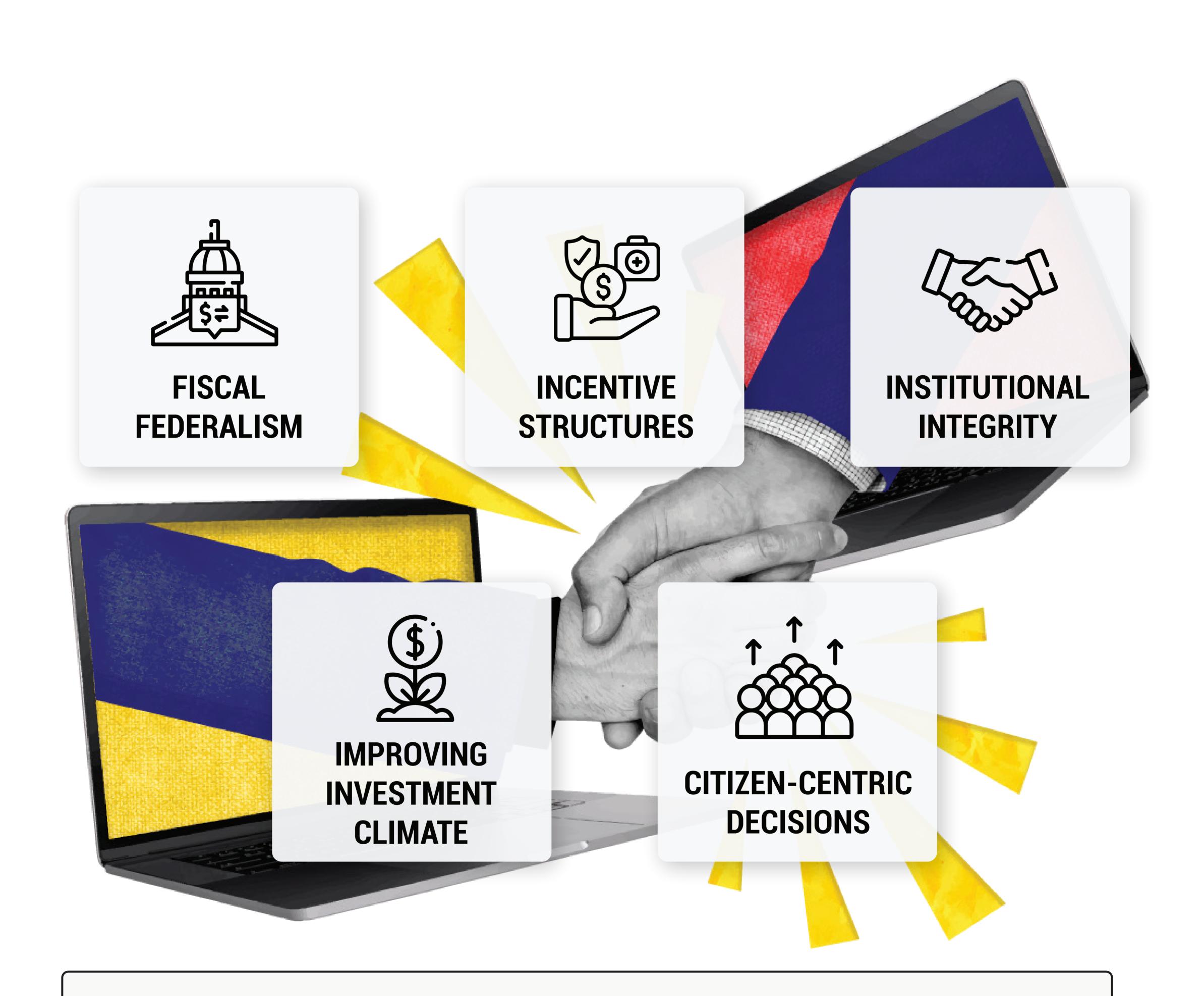


Implementing PPP Projects in Province 1: A Diagnostic Study



FOR FREE AND RESPONSIBLE ECONOMY AND DEMOCRACY IN NEPAL

Executive Summary

Province 1 contributes to about 15% of the national GDP. As the economic potential of the province is quite high, it is imperative for the stakeholders from the public and private sectors to collaborate for increased economic development. Federalization has further contributed to an increase in economic activities which in turn, also increases government spending in the province. However, raising taxes to sustain the growing administrative expenses mandated by the current federal structure is a challenge. So, one of the focuses of the provincial government has been to switch to public-private cooperative partnership (PPCP) models. The provincial government has also been encouraging the local governments to forge public-private partnerships by regularly allocating budgets to the local governments in the form of conditional fiscal transfer for forming PPP initiatives. Yet, there is a big gap between the pace at which PPP projects are being planned and executed. The environment for investment remains uncertain as the province continues to lose its industries to other provinces. Furthermore, challenges of institutional capacity and integrity, lack of project preparation, underrepresentation of citizens, and generating interest from the private sector to invest still rests.

The public sector should continue taking the lead in developing sustainable and resilient infrastructure to support economic development and human well-being. But the real advantage of such development projects can be availed by using the PPP modality in the provision of infrastructure through additional funding, more efficient management, and better public services. These partnerships, however, face considerable risks and challenges.

For proper implementation of PPP projects by empowering the public and the private sectors, creating an enabling environment to foster collaboration is imminent. There can be seen an important role of partnership between the public and the private sectors for realizing the goals of Fiscal Federalism. For this, continual dialogue between the stakeholders as a means to bridge the trust and information gap between the two parties, while developing institutional capacity and integrity is required. There can also be seen a need to develop tools to help the government monitor and evaluate ongoing PPP projects to better incentivize good behavior within and outside the government, as well as to prosecute illicit activities that hampers the partnership.

