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Colombo Port in Sri Lanka

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Public Policy and Market Building: Container Operations at Colombo Port in Sri Lanka

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ABSTRACT: The objective of this paper is to analyse the challenges involved in maintaining public policy consistency to open the market for container operations at Colombo Port to the private sector. Colombo Port has historically functioned as a traditional public sector port. Firstly bids were invited on a BOT basis for expanding the port but this was not successful. Then the private sector was invited to operate the Queen Elizabeth Quay (QEY) on an exceptional basis. Subsequently the government agreed to corporatise the Jaya Container Terminal (JCT) as a prelude to inviting private sector participation. However this was not implemented and it continued to be run by the port authority. For the new South Harbour Container Terminal, the Government agreed to the private sector taking the dominant role. When fully implemented this would mean that the private sector would be running the bulk of container terminal operations at Colombo port reversing the present situation. Thus the objective of opening up the market for container operations to the private sector would be achieved. During the entire process which took over 10 years, different political parties with very different ideological stands formed the Government. The Asian Development Bank assisted the government throughout the process. This paper will analyse the reasons for the very different outcomes achieved for market building in the four cases even though it all involved the same organization. The paper will first set out the policy and economic operating context underlying each of the four episodes. It will next identify the different factors involved including the stand of key stakeholders such as the port management and the trade unions, the type and quantum of capital investment involved, and the impact of phasing the capital expenditure over several years as opposed to not phasing it. The paper will next analyze the interactions between the individual factors, operating characteristics, and the characteristics of the proposed investment. It is seen that the effect of each of the factors is not constant but rather varies considerably depending on the characteristics of the proposed private sector involvement. The paper will conclude with lessons that can be used by both governments to structure and maintain public policy consistency in market building as well as by the private sector in ensuring a successful market opening outcome in previously closed sectors.

Introduction

Colombo Port is located in an artificial harbour formed by three breakwaters constructed more than a century ago. The current port basin (called the inner harbour) covers 200

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hectares and is dredged to depths of up to 15 meters (m). Access to the inner harbour is provided on the Western and Northern sides. The entire perimeter of the harbour is occupied with berths, terminals, and vessel-related activities. Colombo Port serves as a transshipment hub port for South Asia. About 70% of Colombo's container volume consists of transshipment traffic to and from the Indian subcontinent (ISC). The volume of containers handled increased from 200,000 twenty-foot equivalent units (TEU) in 1985 to 1 million TEU in 1995, but the growth rate then tapered off and stagnated between 1997 and 2000 with an annual average of 1.7 million TEU. Growth then increased, and in 2006 Colombo Port handled 3.08 million TEU (ADB 2007, p. 1). One of the main reasons for the stagnation and slow increase in growth is Colombo Port's lack of competitiveness with other major transshipment ports established to cater for ISC traffic. Because of the physical constraints, the possibility of increasing capacity of the existing port by building additional infrastructure within the existing inner harbour is severely limited. Some capacity increase through more efficient utilisation of the existing port was possible. However any major capacity expansion of the port would have to come from expanding the port by building a new breakwater to construct additional berths south of the existing harbour. This scheme was interchangeably called the Outer Harbour or the South Harbour Development proposal.

This need for capacity expansion through efficiency improvements combined with infrastructure construction was the underlying rationale behind the Government's efforts to build a competitive market for container operations at Colombo Port. The Sri Lankan government carried out four attempts to build a competitive market for container operations in Colombo Port as follows:

- (i) in 1995 when the government invited bids for a private sector build-operate-transfer (BOT) for the Outer Harbour project
- (ii) in 1999 when the government allowed a private sector consortium to lease and convert the existing mixed-use Queen Elizabeth Quay (QEQ) within the inner harbour into a dedicated container terminal called South Asia Gateway Terminal (SAGT);
- (iii) in 2001 when the Government decided to corporatise the existing Jaya Container Terminal (JCT); and
- (iv) in 2007 when the government decided to develop the South Harbour using the public-private partnership model whereby the breakwater and dredging is done by the public sector while the container terminals are built by the private sector under a BOT concession agreement.

Two of the above-mentioned attempts i.e. (ii) and (iv) succeeded while the remaining two failed. This paper will analyse the reasons for the very different outcomes achieved for market building in these four cases. The paper will first set out the background including the underlying political-economic context, port sector governance and the infrastructure facilities for the container business in the port. Next it will analyse each of the four cases involved. In this analysis the paper will briefly describe the details of the project/scheme envisaged, the legal position of the scheme as perceived by the government at that time, and the influence of key factors. These key factors include the impact of the project/scheme characteristics as well as the stance of key stakeholders such as the port management, labour unions, other key government agencies and international

financial institutions (IFIs). It is seen that the effect of each of the factors is not constant but rather varies considerably depending on the characteristics of the proposed private sector involvement. The paper will conclude with lessons learned to effect policy change and maintain public policy consistency in market building for previously closed sectors.

Background

Political economy context

The Sri Lankan economy was liberalised in the 1970s to promote economic growth. This included partnerships and private sector involvement in many aspects of the economy (UNDP 2007, p. 2). However there was no specific attempt to attract private sector investment in the infrastructure sector in general or the port sector in particular at that time. In the mid-1990s, the Government made concerted efforts to attract private sector investment in the infrastructure sector and to reform public enterprises for greater efficiency. Several key agencies were set up for this purpose such as the Public Enterprise Reform Commission (PERC) and the Board of Infrastructure Investment (BII). These agencies were also tasked to assist line ministries in the privatisation and corporatisation of public sector enterprises.

