Facilitating Private Entry into Urban Infrastructure: What it means within the framework of the Jawaharlal National Urban Renewal Mission (JNNURM)

In most countries in the world, including China, it is the state which is the largest investor in infrastructure. Infrastructure, other countries have found, cannot be left to the private sector for a number of good reasons. Infrastructure projects require lumpy, large investments with long gestation periods and it is difficult to recover the full capital costs on the investment. They often pose high risks because they provide social goods that are necessary, that cannot be restricted to a few users but for which nobody wishes to pay[1]. Perhaps most importantly, if the private sector is in control of urban infrastructure, they will naturally push the goods they think most important for their needs and in the locations of their choosing. This means that basic services like sanitation, water supply, drainage, and low income housing will be neglected for the more lucrative projects like airport modernization, construction of hotels and shopping complexes, and high-end townships. It also means poorer areas and rural areas will tend to be neglected and big cities will be over-represented. India's approach to urban infrastructure, however, seems to be the opposite of this – trying to lessen the role of government while reducing barriers to private entry into infrastructure one by one. This paper studies the key ways by which this approach is being advanced, the basic premises behind such an approach, some key implications and practical lessons learned from the ground.

Special focus is on the much hyped Jawaharlal Nehru National Urban Renewal Mission (JNNURM) which acts together with a series of fiscal, financial, and governance reforms, to transform the way in which infrastructure is financed, operated and delivered in cities. These transformations aim at:

- Making entry of private sector in basic services and infrastructure more profitable and less risky.
- Promoting a role for government as purchaser of services (from the private sector) rather than provider of services thereby dismantling the monopoly of municipalities and public sector utilities in basic services
- Converting residents into consumers and taxpayers who are project stakeholders by virtue of their contribution to project costs through tariffs or beneficiary contributions. Only consumers and taxpayers have the right to demand accountability from urban local self governments (ULSGs) and monitor local officials' actions.

Restructuring urban infrastructure to reduce barriers to private entry

1. *Linking fiscal reforms with urban reforms especially PPPs and privatization of infrastructure services.*

   Private sector participation in urban infrastructure is facilitated by linking individual and multi-sectoral urban reforms (through programmes like NURM) with a fiscal and financial reform agenda. The tying together of fiscal and urban reform agendas means that cities and states are often forced to comply with (fiscal and urban) reform conditions in return for central resource transfers. This is part of a broader trend toward "incentivizing" improved fiscal performance and increasing urban local self government (ULSG) reliance on private finance.

[1] This is also known as the free rider problem which occurs when many people benefit from the provision of certain goods but nobody wants to pay for them because their ownership and use cannot be restricted eg. roads.

The 12th Finance Commission for instance imposes conditions on states in return for funds from GOI- eg, states must introduce and adhere to state Fiscal Responsibility Acts (FRAs) and comply with FRA targets. It has also incentivised reforms by increasing the size of the incentive fund available to states who comply- states that adopted Fiscal Responsibility Acts (FRA) by 2005 will receive substantial debt relief (32000cr across all states)[2]. The introduction of FRA puts a ceiling on state/local government spending, especially for certain activities, even if funds are available. Attempts to comply with FRA conditions has resulted in reduction in spending in social service sectors (education, health, rural development) as these are 'soft' targets for pruning down on expenditure (Isaac and Ramakumar 2006). At the same time education and health are not included in moneyed programmes like NURM. While reduction of salary costs through staff cuts is another means of reducing expenditures, this is a politically difficult decision. If staff prove to be more resistant to cuts than maintenance or other expenditure, then we could see a sharp decline in quality of services/infrastructure.

Financial transfers and loans (eg thro NURM) from GOI are increasingly linked to whether states can attract Public-Private Partnerships (PPPs) and whether they implement fiscal reforms at state and ULSG level. Thus those states that have less capacity and fiscally mismanaged states are not eligible for this money. This not only ties future financial transfers to reforms but increases the divide between better performing/managed states (those better able to compete) and those less able to compete in the fight for GOI transfers.

Private sector participation (PSP) and (PPPs) in infrastructure are promoted by linking them to mandated state fiscal reforms such as Medium Term Fiscal Plans (MTFPs)[3] and to annual state budgets. This ensures state/city budget allocations to make PSP/PPP projects bankable. It could also involve creating Private Finance Initiatives (PFI)[4] in state Finance Departments, a proposal of the ADB (2005). PFI units would evaluate, at an early stage, "the most appropriate PSP mode and level of financial support [from government] for commercial viability, and linking the financial support to the budgetary process" (ibid p. 13). Further, the ADB has recommended that PFI units be located within the Department of Finance. This would imply a focus on achieving commercial viability and financial closure of the project and not on achieving certain performance parameters in urban development.

