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Devil in the Bidding Detail

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Devil in the bidding detail

As India reforms its resource-management systems, it could learn from the experience of other resource-rich countries

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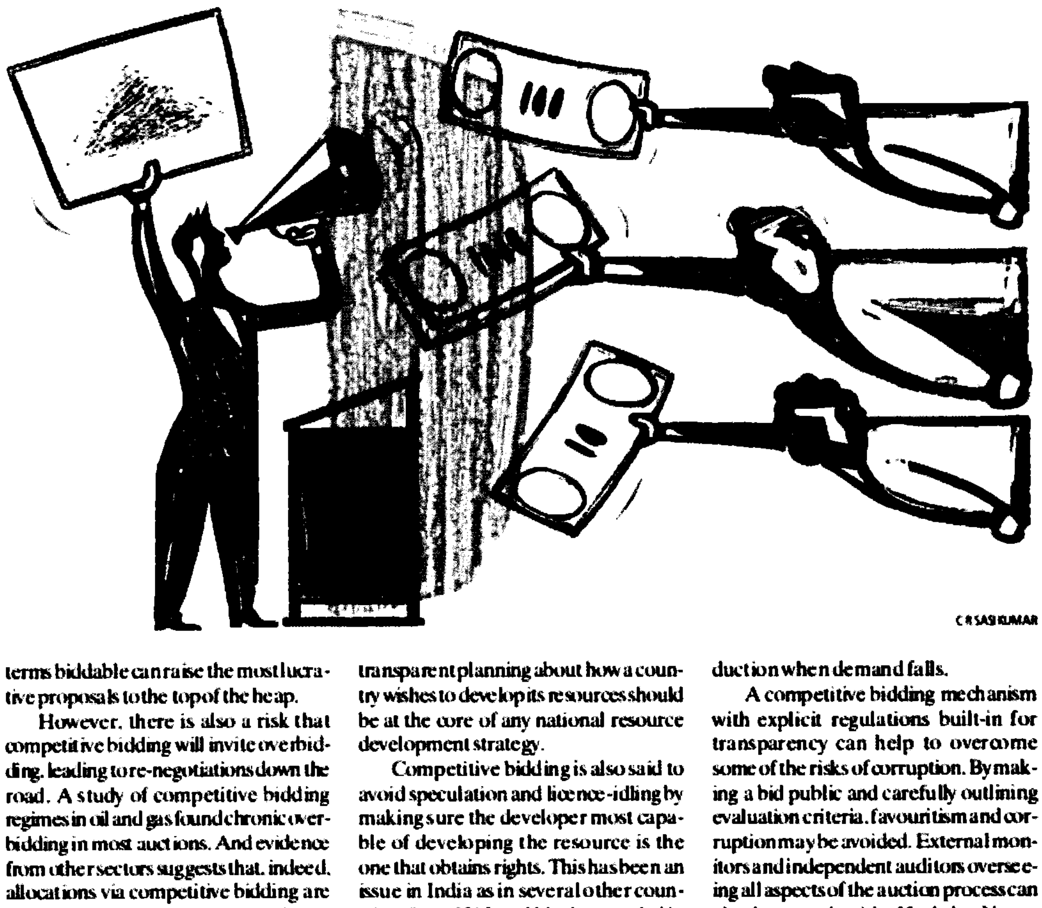

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IN LIGHT of the recent boom in natural resource prices, India is one of many countries facing heightened scrutiny of the allocation and terms of their resource deals. In India, that scrutiny has uncovered a multi-billion dollar controversy over coal block allocations that has gridlocked Parliament. More generally, citizens in resource-producing countries around the world are asking whether the public is getting a fair value for their countries' resources, or whether investors and politicians are walking away with the prize. Finally, the important questions are being asked: how should resources be managed to ensure that they benefit the citizenry, rather than sitting idle or ending up enriching the rich and powerful at the expense of the public?