This policy gained momentum after the 2001 elections and in 2002 the new Government published a policy document *Regaining Sri Lanka* setting out its approach to economic development. The document states that by introducing public-private partnerships, the scope for investment can be expanded and a wider range of services provided to the public, in such areas as energy, ports, water supply, and transportation (GoSL 2002, p. iv). For the port sector, in particular, the document explicitly advocated public-private partnerships stating: “The South Harbour Development Project, which will include breakwater construction, dredging the harbour and preparing the quay walls for deep draft berths in container terminals. This last project will be undertaken with both private and public sector support” (GoSL 2002, p. 55). It also implicitly endorsed corporatisation and privatisation of existing facilities stating: “Management of port operations will be dramatically improved. Participation of the private sector in port upgrading and management will be actively encouraged to inspire high standards of management and efficiency in port operations” (GoSL 2002, p. 55). The role of PERC and BII continued to remain strong.

There was a change in government after the 2004 elections. The new government was more statist in its economic orientation. It published a new policy document *Mahinda Chintana* setting out its policy approach. This approach was subsequently described as a belief that State has a key role to play in managing the economy and against unregulated markets. It also showed an ideological slant against privatisation (Special Supplement 2009, p. 1). However the Government recognised infrastructure as a critical prerequisite for development. It sets out the country’s vision for the ports sector as follows: “(i) develop the main ports of the country to facilitate increasing export and import trade associated with rapid economic development of the country as well as the region by taking advantage of the liberalisation and globalisation process, (ii) decongest Colombo Port by constructing South Port in Colombo, Galle and Hambantota Ports, (iii) develop medium-scale ports in identified provinces such as South, East, and North to divert increasing volumes of

domestic bulk freight transport from road to sea transport; (iv) encourage alternative source of funding for new investment in port related infrastructure development, (vi) operate ports as commercial entity without Exchequer support, and (vii) encourage public-private partnership investment for new investment in the port sector” (MoFP 2005, pp. 100 – 101). It is seen that the new policy explicitly endorsed PPP for new investment. However it is silent on corporatisation. Since Sri Lanka Ports Authority (SLPA) was already operating without Exchequer support, it could be seen as an endorsement of the status quo.

In line with the new Government’s policy approach, the influence of the PERC gradually diminished before it was finally abolished in 2010. The government also set up a new agency Strategic Enterprise Management Agency (SEMA) in June 2004. Its stated role is to facilitate and ensure the efficient management of State Owned Strategic Enterprises (SSOEs) that will not be privatised, but be managed as independent commercial enterprises with autonomy under the supervision of the SEMA. The SLPA was one of the agencies termed as an SSOE (SEMA 2007, p. 1). This inclusion of SLPA brought some policy uncertainty as to whether private sector investment in the port sector was in fact to be encouraged. There was also some ambiguity about SEMA’s role. SLPA did not have any reporting relationship to SEMA. Neither was SEMA a holding company. Hence the relationship of SEMA to SLPA was far different than the relationship between PSA Corp and Temasek in the case of Singapore Port.

Port sector governance

There are four models for port sector governance i.e. public service port where the port authority owns and operates all assets and carries out cargo handling activities directly; tool port where major equipment and assets are owned and operated by the port authority but onboard cargo and quayside handling may be done by private contractors licensed by the port authority; landlord port where the port authority acts as the regulatory authority and landlord while all cargo handling activities including infrastructure and equipment are by the private sector; and private service port where even the land belongs to the private company. Currently the landlord model is the dominant model for large and medium ports (World Bank 2000, pp. 16-18). The landlord port model is particularly well suited for container terminals since they are more viable financially and allowing the market in this sector has been seen to bring about operational efficiency. Colombo Port however currently follows a predominantly public service port model.

Colombo Port is run by the SLPA which is a statutory corporation established under the Sri Lanka Ports Authority Act. A board comprising eight appointees manages SLPA; the minister responsible for ports appoints the chairperson and five of the members. The remaining representatives are senior government officials from other key government agencies. The SLPA Act endows the Minister responsible for ports with wide powers over the sector (GoSL 1979, pp. 2-8). The SLPA Act is based on the philosophy of a public sector service port whereby the port authority is the owner, operator, and sole supplier of marine and cargo-handling services at the country’s ports.

Container market at Colombo Port

At the Colombo Port, container traffic is handled at three container terminals. JCT is the largest facility and has a capacity of 2.0 million twenty-foot equivalent units TEUs. Unity Container Terminal (UCT) is a satellite terminal for JCT and has a capacity of 300,000 TEUs. JCT and UCT are run by the SLPA. The OEQ was rehabilitated under BOT Concession Agreement referred to in paragraph 2 by a private consortium. It became partially operational in 2000 and fully operational in 2003 as the SAGT. It has a capacity of 1.0 million TEUs (ADB 2007, p.25). SLPA has 15% shareholding in the SAGT consortium.