2. *Reducing untied financing options for ULSGs so they are forced to access market finance and undertake reforms that promote PSP in infrastructure.*
   The last several years have witnessed a drying up of untied central and state government budgetary assistance for infrastructure as seen in the NURM, a scheme with conditional funds that subsumes all other government schemes and programmes in NURM cities. This has pushed cities to consider market finance and IFI loans for infrastructure projects. In turn, IFIs heavily promote PSP and commercial models in urban infrastructure provision. The ADB's first urban sector loan in the country was water and sanitation provision in 4 towns in Karnataka and involved the state government signing an order raising water tariffs in keeping with a commercial model of service delivery. As described later in the paper, local residents could not pay such high tariffs and these towns are in debt with no way of paying back.

---

[2] This is 3 times the incentive fund set by the 11th Finance Commission.

[3] The MTFP of states lays out a roadmap for adhering to the conditions of Fiscal Responsibility Acts (FRAs). It establishes policies to improve fiscal performance and presents status of various fiscal reforms.

[4] In the UK, the Private Finance Initiative (PFI) has an estimated 39 percent average return on investment, rising to 58 percent in health, making it tremendously lucrative for the private sector (Ray 2007).

Rather than push for greater financial devolution to ULSGs and greater autonomy in decision making and the accountability that comes from being the agency directly responsible for service provision, the NURM and IFIs like the World Bank (WB) focus on ensuring ULSGs comply with fiscal and urban reforms. In its Urban and Local Governance Review (2004), the WB recommends stopping bailouts of city governments in an effort to get them to comply with reforms. "For a hard budget constraint to work, individual states must be committed to letting ULSGs fail rather than bailing them out", argues the World Bank (p. 40). Further, there is growing emphasis on stopping intercepts of state transfers to pay for arrears by ULSGs and instead impose sanctions on the consumers or the ULSG violating for nonpayment of bills.

3. *Financial incentives provided by state encourage private capital into urban infrastructure*
The way the JNNURM is set up aims to encourage entry of private capital into urban infrastructure because part-grant financing by the JNNURM increases the bankability of a number of large urban infrastructure projects. The financing gap arising from the state- and city-level contribution for the JNNURM projects in turn increases the need for leveraging funds from private sector. There is also a clear split between sub-missions Urban Infrastructure and Governance (UIG) and Basic Services for the Poor (BSUP) involving separate ministries, mandates, facilitatory agents such as the Technical Advisory Group-TAG, and differing levels of IFI involvement. This split ensures that the higher risk BSUP component is kept apart from the more lucrative and less risky UIG so that it can easily attract private investment.

Additionally, reforms mandated by JNNURM and other GOI programmes help to create a more enabling framework for private sector in investment and delivery of urban services. Chief among these are municipal level reforms aimed at property tax reform, tariff increases and levy of user fees. They ensure increases in tax and non-tax revenue and this helps make PPPs in municipal service delivery more profitable and attractive to the private sector.

4. *State promotion of PSP and PPPs in urban infrastructure*.
Several initiatives have been put in place at national, state and municipal level to promote PPPs. They include:
   a. Establishment of a PPP cell in the Department of Economic Affairs in the Ministry of Finance
   b. Setting up the India Infrastructure Finance Company Limited (IIFCL) to provide long term debt for financing infrastructure. IIFCL will lend upto 20% of capital project costs by way of refinance to banks and FIs or by direct lending to project companies. IIFCL will lend to public sector companies but overriding priority will be given to PPP projects for direct lending. IIFC will raise funds through domestic and external market on the strength of government guarantees[5].
   c. Creating a viability gap fund (VGF) of up to 20% of total project costs to make PPP projects bankable. Eligibility is conditional on the project being a PPP delivering an infrastructure service for which a user fee is charged and the service is provided by a private company that has 51% subscribed and paid up equity owned and controlled by a private entity[6].
   d. Preparation of PPP toolkits and model concession agreements

[5] In the first year of operation (2005-06), a guarantee limit of Rs 10,000 crore has been specified.
[6] If it is felt necessary, additional assistance, not exceeding a further 20% of total project costs, will be made available.

e. The 12th Finance Commission states that at least 50% of grants provided to states for ULSGs should be earmarked for solid waste management through PPPs[7].

