Chapter 4

Private Investments

There is a growing demand for investment to improve the quality of public services. Public sectors or governments worldwide are experiencing significant challenges as public resources are often insufficient to meet the increasing demand for new infrastructure projects to facilitate and sustain economic growth. As a result, there has been a growing and intense debate about the respective roles of the public and private sectors in the delivery of traditional public services. The United Kingdom and many other developed countries in Europe, United States, Canada, Australia, New Zealand and many developing and middle-income countries from Asia, Latin America and the Caribbean, Eastern Europe, Africa and the Middle East have now recognized the importance of the private sector in the delivery of traditional public services.

There are various definitions of the term 'public-private partnership (PPP)'. PPP is a generic term for any type of partnership involving the public and private sectors to provide services. It is generally a contractual arrangement where the private sector performs some part of a public sector service delivery responsibilities or functions by assuming the associated risks in return for payment. A recent research paper by the World Bank (2007) defines a PPP broadly as 'an agreement between a government and a private firm under which the private firm delivers an asset, a service, or both, in return for payments contingent to some extent on the long-term quality or other characteristics of outputs delivered'. The Indian definition of PPP states that Public Private Partnership (PPP) Project means a project based on a contract or concession agreement, between a Government or statutory entity on the one side and a private sector company on the other side, for delivering an infrastructure service on payment of user charges. Private Sector Company means a company in which 51 percent or more of the subscribed and paid up equity is owned and controlled by a private entity. But regardless of the definitions, the objective is to utilise the strengths of the different parties to improve public service delivery and should always be underpinned by clear principles and contractual commitment reflecting a balance between profit and the need for regulation to ensure value for money in the use of public resources. Under a PPP approach, public sector expertise are complemented by the strengths of the private sector such as technical knowledge, greater awareness of commercial and performance management principles, ability to mobilise additional investment, innovation, better risk management practices, and knowledge of operating superior business models with high level of efficiency. In a developing country like India, the model of this type has enormous opportunities in the upliftment of economy specially in infrastructure and service sectors.

Evolution and Development of PPPs

Public—private partnerships have a long history in many countries, but grew significantly more popular during the 1980s. At this point, private sector thinking was introduced and used in the public sector, and market-based criteria were applied to the delivery of public products and services. During the 1990s, New Public Management (NPM) and market-based philosophies further influenced public management in many countries. Because the degree of complexity of the problems needing to be solved increased as a result of growing interdependencies between assignments and parties involved, more partnerships between public and private sectors were formed.

Public—private partnerships have the longest tradition in the USA. In the 1950s and 1960s, PPPs in the USA were set out by the federal government as a tool for stimulating private investment in intercity infrastructure and regional economic development. They became an explicit instrument during President Carter's administration: the 1978 National Urban Policy and Urban Development action grant (UDAG) encouraged cities to go from private investment subsidies to joint equity venture PPPs.

Throughout the 1980s, PPPs increasingly became a derivative of the privatization movement and government rethinks. Private providers were assumed to be able to provide higher quality goods and services at lower cost, thereby significantly reducing the government's tasks and responsibilities. It was not only in the USA that PPPs assumed greater importance in the latter half of the twentieth century. In Spain, early examples occurred in the 1960s and toll roads had already been developed by 1968. In the UK, the 1979 Conservative government believed that central government was too involved in the economy and needed to step down in favour of utilising private capital. Enterprise zones and urban development corporations (UDCs) were important instruments in this ambition. In the UK in the late 1980s, the Thatcher administration turned to PPPs as the preferred method for economic regeneration. "City Challenge", the programme that encouraged local authorities to propose schemes for economic regeneration in partnership with local businesses, replaced UDCs. The UK thinking on partnerships was significantly influenced by the best practices in the USA.

Other parts of Europe also started using PPPs in the late 1980s. Examples of PPPs in developed countries can also be found outside Europe and the USA. In Australia, for example, the introduction of public—private arrangements for the provision of infrastructure dates back to the early 1990s. In many countries worldwide we see similar trends in private sector involvement and PPP developments. At first sight the rationale behind public–private cooperation is similar: in all countries, governments are relying increasingly on private sector money and skills. However, there are major differences in the motives and procurement rules in different forms of PPP between countries.

Types of PPP Models

There are various types of PPPs, established for different reasons, across a wide range of market segments, reflecting the different needs of governments for infrastructure services. Although the types vary, two broad categories of PPPs can be identified: the institutionalised kind that refers to all forms of joint ventures between public and private stakeholders; and contractual PPPs.

Concession Model

Concessions, which have the longest history of public-private financing, are most associated with PPPs. By bringing private sector management, private funding and private sector know-how into the public sector, concessions have become the most established form of this kind of financing. They are contractual arrangements whereby a facility is given by the public to the private sector, which then operates the PPP for a certain period of time. Oftentimes, this also means building and designing the facility as well. The normal terminology for these contracts describes more or less the functions they cover. Contracts that concern the largest number of functions are "Concession" and "Design, Build, Finance and Operate" contracts, since they cover all the above-mentioned elements: namely finance, design, construction, management and maintenance. They are often financed by user fees (e.g. for drinking water, gas and electricity, public transport etc. but not for "social PPPs" e.g. health, prisons, courts, education, and urban roads, as well as defence).