Currently SLPA controls 70% of the container capacity at Colombo Port while the private sector controls 30%. In terms of market share, SLPA has 57% while the private sector has 43% of the container market (SLPA 2007, p. 13). As part of the Concession Agreement, the Government was to set up an independent port regulator by 2004. However this was not done. Thus despite the setting up of SAGT, there has been no substantial change in the governance structure of Colombo Port.

Proposed development of Outer Harbour in 1995

Project synopsis

In March 1995 the government invited bids from the private sector for the development of an Outer Harbour for the port requiring the construction of a new breakwater structure. Container terminals would then be built inside the new protected area. The estimated cost of the project was \$430 million (USD?) of which over half was estimated to be the cost of the breakwater. When completed, this project was envisaged to double the container capacity of Colombo Port and would have resulted in a significant dilution of the share to SLPA to only 50% of the container capacity. This would therefore have created a competitive market within Colombo Port for container operations. Although several developers declared their initial interest, no bid for the proposed project was submitted. This attempt to build a competitive market therefore failed. An analysis of the possible reasons for this failure is given below.

Legal position

There was no large-scale private sector investment in the port sector prior to this and so there was uncertainty of the legal position under which private sector investment could participate. The SLPA Act itself does not make explicit reference to private sector participation. Sec 36 of the SLPA Act states that:

“With effect from the appointed date, all port services in any specified port shall be provided exclusively by the Port Authority or in exceptional circumstances, on a direction by the Minister, by any person authorized by the Port Authority.” (GoSL 1979, p. 19)

This provision was at that time interpreted to mean that in normal circumstances, only SLPA could provide port services such as container handling and that the private sector could not be allowed to have BOT contracts to run any port services including

container terminal operation. Private sector could only be allowed to do so in exceptional circumstances on a direction by the Minister. When the bids were invited in 1995, this provision of exceptional circumstances was used as the legal authority. It is possible that requesting BOT contracts on an exceptional basis only highlighted the political risk factors to potential bidders.

Impact of project characteristics

More than 50% of the project capital expenditure was for the construction of the breakwater which by itself is non-revenue generating. Furthermore, because of technical reasons, the breakwater would have to be constructed first. This technical factor aggravated the cash flow situation for potential bidders. It also increased political risks, should there be a change in government policy after breakwater construction commenced but before container terminal construction commenced.

Other factors

Since no bids were received, the question of the impact of SLPA Management, labour other government agencies or IFIs does not arise.

Queen Elizabeth Quay/South Asia gateway terminal case

Project synopsis

The scope of the project was to increase the capacity of QEQ from 285,000 TEUs to 1 million TEUs annually. The project was structured as a BOT scheme under a 30-year concession agreement between the private consortium and SLPA. This project was successfully implemented. This was the start of a competitive market in Colombo Port.

However it was still not a fully competitive situation. As part of the concession agreement, SAGT could not initiate any tariff reduction at the port; it could only match SLPA tariffs. SAGT therefore could not compete on price with SLPA. SLPA was also represented in the SAGT Board as it had 15% equity in SAGT. There was therefore information asymmetry as SLPA was privy to SAGT's Board discussions but not vice-versa. Furthermore the concession agreement specified that the Government would set up an independent regulator within 5 years of the concession agreement. This meant that in the initial five years, SLPA was also the regulator for SAGT. As mentioned in paragraph above, this independent regulator was not set up and SLPA continues to be SAGT's regulator even today. SLPA is thus SAGT's competitor, regulator and shareholder all in one.

Legal position

The legal position remained the same as discussed in para 14 and 15 above. The Government entered into the Concession Agreement relying on the exceptional circumstances wording of Section 36 SLPA Act.

Impact of project characteristics

The project scope was much smaller than the abortive proposal i.e. i.e. \$206 million against \$450 million. It did not require costly initial capital investment in a breakwater. The limited size would also permit demand for the terminal to be tested in an intermediate phase and at the least cost. (ADB 2005, p. 9) and so the chances of successful implementation higher. The maximum capacity of JCT and OEQ together before the SAGT proposal was 1.6 million TEUs. At that time, JCT was handling about 1.7 million TEU annually. The maximum capacity of the modernised QEQ under the proposal was 1 million TEUs annually. Hence the size of the potential investment was not thought to significantly threaten JCT's volume especially since the new terminal would not be able to compete of price for the first 5 years. The project size having only 30% of the overall capacity with SLPA having 70% made it more acceptable to the SLPA. This meant that its target market would be overflow traffic rather than SLPAS's base traffic and thus the public sector port model would remain the dominant paradigm at Colombo Port.

SLPA management stance

The SLPA management was not in favour of this proposal submitted by the consortium. An SLPA Technical Evaluation Committee was set up by the Government to study the proposal. After taking a relatively long time to study the proposal, this Committee objected to the proposal on the grounds that this project, if implemented, would make it extremely difficult to handle ship traffic in the harbour basin (Hadjirin 1996a, p. 2). Even after the letter of intent was issued, the then Post and Shipping Secretary was quoted as saying that the Government was reviewing the letter of intent and that it was not sure when the deal would be implemented (Hadjirin 1996b, p. 1). Although the formal objection was based on technical grounds, it is believed that there were other underlying reasons for SLPA Management objections. Newspaper reports stated that SLPA Management sources believed that the proposed deal itself was improper and that it would lead to a loss for the SLPA ostensibly because the facilities lost by SLPA in the QEQ would have to be redeveloped by SLPA in other parts of the port. (Hadjirin 1996a, p. 2).