What are the underlying reform principles?
The diagram 1 on page 12 shows the logical steps on which the argument for private investment in infrastructure rests. The 3 basic assumptions underpinning this logic are as follows:

- Private investment in infrastructure is justified both by the urgent need for capital and the state's purported inability to fulfill this need.
- Assuming that delivery of basic services is superior when delivered by a private service provider. This creates the need for improved cost recovery and better rates of return on urban infrastructure projects to attract private service providers.
- Financial considerations and commercial viability are the basis on which projects are decided on and implemented NOT greater access or better quality of services. Bankability of projects is decided by rating agencies and potential investors.

What are the key characteristics and implications of this new approach to urban infrastructure?
I. Making Private institutional finance a condition
IFIs, the private sector and others argue that creation of a system to support PSP in urban infrastructure is necessary if India is to compete for private capital on equal terms with other emerging markets. However, Indian experts say that it will be difficult for any agency or consultant to prove that going in for PPPs will be economically and financially a better option in present status of financial market in India. What then are some implications of going ahead with accessing private finance given current financial market in India?

Promoting access to market finance promotes likelihood of debt with no understanding of who is actually paying this debt burden
From a finance point, PPP or private project financing is unviable in urban infrastructure at present in India, say experts. The Indian capital market structure is such that government (such as ULSGs) can raise funds at a much lower rate that even a triple AAA rated private player. This is mainly due to differences in default risk. The government's power to (forcibly) tax reduces the likelihood that it will default on its obligations (and hence reduces its default risk), and investors are therefore prepared to lend to the government at lower interest rates even to finance risky projects. This is not the case for private financing. An expert from Crisil reveals that even agencies like IL&FS and IDFC have not been able to forge private financing with ULSGs.

Despite this, large loans are taken for infrastructure projects from IFIs. These are often based on unrealistic projections of ability to pay back without taking into account political factors (what are consequences for politicians of increasing property taxes and tariffs), economic conditions of ULSGs (a lack of financial autonomy and poor revenue generating abilities), and economic growth and poverty of the area (can people, especially poorer groups, afford to pay). In the case of the ADB water sector loan to 4 towns in Karnataka, ADB projections about ability to pay back comprised a 251% increase in monthly water and sewerage bill in real terms between 1996 and 2005 and rise in property tax revenues of 123% in four years (2000 to 2004), projections that were completely unrealistic (Celestine 2006). These 4 towns are now in a situation of being unable to pay back, leaving this debt burden to fall on the state government.

[7] 6 Mega cities are exempt from this grant for SWM as they are capable of raising funds on their own.

Relatively little is known of which sources state governments would use to pay this debt and who this debt burden ultimately falls upon. Are rural residents subsidizing urban residents? Are residents of the state of Karnataka subsidizing the city of Bangalore as for instance in the WB funded Karnataka Municipal Reforms Project (KMRP) where 58% of project funds are for roads and sewerage in Greater Bangalore. If the money is coming from petrol surcharges then it means that poor groups are subsidizing richer groups who stand to benefit more from large infrastructure projects.

The increased cost of borrowing in the market and the difficulty of finding private investors for bankable projects has led to greater willingness to accept loans from IFIs because they are longer term and have relatively more reasonable interest rates than the market. Further, the recent National Urban Transport Policy has stated that all urban transportation projects must emphasize public transportation over road development for private vehicle owners. This has led to a stoppage of NURM funding for road development. However, most NURM cities have road projects worth between 50-80% of total costs as laid out in their City Development Plans (CDPs). Where is this money now going to come from? An official from the Bruhat Bangalore Municipal Corporation says that it is very likely that they, and other cities, will approach IFIs like the World Bank to pay for road projects. Thus the way in which NURM is being restructured is pushing cities to accept loans from IFIs. This begs the question: to what extent does increased borrowing from IFIs enable them to play a substantial role in policymaking and the rush toward privatization of basic services?

Financial considerations and commercial viability are the basis on which projects are decided on and implemented NOT greater access for poor or better quality of services. Within NURM, an increase in the amount of private capital invested in urban infrastructure and the number of private sector operators in urban service delivery is looked on as an indicator of better performance and efficiency (ADB NURM TA). This is without regard for where the capital is going, for what kind of projects, and equity, access and environment concerns. For instance, the BSUP component is to be largely administered and run by government agencies. There are no clear indicators measuring performance for BSUP projects nor are there clear criteria by which BSUP projects must be designed/implemented or benchmarked such that access and quality of services to poor are enhanced[8].