Key Terms

<u>Public-Private Partnership (PPP)</u>: Public-private partnerships involve collaboration between a government agency and a private-sector company that can be used to finance, build, and operate projects. (Investopedia, 2021) In respect to this paper, PPPs are all collaborations between the public and the private sector for development.

<u>Public-Private Dialogue (PPD):</u> Public-private dialogue is a process that involves bringing in members from the government, and the private sector (along with other important stakeholders such as media, academicians and affected citizens in reference to this paper) that helps solve issues between the two bodies and allow for improved collaboration between the government and business with continued feedback.

<u>Citizen-centric:</u> Citizen centric means decisions based on citizen feedback, and making decisions keeping citizens at the center.

Mini-meetings: Thematic meeting conducted with a small number of stakeholders (anywhere between 2 to 20), on a specific topic to identify problems/issues/concerns pertaining to a specific group of people, and receiving their feedback.

<u>Elected Representative</u>: All individuals who have participated during this process are people's representatives elected as local and provincial government of Lumbini Province and federal government.

Sub-National Government (SNG): The provincial, local and ward levels of government in Nepal.

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We would also like to extend our gratitude to FFNCCI Morang and Bikalpa - An Alternative for informally partnering with us at the local level, providing great context to the problem of public-private partnership in Province 1, and helping map stakeholders for the public-private dialogue.

This policy paper would not have been completed without the participation and feedback from FNCCI Morang, Chamber of Commerce Morang, Big FM Media, along with other small-medium businesses as well as entrepreneurs, providing the private-sectors perspective on the issue.

Extended gratitude to all the academicians, media persons, and citizens involved in the process, mini-meetings and interactions, surveys, and participated in the public-private dialogue.

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1. Introduction

1.1 Public-Private Partnership in Province 1 - Background

Province 1 was carved out as one of the 7 provinces of the federal republic of Nepal following the promulgation of the new constitution in 2015. It ranks third in terms of population with 4.5 million inhabiting the province.

