The Increasing Incidence of PPP Project Cancellations in India

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A spurt in the cancellation of public–private partnership projects in recent times can be attributted to macroeconomic crises, inherent problems in the water sector projects, and foreign sponsorship of these projects. Since giving the renegotiation relief to many of these projects seems to be problematic, cancellation is probably the only way for the government to elicit more realistic bidding from the private sector.

Views expressed in the article are personal.

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Twenty-six public–private partnership (PPP) road projects have been cancelled in India since 2013. With this, India has caught up with the worldwide average rate of PPP project cancellations[1] (Table 1). While 4.7% of the 6,318 PPP projects were cancelled[2] in developing countries worldwide during the period 1990–2014, India has seen 4% of its 834 PPP projects being cancelled in the same period. As a percentage of total investments, India has seen 4.7% of these investments cancelled compared to the worldwide rate of 4%.

Admittedly, these percentages seem low as "freedom to fail" is part of the reason to turn to the private sector in infrastructure provisioning. The low proportion of project cancellations could be because infrastructure projects acquire a resilience of their own once they are set up owing to concerns about service continuity (Tata Mundra Project), possible termination payments (Delhi–Noida toll road), and negative publicity surrounding these perceived failures.

PPP Project Cancellation

The most important factors in PPP project cancellation have been identified as macroeconomic crises, challenges involved in the water sector, and foreign sponsorship of projects (Pratap 2011: 46, 51).

In the list of cancelled projects, toll road projects in Mexico, power generation projects in Indonesia, and water projects in Argentina are featured prominently. All these projects suffered from macroeconomic shocks occurring at different times in these countries—Mexico in 1994, East Asia in 1997, and Argentina in 2002.

Macroeconomic shocks can dramatically increase the cost of project financing, through exchange rate depreciation when foreign currency financing is used or through increases in domestic interest rates. These shocks may also affect demand for services from the projects through lower economic growth.

In the water and sewerage sector, there are many important challenges—low cost recovery, dilapidated assets, and the need for substantial investments—and political sensitivities around the very involvement of the private sector in water supply can make for a difficult operating environment. While private sector efficiencies may narrow the cost under-recovery, generally the initial gap between revenues and costs may be too high to bridge with politically feasible tariff increases, which may result in project cancellation. In fact, 51 of the 864 PPP projects (5.9%) in the water and sanitation sector in developing countries worldwide have been cancelled, accounting for $16.1 billion of the $75.2 billion (21.4%) investments—the highest cancellation rate in terms of investments across all infrastructure sectors.

The presence of foreign sponsors engenders greater political sensitivity than domestic sponsors, and foreign sponsors may feel more able to abandon a project in difficulty. Some have argued that domestic firms are likely to be more accommodating in renegotiations than foreign multinational firms. As a result, projects with domestic sponsors are less likely to be cancelled even after a macroeconomic crisis, as with some of the Indonesian power projects after the 1997 East Asian financial crisis (Wells and Ahmed 2007). In addition, projects with foreign sponsors may be more likely to use foreign financing, which can cause mismatches when revenues are earned

Table 1: Cancelled Infrastructure Projects with Private Participation in Developing Countries and India, 1990–2014

Countries	Projects Reaching Financial Closure		Projects Cancelled		Cancelled Projects as Percent of Total	
	Number	Investment Commitment[a]	Number	Investment Commitment[a]	By Number	By Investment Commitment
Developing countries, including India	6,318	2,262	297	89.7	4.7	4
India	834	330	33	15.6	4	4.7

[a] in current $ billion.
Source: World Bank, Private Participation in Infrastructure (PPI) Project Database.[3]

in local currency as in most infrastructure projects.

Interactions among these variables may increase the probability of project cancellations dramatically. Thus, the foreign-sponsored, water and sewerage project in Argentina, Aguas Argentinas, failed in the aftermath of the Argentinean macroeconomic crisis of 2002.