II. Promoting PPPs in providing utility services

Skew between large infrastructure (better suited for PPPs due to higher rates of return) and less profitable basic services where Government tends to remain the provider and charging for such services is less common. In NURM typically less than one-third funds have been applied for and allocated under BSUP as compared to UIG leading to a skew between provision of large infrastructure and basic services[9]. Infrastructure is fast coming to mean goods needed for economic growth and private sector development, like expressways, airports and malls. These are typically mega projects, often privately financed and commercially operated, which benefit the middle and upper classes. This is in contrast to basic services provided incrementally by local government which benefit the urban poor.

---

[8] In the ADB TA on NURM, no criteria of measurement is given for how they will measure decreased urban poverty except for a generalized statement saying, "significant benefits from infrastructure improvements [will be] realized by urban poor in participant cities".

[9] As on 16.7.07 under NURM, GOI had released to Greater Bangalore Additional Central Assistance (ACA) for UIG of Rs 6830.43 lakhs and for BSUP Rs 32.19 lakhs. http://www.bmponline.org

Private sector borrowing generally costs more than government borrowing so PPPs must offset higher costs of private borrowing by rises in efficiency gains. This being the case, when PPPs substitute private borrowing for government borrowing, financing costs will rise even if project risk is lower in the private sector. The key issue then becomes whether PPPs result in efficiency gains that more than offset the higher private borrowing costs. Much of the case for PPPs rests on the relative efficiency of the private sector, an efficiency that needs to be defined (as greater coverage of poor groups for e.g.) and measured through a transparent process. This completely rejects the basic assumptions made in ADB TA documents and borne out in PPP guidelines commissioned by the Planning Commission that the private sector is automatically more efficient than the public sector in service design and delivery. In the case of the Greater Bangalore Water Supply and Sanitation Project (GBWASP), a commercial model of service design and delivery was put in place to provide greater efficiency. However, length of distribution pipeline needed to be laid was misestimated by 60% leading to a cost escalation of Rs 116 crores. Water supply under GBWASP has been pushed back by 5 years (from 2006 to 2011). This raises the serious issue of not taking for granted the relative efficiency of the private sector but putting in place concrete performance criteria.

Key Recommendations for PPPs in service delivery

- In the case of PPPs, rather than just offer guarantees the government needs to set minimum performance standards for private operators and establish some penalties for defaulting on these. Otherwise what the IMF (2006) describes as a "guarantee culture" could be created, leading the private sector (and in some cases IFIs and bilateral lenders) to seek guarantees as an alternative to properly managing risk themselves.
- Since the transaction costs of designing and implementing PPPs are quite significant, it is essential to undertake proper evaluation of whether and in which situations they are the best option. Rather than automatically promote PPPs as more efficient than government, the decision about whether a worthwhile project should be undertaken through a PPP could be informed by a 'public sector comparator' indicating the cost of public provision. This could be used as a benchmark for determining whether the best private sector bid for a PPP contract offers better value for money for the government. The UK and South Africa use it.
- To ensure that governments do not use PPPs to bypass expenditure controls, move public investment off budget, and move public debt off the government balance sheet there needs to be full disclosure of the relevant terms of original and renegotiated PPP contracts. Else this builds up extra costs for taxpayers in the long run. In the UK, government has found PFI useful because only one thirtieth of what is borrowed is counted on state figures because of the extended repayment cycle (Ray 2007). While the RTI Act is a powerful means for citizens to get information, it is not clear how they apply to PPPs. It should be made mandatory that every PPP project should practice voluntary disclosure of the terms of contracts and project related documents.

III. Ensuring private investors are paid back first and that private concessionaires receive full cost recovery + 'reasonable' rate of return from project users

Cost recovery and revenue generation through property tax reform, tariff hikes and levy of user fees

ULSGs have few sources of tax revenue and mostly depend on states for grants and budgetary allocations. Two of their biggest sources are property tax and tariff hikes, in particular water tariff hikes. Property tax is the most important own source of revenue in most cities[10]. In Karnataka it accounts for, on average, 53%[11] (World Bank 2004). However, property tax coverage is generally low, especially on the urban fringes. In Bangalore, for example, 70% of newly developed properties do not pay taxes for the first six years after development (ibid). For PPPs to become more profitable and less risky it is therefore important to increase the revenue from these two sources and go in for improved cost recovery, typically through elimination of free water (through public stand posts) and subsidies.

Property tax reform, tariff hikes and charge of user fees to generate revenues are, however, politically difficult decisions that could damage the political stock of elected representatives and the ruling party as they will be resisted by user groups. The intrinsically political nature of these decisions is commonly neglected in designing financial models of large infrastructure projects. This means that a decision to go ahead with a particular PPP based on purely financial feasibility concerns will almost certainly lead to its failure (see example of ADB water sector loan on pg 4). This is one important reason why it is important to involve local councilors in project decision making because they have a sense of the ability and willingness to pay of their constituency and know how much of a tariff hike they can swing politically[12].