According to the Economic Survey 2018/19, the province contributed to 15% of the national GDP. Industrial activities largely revolve around the agriculture processing of products like sugarcane, jute, tobacco, and grains. Other emerging sectors include hydropower, whose potential stands at 34000 MW, and is the least tapped resource, with less than 500 MW of electricity being generated currently. The province also collects the largest share of revenues generated from mountaineering from the Mundum trail and Everest expeditions. This shows the economic potential of the province in various areas^[1].

With its densely populated southern belt continuing to grow, federalization has further contributed to an increase in economic activities and government spending in the province. However, Province 1, like other provinces, has not been able to meet its target of raising taxes to sustain the growing administrative expenses mandated by the current federal structure. This is where it has to rely on investment from the private sector to continue the economic growth. Therefore, one of the focuses of the provincial government has been to switch to public-private cooperative partnership (PPCP) models. The provincial government has also been encouraging the local governments to forge public-private partnerships by regularly allocating budgets to the local governments in the form of conditional fiscal transfer for forming PPP initiatives. The government also constituted the Province Investment Authority (Province 1) for the promotion and mobilization of domestic and foreign investment in province 1.

Nepal Infrastructure Bank Limited has recently signed a Memorandum of Understanding (MoU) with the Public-Private Cooperative Partnership and Investment Authority (PPCPIA) of the province for financial and technical support in infrastructural projects. The provincial government is currently initializing projects like Koshi Refreshment Centre, Beema Bamboo project, Electricity Bus project, and Udayapur Cement Revitalization project through the Public-Private Cooperative Partnership model (PPCP)^[2].

The Office of the Investment Board Nepal (OIBN) also handed over the Integrated Agriculture Project under construction in Urlabari, Morang to the Province 1 government on 19 July 2020. The project covers programs including establishing agriculture infrastructures such as cold storage, warehouses, and processing centers. The cost of the project is estimated at USD 5.45 million and will be operated through the PPP model. The OIBN is also providing the technical support

¹ https://nepaloutlook.com/province-1/

² https://risingnepaldaily.com/business/nifra-signs-mou-with-investment-authority-of-province-1

necessary for the facilitation of the process. Despite the handover, the project has not seen any significant progress^[3].

Notwithstanding the renewed effort of the government to attract investment into the province primarily through the PPP model, many experts argue that the government had misplaced its priorities pointing out the fact that import accounts for 85.38% of the total trade of the province. The agriculture and tourism sectors that need transformation have not been paid much attention to, and the environment for investment remains uncertain as the province continues to lose its industries to other provinces^[4].

1.2 The rationale of study

Public-Private Partnership has been seen as an important tool to boost investment in the province and currently, the mandate of implementing PPP projects has come under the provincial government. This paper aims to understand the possible constraints behind the implementation of PPP projects in province 1 and how they have affected the overall progress of such PPP projects. It documents the experiences of development practitioners, government authorities, and private sector actors. The purpose of this paper is to provide recommendations for the proper implementation of PPP projects by empowering the private sector.

1.3 Objective

- To identify possible constraints in the implementation of public-private partnership projects in Province 1.
- To explore better policy practice for the implementation of public-private partnership projects.



Figure 1: Panel discussion on PPP policies at the province level

³ https://ibn.gov.np/oibn-intensifies-handover-farm-projects-to-provinces/

⁴ https://myrepublica.nagariknetwork.com/news/entrepreneurs-studying-investment-prospects-in-province-1/

2. Methodology

A qualitative approach was followed for this study. Tools like key Informant interviews and stakeholders meetings were conducted to collect relevant information and data for this study. gathered from the earlier interactions was also used. Stakeholder Meetings termed "Public-Private Dialogue" were also conducted that included the majority of the stakeholders reaching out to, as well as the CEO of the Provincial Investment Authority, officials from ministries of Province no. 1, business federations, and civil society organizations. The stakeholders were presented with the current scenario of Province 1 in terms of public-private projects followed by the findings from the previous interviews and discussions. The stakeholders also contributed their understanding of the issue through a survey during the discussion.

