

SECOND ANNUAL GLOBAL REGULATORY NETWORK CONFERENCE

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Session V: “Encouraging Investments”

Leveraging finance

- *“Infrastructure can deliver major benefits in economic growth, poverty alleviation, and environmental sustainability – but only when it provides services that respond to effective demand and does so efficiently...”*
- *... the causes of poor past performance, and the source of improved performance, lie in the incentives facing providers to ensure efficient, responsive delivery of infrastructure services, incentives need to be changed through the application of three instruments - commercial management, competition, and stakeholder involvement.”*

World Development Report, 1994

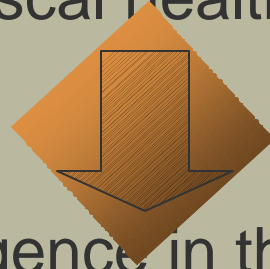
Investments in infrastructure

- **Characteristics of investments in the infrastructure sector**
 - Up-front
 - High degree of asset specificity
 - Long payback periods
 - Revenue streams/Return
 - Developed countries - typically regulated and relatively certain
 - Developing Countries - Uncertainty

■ **The above factors limit the participation of the private sector in Developing nations**

Public Vs Private?

- Deterioration in fiscal health of governments

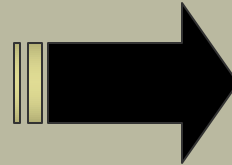


Growing convergence in the cost of financing for public investment and private investment related to the inherent risks of the project

- Private infrastructure may appear more expensive, increased efficiency could ultimately result in lower costs
- Techno-economic changes have also made greater private participation possible

Public Vs Private?

- The ongoing changes in technology and need for increased efficiency in delivery



- Greater participation of the private sector in the future
- Even in areas of social responsibility for providing universal access to the underprivileged

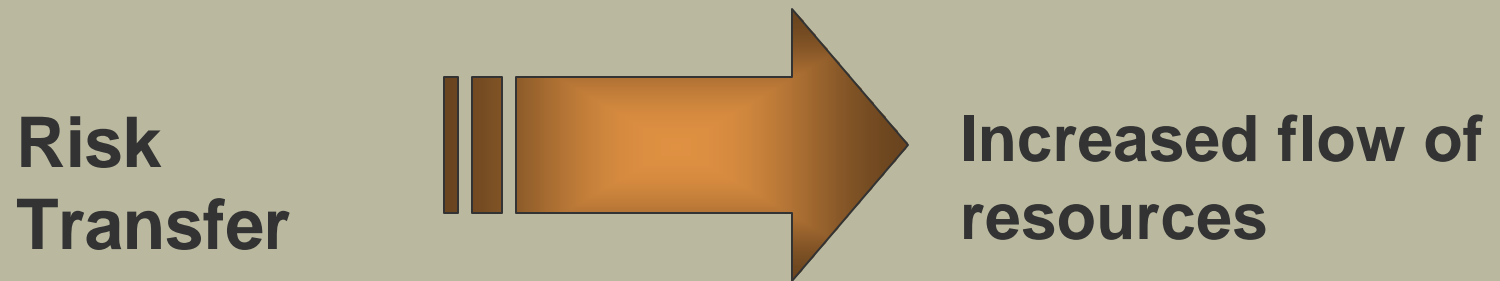
- ❖ The public sector to have significant presence in infrastructure, though fiscal pressures will increasingly constraint the government
- ❖ Policies for financing infrastructure will thus have to look at the concerns of both the sectors

Issues to be addressed.....

