Chapter IV

Public - Private Partnership

Privatisation

Privatisation is the act of reducing the role of the Government, or increasing the role of private sector, in an activity or in the ownership of Assets[41]. The practice of privatisation has preceded the theory and in its broadest sense, the word is used to describe any rollback of state or Government in the lives and activities of the citizens, and any activity strengthening the role of the markets. Thus economic reforms in India, liquidation or closure of Public enterprises in Africa, the sale of shares or assets in UK and contracting out or franchising refuse collection and bus routes in Europe are all described as privatisation. Implicitly privatisation (or redefining boundaries of state action) is treated as a process and not a normative goal[42].

The Forces Influencing Privatisation

There are several influences or pressures that are behind the privatisation movement: these are pragmatic, economic, philosophical, commercial and populist. The characteristics of these forces are summarised in the table 4.1 and discussed briefly here[43].

Pragmatic Forces

When governments face fiscal stress, they also encounter public's antipathy to higher taxes. Governments look out for easy solutions; the first option is normally creative accounting that masks the difference between the revenue and expenditure. In the Indian context these are typically off budget items like oil and fertiliser bonds, overstating the projected revenues and understating expenditures etc. The second option is borrowing to support the wasteful government expenditure and close the gap between revenue and expenditure, however this leads to structural deficits thereby impairing government's capacity to invest in capital assets, crowding out the private sector and raising the costs of

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41 Savos, E. S. (1987), *Privatization: The Key to Better Government*. New Delhi: Tata McGraw – Hill.

42 Reddy,Y. V, "State, Market and Privatisation" in Sankar, T. L. and Reddy, Y. V. (Eds) (1989). *Privatisation: Diversification of Ownership of Public Enterprises*. Hyderabad: Institute of Public enterprises.

43 Savos, E. S. (2001), *Privatization and Public Private Partnerships*, New Delhi: Affiliated East-West Press

borrowing for all. Only options left for government in such a situation are productivity enhancement or reduced activity. Reduced governmental activity faces opposition from the beneficiaries of the activity, a safer political option is productivity enhancement, but this option also faces opposition from affected public employees. Privatisation is the strategic approach to improving the productivity of Government agencies and thereby delivering more value for money.

Table 4.1: The influences promoting privatization

Force	Goal	Reasoning
Pragmatic	Better Government	Prudent privatisation leads to more cost effective public services
Economic	Less dependence on government	Growing affluence allows more people to provide for their own needs, making them more receptive to privatization
Ideological	Less Government	Government is too big, too powerful and too intrusive in people's lives and therefore is a danger to democracy. Government's decisions are political, thus are inherently less trustworthy than free market decisions.
Commercial	More Business	Government spending is a large part of the economy; more of it can and should be directed towards private firms. State owned enterprises and assets can be put to better use by the private sector.
Populist	Better Society	People should have more choice in public services. They should be empowered to define and address common needs, and to establish a sense of community by relying more on family, neighbourhood, social and religious associations and less on distant bureaucratic structures.

Source: Savos, E. S. (2001), *Privatization and Public Private Partnerships*, New Delhi: Affiliated East-West Press

Economic Forces

Growing pressure on government finances has also been accompanied by increased wealth of the individuals. People now believe that they can make better choices about health, education etc. and get better return on their expenditure by allocating funds to competing organisations, public and private, rather than by paying taxes.[44] Consumers are able to pay for, and are therefore demanding, better education, health care, housing and other services that state provides. Increasingly private sector is able to provide these goods and services more efficiently, and therefore the dependence of a large section of population on government services is decreasing.

