ICR Review
Operations Evaluation Department

Report Number : ICRR11247

1. Project Data:		Date Posted :	08/22/2002	
PROJ ID :	P039935		Appraisal	Actual
Project Name :	ILFS-Private Infrastructure Finance	Project Costs (US$M)	1600	199.8
Country:	India	Loan/Credit (US$M)	205	31.7
Sector(s):	Board: PSD - Roads and highways (34%), Power (24%), General water sanitation and flood protection sec (24%), Ports waterways and shipping (15%), Central government administration (3%)	Cofinancing (US$M)	1395	168.1
L/C Number:	C2838; L3992			
		Board Approval (FY)		96
Partners involved :	Infrastructure Leasing and Financial Services Ltd; Indian financial institutions and banks; export credit agencies and bilateral donors; state governments and agencies	Closing Date	09/30/2001	09/30/2001

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2. Project Objectives and Components

a. Objectives

An important objective of the FY1996-98 CAS was to help in the expansion and efficient use of infrastructure, largely by establishing an environment conducive to efficient private participation in infrastructure (PPI). Towards these larger goals, this project's key objective was to facilitate the entry of the private sector on a much larger scale in infrastructure areas so far dominated by the public sector (transport, water, community infrastructure) by (i) developing prototype contractual arrangements for private participation in infrastructure (PPI); (ii) alleviating the financial constraints to the expansion of commercial infrastructure projects, and especially in long -term rupee financing; and (iii) assisting in the institutional development of the Borrower .

b. Components

The project had three components: (i) an investment component of $1,580 million channeled through Infrastructure Leasing and Financial Services (IL&FS) Limited, a non-bank, majority-private, IFC-supported financial institution; (ii) a $1 million technical assistance component toward IL&FS' needs for staff training and specific studies to facilitate the evaluation and implementation of commercial infrastructure sub -projects; and (iii) a $5 million subproject preparation component toward meeting the needs of public authorities (including at the sub-national level) for specialized advisory consultancy services, including IT hardware and software .

c. Comments on Project Cost, Financing and Dates

In addition to a $200 million loan from IBRD to IL&FS guaranteed by the Government of India (GOI) and intended for components (i) and (ii), a $5 million IDA credit to the GOI was approved for component (iii). IL&FS was expected to contribute $44 million (including equity participation and sub-loans). The rest of the financing was expected from other Indian financial institutions ($430 million); the Indian capital market ($150 million); project sponsors ($396 million); export credit agencies ($200 million); bilateral donors ($75 million); and from state government and other public agencies ($100 million). Against an expected total project cost of $ 1,600 million, actual project financing, as well as IBRD financing, turned out to be only 13% of appraisal. IL&FS' actual contribution was 65% and that of export credit agencies/bilateral donors was 0% of appraisal. $168.87 million was cancelled from the IBRD/IDA loan/credit. Little of the $5 million allocated to subproject preparation was used, as IL&FS used its own less expensive funds.

3. Achievement of Relevant Objectives:

The project fell well short of its ambitions regarding entry of the private sector in the targeted infrastructure sectors and more efficient delivery and use of infrastructure services, namely objective (ii). It succeeded, however, in piloting contractual arrangements and in assisting the institutional development of IL&FS, namely objectives (i) and (iii). Sections 4 and 5 provide more details. The major factors negatively affecting implementation were the need to develop from scratch a regulatory and legal framework for PPI in the targeted sectors; weak subproject readiness and viability assessments by the Bank and IL&FS; and convoluted IDA credit arrangements for on -lending to states.

The ICR also mentions two external shocks: the 1997-98 international financial crisis, which had a detrimental effect on infrastructure project finance in emerging markets, and the economic sanctions imposed on India by G -7 governments following the nuclear testing in May 1998, which heightened the risk perception of potential private investors. According to the ICR, the slow pace and repeated setbacks of private involvement in India's power sector (e.g., the Enron Dabhol power project) may have also further reduced investors' interest in India's infrastructure projects altogether. However, these negative developments cannot explain the slow progress and the paucity of funded sub-projects, as the ICR itself points out (page 23, para 8.6) that financing constraints perceived at appraisal turned out to be not binding. In fact, the increased availability and flexibility of long -term financing from domestic sources proved more attractive than the Bank's on -lending terms and reduced the Bank's expected role as a funding source. FDI fluctuated between $2.1 and $2.5 billion between 1995 and 2001 with little apparent link with the sanctions (in place between May 1999 and May 2000), up from less than $1 billion in 1992-93.

Comment by Region : The Region disagrees with this evaluation, pointing out that the project should be seen as an "innovative process operation" through which the Bank could "credibly demonstrate to equity investors . . . its ability to structure and fund PPI transactions."

4. Significant Outcomes/Impacts:

1. The project succeeded in pilot-testing institutional and contractual arrangements and establishing a track record for demonstration and lessons. Limited to the first demonstration subprojects in roads and water investments, comprehensive legal and financial frameworks were developed, legislative measures taken, contractual arrangements were adopted, appropriate accounting rules introduced, and cooperative processes established among lenders, equity holders and public authorities.
2. Another significant impact of the project was on IL&FS's capacity, which will accelerate preparation and strengthen appraisals of future subprojects.

5. Significant Shortcomings (including non-compliance with safeguard policies):

1. Only four road infrastructure sub-projects were financed during the five years of implementation, equivalent to a mere 13% of the total projected physical investment. One of these four road subprojects and a further water subproject, which reached financial close after the project closing, were not financed under the Bank loan, nor did they attract other foreign financing.
2. At the country and state levels, the CAS objectives of overcoming overall policy and institutional weaknesses and the capacity constraints on the government's side hampering PPI have hardly been addressed (paras 4.2.10 and 7.5.1 of the ICR), thus undermining the chances of success of the project.