Reducing risk for private sector

Urban local bodies will need to raise over Rs 10,000 crore from the market to meet their portion of project costs under JNNURM (TOI Aug 3 2007). Except for the seven biggest ULSGs, the rest are unlikely to have a good enough credit rating to access the market. The focus is then on making ULSGs creditworthy[13] through employing one of several credit enhancement mechanisms so that they can access the market. The main objective of credit enhancement mechanisms is to reduce risk for the private investors. The key features of each are described below.

Escrow: Locking an identified revenue stream into a separate escrow account to ensure payback. This could come from the ULB's own resources (eg. property tax) or from state government grants

Pool financing: is used to enhance credit worthiness of small and medium towns so that they can access the market. By themselves they have small revenues and poor credit rating. So a number of them come together to issue bonds. The pooled revenues of these ULSGs are sufficient to service debt obligations and get an investment grade rating. In Tamil Nadu, the Tamil Nadu Urban Development Fund (TNUDF) uses this mechanism. This mechanism is being heavily pushed by the USAID and there are plans afoot to replicate this model in other towns.

Subordination: Here part of the debt is made senior or priority and the rest is subordinate. When the tenure of the bond ends, first the senior debt is repaid and then the subordinate debt. How this mechanism is typically structured, is if the state government gives a loan to a ULSG, this loan becomes subordinate to the debt being raised on the market. Since this ensures investors are paid back first, it increases the credit worthiness of the senior debt.

---

[10] This is with the exception of cities where there is octroi.

[11] The breakup of this figure is: in municipal corporations it accounts for 62%, in CMCs for 30%, and in TMCs for 28%.

[12] For a good example of how this works see the film "Local Self Governance: Some Reflections" produced by Centre for Budget and Policy Studies 2007.

[13] The World Bank defines the basic requirements for creditworthiness to be: 1) stable, predictable and adequate revenues to support borrowing 2) managerial and financial capacity to use debt responsibly and do strategic planning for investment 3) track record of timely payment of principal and interest.

Guarantees: are given by entities having a higher credit rating than the ULB taking the loan, most commonly by the central/state government.

Rather than being based on the adequacy of the overall budget of the ULSG to repay debt, these market based initiatives rely on pledging government guarantees or locking narrow revenue streams to repay debt. This locking is done regardless of whether this compromises the ability of ULSGs to provide adequate services to poor groups or maintain their assets. Clearly some financial reforms, like pool financing and escrow, have preceded others like the creation of independent regulators and ombudsmen although the latter serve the vital functions of regulation and conflict resolution. It therefore seems clear that the goal here is to attract private financing and PPPs in provision of services and NOT building longer term fiscal capacity and fairness in service delivery.

IV. Fracturing local democratic processes and local democratic accountability

Fiscal centralization and minimal autonomy of local governments

Most cities still depend on state handouts, which are arbitrary, rather than on own collections[14]. In the NURM and most IFI funded projects, ULSGs aren't making fiscal decisions[15] based on assessments of need and justifying these decisions in open debate on the floor of the assembly; the money typically is routed through a parastatal that reports to the state government and not to the city. Thus state/parastatal control is only reinforced. Despite considerable fiscal reform to date, there has been no attempt under NURM or other programmes to implement *real* fiscal decentralization where cities are given financial autonomy and functionaries commensurate with their responsibilities. However, there is considerable focus placed on realizing accountability of local governments to local taxpayers. But what is the point of local residents becoming aware of costs of services and subjecting local officials' actions to close scrutiny when local officials themselves have very little information and often no say in decision making and projects?

State-municipal transfers are justified on three grounds: of equalizing vertical disparities (between states and ULSGs), horizontal disparities (among ULSGs), and as an incentive to change behavior. Increasingly, state governments are focusing on the third of these[16]. Often equalization fund allocations are based on discretionary criteria for capital projects. Deductions are often made at source from these grants to pay for outstanding debts of ULSGs. Thus for large loan projects where ULSGs can't pay back, grants from SFC allocations are being deducted at source to pay back investors first. How does this impinge on the state governments' mission of horizontal equalization among ULSGs? How does this compromise the ability of ULSGs to plan, budget and implement development projects in their jurisdictions?

