

# Putting the Railways on Track: Procurement Issues in Indian Railways

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**Ira Sharma**

*In the light of the recent revelations of discrepancies in procurement in Indian Railways, this brief discusses the procurement patterns in the sector and reflects on the current government's reformative initiatives towards the tendering processes in order to ensure sectoral transparency and accountability. It analyses the recommendations of the committee formed by the ministry and its subsequent actions on delegation of decision-making powers for contracting railway works and services to field officials to facilitate faster implementation of projects. The presence of structural discrepancies in the sector mars the process of its procurement through prevailing restrictive and anticompetitive practices. Analysing cartels and other restrictive procurement practices in the sector, the brief concludes with the suggestion that an incremental and evolutionary solution will not suffice to address centralisation, nontransparency, inordinate delay and nonaccountability in commercial and other decision-making that the Indian Railways has reached. Instead, there is a need to shake the system out of its cultural status and to enthuse a new quintessence to reorient it to the path of sound and fast effective business like decision-making.*

**Ira Sharma** (is@circ.in) is a Research Associate at CUTS Institute for Regulation & Competition, New Delhi.

When the Central Bureau of Investigation busted 'Rail Neer'<sup>1</sup> scam this October, its sources said that two government officials connived with private catering companies in the supply of cheap package drinking water other than the mandatory Rail Neer in trains, causing undue gain to themselves and loss to the exchequer. The arrest of these Northern Railway officials by the CBI was based on the complaints by Indian Railway Catering and Tourism Corporation (IRCTC). CBI has recovered around INR 280 million during its raid at the private companies to which alleged favours were made. The Railway sector has been simmering in the recent past with scams like this. Be it the case where under-reporting of the actual weight of loaded goods wagons through the manipulation of software or the case of hoarding of confirmed berths by the touts. It is less likely that such manipulations would have been done without involvement and collusion amongst railway officials and private vendors.

Corruption generates public losses. Given the involvement of roughly one third of public money being spent in procurements<sup>2</sup> and the deleterious effects of corruption in diminishing competition, increasing the cost of procurement and resulting in procurement of low quality of goods and services, preventing corruption in public procurement is of utmost importance. Being the biggest state-owned enterprise and the largest procurer, railways procurement is estimated at over INR 250 billion<sup>3</sup> annually for goods and works, which amounts to about 75 percent of its annual procurement expenditure. The table (at the end) shows that total procurement is observed to have increased by over 52 times over three decades.

The drastic increase in procurement is clearly demonstrated here. While it took about two decades for procurement to reach the 100 mark, it increased by nearly four hundred percent to reach the level of 430 in the next one decade.

The current minister Suresh Prabhu took over the Railway ministry in November 2014 with a new vision and outlook to transform it for better. On

his very first day in the office, a one man committee was formed, headed by former Delhi Metro chief E Sreedharan, tasked to suggest a set of procedures to be followed in tendering processes so that transparency and accountability are ensured. Interim report of the Committee pointed out that by centralising procurement powers, the railway board has accumulated enormous sum of money in the hands of few, and hugely enhanced rentseeking power that encourages corruption. Thereafter, the committee after scrutinising current practices and procedures followed at the railway board presented their final report in March this year. Rendering the scale of the scandal and losses in a diminished tone, the report broadly observed:

- **Decentralisation:** improving and decentralising the system with empowerment and accountability shall affect annual economy to the tune of INR 50 billion in stores procurement and equal amount in works contracts.
- **Responsibilities of the Board:** Pointing out at the functioning of the Railway Board, Sreedharan said that it was set up originally to "make policies, plans, to lay broader principles of railway management, to frame rules, to inspect and guide the railways". And today the board is not performing these roles.
- **Power to General Managers:** The report also recommended that the board should not take any commercial decision, and even procurement for its own needs should be done by the Northern Railway. Basically it has called for decentralisation of all those powers to general managers and lower levels. The general managers should have full powers with regard to works, stores procurement, services and commercial tenders among other things.
- **Anticompetitive vendor behaviour:** Check on emergence of extremely high rentseeking behaviour and cartelization amongst vendors and collusion with officials that finally fleeces

railways and eats into its body fabric like termite.

The centralisation of powers with the board leads to two major setbacks: a hit on innovation and experimentation, and predominance of lack of transparency and lack of accountability. The Railways Ministry has, however, already delegated decision-making powers for contracting railway works and services to field officials to facilitate faster implementation of projects. "My decision not to deal with tenders by minister moves closer to implementation by Sreedharan submitting report," Railway minister had tweeted in sync with the final report, after its release. Recent initiative of decentralisation<sup>4</sup>, would work effectively only if there are standard procedures for the railways procurement, embedded with principles of transparency and competition. Recent report of the Bibek Debroy Committee<sup>5</sup> also suggested that there must be decentralisation down to the level of divisions and divisions must be treated as independent business units. Further, the report recommended that divisional managers should be sufficiently empowered to handle all tenders connected with works, stores procurement and services. However, there are certain structural discrepancies existing in the sector which mar the process of its procurement through prevailing restrictive and anticompetitive practices.

## Anticompetitive behaviour of Indian Railways

Tender system, as the normal method of public procurement, works on the premise of competitive rate quoting, but cartel formation destroys this basic premise. The bidders join together and manipulate the rates and competitiveness is lost. There are various ways in which the manipulations are done: the cartel deciding who shall win the bid and others quote higher; the cartel decides on the quantity distribution among its members and each quote for his allotted quantity; and each quoting for his

preferred location only or quoting lowest rate for that location.

