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   RESEARCH METHODOLOGY

   RESULTS & DISCUSSION

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REGULATING NATIONAL HIGHWAYS IN LIGHT OF THE CHANGING SCENARIO

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ABSTRACT

In light of the B K Chaturvedi Committee, set up to recommend ways for prompt completion of the National Highways Development Projects, seems to have been guided by the misconception that infrastructure can be built by simply providing with additional concessions to the investors. This paper tries to introspect into, whether the new rules make inadequate capacity highly rewarding for investors, and offer the entire viability gap-funding grant during the construction phase itself or acts as a progressive step to attract investors. The concern, however, is whether these concessions are necessary and justifiable, given the huge costs they impose on the road user and the taxpayer at large.

KEYWORDS
national highways, development projects.

1. INTRODUCTION

India has an extensive road network of 4.24 million km – the second largest in the world. While highways constitute only 2% of the length of all roads, they carry around 40% of the road traffic. The Government of India has mandated **National Highways Authority of India (NHIA)** to implement **National Highways Development Project (NHDP)**.

Traditionally financing for development of national highways was from the budgetary resources of GOI. Due to the need for augmented growth, loans were also raised from Asian Development Bank (ADB) and Japan Bank of International Co-operation (JBIC), which were expected to be returned from the toll incomes of the projects. After constituting NHDP most the projects have been developed or are under development on Public Private Partnership (PPP), through Built Operate and Transfer (BOT) – annuity or toll modes. Typically in an annuity project the project IRR is expected to be 12%-14% and for toll projects where the concessionaire assumes the traffic risks, the project IRR is expected to be around 14%-16%.[1]

Recently government has accepted the recommendations of the B.K. Chaturvedi Committee Report (2009), which has suggested ways for expeditious financing, granting several additional concessions to the investor the highway project in order to woo more investors and make the economically viable projects financially lucrative.

In this paper we try to see of regulations between the parties i.e. the contractual obligations guiding the terms of immobile investment, revenue generation and risk sharing and the impact of amended provisions over the parties to the contract.

2. EXISTING AND THE CHANGING SITUATION

Initially, projects under NHDP were awarded as item rate cash contracts. But almost 90% of these contracts in the first two phases have experienced delays and cost overruns. The problem with these contracts was that neither the authority nor the developer has incentives to prepare for the initial cost and the time estimates carefully. This causes large variations both in scope and quantities used in the project. To overcome this problem the government came up with the BOT (Toll) contracts which instigate stronger incentive to complete the project on time.

BOT (toll) contracts are governed by the rules specified in the Model Concession agreement (MCA) where the developers of the highway projects are granted the rights to charge toll fees[2] from the users for a period of 20 years extended up to 30 years for unviable projects allowing 100% tax exemptions in any 10 consecutive years within a period of 20 years after completion of the construction, provided the project requires additional capacity expansion, depending on the designed and actual traffic variations. The justifications for promoting these types of contracts is that it alleviates the tax-payers from initially funding the project and the developer is vested with bearing the Construction, O&M, Financial and Traffic risks associated with the project though the land acquisition and approval risks lies with NHAI. In the initial MCA if the actual traffic had exceeded the designed capacity for a consecutive 3 years, then the concessionaire had to widen the road at his cost and the taxpayers would gain from unanticipated traffic risks. But government pressurised by the predominance of unbidden tenders during the recent financial crisis has bend backwards to woo private investments in infrastructure by extending the concession period, if it asks the developer to go for capacity expansion. This can actually mean investors creating inadequate capacity so to achieve unexpectedly high profits and the taxpayers have to foot the bill of capacity expansion along with the underreported capacity loses (traffic risks).

TABLE 1: VARIATIONS IN TRAFFIC

Type of variation	Change in concession period	Cap on concession period variation
Actual traffic< Target traffic	For every 1% shortfall, concession period increases by 1.5%	20%
Actual traffic> target traffic	For every 1% excess, concession period reduction by 0.75%	10%

Viability Gap Funding(VGF) scheme provides financial support in the form of capital grant for PPP projects in various infrastructure sectors to make the non-attractive projects viable by allowing VGF up to 40% of the project cost, half during the construction and the latter during the maintenance phase. Under the new circumstances it is suggested that the entire grant should be given during the construction phase besides 20% of the concessional loans that the investors can avail from the IIFCL (India infrastructure finance company ltd.) Thus it reduces the VGF to a mere cost-sharing device and thus creates a situation of irrational allocation of the grant (with higher demand and shortage of funds) and project delays. Also it would lead to the problems of moral hazards in terms of quality and design in the construction phase. Lastly the incentives of terminating the contract NHAI's event of default or due to force majeure event is pro-investors as it receives 90%of the due debts.

3. CAUSES & IMPLICATIONS OF SHIFT IN POLICY REFORMS

Arranging funds for financing the highways during the economic slowdown of 2008-09 became a challenge for the developers. Highways are public assets and hence cannot be used as "tangible loan security", as warranted by the RBI. Thus stringent capital-adequacy norms as well as quantitative restrictions in turn increased the lending rates of highway projects. Another cause of shortfall in interest of private developers was RFQ and RFP norms of 2008.

With the problem of negligible private interest in developing highways, NHAI on committee recommendations has incorporated single bids of developers, modifications in standard RFQ, RFP and concession agreement, reduction of technical threshold experience range from 10%-20% to 5%-10% of the estimated

[1] Guidelines for investment in road sector, GOI, Ministry of Roads Transport and Highways
[2] Details of the toll fee collection and the base rate revision regulation as given in the gazette of India published on 12/01/2011

project in order to claim eligibility, increasing the base premium by 5% every year[3] as annualised revision of the rate of fee from 4% where the bids are on a revenue sharing basis and reducing the technical experience score for the purpose of pre-qualification by half, equalling the estimated project cost. These moves may seem to be incentivising enough for bringing back the investors in the post crisis period but this creates more possibilities for adverse selection and also transfer of traffic risks and financial risks over taxpayers.

Provisions are in place where the cost of construction of a permanent bridge, bypass or tunnel exceeds Rs. 50 crores, then such infrastructure shall be excluded from the section of national highway and separate toll taxes shall be levied as specified by the government in the official gazette. Thus if there is lack of vigil in designs and estimation, this can lead to over capitalisation with underutilized capacity which provides the developers with two way benefit of concession period extension and additional toll levy on users.

4. CONCLUSION

The authorities have to be very selective in choosing the right set of contracts that govern the restrictions in the progressive path and certainly should not be distortionary in nature as one can be the problems with annuity payments of BOT (annuity) contracts as it burdens the authorities to compensate the private developers with a higher differential associated with private costs in financing projects, in order to forgo their right to chare toll and thus in turn look out for sources of financing. Thus it should look out for vast untolled segments by collaborating the current O&M contracts with the duties of toll collection along with adopting engineering procurement and construction (EPC) contracts. Differential toll taxes can also be considered taking the freight corridors into consideration.

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[3] Applicable Rate of Fee = Base Rate+ Base Rate* {(WPI A – WPI B)/WPI B}*0.40

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