Breaking the democratic accountability chain

Decentralized democratic accountability makes a case for ULSGs (with elected councils) to provide design, planning, investment and delivery of services, rather than parastatal boards or PPPs, as this would allow more people's participation, greater accountability and give incentives

[14] In Karnataka (World Bank 2004), the most significant grants are state plan schemes (685cr), state finance commission (SFC) grants (590cr) and central schemes for urban development and water supply (57cr). The former mostly flow to parastatals not ULSGs, while SFC grants are untied but linked to salary payments. So ULSGs have limited discretion in how they use these funds.

[15] Take the example of the Bruhat Bengaluru Mahanagara Palike (BBMP) developing a CDP and a list of projects for submission to NURM when there was no elected council.

[16] This can be criticized, similar to the 12th Finance Commission, for its extra-constitutional mandate in proposing conditionalities on central/state transfers to states/ULSGs.

to pay attention to financial sustainability and operation and maintenance implications of new investments. But are we moving toward this goal? Financial reforms have preceded real fiscal decentralization despite the passing of the 74th Amendment in 1992. While the NURM states that decentralization is one of the conditions that must be complied with to attain funds, in practice this is mere tokenism. The decision making structure brought in by the NURM is highly centralized and technocratic and approvals are being given for projects that are not under the control of local governments. A local BBMP official confided that one reason for this was that the central government was eager to disburse second installments of funds to cities and so could not afford to be constrained by whether a elected council was in place and taking decisions or not.

Competition for funds increases regional imbalances and hits the poor hardest.
In schemes like NURM, there is fierce competition for funds between states, agencies, and beneficiary groups. The fallout for poor groups and poorer cities is especially serious as they are fighting for funds with other poor groups and the middle classes in their own cities and in cities in other states. Given that NURM subsumes all other central government schemes, all hinges then on a successful outcome from this competition.

Blaming politicians. Many IFIs, led by the WB (2004), argue that political unwillingness to levy local taxes is more of an impediment to accountability than limited autonomy in defining tax rates. ‘Vote bank politics’ and populist politics, which are often the primary means by which poor groups gain access to city resources, are deplored as this goes against the principle of privileging consumers/taxpayers over others.

Privileging improvement of services for taxpayers over others.
The push to enhance services for taxpayers and payers of user fees and to make explicit the link between improved services and tariff/user fee/property tax has increased. This association is needed, it is argued, to get better tax yields because it builds taxpayer confidence that if taxes and user fees are paid, service delivery will be more effective. While most people would agree on the need to increase tariffs for the subsidized middle classes, the move to provide enhanced quality of services for consumers/taxpayers and lower (it is not clearer how much lower) levels for others is a dangerous one. It serves to further create divisions between those who are perceived as ‘deserving taxpayers’ and those who are not, particularly with respect to accountability and local provider response. Underscoring this trend the World Bank in its “India Urban Finance and Governance Review” (2004) goes so far as to define local accountability as the accountability of ULSGs to local taxpayers and not to residents or citizens.

Limited role for select civil society organizations (CSOs) to provide soft edge to reforms.
Public participation and accountability seems restricted to the accountability of “front line” service delivery units to clients, as the World Bank puts it (2004). This involves select local stakeholders in monitoring the performance of local officials, such as the Bangalore Agenda Task Force (BATF) in Bangalore or Bombay First in Mumbai. But these groups comprise elite corporate and civil society groups and are not accountable to or representative of local residents.

V. Government as purchaser NOT provider of services
Elimination of state responsibility to ensure basic supply of amenities to all and reduction and narrow targeting of subsidy programmes. The role of government is now becoming that of purchaser of services from the private sector. Government resources are being used to make projects commercially viable and attract PSP. There is no mention of the responsibility of government to ensure supply of basic amenities to all groups, or of subsidies to be provided to

poor groups. In fact, FRAs specify the control of "expenditure risk areas" such as subsidies and the more effective (read narrow) targeting of social transfers[17].

***Reducing staff*.**
It is 'commonly believed' that ULSGs are overstaffed (World Bank 2004) and this is used as justification for reducing public sector staff size to restrain growth in spending and keep in line with FRA mandates. The freeze in hiring is often implemented blindly without clear understanding of what the staffing requirements of organizations with certain responsibilities and functions are. Staff reduction also translates into opportunities for outsourcing functions and staff to the private sector.