The basis for the stance that the proposal was improper arose from the fact that the Government did not invite proposals for this project. In fact the Government signed a loan agreement with the Japanese Government's Overseas Economic Cooperation Fund (OECF)² for the upgrading of inner harbour facilities as a public sector project (JICA 1999, p. 5). The BOT proposal arose from the abortive bid described in para. 12 above. That bid procedure allowed for the submission of alternative proposals. A private consortium proposed a two-phased approach, the first phase for the rehabilitation of QEQ at a cost of \$206 million and the second phase for the development of the Outer Harbour on a PPP after further feasibility studies confirmed its viability (ADB 2005, p. 9). The SLPA Management was concerned that if this proposal were accepted, the OECF loan for SLPA's own project would be cancelled³. Another concern was that having a competitor would adversely affect them

² Subsequently renamed the Japan Bank for International Cooperation (JBIC) and now the Japan International Cooperation Agency (JICA).

³ The OECF loan was cancelled after the SAGT Concession Agreement was signed.

since the container operations of SLPA were quite inefficient. SLPA at that time managed only 12 moves per hour per crane (ADB 2005, p.3). If the private sector-operated new container terminal became more efficient, there was the possibility that they would undercut JCT on tariff and thus JCT's customers would move to the new terminal.

However the Government was determined to demonstrate to the international community, at a time when interest from private sector was difficult to attract due to the country's fragile political environment, that private infrastructure projects in the country can have positive results. It was hoped that a successful private sector investment in the port sector would encourage more private sector investment in infrastructure development in general (ADB 1995, p. 2). The Government dealt with the SLPA Management concerns in a technocratic fashion. To allay the fears of price competition, the Government included in the Concession Agreement clauses preventing SAGT from engaging in price competition as mentioned in para. 18 above. The modest nature of the SAGT proposal itself was a beneficial factor in overcoming SLPA management concerns as it would not be able to challenge SLPA's dominance.

SLPA labour union views

The SLPA at that time had a workforce of approximately 15,000 and was highly unionised. The labour unions were opposed to the proposal mainly because they feared job losses among QEQ workers. The initial claims that were made in the newspapers were that approximately 2000 workers at OEQ would lose their jobs (Hadjirin 1995b, p.1). In fact only 500 workers were involved. The Government agreed that there would be no redundancy. The consortium was required to offer employment to all 500. If any worker did not take up the consortium's offer, that worker would be redeployed other parts of Colombo Port and continue as an SLPA employee. In the event only 15 of the 500 took up the SAGT offer and the remaining 485 continued to be on the SLPA payroll (ADB 2005, p. 5-6). It is seen that the Government directly addressed the main concerns of the labour unions and thus neutralised the objections of the labour unions. This was possible because the number of workers affected i.e. about 500 was rather small.

Role of other government agencies and international financial institutions

The key role played by PERC and BII was an important factor in the success of this project. These institutions obtained expertise through the partial privatisation of the telecommunications sector. Both institutions played assisted in the finalising of the SAGT Concession Agreement (Maunsell 2001, p. F3-F4). The Government was thus less reliant on SLPA in this transaction. The Government appointed the International Finance Corporation (IFC) as its financial adviser for this project primarily to coordinate the financial assistance package being offered by IFC, the Asian Development Bank (ADB) and the Commonwealth Development Corporation. The involvement of all three IFIs was critical to mobilise financing since funding from commercial lenders was not available at that time due to concerns over political stability in the country and the general market sentiment for emerging market risks. Besides providing financing, ADB took part in negotiating the concession and the implementation agreements to ensure that they were structured in a

way that served the country's interest while at the same time addressing the concessionaire's concerns (ADB 2005 p. 6).

Proposed corporatisation of JCT

Scheme Synopsis

In 2001, ADB provided a technical assistance (TA) loan to the Government for Colombo Port. The loan consisted of two components i.e. (i) addressing port sector policy, institutional, and regulatory issues; and (ii) preparing the technical and economic feasibility study for the Colombo South Harbour project including preparation of the detailed design and tender documents. The thrust of the first component was to be the corporatisation of JCT. This would be done by transforming JCT from a facility under the SLPA to a separate corporation wholly-owned by the government. The objective of this corporation exercise was to increase the efficiency of JCT.

The Government gave the following specific assurances regarding to JCT corporatisation which were incorporated into the loan legal documents:

- (i) the SLPA would submit to the ADB copies of legal documentation showing that
 - (a) a legal entity has been registered to operate JCT,
 - (b) such legal entity has been empowered to operate JCT, and
 - (c) a Board of Directors has been established and empowered to operate the JCT.
- (ii) within three months of (i) above being submitted, the JCT will have:
 - (a) recruited 4 skilled managers for the key management positions of JCT as agreed with the SLPA, and suitable documentation e.g. employment contracts shall have been submitted to the ADB.
 - (b) approved a labour rationalisation plan and will have submitted a copy of the Board resolution and plan to the ADB (ADB 2001, p. 10).