2.1 Daily Interactions

Various stakeholders were reached out to. This included regular interactions with key stakeholders from the public and private sectors and personal interviews were conducted and relevant stakeholders were identified.

2.2 Mini Meetings

Six mini-meetings were conducted with diverse sets of stakeholders prior to the PPD conducted before drafting this policy paper. The mini-meetings added to the discussion around the need for public-private dialogues, solving public-private partnership issues, and how the public and private sectors, as well as the citizens, can come together to solve the underlying issues. A total of 73 stakeholders were reached out to during this process. The following table gives the detail of stakeholders reached out during mini-meetings.

Provincial and Local CS0s Entrepreneurs **Government Representatives** Bikalpa – an alternative, **NYEF Morang Chapter** Province 1 Province Planning Commission Hami Yuwa Biratnagar Metropolitan City Office **Business Associations Industralists** Academicians **Elected Representatives FNCCI Morang** Individuals Major Colleges Biratnagar Metropolitan City Office in Biratnagar Chamber of Commerce - Morang

Organizational representation of the stakeholder's

Figure 2: Organizational representation of the stakeholder's



Figure 3: Participants participating in the group activity

2.3 Public-Private Dialogue

Public-Private Dialogue is a program wherein stakeholders from the government, private sectors, and civil society are invited to engage them in proper dialogue. 57 stakeholders were present at the public-private dialogue event organized by Accountability Lab in Biratnagar on 6th October 2021. The stakeholders included public officials, elected representatives, and civil society members.

2.4 Policy Paper Review Meeting

A policy review meeting was conducted to discuss the preliminary draft of the policy paper based on the public-private dialogue conducted. A small group of major stakeholders from the public and private sectors, as well as academicians, CSO communities, and citizen representatives, were invited to discuss the Findings, provide feedback, and derive the recommendations for the policy paper. This helped produce a realistic list of recommendations included in this paper.

3. Findings

3.1 The drive for PPP projects

Before federalization, Nepal Investment Board was the sole authority responsible for looking after the investment and used to design public-private partnerships in tandem with the National Planning Commission. After the formation of the federal and provincial governments, several acts like the Public-Private Partnership and Investment Act (2019) (PPPIA) and Provincial Public-Private Partnership and Investment Act (2020) handed over substantial authority related to investment to the respective provincial and local governments. In the 2019 Infrastructure summit, Province 1 was at the forefront pitching many infrastructure projects in a bid to attract investments into Province 1. While many major hydropower projects were already being financed by the federal government and private investors, the provincial government also showcased many other infrastructural project ideas to the investors at the summit^[5]. Some other proposed PPP projects includes:

Proposed PPP Projects in Province 1
International Convention Centre and/or Exhibition Hall
Special Economic Zone (Amaduwa, Morang)
Mass Transportation Project in Greater Birat
Biratnagar Regional International Airport
Greater Birat Area Ring Road Project
Chatara-Tumlingtar-Dolalghat Waterways
Dharan-Bhedetar-Namje Cable Car project
200 MW solar power plant
Kechana-Sagarmatha Tunnel and Cable car project
Taltalaiya Theme Park project
Chaurikharka-Namjee-Dudhkunda Cable car project
Herbs Factory
Organic Fertilizer Factory
Modern Agriculture Machinery Factory
Biratnagar Commercial Complex
Biratnagar View Tower
Mundum trail construction

Apart from the aforementioned ideas, the Province 1 government also allocated budget to local governments for various PPP initiatives. Likewise, the provincial government is also directly financing various private and community projects directly. Most of those projects are in the infrastructure or Agriculture sector. Provincial Investment Authority (Province 1) has also shortlisted 96 potential PPP projects across 14 districts and is conducting a feasibility study on those projects, and soon plans to host an investment summit to attract private investment into the province^[6].

However, among the PPP projects envisioned by the government, very few of them have been given further consideration. Most of the infrastructural projects have largely been either delayed

or ignored due to other outstanding issues; most notably due to the economic slowdown following the COVID-19 pandemic. This shows that constraints faced by the PPP projects haven't been overcome post federalism.