.....to leverage finance

- Tariff and Collection Problems
- Entry problems
- Allocation of risks between the equity investor, the lender and the government.
- Financial Sector reform

Risk and risk allocation



Good risk allocation between the public and private sector requires that risk be allocated to the party that is able to control it best

Political and Regulatory Risk

- Definition
 - Actions and inaction on the part of governmental authorities
- Infrastructure projects features:
 - Public Supervision
 - Essential commodity
 - Long pay back period: Sunk cost
 - Government-owned entities major supplier & buyers from private firm in most cases
 - Currency convertibility and remission risk
- Role of regulatory Bodies to mitigate these risks

CASE I: Cogentrix

■ Events

- 1992: Interest shown, given the status of among the eight fastest project
- 1993: PPA signed
- 1996-97: PIL by environmentalist and also on Corruption charges
- Nov 1997: Renegotiated PPA signed
- June 1999: Forced to renegotiate as new policy came in.
- Dec 1999: Walked out the project
- Later all charges cleared by the Supreme Court

CASE I: Cogentrix

■ Issues:

- What should be the mechanism to ensure that validity of continuity of already concluded contract would not depend on political compulsions of successive governments?
- Should the policy changes be prospective or retroactive i.e. should policy change effect previous contracts/PPA?

CASE II: KESCO Privatisation

■ Events

- March 1999: Selection of bidders
- January 2000: Request for proposal (RFP) issued
- 1st March 2000: First date bidding
- July 2000: First tariff order 2000-01 issued
- Bidding date extended
- KESCO unable to achieve the targets laid down by the Commission: T&D loss reduction, collection efficiency.
- Feb, 2001: KESCO applied for 2001-02 tariff order
 - Demanded MYT framework
- Nov 2001: Tariff Order 2001-02 issued
 - The Commission has not accepted the framework stating some reasons and issues.

Issues

- Sufficient Data is not available to correctly set the initial level.
- Principles for sharing of risk if demand and/or demand-mix changes substantially.
- What should be the basis for laying down targets for investment in advance and method for relating it to target improvements.
- Linking of the return on capital base to achievement of certain performance standards such as improvement in service quality, extension of coverage to specified group of consumers' etc.

Telecom Sector

Case III: NLDO Issue

- December 1999: The TRAI, recommended that there would be free competition with open entry subject to pre-qualification and performance obligation.
 - The recommendation was strongly opposed by the basic and cellular service, it would adversely affect the viability of the existing basic and cellular service providers.
- April 2000: Matter again referred to new TRAI; the regulator changed its earlier stand, allowed limited competition
- Issue: There is a need to have policies that are consistent and predictable

Case IV: Change in Regulatory Framework

- The TRAI Act 1997 amended through ordinance:
 - reconstituted a regulatory institution, remove from office regulators in place, and alter the regulator's tenures, or its jurisdiction without a public debate or parliamentary approval.
 - Wrong signals to international investors
- Change in government policy: Draft Convergence Bill
 - This will change regulatory framework.
 - Uncertainty for investor

Issues, to sum up

- What could be the altered economic circumstances under which renegotiations of the long-term contract be considered in the interest of overall sector development?
- Transparency in negotiation/renegotiations process may reduce political risks
- What should be the mechanism to ensure that validity of continuity of already concluded contract would not depend on political compulsions of successive governments? Should the policy changes be prospective or retroactive?

Treatment of different types of risks by the Regulatory and political institutions

■ Risks

- Retained with the government (country risk)
- Through insurance (force-majeure risks)
- Through changes in the framework such as instituting a multi-year tariff regime (regulatory risk).
- Commercial risk - Performance (including construction) risk and Market (i.e., demand/ volume/ traffic) risk –
 - Usually under the control of the operator

Need to strike a balance between the risks undertaken by the Government and the private sector

Financial Sector Reforms

Need to undertake financial sector reform to:

- Institutions are capable of taking decisions based on market parameters
- Evolve a wide range of financial instruments suited to the task at hand
- Need to rein in on the overall fiscal deficit
- Foreign Funds
 - Review periodically the need for protection to foreign investors in required or not
 - Any special incentives needed to promote foreign PSP

To sum up....

- Gradual move away from budgetary financing of infrastructure - healthier and more sustainable path of growth for the infrastructure sectors
- The case for project based financing (especially in the private sector)
 - Potential ability to usher in additional funds
 - Lead to greater risk sharing, accountability, monitoring and management
- Minimise risk through strong independent regulatory institutions
- Lay down a framework with a view to maximize competition and ensure that investment decisions are taken in response to market signals

Thank You