The SLPA fulfilled the letter of most of the specific steps listed above without actually corporatising JCT. SLPA set up a wholly-owned subsidiary named JCT Corporation which was registered under the Companies Act. JCT Corporation in its Memorandum of Articles of Association was empowered to operate the JCT. Members of the SLPA Board of Directors were appointed as the Board of Directors of JCT Corporation. Hence all the conditions listed in para 27 (i) above were complied with. A retired SLPA Managing Director was appointed as the JCT Corporation Managing Director thus partially fulfilling condition listed in para 27 (ii) (a) above. The SLPA also carried out a voluntary retirement scheme in 2003 to reduce overmanning within the SLPA as a whole and not just within JCT. Since the agreement did

not specify the labour rationalisation was specifically for the JCT, it could be said that the SLPA also fulfilled condition listed in para 27 (ii) (b). Hence most of the specific assurances were fulfilled. However no assets were transferred to the JCT Corporation and neither was a sale of business or any other form authority to actually operate the JCT ever given by SLPA to JCT Corporation. JCT Corporation therefore remained a shell company and corporatisation of JCT was not implemented.

Legal position

The requirement of Sec 36 directly influenced the way the JCT Corporation was structured. Because the prevailing opinion was that only SLPA could run port services, it was decided that the JCT Corporation would be set up as a wholly-owned subsidiary of the SLPA. Other options which would have fulfilled the loan agreement condition as stated in para 27 (i) (a) above such as making JCT Corporation a subsidiary of the Ministry of Finance or other government agencies were not considered because it was felt that they would contravene Section 36 of the SLPA Act as explained in para. 13 above. Hence this meant that SLPA was the main implementer of the corporatisation exercise. Other agencies, which played a key role in ensuring the success of the SAGT concession such as PERC and BII, did not play a role in this case.

Impact of scheme characteristics

JCT has approximately 1,500 workers or 11% of the total SLPA staff strength of approximately 13,000 (ADB 2007, p. 2). However JCT accounts for 62% of SLPA's entire revenue from port activities. The total revenue from port activities for SLPA as a whole is SLRs. 15.8 billion and JCT contributes SLRs. 9.8 billion. (SLPA 2005, p. 63). The disproportionate contribution of JCT was the key factor that influenced the reactions of SLPA staff.

SLPA management factor

With the exception of the Chairman who is the Chief Executive Officer and is a political appointee, the rest of the SLPA senior management are career SLPA staff. The respective Chairmen initiated steps to try and operationalise the Government's commitment to corporatise JCT. In 2003, SLPA through JCT Corporation appointed management consultants to develop the organisational structure and business arrangements between JCT Corporation and SLPA⁴. However the results of this study were not acted upon. In 2004, SLPA held a workshop attended by all SLPA senior management to discuss how best operationalise the corporatisation of JCT⁵. The workshop identified the issues related to the corporatisation of JCT as:

⁴ Conversation between Mr. Parakrama Dissanayake, then Chairman SLPA and author between 29 – 31 Oct 2003.

⁵ Conversation between Mr. Dileepa Wijesundera, then Chairman SLPA and author between 13 – 15 Oct. 2004

- (i) agreement on the division of assets between SLPA and JCT as well as the schedule for implementation;
- (ii) decision on liabilities to be transferred to JCT;
- (iii) complete concession agreement between JCT and SLPA;
- (iv) agreement on lease and rental terms between JCT and SLPA;
- (v) defining the roles and responsibilities for SLPA and JCT personnel and staffing the roles in each organisation;
- (vi) identification of a management team for JCT and development of a staffing plan for key functional roles;
- (vii) have a study tour to see how other corporatised terminals operate and their relationship with port authorities;
- (viii) agree on a new date for JCT to commence operations as an independent but fully owned subsidiary of SLPA;
- (ix) agree on new articles of association for JCT and shareholders to nominate directors;
- (x) change the organisational structure of SLPA and JCT and develop new mission and vision statements for both entities; and
- (xi) develop communications plan to get the message across to all stakeholders in JCT and SLPA.

It was decided the SLPA would convene internal meetings very soon to decide on issues identified at the workshop to ensure that corporatisation is implemented as soon as possible. The Chairman stated that in the interim the Government will be asked to consider appointing Directors from the private sector to the JCT Board. However these follow-up meetings did not take place. Neither was the JCT Board reconstituted with private sector representatives.

The career SLPA senior management did not share the urgency shown by the respective chairmen. In any case there was no single senior management person whose dedicated task was to handle the day-to-day matters related to JCT Corporation. Hence there was no momentum within the career management ranks to see this through. With the passage of time, the rationale for corporatisation began to be questioned. SLPA management pointed out that the original rationale for corporatisation in 2001 was to increase the operational efficiency of JCT, which was considered to be below average world standards. However since 2001, efficiency indicators for JCT have improved significantly. Average turnaround time for container ships improved by 30% from 23.1 hours in 2001 to

16 hours in 2005; average waiting time per ship improved by 77% from 3.6 hours in 2001 to 0.8 hours in 2005. The introduction of a private sector competitor—SAGT—has therefore helped to increase operational efficiency of the SLPA-run JCT until both JCT and SAGT had similar levels of operational crane productivity at 23 moves per crane per hour (ADB 2007, p. 5). Hence the SLPA Management made the argument that the objective for JCT corporatisation was already achieved and so it was no longer necessary to go through with the corporatisation. This argument gained force with the coming of the new government in 2004 which had a more statist economic philosophy than the previous government.

