but competition remains conspicuous by its absence. The state governments have found ways to ensure that the supply of electricity to consumers remains a monopoly of the state-owned distribution companies.

It is evident that the unbundling of the SEBs has been pursued mechanically as an end in itself, though it was meant primarily as a means to enable competition. Despite the mandatory provisions of law, the incumbents have created barriers to the introduction of competition in supply to the consumers.

The rapid rise in the losses of distribution companies cannot be sustained for long and it may soon reach a flash point. The single most critical reform is the introduction of open access and competition in the supply of electricity to consumers. This alone can turn around the power sector within a comparatively short period of time.

Highways: There is growing consensus that investment in highways should be sustained by user charges so that road projects become self-sustaining. This paradigm shift towards commercialisation of highway projects constitutes the foundation of the PPP approach.

NHAI was created by law to function on business principles, which essentially means that it should break even on its costs and revenues. It could either borrow from the market and repay out of user charges or award projects on a PPP basis to private entities. Unfortunately, NHAI has not shown the dynamism needed to pursue either of these self-sustaining alternatives. The pace of the highway development programme remains slow while certain aspects do not seem to reflect adequate sensitivity to commercial considerations that are critical for PPP. Moreover, there is a tendency to over-engineer projects, which increases the costs of the programme, which would ultimately face the hurdle of budgetary constraints.

The Ministry of Road Transport and Highways has recently made significant concessions in the toll rates, which were already very low by international standards. Increasing the project costs, on the one hand, while neglecting resource mobilisation, on the other hand, has jeopardised the financial health of NHAI. These handicaps are often compounded by allegations of corruption, manipulation, and cartelisation, some of which are under investigation.

Ports: The major ports in India function through their respective Port Trusts which do not have adequate capacity, commercial flexibility, and functional delegation.

In 1997, the PPP mode was introduced for building and operating port terminals through concessions to be awarded by the Port Trusts. However, between 1997-98 and 2007-08, only 15 PPP concessions

for port terminals were awarded, and these were based on a sub-optimal framework that has promoted user exploitation, rent-seeking, and litigation. Even after the rationalisation and standardisation of documents and processes was completed, the roll out of projects has continued to be inadequate, primarily on account of the resistance of Port Trusts.

The Port Trusts also need to be corporatised. There has been resistance to this initiative for the past several years, but it can be argued that governance and transparency would increase greatly if the major ports were not only corporatised but also privatised.

Airports: India can take pride in building world-class airports at Delhi, Mumbai, Bengaluru, and Hyderabad. These projects have clearly demonstrated the benefits of private sector efficiencies as compared to the airports operated by the Airports Authority of India (AAI). However, a closer scrutiny of these cases would suggest that the selection process and contract terms were wanting in several aspects. The existing concession framework, though comprehensive and balanced in most parts, could be viewed as sub-optimal in some parts. For example, there is little oversight or restraint in expending capital costs that directly raise the user charges. In the Delhi and Mumbai airports, some post-bid concessions have also been granted.

A number of other airports are undergoing a complete makeover through the award of high-cost construction contracts that would inevitably lead to an upward revision of user charges. The existing arrangements for the operation and management of these airports would remain unchanged in the hands of AAI. The gains of the PPP approach at the four metro airports have obviously failed to move the incumbent AAI to cede control in favour of PPPs.

Railways: The railways sector is the least reformed, functioning as a monolithic government department, unlike in any major economy including even China. Several reports on the functioning of railways have pointed out that in the absence of corporatisation, it displays an inadequate commercial perspective; operates an outdated network and rolling stock; suffers from huge over-staffing; recovers irrational and unsustainable passenger fares; and levies excessive freight charges that add to the costs of the economy. As a result, the railways sector has steadily lost its market share in favour of roads and air travel. This has not only imposed large additional costs on the economy as a whole, but also degraded the environment.

In the present institutional arrangement, there is little hope for reform, which is critical for achieving energy efficiency transport and for the transition to a low carbon economy. The problem is compounded by the colonial legacy of a separate Railway Budget that perpetuates a government within the government. In the absence of modernisation, the railways would continue to be a drag on the economy. This could well continue for years to come, until a serious crisis would precipitate the much-needed reform. ▀