Public Finance Initiative (PFI) Model

Another model is based on the UK Private Finance Initiative (PFI) which was developed in the UK in 1992. This has now been adopted by parts of Canada, France, the Netherlands, Portugal, Ireland, Norway, Finland, Australia, Japan, Malaysia, the United States and Singapore (amongst others) as part of a wider reform programme for the delivery of public services. In contrast to the concession model, financing schemes are structured differently. Under PFI schemes, privately financed contracts for public facilities and public works cover the same elements but, in general, are paid, for practical reasons, by a public authority and not by private users. For Example, public lighting, hospitals, schools etc. come under such scheme.

There are a range of PPP models that allocate responsibilities and risks between the public and private partners in different ways.

The following terms are commonly used to describe typical partnership agreements:

Buy-Build-Operate (BBO): Transfer of a public asset to a private or quasi-public entity usually under contract that the assets are to be upgraded and operated for a specified period of time. Public control is exercised through the contract at the time of transfer.

Build-Own-Operate (BOO): The private sector finances, builds, owns and operates a facility or service in perpetuity. The public constraints are stated in the original agreement and through on-going regulatory authority.

Build-Own-Operate-Transfer (BOOT): A private entity receives a franchise to finance, design, build and operate a facility (and to charge user fees) for a specified period, after which ownership is transferred back to the public sector.

Build-Operate-Transfer (BOT): The private sector designs, finances and constructs a new facility under a long-term Concession contract, and operates the facility during the term of the Concession after which ownership is transferred back to the public sector if not already transferred upon completion of the facility. In fact, such a form covers BOOT and BLOT with the sole difference being the ownership of the facility.

Build-Lease-Operate-Transfer (BLOT): A private entity receives a franchise to finance, design, build and operate a leased facility (and to charge user fees) for the lease period, against payment of a rent.

Design-Build-Finance-Operate (DBFO): The private sector designs, finances and constructs a new facility under a long-term lease, and operates the facility during the term of the lease. The private partner transfers the new facility to the public sector at the end of the lease term.

Finance Only: A private entity, usually a financial services company, funds a project directly or uses various mechanisms such as a long-term lease or bond issue.

Operation and Maintenance Contract (O and M): A private operator, under contract, operates a publicly owned asset for a specified term. Ownership of the asset remains with the public entity. (Many do not consider OandMs to be within the spectrum of PPPs and consider such contracts as service contracts.)

Design-Build (DB): The private sector designs and builds infrastructure to meet public sector performance specifications, often for a fixed price, turnkey basis, so the risk of cost overruns is transferred to the private sector. (Many do not consider DBs to be within the spectrum of PPPs and consider such contracts as public works contracts.)

Operation License: A private operator receives a license or rights to operate a public service, usually for a specified term. This is often used in IT projects.

PPP vs. Privatisation

The central question on governance from the perspective of PPPs is how to organise the interaction between public and private sector. The main goal is to improve efficiency, quality of public services and products, and legitimacy. The question how to organise a PPP cannot be answered in general for every market, and, in most cases even for every project, the answer has to be customised. Confusion about the PPP concept is striking in the political and social discussion on these governance questions. Often, PPP is used as a synonym for privatization. Nevertheless, there are significant differences between PPP and privatisation. In PPPs, public and private parties (actors) share costs, revenues and responsibilities. Privatisation represents the transfer of tasks and responsibilities to the private sector, with both costs and revenues being in private hands. The confusion impedes a rational discussion about PPPs since all the disadvantages of privatisation are imputed to PPPs.

The key differences between public-private-partnership and 'privatisation' may be summarised as :

***Responsibility*:** Under privatisation the responsibility for delivery and funding a particular service rests with the private sector. PPP, on the other hand, involves full retention of responsibility by the government for providing service.

Ownership: While ownership rights under privatisation are sold to the private sector along with associated benefits and costs, PPP may continue to retain the legal ownership of assets by the public sector.

Nature of Service : While nature and scope of service under privatisation is determined by the private provider, under PPP the nature and scope of service is contractually determined between the two parties.

Risk and Reward : Under privatisation all the risks inherent in the business rest with the private sector. Under PPP, risks and rewards are shared between the government (public) and the private sector.

PPPs in India

There is now over 10 years experience in India in the development and use of PPPs for delivering infrastructure services. Policies in favor of attracting private participation have met with varying degrees of success, but real progress has been made in some sectors, first in telecommunications, and now in ports and roads, and with individual projects in other sectors. There has been considerable innovation with different structures now being developed to attract private participation. But at the same time progress has been uneven.

