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GUEST VIEW

How funding from multilateral agencies aids road projects

Agencies, such as the World Bank, bring development to those regions that private investors consider risky

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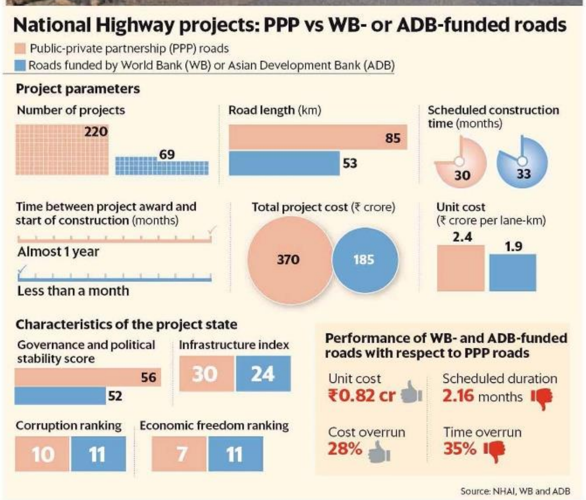

Infrastructure projects are engines of development. In the case of road projects, better connectivity increases movement of goods and people and thereby economic activity. While the largest funding for road projects comes from the government, significant private sector investment has happened in recent years in the roads sector. A major limitation of private sector funding is that sponsors show interest only if the projects are commercially attractive. Unless the returns from the project exceed the cost of capital, it would be an unviable proposition for the private investor. What about funding for those projects that can lead to greater good for the economy because of positive externalities but may not be commercially attractive?

It is here that funding from multilateral agencies such as the World Bank (WB) and the Asian Development Bank (ADB) have helped. They provide low-cost loans to those road projects that have the potential to catalyse large-scale development. However, beyond their role as financial institutions that fund development projects, what else do they bring? What characterises the roads funded by these agencies, as compared to roads built under the public-private partnership (PPP) model?

Both WB and ADB have a long history of investing in various sectors in India. These two agencies account for about 90% of the national highway projects that were funded by various multilateral and bilateral agencies. The graphics (right) provide a comparison of PPP roads vis-a-vis WB- or ADB-funded roads in national highways.

It is easy to observe the contrasting trend between road length and project duration. Though the WB- and ADB-funded projects are shorter, the scheduled construction time is higher. A possible explanation for this could be the rigorous governance processes followed by these agencies. A striking difference could be noticed in the time between project award and start of construction for the two road types. The time for construction to start for PPP roads is about 18 times higher than that of WB- and ADB-funded projects. This indicates that as lenders, the agencies could be insisting on elaborate project documentation and pre-development activities before the project is awarded. An important area of difference is cost per lane-km, which for the WB- and ADB-funded project is about 20% lower. While a part of this could be attributed to lower cost of capital, it could also be due to higher economic efficiency of WB- or ADB-funded projects because of processes such as international competitive bidding and so on.

Our results also indicate that WB and ADB fund projects in those states that have lower scores on various governance, economic and political indicators. Private investors consider not only commercial viability but also the prevailing business environment in their decision making. A big contribution of institutions such as WB and ADB is that they are able to bring in development to those regions that are often bypassed by private capital.

It was seen that the unit cost of a WB- and ADB-funded project would cost ₹82 lakh less compared to that of a similar PPP road. However, the time taken to complete a road project with WB and ADB funding is higher by 2.16 months compared to that of a PPP road. A possible reason could be the elaborate adherence to processes and other compliance requirements that the agencies usually mandate. The cost overrun is lower for WB- and ADB-funded projects by 28% compared to that of PPP projects, while the mean time overrun is higher for the former. PPP developers are motivated to complete the project on time as any delay would lead to a loss in collection of toll revenues.

So what do WB and ADB bring to the party? First, definitely is their ability to channelize capital to those regions that cannot attract private capital. They, thus, help to bring in development in those regions that private investors consider risky. Second, the cost of capital provided by WB or ADB is significantly lower, which in turn reduces the project costs. If the government is unable to bring low-cost capital on its own, it can create conditions that can reduce risk and thereby lower the cost of capital for PPP developers. Examples include land clearances, providing flexibility in contractual clauses, ensuring pre-development activities are completed at the time of bidding, and so on. Third is the active monitoring and oversight of the project development phase. Following best practices such as international competitive bidding reduces the cost of construction. In many PPP projects, construction contracts are awarded to the project development companies of the sponsors, which can lead to inefficiencies. The cons of elaborate compliance include the fact that projects take more time to be completed. However, for a capital-scarce economy such as ours, ensuring lower cost is preferable to quicker projects at higher cost. If best practices prevalent in WB- and ADB-funded projects are also adopted in PPP projects, significant cost savings can be realized.