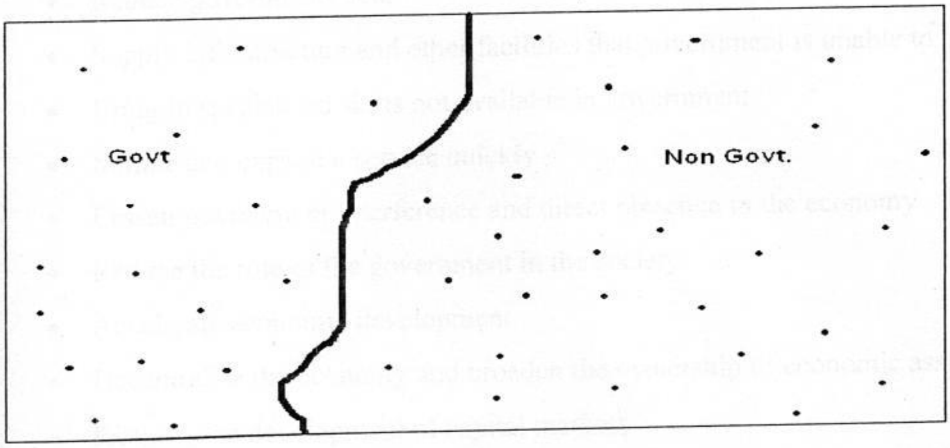
Philosophical Forces

The role of government differs in different societies, and even within any society it changes over time, waxing and waning over a period. For example the rallying cry of Reagan Revolution was "Get government off our backs and out of our pockets", while in Thatcher's Britain, it was "Rolling back the frontiers of the state". A visual conception of the role of government and nongovernmental (Private) agencies in provision of goods and services is given in figure II[45]. Different goods and services are represented by dots in the figure. Even at a given point of time the role of government may shrink in one area and expand in other. For example, in the Indian context, the strength of police force had not increased over last few decades in line with population growth, as the government was reducing the expenditure on public service. This led to sharp reduction policemen to population ratio to 130 against UN norm of 230. To prevent crime and ensure security, the well to do citizen in urban areas arranged for private security in colonies and personal security whenever required. Now, the growing concern over internal security scenario has forced government to increase the number of policeman to bring it on par with UN norms over next five years.[46]

Similarly in the health, Education and other social sectors government has been expanding, while shrinking in economic sector. Thus different sections of the boundary can be moving in different directions at the same time.

[44] Glazer, Nathan (1988), *The Limits of Social policy*, Cambridge, MA: Harvard University Press, 126.
[45] Savos, E. S. (1987), *Privatization: The Key to Better Government*. New Delhi: Tata McGraw – Hill.
[46] Union Home secretary G. K. Pillay, in Business Standard dated 14/02/2010

Figure II- Society depicted in Government Private Continuum



Commercial Forces

Private industries support privatization due to two reasons, one Government is also the biggest spender in the economy and many of the functions performed by government can be performed more efficiently by the private sector.

Other opportunity for private sector lies in large capital projects of the government like power plants, highways etc, which a government hard pressed for funds urgently needs but cannot afford.

Populist Forces

Populists are against both big government and big business; they are for local institutions and empowerment of people. The key elements of populist position are that people should have greater choice in public services than they now have, and they should be empowered to decide their common needs and address them locally. They can rely on local social and voluntary associations than on government.

Objectives of Privatisation

There are several objectives for privatisation in developing countries, some of them related or overlapping also. The most appropriate ones are[47]:

- Reduce the cost of government

[47] Savos, E. S. (2001), *Privatization and Public Private Partnerships*, New Delhi: Affiliated East-West Press

- Generate revenue both by selling assets and collecting taxes from them
- Reduce government debt
- Supply infrastructure and other facilities that government is unable to provide
- Bring in specialised skills not available in government
- Initiate and expand a service quickly
- Lessen government interference and direct presence in the economy
- Reduce the role of the government in the society
- Accelerate economic development
- Decentralise the economy and broaden the ownership of economic assets
- Promote the development of capital markets
- Attract new foreign and domestic capital and encourage return of capital
- Show commitment to economic liberalisation and increase business confidence
- Gain popular support by getting rid of malfunctioning bureaucracy
- Weaken political opponents (for example, trade unions)

Delivering the Services

There are three basic participants in the delivery of a service: the service consumer, the service producer and the service arranger or provider. The consumer obtains or receives the service directly and mày be an individual, all the inhabitants of a particular geographical area, a private organisation, a government agency or a class of individuals with common characteristics (like poor people, students etc.).