SLPA labour union views

The SLPA labour unions opposed the corporatisation of JCT. This opposition was more prevalent among the more than 12,000 SLPA workers who were not assigned to JCT than among the 1,500 workers who actually worked in JCT. The reason for the opposition by the non-JCT workers was obvious and from their terms even rational. As shown in para. 30 above, over 60% the revenues of SLPA were generated by JCT. The fear was that if JCT were no longer an integral part of SLPA, these revenues would no longer be available to SLPA and thus their own job security and benefits were likely to be affected. The argument that SLPA would have access to JCT's revenues because JCT was a wholly owned subsidiary of SLPA did not reassure the labour unions. This was because of the underlying fear that the JCT corporatisation was merely a prelude to the full privatisation of JCT to non-SLPA investors. This fear gained credibility because several previous studies commissioned by the government which had in fact advocated corporatisation as a stepping-stone to privatisation. One of those studies was done by the World Bank in 1999 which not only recommended JCT corporatisation but also suggested procedures and alternatives for privatising it. (Maunsell 2001, Pg F-4). In this respect the fact that the JCT was the dominant revenue earner of SLPA and the fear that corporatisation was a prelude to privatisation solidified labour opposition to the corporatisation of JCT.

Role of other government agencies and international financial institutions

With the decision to have JCT as a wholly owned subsidiary of SLPA, other government agencies such as PERC did not play a role. This is despite the fact that reform of public enterprises such as SLPA was part of PERC's remit. The World Bank played a role in carrying out the study mentioned in para. 34 above. The study findings provided a road map for the JCT corporatisation. This included the following steps:

- (i) Legal structure of the firm, Memorandum and Articles
- (ii) Concession Agreement with SLPA
- (iii) Definition of institutional, financial and operational relations with SLPA
- (iv) Determination of leasehold area and asset base

(v) Transfer of personnel and organisation (World Bank 2000, p. 47)

The ADB played a key role in this abortive corporatisation exercise. However, this support by ADB was not effective for several reasons. The formal commitment by the Government was reduced to a few initial steps, which it was assumed would lead to the corporatisation. However as described in the paragraph above, the Government could fulfill the letter of most of these steps and still not corporatise JCT. Even the consultancy support provided by ADB was not properly structured. The two components of the technical assistance i.e. (i) addressing port sector policy, institutional, and regulatory issues; and (ii) preparing the technical and economic feasibility study for the Colombo South Harbour project were combined into one consultancy contract. Out of the total of 288 person-months, only 12 person-months (less than 5%) was directly allocated for JCT business reorganisation and corporatisation. The bulk (225 person-months) was allocated for the engineering works. It was therefore understandable that both the consultant team, the SLPA staff supervising the consultants as well as the ADB staff responsible, concentrated more on the South Harbour development engineering deliverables rather than on JCT corporatisation deliverables. With hindsight, it would have been better to have two separate consultancy contracts and separate SLPA project teams to ensure adequate attention to the JCT corporatisation. ADB support was therefore not properly structured and implemented.

South Harbour development project

Project Details and Results

This Project provides for dredging and breakwater construction sufficient to accommodate three terminals, which will be constructed sequentially. It includes the establishment of a new marine operations center, relocation of a submarine oil pipeline, provision of navigational aids, and construction of shore utilities. These works were collectively termed as the harbour infrastructure works (HIW). The Project will be developed on a PPP basis with HIW to be implemented by the SLPA while the container terminal and equipment will be the responsible of the private sector. ADB provided a loan for \$300 million to finance approximately 80% of the construction cost and supervision consultant cost for the HIW (ADB 2007, p. 20). Construction started in May 2008 and is expected to be completed in April 2012.

The HIW will be sufficient to allow the construction of three terminals, which will be constructed sequentially. The first two terminals will be constructed by operators' chosen through open competitive bidding under a BOT concession agreement. The Government agreed that SLPA's equity share in the terminal concession companies would not exceed 15% i.e. the same limit as in the existing SAGT concession. The first concession bid was for one terminal and the Concession Agreement was signed in August 2011 (SLPA 2011, p. 1).

Each of these terminals will have a capacity of 2.4 million TEUs (ADB 2011, p. 7). This means that the capacity share of the private sector for the container market in Colombo Port will increase from the current 30% to 60% when the first terminal is operational, and thereafter to 72% after the second terminal is operation. The trend

towards the landlord port model is thus strengthened with 72% of the total capacity being in private hands. Even if the final terminal is run by SLPA, the total share of the private sector will be 55%. Hence this project will mean that Colombo port will move from being predominantly a public service port to being primarily a landlord port with a competitive market for container operations.

Legal position

The key difference in the legal position adopted by SLPA for this project compared with previous projects and schemes is that SLPA decided that under Section 7(1)(a), it has the positive power to award BOT concession. This section reads as follows:

“7(1) Subject to this Act, the Ports Authority may exercise all or any of the following powers:
(a) To acquire, hold, take on lease to give on lease, hire, pledge and sell or otherwise dispose of any movable or immovable property” (GoSL 1979, p. 4).

This was a major change and removed any legal uncertainty regarding the award of the terminal concession. It therefore reduced the political risk for potential investors.