⁵ https://nepalinfrastructuresummit.com.np/wp-content/uploads/2019/09/Other-Projects-List-4.pdf

⁶ Information based on Interaction with the CEO of Provincial Investment Authority Province 1, Dr. Saroj Koirala

3.2 Factors Affecting the Public-Private Partnership Outcome

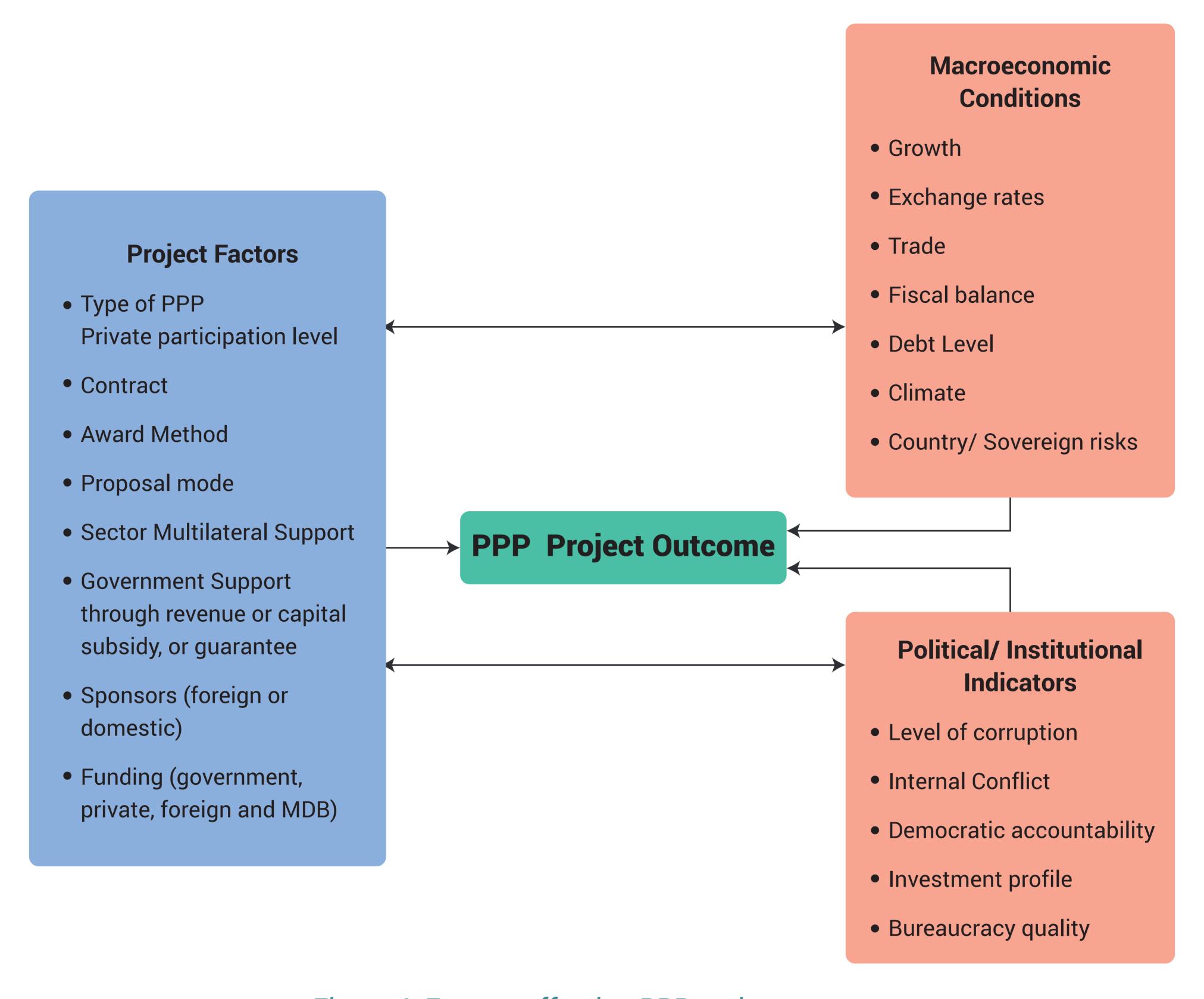


Figure 4: Factors affecting PPP project outcome

Several key conditions are required for the successful implementation of PPP projects. They include political will, support from the public and state, reliable legal framework able to protect private players and reduce risks, fair and transparent tender, reliable feasibility study, fair risk allocation between partners and flexible financing through equity and debt, and high expected rate of return for private partners.

3.3 Major Constraints in PPP initiatives

3.3.1 Improper Planning

Planning is the crucial phase of the project. A lot of decision-making in public institutions is made on political lines, thus making the plans unsustainable in the long run. Therefore, the long-term nature of PPP contracts and the many different stakeholders involved in these partnerships can heighten project risk, making PPPs less attractive to private partners. Improper planning includes long-term planning horizons, overly complex projects, lack of institutionalized competition rules for public projects, hold-ups caused by a change in the position of public partners, technocratic

implementation styles, and cultural differences. The Arun III project was canceled due to a change in the perception of the public partners and conservation groups. Similarly, the haphazard transfer of ownership from the private players to the state, like in the case of Biratnagar Eco-Park, and the solid-waste management project hampered its sustainability and caused the projects to close down and underperform respectively. Recently, the earlier government got into controversy when a proposed water-way project in the Koshi river included removing a boulder greatly revered by the Kirati people as Khuwalung. The risks on project lifecycles are interrelated from feasibility study and project design to financing and construction, operation, and transfer. For example, poor economic and financial assessments done for feasibility studies, inappropriate risk allocation between partners at the procurement stage, delayed land acquisitions at the construction stage, and lower user demand at the operation stage.

3.3.2 Complexity and High cost of project implementation

The complexity and long duration of the PPP projects implementation affect the project. Not all the factors can be predicted. Also, the complexity in determining the conditions that must be met by a private partner, commitments sought by the partners, and the possibility of revising the contract further complicates the process. Due to the inability to predict all risks and conditions for the entire period of cooperation the cost of implementing PPP projects increases stemming from the complexity of the process. The integrated agriculture project, Urlabari, Morang, which is being constructed in the PPP model was handed over by the federal government to the provincial government in 2020. Despite securing funding from the government, the project did not find private investors as its feasibility study couldn't assure private investors. Similarly, many infrastructure projects, from view towers, amusement parks to cold storage warehouses began to prop up without proper planning and are yet to be operational, thus incurring losses to the parties involved.