The service producer directly performs the work or delivers the service to the consumer. A producer can be a government unit, a voluntary association, a private firm or the consumer himself.

The service arranger or provider assigns the producer to the consumer, or selects the producer who would serve the consumer. In most cases government or government agencies are the service arrangers.

The distinction between providing or arranging a service and providing it is at the heart of concept of privatisation. For many collective goods, government is essentially an arranger or provider- an instrument of the society for deciding what shall be done collectively, for whom, to what degree or at what level of supply, and how to pay for it. For example the same highway can be built by government from additional taxes collected and it could be toll free or it may be constructed by a private agency and tolled. A municipality hires a contractor to resurface a road, the municipality in this case, is the arranger, the firm is the producer, and the people who use the road are consumers. A government that decides to provide a service at collective expanse need not produce it, using government employees and equipments. Privatisation is opposed by various groups due to lack of understanding about the difference between providing a service and producing it. It is assumed that the moment Government abandons the producer role; it automatically abandons its role as provider also, which is normally not the case.[48]

Based on this difference between providing and producing services, different institutional arrangements arise; these are depicted in Table 4.2 below:

Table 4.2 – Institutional Arrangements for providing Public Services

Service Arrangement	Arranger	Producer	Who pays?
Government Service	Government	Government	Government
Government Vending	Consumer	Government	Consumer
Intergovernmental agreements	Government (1)	Government (2)	Government (1)
Contracts	Government	Private Sector	Government
Franchise (exclusive)	Government	Private Sector	Consumer
Franchise (Multiple)	Government & Consumer	Private Sector	Consumer
Grants	Government & Consumer	Private sector	Government & Consumer
Vouchers	Consumer	Private Sector	Government & Consumer
Free market	Consumer	Private sector	Consumer
Voluntary Service	Voluntary association	Voluntary association	N.A.
Voluntary service with contract	Voluntary association	Private Sector	Voluntary association
Self-service	Consumer	Consumer	N.A

*Government 1 and 2 are two different governments

Source: Savos, E. S. (2001), *Privatization and Public Private Partnerships*, New Delhi: Affiliated East-West Press

[48] Savos, E. S. (2001), *Privatization and Public Private Partnerships*, New Delhi: Affiliated East-West Press

From our perspective the exclusive franchise or concession is one particular arrangement which forms the core of Public- Private Partnerships in infrastructure sectors and is discussed here in detail.

Franchises

An exclusive franchise or concession is an award of monopoly privileges to a private firm to supply a particular service in a specified area, usually with a price regulation by a government agency. Non- exclusive or multiple franchises can also be awarded like in case of taxis, buses etc... "Public-Private Partnerships" is being increasingly used as a substitute for "Franchise" and for that matter for practically any agreement between government and the private sector.

In contracts as well as franchises, government is the arranger and a private organisation is the producer, but in contracts Government (the arranger) pays the producer for contract service, while in case of franchises the consumer pays the producer (Concessionaire or Franchisee). Franchises are especially suitable for providing toll goods, such as electric power, gas, roads and bridges, ports and airports etc. The "Chunnel" or the tunnel under English Channel is a franchise from the British and French governments.

Public- Private Partnership (PPP)

PPP is defined as "any arrangement between a government and a private sector in which partially or traditionally public activities are performed by the private sector)"[49].PPP is commonly used in two different ways. In broad terms, it refers to the arrangement in which the public and private sectors join together to produce goods and services. Alternatively, PPP refers to a formal collaboration between business and civic leaders and local government officials to improve the urban conditions. In the latter, the private sector goes beyond their usual role in the market and becomes involved in social services like, education, medical care, housing and urban development.