More than a decade ago, before the spike in commodities prices, many resource-rich countries were luring investors with attractive fiscal terms and licensing systems where the first qualified investor to express interest was granted a licence. In many cases, those deals were awarded opaquely and have resulted in inequitable deals and significant financial losses for the state that still persist. For instance, in the last four years, estimates suggest that the Democratic Republic of the Congo lost over $5.5 billion in asset sales from its state-owned mining company to private investors in which the assets sold, on a first-come first-serve basis, were outrageously undervalued.

In India, part of the blame for lost revenue has been placed on the lack of a competitive bidding framework. As a result, India is one of many countries moving towards competitive bidding systems, attempting to maximise revenues, minimise corruption and improve transparency. We recently surveyed 29 mineral-rich countries and found that well over half had introduced some requirement for competitive bidding into their national mining legislation within the past decade, and most within the past three years. In our sample, this trend was observed predominantly in developing countries, a number of which had, in the past, entered into deals that vastly undervalued the country's assets.

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terms biddable can raise the most lucrative proposals to the top of the heap.

However, there is also a risk that competitive bidding will invite overbidding, leading to re-negotiations down the road. A study of competitive bidding regimes in oil and gas found chronic overbidding in most auctions. And evidence from other sectors suggests that, indeed, allocations via competitive bidding are far more likely to result in re-negotiation in comparison to bilaterally negotiated contracts. For instance, the World Bank Institute found that the rate of re-negotiation for infrastructure projects awarded through competitive bidding was around 46 per cent, compared to an average of 8 per cent for negotiated deals.

Another possible advantage of a competitive bidding system is that it should compel policymakers to plan and prioritise the expected benefits from mineral projects, since the tenders will have to articulate the criteria on which

transparent planning about how a country wishes to develop its resources should be at the core of any national resource development strategy.

Competitive bidding is also said to avoid speculation and licence-idling by making sure the developer most capable of developing the resource is the one that obtains rights. This has been an issue in India as in several other countries. Out of 213 coal blocks awarded in India since 1993, only 28 have begun production. A competitive bidding framework that requires investors to meet certain pre-qualification criteria, to pay a fee to participate in the bid and to bid on upfront bonus payments may deter speculation and licence-idling. However, pre-qualification can (and should) be a routine part of any allotment system, whether for a competitive bid or for a negotiation, and bonus payments can be negotiated as well. A competitive bidding system also does

duction when demand falls.

A competitive bidding mechanism with explicit regulations built-in for transparency can help to overcome some of the risks of corruption. By making a bid public and carefully outlining evaluation criteria, favouritism and corruption may be avoided. External monitors and independent auditors overseeing all aspects of the auction process can also decrease the risk of foul play. Nevertheless, competitive bidding systems may still be more vulnerable to corruption than a first-come first-served system, which essentially eliminates subjective selection, but at the potential risk of lost revenues. Chile, for example, has a strictly first-come first-serve system in assignment of concessions. Because the process is highly regulated and clearly articulated in legislation, less discretion is left to state officials, providing fewer opportunities for allocation to be based on cronyism and bribes.

The important conclusion is this: competitive bidding systems have the potential to cut corruption and boost public revenues for India's development. Yet implementing an effective competitive bidding process is much more difficult than it sounds. As India reforms its resource management systems, the devil will be in the detail. India's reforms

There are many plausible merits of competitive bidding. For one, it may be an effective method of overcoming information asymmetries by revealing the market value of a host country's assets. With sufficient competition, competitive bidding can indeed result in better terms for the country. In India's case, the recent bid rounds in the coal sector have shown considerable investor interest. Making bonuses, royalty rates or other fiscal projects will be evaluated. In Afghanistan's auction of the Aynak deposit, for example, considerable time was spent upfront in outlining the objectives that Afghanistan wished to achieve from the development of its mine and an inter-ministerial committee was established to guide the process. Such planning can, of course, be done even in the absence of a competitive bidding framework: collaborative, inter-ministerial and not prevent "exceptions" to the rule, as has happened in India, wherein several companies that did not meet the pre-qualification criteria were nevertheless awarded the bids. A solution that is applicable whether or not competitive bidding is undertaken is to include "use it or lose it provisions" in legislation or mining agreements to make sure that companies actually plan to exploit the asset and do not cut pro- should be transparent, publicly debated and informed by the lessons learned by other resource-rich countries.

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