Impact of project characteristics

The viability of the project was dependent on the new terminal being able to attract transshipment traffic volumes. The major competition for the South Harbour terminals would not be JCT or SAGT but rather ports in other countries which were also vying with Colombo port for the ISC transshipment market. These included Singapore, Port Klang, Dubai and Salalah (ADB 2007, pp. 2-3). Transshipment volumes are by their very nature footloose and can easily shift from one container terminal or port to another. This market characteristic and the project size both had direct implications on the financing option chosen and thus the amount of competition that would be introduced into the container market. The available options are as follows:

- (i) Option 1: finance the entire Project as a public sector project with the Government or the SLPA borrowing the necessary finance from lenders;
- (ii) Option 2: finance the entire Project as a single private sector project with the selected terminal operator also developing the HIW;
- (iii) Option 3: finance the entire Project on a public private partnership (PPP) basis with the public sector financing the HIW and individual private sector parties developing the terminals.

Option 1 would mean that the trend to introducing the landlord port model in Colombo would have been reversed with the SLPA's share of container capacity increasing from 70% to 91% of the total resulting in reduced competition. It would also mean that the SLPA itself would have to do its own marketing to shipping lines to attract the required volumes. In both Options 2 & 3, private sector participation would mean that the possibility

would be open for large international port operating companies and/or shipping lines to be part of the consortium. Their involvement and the established market contacts that they would bring would be an added factor in ensuring that the required volumes are in fact achieved.

Both Option 2 and 3 are in line with the landlord port model. However while considering Option 2, it needs to be borne in mind that the HIW component is indivisible and would cater for all three terminals. This therefore means that in practice, commercial considerations would mean that the entire Project i.e. the HIW and all three container terminals that it protects would have to be concessioned out to a single private sector party. This would result in a single company controlling 68% of Colombo Port's container capacity and thus also restrict intra-port competition. The most practical option for increased market competition is therefore Option 3. With the public sector undertaking the HIW as a common public good for the Project, the three container terminals in the South Harbour can be concessioned out individually. Thus the potential for a dominant single player in Colombo Port is avoided and competition enhanced.

SLPA management factor

The SLPA Management's views were conditioned by the long preparatory period (from 2001 – 2007) using ADB TA for the project. The TA was implemented on the premise that the PPP option would be chosen. The SLPA management accepted the rationale that private sector participation would be advantageous in terms of having better market connections. Hence SLPA management was reconciled to this option. The main concern that SLPA management had was to show some financial return from the enabling investment that SLPA was making in the HIW. The agreement to allow SLPA to take 15% equity in the winning concessionaires for the first two terminals bid out, allowed management to feel that SLPA would also be benefitting from their relatively large investment in the HIW. SLPA Management was also anxious to keep open the possibility of having one terminal in the South Harbour in the future. Their initial position was that SLPA be given the right to have the second terminal in South Harbour. However they eventually accepted that this would not be possible because it would make it impossible for ADB to lend for the HIW. ADB's agreement to only specify that the first two (out of three terminals) in the South Harbour need to be competitively bid left open the possibility that SLPA would be allowed in the future to have the third terminal. This was a second-best solution from SLPA Management's point of view but it did assuage SLPA's concern.

SLPA labour union views

The labour unions were relieved that the corporatisation of JCT did not happen and was not made a condition of any ADB loan for the project. They did not perceive any immediate threat to their interests. The concessions secured by SLPA Management especially that SLPA may have the possibility of having a terminal in the South Harbour also contributed to the perception that SLPA's own future was secure even in the long-term and thus there was nothing that would adversely affect their interests.

Role of other government agencies and international financial institutions

SEMA was the only other government agency that attempted to play a role in the process. SEMA's argument was that since the all terminals were financially viable, SLPA could develop them all if it chose. To prevent it to do so was to potentially adversely affect the financial standing of SLPA. SEMA was opposed to the ADB's stand that HIW loan could only be sanctioned if the first two terminals were competitively bid out⁶. During these discussions, ADB pointed out that although the projects were financially viable, this viability was contingent on attracting more of the transshipment cargo which by its very nature is footloose. Although SEMA's view was that it was protecting the financial interest of SLPA, its stand was not supported by SLPA itself, the line Ministry or the Ministry of Finance who accepted the argument that the private sector involvement would be beneficial from a commercial standpoint. SEMA's opposition therefore had no impact on the way this PPP was structured.

ADB TA prepared the detailed engineering drawings and tender documentation for the HIW. ADB TA also prepared the Business Plan which was used in preparing the Request for Proposal for terminal concession bids. This long and intensive engagement with ADB enabled ADB to sensitise the SLPA Management as to the need and the value of using a PPP approach for the South Harbour development. ADB also ensured that with the development of the South Harbour, Colombo Port will move from being a predominantly public service port model to following a landlord port model.