3.3.3 Political and Social Risks

Citizens will always look to the state to take up responsibility and will continue to consider the

public institutions responsible for the quality of public services. There are examples where projects have become socially and politically complicated due to the increase of tariffs, workforce reduction, land allocation and/or relocation, and so on. This has led to negative publicity and abandonment of the project. Furthermore, there have been instances where a Private partner will have an advantage of experience in determining the conditions of the project and greater access to information on the project during its implementation, which complicates the control of the state and society.



Figure 5: Participant listening to panels opnions during the PPD

3.3.4 Lack of policy harmonization between the federal and Sub-national governments

There is an absence of clear demarcation of roles and coordination mechanisms between the newly formed institutions and the existing ones. There are overlapping roles and authorities among government tiers, particularly concurrent functions, which have created confusion and complications in the delivery of important public services. Furthermore, there are weak links between policy targets, plans, and budgets which has led to many PPP projects proposed by the state being unappealing to the investors. More realistic and grounded projects can be presented by respective local governments, who have the authority to plan and budget, but there is a lack of interaction between them and the provincial government, like management of public spaces, operation of commercial markets through private or cooperative management and other forms of public service delivery. Some of the most notable hassles faced during registration of business require businesses to be registered under the ward of their respective local government, and also register with the department of the cottage and small industries. During the PPD conducted one of the representatives from the business associations said "There is a lack of policy harmonization in registration and renewal services for industries with capital below NRs. five hundred thousand and above. We are told to pay registration charges at the respective local government, provincial government, and the inland revenue department. The confusion prevails on registration and renewals of business at the local government level and provincial government level. This should be addressed as soon as possible". Also, investors need to furnish separate documents for the provincial government, ward office, and the federal government.