What kind of regulation in urban infrastructure and what is state's role?
While there has been increasing discussion in recent years on the state's role in regulation, supervision and monitoring (rather than financing and provision) of infrastructure, there is not much clarity on the roles for the state, for independent third party regulators, and for the private sector or on how this will be operationalized on the ground. The Special Subject Group within the PM's Council of Trade and Industry constituted in 2001 recommended the establishment of enabling regulation, especially rights of way and environmental clearance. Here the focus was on regulation that would enable PSP in infrastructure. In the case of lending under IIFCL and VGF, the focus is on commercial viability and achieving financial closure of PPP projects and not on performance criteria or improved quality of infrastructure provided. This is revealed by the lead bank, in most cases, being the appraisal agency and responsible for ongoing monitoring. The lead bank will naturally be more interested in seeing investors get paid back first rather than public interest or improved access or quality. Additionally, PPP financing is often provided via special purpose vehicles (SPVs). In practice, SPVs are often a group of banks and other financial institutions that combine and coordinate the use of their capital and financial expertise (IMF 2006).

Conclusion
The paper started off describing some of the reasons why states invest in and control a large proportion of infrastructure development in countries across the world. India, by contrast, seems to be chasing an approach toward urban infrastructure that aims to reduce the barriers to entry for private sector by providing guarantees and seed funds, ensuring investors are paid back first, promoting property tax reform and tariff hikes etc. Schemes like the JNNURM only reinforce the state's position of facilitating private entry into urban infrastructure. Despite these measures, out of the first 240 Detailed Project Reports (DPRs) approved till August 2007 there was declaration of intention of exploring PPP option in less than 6% cases (Discussion with R Joshi, Crisil October 2007). Why is this?

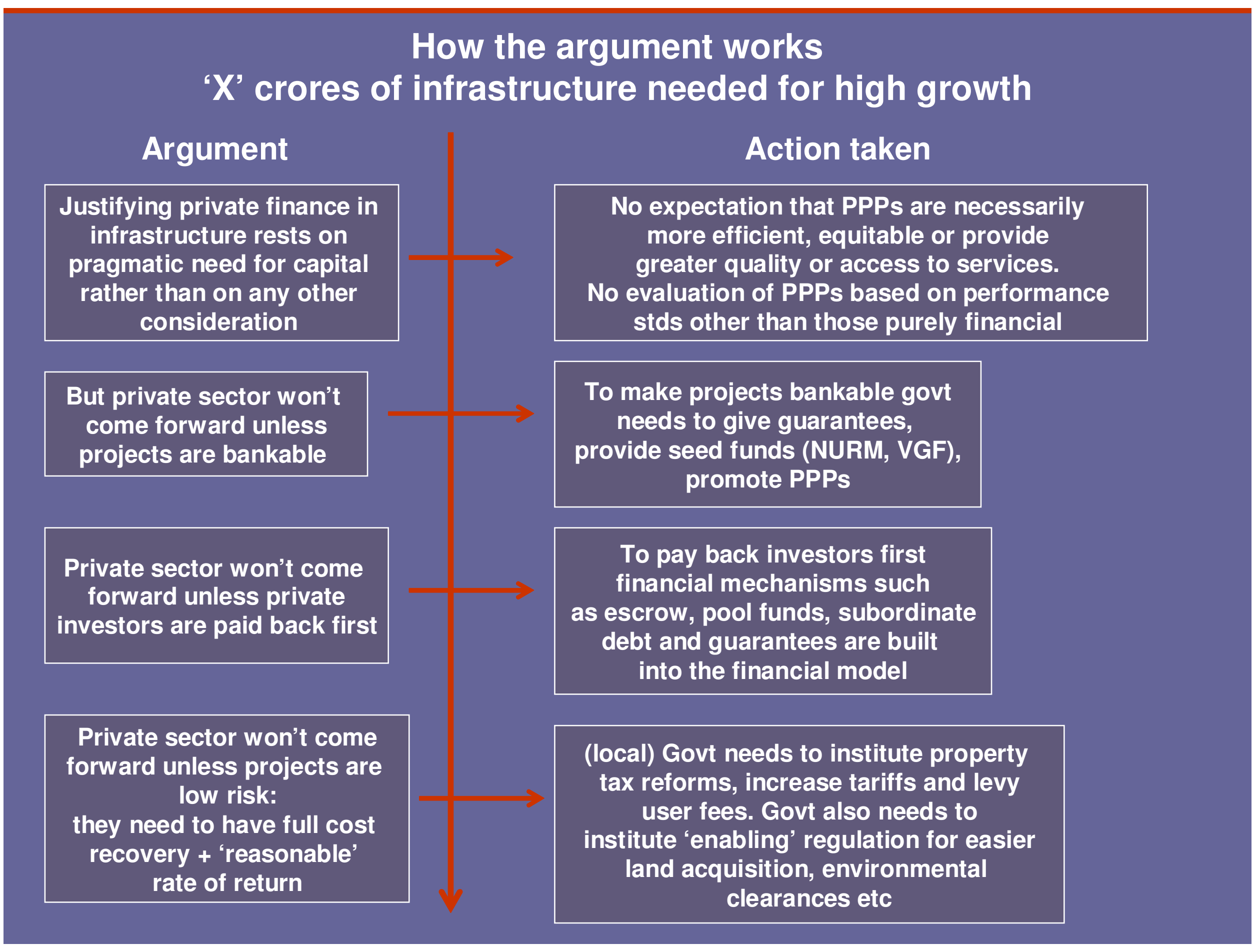
Private players claim that there are insufficient financial incentives (like tax concessions) as in the Special Economic Zone Act for them to enter urban infrastructure. Moreover, there is no proper legal framework in place to facilitate the design and implementation of PPPs. While a few states like Gujarat, Andhra Pradesh, Maharashtra and Karnataka have passed broad Infrastructure Acts under which PPPs are included, confirmatory changes in the Municipal Acts have not taken place even in all these States. Finally, PPPs are motivated by profit concerns and, with the exception of real estate projects, the returns from urban infrastructure are much lower than opportunities provided by the booming private sector. Practical problems entailed by the huge resistance to large scale land acquisition in recent years have also cast a damper on the interest of private