Lessons learned

The policy initiatives for introducing private sector participation and competition in Colombo Port had mixed results which two being successful and two not being successful. Several lessons can be learned from these attempts. It is clear that the reaction of the same key stakeholders will vary depending on their perception of the impact of a same policy as applied to different schemes. The impact of the proposed policy on not just the entity but also its dependent entities needs to be carefully considered before deciding on the scope of the proposed policy. It is seen that the reactions of the SLPA labour unions was different in the case of the SAGT BOT Concession case than in the proposed JCT corporation case even though the SAGT case represented leasing of asset to a non-SLPA entity while the JCT case would have involved a wholly owned SLPA subsidiary. The same assurances of guaranteed employment in SLPA which were sufficient in the SAGT case became irrelevant in the case of JCT because of the predominant role that JCT plays as SLPA main revenue earner. It may have been easier for the government to assuage labour union concerns if its policy was to propose corporatising all SLPA facilities to a single concessionaire with guaranteed employment in the corporatised entity than just corporatising JCT. In this way the vast majority of the employees would not have feared that their organisation's main source of revenue would be in a different entity with potential negative impacts on them.

In making decisions which involve policy change, equal attention needs to be given to policy execution to ensure success. The first policy change attempted by the government

⁶ Conversation between Mr. Chris Dharmakirti, Chief Operating Officer, SEMA and the author in 12 – 20 Sept. 2006

was to allow private sector participation in the QEQ/SAGT case instead of going for a public sector OECF project. Although the SLPA objected to this policy change it could still be successfully implemented because execution of the policy was not made the sole responsibility of SLPA. Instead other central agencies such as PERC and BII were given leading roles in executing this policy change and in the end this policy was successfully executed. By contrast in the case of the JCT corporation exercise, execution of the policy was left solely to SLPA which acted in a desultory fashion and ultimately the policy was reversed. Hence involvement of outside central agencies in addition to the line agency involved is important. Similarly, timelines for key actions and responsibilities for the actions to be taken should be clearly demarcated to ensure that momentum to implement a policy change is not lost.

Maintaining consistency in public policy for market building is critically dependent on there being demonstrable tangible benefits from such market-building. This is seen in contrasting the efforts to corporatise JCT and to attract private sector participation in the south harbour development. In the case of the JCT corporatisation policy, no lasting tangible benefit from the corporatisation could be demonstrated. The original rationale was to increase efficiency. However when JCT efficiency figures improved and matched those of SAGT, there was no further tangible benefit that could be shown that would occur from the corporatisation. The impact of the increased efficiency was not so much on increased throughput (and thus increased earnings) for JCT but rather reductions in ship waiting times. This meant that over time the rationale for the corporatisation was perceived as primarily ideological in nature and not to deliver any additional benefits to JCT or SLPA. When the Government's orientation in economic policy changed to a more statist approach, this changed situation meant that policy consistency could not be maintained and the policy was changed.

By contrast, in the case of the South Harbour development, the rationale for opening up the market was perceived as having tangible benefits in addition to the ideological dimension. As mentioned in paragraph above, it was accepted that the new terminal will face inter-port competition from regional ports rather than intra-port competition for transshipment cargo. In this market situation, private sector participation would potentially bring benefits in terms of commercial contacts with shipping lines, competitive pricing structures, etc., which would help attract main line operators to the terminals. Such tangible potential benefits meant that even when a government with a more statist economic policy came in, the rationale for allowing in private sector continued to remain valid as it was not seen to be merely an ideological construct. Hence there was no policy change and the South Harbour container terminal concession was successfully implemented.

It is also important that the government ensures that it is on a firm legal footing for any policy changes that it envisages. Relying on exception clauses detracts from the legitimacy of the policy change and this increases the political risks to market participants especially for large-scale projects requiring high capital expenditure. This could have been one of the reasons for the lack of interest in the 1995 attempt to develop the South Harbour on a BOT basis. Having said that, it is sometimes the case that legal barriers are more of a matter of perception than strict barriers. This is seen in the legal provisions used in 1995 and 2006 for the proposed South harbour project. In 1995, a Government with a market orientation relied on an exception provision in the SLPA Act whereas in 2006, a

Government with a more statist approach decided that the same Act in fact gave it positive powers to enter to a BOT contract.

In formulating public policy for market opening, it needs to be kept in mind that maximising private sector participation may sometimes conflict with the objective of maximising competition. This may at times mean that public sector finance may need to be used to maximise competition. It is seen that Option 2 of para. 41 would have maximised private sector participation but minimised competition. Hence Option 3 which requires public sector financing for the HIW works is the more optimal to promote the objective of greater market competition.

Conclusion

Container operations at Colombo Port historically were a public sector monopoly. Hence attempting to build a competitive market necessarily involved public policy choices such as two attempts (one abortive and one successful) at BOT concessioning of the proposed South Harbour Development greenfield project of developing new terminals, a successful BOT concession for the SAGT which can be considered to be a brownfield project, and the failed corporatisation attempt for JCT, which again is akin to a brownfield project. These attempts were made over a 10-year period where the orientation of the government regarding the state's role in the economy changed. Similarly there are other key stakeholders who have influence over the formulation and implementation of policy. The challenge in building a competitive market, where previously the public sector had a monopoly, therefore is two-fold i.e. to maintain consistency in public policy and to ensure successful implementation of the chosen public policy. It is seen from the Colombo Port example that some key factors need to be kept in mind to meet this two-fold challenge. Although public policy choices inherently have some ideological context, the presence of tangible "value addition" characteristics enhances the possibility of ensuring policy consistency over election cycles. Institutional arrangements for policy execution are also key to ensure that the momentum behind the chosen policy is maintained and the policy is successfully implemented.

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