3.3.5 Increased costs of doing business in Nepal stemming from institutional malpractice

Bribery in the form of "facilitation payments" are widespread in the distribution of permits and approvals, public procurement, contract awards, and when registering a business. Endemic corruption has reduced competitiveness and significantly increased the costs of doing business in Nepal. Weak internal control and public finance management system make it easier to misuse resources. Inadequate and ineffective supervision and monitoring by all concerned contributes to poor quality outputs for the same costs, noncompliance, and cases of resource misuse and collusion going unnoticed and unpunished. Ineffective, nonuniform, and non-transparent procurement systems facilitate collusive practices among bidders and procuring entities. Despite the constitutional mandate to punish corrupt practices, oversight institutions have not been effective in reducing corruption, exemplified by Nepal's low ranking in various international.

3.3.6 Weak institutional capacity

There are inadequate institutional arrangements in place for proper functioning and the capacity of provincial and local governments is severely limited due to this. In accordance with the federal structure of governance, provincial governments are given authority but are yet to establish or reorganize their agencies to execute their sectoral functions. For instance, the Local Government

Operations Act, 2017 includes mandates for local governments for small hydropower projects up to one-megawatt capacity and alternative energy but most do not have the required institutional arrangement, capacity, or human resources to execute their functions^[8]. At the provincial and federal level, budget allocation and expenses of the last three fiscal years in the ANR sector show a trend to high levels of virements in capital expenses and unspent budget amounts. The OAG 2018 report found that budgets were appropriated for projects without feasibility studies.

3.3.7 Keeping the main beneficiary in the loop to keep the program from derailing

A successful PPP project must meet three objectives: the first objective is about the short-term goals of PPP project implementation, which are closely associated with the design and construction stages of a PPP project; the second objective is to satisfy the stakeholders' objectives that can be assessed only at the end of the concession contract, and the third one is to provide benefits for the entire industry and social development. noted that the end-users should join a PPP project at the beginning of the project and stay through the end of the project, implying a significant relationship between "benefits to private partner" and "benefits to public partner." However, the findings of our study revealed that neither the private partner nor the public partner benefits were significantly associated with "benefits to end-user" which meant that the end-user benefits are not the major concern throughout the implementation of a PPP project. As the objective of a PPP project is to procure a better service, the primary issue for practitioners is "what is a better service." For the public sector and the end-users, the better service not only means that a project with higher quality and lower cost should satisfy technical and functional requirements, but also that the project should be delivered to the end-users as soon as possible with a lower payment. Since the criterion of better service is known, the next thing for practitioners is how to achieve it and make a project successful. As the achievement of the objectives relies on the outstanding technique and management skills of the private partner, the foremost step to securing the success of a PPP project is to select a qualified private partner. Meanwhile, because the implementation of a PPP project is to provide better services for the end-users rather than mitigate the financial risk of the public partner, the end user's satisfactions are very important to appraise PPP project success. Therefore, to achieve the success of a PPP project, it merits attention that the benefits of the end-users should be assigned priority over the interests of the private and public partners. If possible, the end users' opinions on a PPP project should be polled before the implementation. In addition, as the benefits of the private and public partners are closely interrelated, to achieve the success of a PPP project, both parties should consider the problems that would be encountered in the project from the perspective of their counterparts. Mutual understanding is considered the basis of contracting. Of course, renegotiation could be considered a useful approach to maximizing the interests of both parties if the contract is not perfect^[9].