India had a few notable PPPs as early as the 19th century. The Great Indian Peninsular Railway Company operating between Bombay (now Mumbai) and Thana (now Thane) (1853), the Bombay Tramway Company running tramway services in Bombay (1874), and the power generation and distribution companies in Bombay and Calcutta (now Kolkata) in the early 20th century are some of the earliest examples of PPP in India. Since the opening of the economy in 1991 there have been several cautious and tentative attempts of PPP in India. However, most PPPs have been restricted to the roads sector. Large private financing in water supply has so far been limited to a few cities like Visakhapatnam and Tirupur. Most PPPs in water supply projects have been through municipal bonds in cities such as Ahmedabad, Ludhiana, and Nagpur. West Bengal has recorded significant success in housing and health sectors. For example, the housing projects coming up on the outskirts of Kolkata City are a good example of what a PPP model can deliver in terms of quality housing and quality living conditions to the lower middle class and the middle class. Gujarat and Maharashtra have had success especially in ports, roads, and urban infrastructure. Karnataka also has done well in the airport, power, and road sector. Punjab has had PPPs in the road sector.

A study conducted by the World Bank of 12 states and 3 central agencies in 2005 in India found only 86 PPP projects awarded by states and select central agencies (not including power and telecom). Their total project cost is Rs 339.5 billion. An optimistic projection of PPPs growing by, say, five times between 2004 and 2006, in a country of India's size, that is, around 500 projects, is not very encouraging. The largest number of PPP projects is in the roads and bridges sector, followed by ports, particularly Greenfield Ports. Apart from these two sectors, there are very few PPP initiatives

Across states and central agencies, the leading users of PPPs by number of projects have been Madhya Pradesh and Maharashtra, with 21 and 14 awarded projects, respectively, all in the roads sector, and the National Highways Authority of India (NHAI), with 16 projects. The other states or central agencies that have been important users of PPPs are Gujarat (9 projects) and Tamil Nadu (7), Karnataka (4) and Ministry of Shipping, Road Transport and Highways (MOSRTH) (4). However, looking at a breakdown by estimated project size, we see that MP becomes significantly less prominent due to the large number of relatively small-sized projects in its portfolio, falling to three percent of total project costs.

States like Andhra Pradesh, Gujarat, and Punjab have legislation which clearly defines what infrastructure is and how these infrastructure projects are going to be executed by the private sector. Some other states have administrative frameworks in place for decision-making. Despite these frameworks, in the last five years the number of successful projects has not increased substantially. Madhya Pradesh and Maharashtra have exhibited the possibility of developing a PPP program in a single sector (roads) by building up capacities in line departments. However, they have no PPPs in other sectors, possibly in part because of the absence of platforms to transfer acquired skills to other departments. Gujarat, Andhra Pradesh, and Punjab have developed cross-sectoral enabling legislation and dedicated agencies but have not had a very successful track record in taking PPPs to the market. Some other states, such as Tamil Nadu, have developed a few PPPs across a wide range of sectors, without explicit cross-sectoral PPP units or legislation. Rajasthan has a cross-sector policy/ regulatory framework and a project development company but has concluded only one tourism project and a few road projects. Therefore, there seems to be no clear link between institutional structure and success of PPP. One possible reason for this is the non-availability of sufficient skilled staff in the Government of India as well as in the states, who could actually look at how PPP projects should be structured. This is one important area where significant capacity building is required, both at the Centre and in the states.

Various studies in developed and developing countries have shown that there is a significant shortfall in infrastructure investment and lack of maintenance resulting in a deteriorating stock of public infrastructure capital to support the delivery of core public services. Public-private partnership is an approach that is increasingly adopted to facilitate the improvement of public services where there are public sector budgetary constraints and there is a need for innovation by stimulating private investment in infrastructure facilities such as health, education, transport, defence and social housing and waste management. The alternative public-private partnership is a whole-life or integrated approach from design to facilities management and service delivery aimed at addressing the problems associated with the traditional approach by creating a shift in emphasis from building contracting and lump sum payment to service contracting and performance-based payment. However, it is important that appropriate policy, strategic and implementation structures and processes are in place to address the key objectives of the public sector in PFI/PPP projects. Another critical success factor that should be added is sustainability to reflect the increasing need to balance economic objectives with environmental and social obligations.

Typically, in larger countries, the national PPP units will not undertake the projects but rather provide the policy, technical, legal and other support mechanisms to local authorities and government ministries that have the responsibility of the project together. Practically, it can help the relevant procuring authority more confidently manage the whole process from the development of the initial project design through to the bid evaluation process and post-financial close. In India, NHAI, MOSRTH attracting PPP projects, is an example of such mechanism. Though PPP is a relatively new approach to procurement, lessons could be drawn from the experiences of developed and developing countries on the conditions for the success of PPP. As a relatively late entrant in the PPP development process, India can learn and benefit from these lessons.