Many of these factors may be playing out in India too. The Dabhol Power Project (now called Ratnagiri Gas and Power Private Limited—RGPPL), featured among the cancelled projects in India in the World Bank's Private Participation in Infrastructure (PPI) Project Database, was cancelled partly because it had foreign sponsors (project sponsors of Dabhol included Enron, Bechtel, and General Electric, all belonging to the United States—US). Foreign-sponsored projects in underpriced sectors like power are highly susceptible to cancellation, because they become highly visible and politically contentious as in the case of Dabhol Power Project. The presence of foreign sponsors adds to the problems, as increases in retail power tariffs to make projects viable are viewed as sell-out of national interests to foreigners. After the Dabhol debacle and given the sorry financial state of the main power offtakers (the State Electricity Distribution companies), foreign investors view the political and commercial risks of investing in India to be excessive (though the sentiment seems to have improved lately). This partly explains the growing importance of domestic firms (like the National Thermal Power Corporation, Reliance Energy, and Tata Power) in the Indian power sector. It is also no coincidence that another cancelled project in India, the Central Electricity Supply Company of Odisha also had a foreign sponsor (AES Corporation of the US).

The union territory of Delhi was trying to induct the private sector in both power and water distribution at the turn of the millennium. However, it failed in the water sector partly because of the low cost recovery and the presence of foreign consultants in the water distribution sector vis-à-vis the power distribution sector.

The post-2013 project cancellations in the Indian road sector are mainly a result of aggressive bidding by the private sector and inadequately prepared projects by the public sector (in terms of insufficient land acquisition[4] and delay in forest and environment clearances). Featured among these cancellations is the Shivpuri–Dewas project in Madhya Pradesh promoted by the GVK group, involving a total project cost of ₹3,000 crore. Specifically, there are no foreign sponsors in these cancelled road projects.

Private companies bid aggressively to make sure that they bag the projects, and the possibilities of renegotiation allow them not to suffer the costs of aggressive bidding as in the case of Tata Mundra and Delhi and Mumbai airports. Tata Mundra (formally Coastal Gujarat Power Limited) was able to obtain relief from the Central Electricity Regulatory Commission, while Delhi and Mumbai airports were able to impose development fees on users though such fees were not envisaged in the Operation, Management and Development Agreement that the sponsors for both these projects (GMR and GVK respectively) signed with the government.[5]

What has happened lately is that the renegotiation route to financial sustainability of PPP projects is closed. Corruption-wary decision-makers are circumspect about giving relief through the renegotiation route, and, therefore, there is no option for the project sponsors that bid aggressively but to walk out of the projects to cut losses. It is also true that the road sector has seen the maximum number of projects in the Indian PPP programme (381 of the 834 Indian PPP projects (or 46%) that saw financial closure in 1990–2014 are in the road sector as per the PPI Project Database) and quite a few of them are stalled. Giving the renegotiation relief to many of these projects would have been problematic, and so cancellation was probably the only remedy for such projects.

Indian and Mexican Road Project Cancellations

India and Mexico have the overt infamy of being countries with the second (33 projects) and third highest (21 projects) number of PPP project cancellations respectively.[6] If one sees the sectoral break-up of the cancelled projects in these countries, one would realise that about three-fourths of these projects were in the road sector. India and Mexico also account for 60% of the road projects that have been cancelled worldwide to date.

In the period 1989–94, the Government of Mexico undertook an ambitious programme of constructing about 5,500 kilometres of private greenfield toll roads in order to benefit from the opportunity provided by North American Free Trade Agreement (NAFTA). By 1995, about 53 contracts had been awarded. However, construction costs were frequently underestimated while traffic was overestimated in the bids (traffic volumes averaged 25%–65% of originally forecasted levels as per one estimate; Standard & Poor's (2006) has found that traffic forecasts turned out to be too optimistic in more than 75% of cases), making the bids aggressive just as in the case of India.