⁸ https://www.adb.org/sites/default/files/publication/543056/governance-institutional-risks-challenges-nepal.pdf

⁹ https://www.hindawi.com/journals/ace/2018/9576496/

4. Conclusion and Recommendations

There is a big gap between the pace at which PPP projects are being planned and executed. As Nepal aims to transition from a least developed nation to a developing one, it is critical to maintain its growth and find means to finance it. Since Province 1 is among the largest contributors to the nation's GDP, the demand for more and better infrastructure reflects the region's strong economic growth. And insufficient finance remains a bottleneck to developing infrastructure across the province. The public sector should continue taking the lead in developing sustainable and resilient infrastructure to support economic development and human well-being. But the real advantage of such projects can be availed by using the PPP modality in the provision of infrastructure through additional funding, more efficient management, and better public services. These partnerships, however, face considerable risks and challenges. Lack of project preparation, competitive systematic project awarding method, poor governance, misaligned priorities, the underrepresentation of the public and private sectors in decision making, and lack of coordination and cooperation between partners are just some of the common risks PPPs face. The renegotiation and termination of PPP contracts impede infrastructure development, disrupt public services, discourage private investments, and increase risk premiums.

4.1 Realizing the goals of Fiscal Federalism

Of the various components of fiscal federalism, domestic resource mobilization is significant as it will make SNGs more independent, accountable, and capable of delivering increased and better public services. There are, however, huge gaps in domestic resource mobilization in SNGs with negligible revenue collection. Increasing partnership with private sectors in infrastructure projects can raise domestic resource mobilization and therefore contribute to making SNGs more independent and capable of delivering better public services. Hence, Partnership with the private sector becomes important for SNG as these governments already have less revenue and the demands of citizens from SNG are increasing. This could be one of the reform areas that will have considerable positive outcomes in development operations, social development, and service delivery. The reform plan should also include capacity development on domestic resources and revenue mobilization.

4.2 Creating incentive structures

There is a need for an incentive model to increase participation in the private sector. Incentives should be provided to SNG officials and taxpayers in the form of tax cuts on an objective basis to increase revenue. "Tax effort" or "revenue effort" can be adopted as a criterion in the revenue sharing formula. Governments can bear some PPP project risks by providing capital and revenue subsidies. Direct government subsidies and indirect support through guarantees can help PPP projects become more viable. In this way, an incentive structure should be set in place. Robust economic growth leads to good PPP project outcomes, as demand for output rises. The government also needs to design an incentive model for the locals and ensure all stakeholders are

consulted. Local government PPP contracts significantly reduce failure rates because they can best determine the kind of infrastructure projects that will benefit their constituents and the local economy. Providing the public with a say in PPP projects can greatly incentivize them.

4.3 Monitoring institutional integrity

For a healthy working of a fiscal federal system, clear demarcation of the functional responsibilities of each level of government is needed and all cases of ambiguity need to be resolved. Taxes like tourism fees, entertainment tax, vehicle tax, and royalty are included under the shared jurisdiction of provincial and local governments. In the absence of proper unbundling of the common taxes and fees, each level of government is interpreting the constitutional provisions the way it suits them much to the annoyance of businesses and enterprises. There has to be institutional integrity in the public offices.

4.4 Improvement of Investment Climate

PPP is a form of attracting investment. It is important to have a strong private sector to ensure more PPP projects. Therefore, the government needs to intensify business processes by attracting new capital and business partnership. The private sector should be allowed to implement international examples and experiences in the implementation and management of infrastructure projects. There is a need to legislate proper acts to improve the doing business index of the country which stands at 94 now. There is a lack of established principles and forms of public participation and budget financing of PPP projects. Furthermore, there are still discrepancies in Identifying and securing guaranteeing the rights of private investors and the return on capital investments, government obligations, including the tariff increase / fair regulation. One of the positive steps towards this would be by ensuring a One-window policy across public institutions and developing industry-standard forms and sample contracts and other documentation.



Figure 6: Youth participant during the PPD





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