[17] One way in which this is achieved is the recently proposed biometric income cards as a procedure for identifying needy groups.

players to undertake mega infrastructure projects that include real estate components. Given the private sector's concerns and their effective ongoing lobbying will we see some of these obstacles being eliminated in the years to come?

The need of the hour is to give priority to basic services over large infrastructure, to not blindly assume private providers to be superior but rather to put in place strong performance standards measuring increased coverage to poor groups and improved quality. The inadequacy of the private sector to provide direction for and take ownership of the effort to provide all citizens with adequate basic services and infrastructure seems evident. If the state is to take on this responsibility, however, it seems likely that civil society, mass based and other groups will need to push their local councilors, MLAs, municipal and state officials, and national leaders before this will happen.

Diagram 1: How the argument for private entry into urban infrastructure works



Bibliography

Asian Development Bank. February 2005. *Private Sector Infrastructure Facility at State Level Project* Volume I Final Report. Provided to the state governments of Andhra Pradesh, Gujarat, Karnataka, and Madhya Pradesh.

Asian Development Bank (ADB) Technical Assistance Report. February 2006. Proposed Technical Assistance India: Support for the Jawaharlal Nehru National Urban Renewal Mission Project.

Bruhath Bengaluru Mahanagara Palike (BBMP) website. http://www.bmponline.org/account-dept/BBMP-jnnurm.shtml

Celestine, A. May 22 2006. "Karnataka's water woes: Unable to repay loans taken for water projects, four towns in Karnataka are stuck between a rock and a hard place," in *Business World*.

Government of India. February 2005. The Report of the 12th Finance Commission. Government of India http://www.fincomindia.nic.in/Report%20of%2012th%20Finance%20Commission/index.html

International Monetary Fund 2006. *PPPs, Government Guarantees and Fiscal Risk*. Staff team led by Richard Hemming. International Monetary Fund.

Isaac, TM and Ramakumar, R. December 2006. "Why do the states not spend? An exploration of the phenomenon of cash surpluses and the FRBM legislation," in *Economic and Political Weekly:* Mumbai.

Planning Commission. 12th January 2006. *Guidelines Financial Support to Public Private Partnerships in Infrastructure*. Published by the Secretariat for the Committee on Infrastructure. Planning Commission. Government of India. www.infrastructure.gov.in

Planning Commission. 4th January 2006. *Scheme Financing Infrastructure Projects through the India Infrastructure Finance Company*. Published by the Secretariat for the Committee on Infrastructure. Planning Commission. Government of India. www.infrastructure.gov.in

Planning Commission. 12th January 2006. *Guidelines Formulation, Appraisal and Approval of Public Private Partnership Projects*. Planning Commission. Government of India. www.infrastructure.gov.in

Singh, Sanjay K R. Aug 3 2007. "ULBs' need of the moment: Innovative credit enhancement mechanisms," in *Times of India* New Delhi.

Ray, Rob. August 2007. "The 3 P's: PFI, Private Equity and Pensions," in *Mute Magazine*. http://www.metamute.org/en/The-3-Ps

World Bank. December 2004. *India Urban Finance and Governance Review* Volume 1 Energy and Infrastructure Unit South Asia Region World Bank: Washington DC.

CASUMM

Dec 2007

With the Support of Action Aid India

We welcome your comments and questions on this Paper

Email: **casumm@gmail.com**