Cartels are a well-recognised phenomenon and occur all over world, CAG studies have established its frequent occurrence in Indian Railway procurement.

## Restrictive Procurement Practices by the Indian Railways

Public procurement is ideally done through open tenders, which, in practice is restricted on account of several reasons like public policy, quest for quality cost and time of procurement process, urgency of requirement, emergency situation etc. It's not necessary that the restrictions are undesirable, given the fact that even the General Financial Rules (GFRs) issued by Ministry of Finance containing rules governing public procurement in India mentions open tendering, limited tendering etc., taking such situations into account.

**Restrictive Procurement Policy:** Some of the restrictive practices of Indian Railways arise due to extending protection to certain PSUs, small Scale Industries, KVIC, and handloom sector as a feature of independent India's Public Procurement Policy. This has since been discontinued in general. Currently only rails are procured from SAIL on single tender basis. GOI policy makes use of public procurement as a tool of social and economic development; in the process it prescribes some restrictive measures. This however is not a competition issue.

**Vendor Registration:** Another restrictive procurement practice by the railways involves Vendor registration due to the high safety norms. The Railways have devised an elaborate system with prescribed norms for selection of suppliers, which validate credentials of any supplier who would like to bid for these items and created a list of approved suppliers who only are eligible to participate in tenders of such items.

This system is restrictive and stifling competition and has attracted criticism. The number of

approved vendors has also remained small in most cases which sometimes is by choice; the approving authority puts a cap on the number of vendors to be retained.

It is alleged that the system of vendor registration has given rise to cartel formation and the Indian Railways in the process buy at higher rates manipulated by vendors. The cartel formation is facilitated by existence of the restricted number of approved suppliers, who have little fear of others joining in. Cartel formation however, does not stop even where the number of registered supplier is large; the number of vendors, small or large, does not affect it.

The Compliance Audit Report<sup>6</sup> of Comptroller and Auditor General of India made some observations on the railways procurement system in the year 2013. It observed a large number of variations in prices across zones leading to extra expenditure in procurement. The report further observes that requisite steps were not taken to develop additional vendors for procurement of Proprietary Articles Certificate (PAC) items thus, depriving the Railways of the possibility of obtaining lower rates. Further, the report notes that there was no effort made by the certifying authority to examine the existence of acceptable substitutes.

### What next?

Indian Railways today is at a cross road. An incremental and evolutionary solution will not suffice at such a stage of centralisation, nontransparency, inordinate delay and nonaccountability in commercial and other decision-making that the Indian Railways has reached. Instead, there is a need to shake the system out of its cultural status and to enthuse a new quintessence to reorient it to the path of sound and fast effective business-like decision-making.

Perhaps no Indian institution has been subjected to review by more committees than the railways.

But the irony is, most reports gather dust with their recommendations unimplemented.

The Sreedharan Committee report pointed out that the railways need to urgently reverse the trend of fast losing its traffic to road and air. Its freight share is down from 82% in 1960-61 to 30% in terms of tonnage and of passengers to 12%. In the next five years, it has to mobilize INR 850 billion, the report pointed out.

To bring the railways on track, few simple but long term changes are required to be infused into the system.

- **Innovation** has to be brought on the front foot. It will not only steer the regular functioning of the sector in motion, but is also required to promote probity. Like in the scam of speculating software and underreporting of weight of wagons, railways had in consultation with Research Development and Standards Organisation (RDSO) installed 200 'Electronic In-Motion Weigh Bridges' at various locations across the country to weigh the freight in transit.
- **Competitive infrastructure** should be build. The need of the day is to expand the network and upgrade its technology. It is also extremely important to increase Rail Road coordination and integration of service to increase Railways share in total transport. This will offload roads, reduce pollution and secure fuel economy.
- **Expansion of Rail network and connectivity and fast tracking Dedicated Freight Corridors:** Expansion of capacity by constructing a third and fourth line on existing corridors; and planning new lines are capital intensive projects with long gestation periods. Ministry of Railways has formulated a New R3i Policy- infrastructure for industry initiative- which seeks to attract private sector participation in rail connectivity projects.

## Procurement (Goods, Services and Works) by Indian Railways since 1980s<sup>7</sup>

Year	Procurement Estimates (INR Million)	Year	Procurement Estimates (INR Million)	Year	Procurement Estimates (INR Million)
1980-81	3,810	1990-91	18,730	2000-01	51,630
1981-82	5,690	1991-92	19,130	2001-02	56,900
1982-83	6,660	1992-93	23,740	2002-03	62,700
1983-84	7,210	1993-94	26,160	2003-04	69,440
1984-85	8,250	1994-95	28,830	2004-05	78,370
1985-86	10,250	1995-96	31,770	2005-06	94,880
1986-87	13,380	1996-97	35,010	2006-07	128,230
1987-88	12,900	1997-98	38,580	2007-08	125,010
1988-89	15,080	1998-99	42,520	2008-09	183,870
1989-90	17,250	1999-00	46,850	2009-10	201,450

### Endnotes:

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T: +91 11 26463021/22, 41064117, E: [circ@circ.in](mailto:circ@circ.in), W: [www.circ.in](http://www.circ.in)

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