Additionally, just like India where the concessioning authority, National Highways Authority of India (NHAI), in its rush to show better results put road stretches with land acquisition much lesser than the desired 80% of the required land, concessions in Mexico were awarded before all permits, approvals, and the right-of-way were secured, introducing delays and exposing concessionaires to community pressures for route realignment—putting upward pressure on costs (Standard & Poor's 2006).

Most of these projects were cancelled in the wake of the Mexican peso crisis of 1994, when highly leveraged foreign-financed firms suffered financial bankruptcy because of the macroeconomic crisis that the country experienced in that year. Toll road traffic declined by 12% in 1995, foreign currency denominated loans became huge liabilities as the domestic currency lost value, and floating rate debt also became expensive to service when short-term interest rates increased to over 71% in April 1995. As per the PPI Project Database of the World Bank, a total of 16 private toll road projects were cancelled in the wake of the Mexican macroeconomic crisis of 1994. Unlike Mexico, India did not suffer a macroeconomic crisis which resulted in a wholesale cancellation of PPP projects.

In Mexico, the concessions were taken over by the federal government because of concerns about the health of the construction and the banking industry. Some of these projects were reconcessioned later after improving the PPP policy regime, given the fiscal resource constraints and the need for increased road infrastructure. Taking a cue from the Mexican experience, India would do well to reconcession some of the projects that have been taken over for similar reasons. What will work in favour of the reconcessioning is that these highway projects have reached the stage of financial closure and would have better data with more predictable cash flows and growth projections rather than being totally greenfield projects, where it is difficult to make traffic forecasts with reasonable degree of accuracy.

Conclusions

The private sector exits only a small fraction of private infrastructure projects before the contract ends. Yet such cancellations can have a sustained impact on a country's PPP programme, reducing the private sector's confidence in the government's commitment as well as the government's confidence in the robustness and "value for money" of these arrangements (Harris and Pratap 2009). This seems to be playing out in India with limited private interest in infrastructure projects (World Bank 2015)[7] and government emphasising the public sector route to infrastructure financing. As the *Economic Survey 2014–15* says:

> India needs to tread the path of investment-driven growth. Can the private sector be expected to rise to the occasion? Highly leveraged corporate balance sheets, and a banking system under severe stress suggest that this will prove challenging. Against this backdrop, public investment may need to be augmented to recreate an environment to crowd-in private investment. (Government of India 2015: 74–75)

However, it also needs to be borne in mind that the recent bout of PPP project cancellations in India is not necessarily bad. Rather than going in for repeated renegotiations to try and sweeten the deal for the private sector, cancellation is probably the only way to elicit more realistic bidding from the private sector. The pain that the stakeholders (including private sponsors) are suffering now because of increasing cancellations is probably the necessary price that needs to be paid for a better tomorrow.

NOTES

1 The incidence of project cancellation was less than 1% in India till 2012.

2 As per the Private Participation in Infrastructure (PPI) Project Database of the World Bank, a project is deemed to have been cancelled if, before the end of the contract period, the private company sells or transfers its economic interest in the project to the public sector; the private company physically abandons the project (such as withdrawing all staff); or the private company ceases operations or halts construction for 15% or more of the licence or concession period, following the revocation of the licence or repudiation of the contract.

3 World Bank's PPI Project Database collects and disseminates information on infrastructure projects with private participation in low- and middle-income countries.

4 The Tilaiya Ultra Mega Power Project (UMPP) saw cancellation in April 2015 overtly due to the incessant delays in land acquisition.

5 Allowing Delhi International Airport Limited to levy and use the development fees violates one of the basic provisions of Operation, Management and Development Agreement, which was part of the bid documents.

6 China with 36 PPP project cancellations has the highest number of such cancellations.

7 In 2014, India recorded a $6.2 billion investment in private infrastructure projects—a nine-year low.

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