Comment by Region : The Region does not agree with the second shortcoming on the basis that it was not a specific objective of the project.

6. Ratings:	ICR	OED Review	Reason for Disagreement /Comments
Outcome:	Satisfactory	Moderately Unsatisfactory	Relevant institutional development objectives were fully met with respect to IL&FS and partially so with respect to public agencies. The project was,

			however, seriously over-funded and hence relevance is rated overall as modest. The actual contribution to PPI, however, was small relative to the project's size of $1.6 billion. As a consequence, and contrary to expectations at appraisal, the actual contribution of the project during the implementation period to easing one of India's key development constraints, i.e. the expansion and efficient use of infrastructure, was very little. On the other hand, this project's longer term impact will probably be important because the IL&FS pipeline of subprojects may successfully come to financial close and implementation with high returns, although without the need for Bank financing, and in general more infrastructure projects will benefit from private sector financing and participation. Hence efficacy was rated as substantial which, in association with modest relevance leads to a moderately unsatisfactory outcome. **Comment by Region :** The Region disagrees with the outcome rating on the basis that the project was "highly relevant to the CAS" and country development priorities, and "achieved its major objectives" efficiently.
Institutional Dev .:	High	Modest	The project helped build the capacity of IL&FS and, to a lesser extent and in the few demonstration subprojects it supported, also that of the local public agencies involved. It also developed model contractual arrangements. But the OED rating is based on a broader ID "impact" definition. And in terms of creating a conducive environment for PPI statewide or countrywide, the ID impact of this project was limited, as the ICR itself recognizes on page 21, para 7.5.1: "...coordination between various government levels has not been effective, a coherent policy approach has not been developed yet, and institutional weaknesses and capacity constraints, hampering the promotion of private participation on the Government's side, have hardly been addressed". **Comment by Region :** The Region disagrees with the ID rating on the basis that "the project promoted several PPI projects and had a spill over effect" at the state level where public/private partnerships were established. In addition, the Borrower and IL&FS clearly benefitted from the project in terms of institutional development.

Sustainability :	Likely	Likely	
Bank Performance :	Satisfactory	Unsatisfactory	The Bank offered too much money for a project not ready to proceed in a general environment of a weak regulatory and legal framework and of bureaucratic inefficiency. It also misjudged financing constraints for both the Borrower and the subproject sponsors. And it made the IDA financing of TA for public authorities so cumbersome to access that it found few takers. During implementation of such a complex project, it offered valuable advice and technical inputs. But supervision was underfunded and inefficiently managed from Washington. It was also unfortunate that the Bank and IL&FS could not agree on a restructuring and extension of the project. **Comment by Region :** The Region disagrees with the rating because it claims that the Bank did not misjudge the financing constraints for PPI.
Borrower Perf .:	Satisfactory	Unsatisfactory	Despite the many positive aspects of Borrower performance highlighted in the ICR, the Borrower is as responsible as the Bank for the unsatisfactory outcome of the project. In particular, it misjudged the readiness of the subproject pipeline and the credit constraints it faced. Thus, it borrowed too much and incurred unnecessary commitment fees. It also fell short in due diligence economic and financial analyses as to willingness to pay for tolls. **Comment by Region :** The Region disagrees with the rating because the quality of IL&FS analysis "would stand at par with many other first time participants in infrastructure finance deals."
Quality of ICR :		Satisfactory	

NOTE: ICR rating values flagged with ' * ' don't comply with OP/BP 13.55, but are listed for completeness.

7. Lessons of Broad Applicability:

The most important lesson is that (i) in untested areas and in weak institutional environments, the Bank should only offer TA and small pilot investment projects to foster institutional development . If policy changes are called for, an adjustment operation may be considered. A (large) credit line is not the appropriate instrument to deal with either poor policies or institutions. Another lesson is that (ii) once a loan is approved, the Bank should try to make the best of it for either commercial or development purposes rather than contributing to its non -utilization five years later. Other lessons well elaborated in the ICR are that: (iii) while public-private partnerships in infrastructure are possible even in non-enabling environments, enhancement of capacity and actions in improving the enabling environment in the public sector ought to be emphasized from the start; (iv) country-, state-, and project-specific frameworks for private sector participation are often more important bottlenecks than the lack of appropriate financing; (v) the Bank should leave to IFC, which is comparatively better suited for this kind of operations, the financing and capacity building of private sector entities.

8. Assessment Recommended? ● Yes ○ No

Why? An impact study was highly recommended by OED management at a review meeting of this ES, because it may still be too early (just after closing) to assess the development effectiveness of this project and because of the interesting issues that are involved and not adequately addressed in the ICR : rush to lend before capacity to absorb or demand is in place; competition with IFC /MIGA; choice of more difficult sub-sectors for PPI, while easier ones (energy, telecoms) had just started experimenting with PPI; selection of a single private -majority financial company as the Borrower instead of competitive access to a Bank loan; and choice of instruments .

9. Comments on Quality of ICR:

The ICR, which involved in-country consultations and a substantive Borrower's input, is frank and covers much ground. Areas of weaknesses are the treatment of the issues mentioned in the previous section, some repetitions, the ratings, and Annex 1, which reports the key performance indicators . The matrix in Annex 1 lists under outputs various process/input indicators and falls short in presenting outcome /impact indicators, both ex-post and relative to Annex 3.6 of the Staff Appraisal Report.