49 Savos, E. S. (2001), *Privatization and Public Private Partnerships*, New Delhi: Affiliated East – West Press.

Different forms of PPP: Several forms of PPP are observed in practice[50]

Service Contract: Specific services associated with infrastructure are contracted out to a private firm for specific time period in return for a management fee. The public agency i.e. the government retains the overall responsibility for the operation and maintenance of the system except for the particular contracted services and it bears the commercial risk. The agency finances the fixed assets and provides the working capital. Compensation to the private firm is generally on the basis of time, lump-sump, fixed fee, or cost plus, or on the basis of a physical parameter. Common examples are billing and collection of water and electricity, Railway support services like ticketing, catering, bedrolls etc.

Management Contract: The private entity performs specific tasks under a management contract for a period and gets payment from the government. The government owns the facility and also retains the ownership and investment decision making. The arrangement is similar to a service contract, but in the former case the private party has overall responsibility for operating and maintaining the system and makes day to day decisions; however it does not assume any capital risks.

Lease: A private entity is given a long term lease to develop (with its own funds) and operate an expanded facility. The private entity pays lease rental to the government, is entitled to keep the revenues to recover its investment plus a reasonable return over the term of the lease and assumes the operational risk; typical examples being leasing of Delhi and Mumbai Airports to GMR and GVK respectively.

Concession: These take various forms like BOOT, BOT, DBOT etc. A private entity is awarded a franchise (concession) to finance, Build, own, and operate the facility, it has a right to collect the user fee for a specified period and also assumes significant investment risk. After the expiry of the concession period the ownership of the facility is transferred to the government. This is the most common form of PPP to build new infrastructure.

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50 Dhameja, Nand, "Infrastructure Financing: PPP Approach- Various forms", *Nagarlok, Vol. XXXIX, No.2 April-June, 2007.*

Greenfield Projects: A private entity or a public-private joint venture builds and operates a new facility for the period specified in the project contract. The facility may return to the public sector at the end of the concession period. The government usually provides the revenue guarantee through long term take or pay contracts for bulk supply facilities or minimum traffic revenue guarantees.

Divesture: government transfers the ownership of existing assets to a private entity through an asset sale, public offering or mass privatisation programme and the latter has full responsibility for maintenance of the assets. Since it involves full transfer of assets to the private entity, it can not be termed as a form of PPP.

Comparison of different forms of PPP

A comparison of various forms of PPP based on parameters like ownership, O & M and capital investment, commercial risk and period of contracts is given in table 4.3. Similarly comparison based on objectives like technical expertise, managerial expertise, operating efficiency or investment needed for which participation is sought is given in table 4.4. On the other hand table 4.5 provides the comparison on parameters relevant to success of PPP like, political commitment, cost covering tariff, regulatory framework or information flows.[51]

Table 4.3 - PPP options comparison to Operating features

Option	Asset Ownership	O & M	Capital Investment	Commercial Risk	Duration
Service Contract	Public	Public	Public	Public	Less than 5 years
Management Contract	Public	Private	Public	Public	3-5 years
Lease	Public	Private	Public	Shared	8-15 Years
Concession BOT	Public	Private	Private	Private	25-30 Years
BOOT/ BOO	Private/Public	Private	Private	Private	20-30 Years
Greenfield	Public/Private	Private	Private	Private	-

[51] Sasi Kumar and Jayashankar Prasad, C (February 2004). "Public-Private Partnerships in Urban Infrastructure", Kerala Calling

Table 4.4 - PPP Options comparison on Private Participation Objectives

Objective / Option	Technical Expertise	Managing Expertise	Operating Efficiency	Investment: In Lump	Investment: Distributed
Service Contract	Yes	No	No	No	No
Management Contract	Yes	Yes	Some	No	No
Lease	Yes	Yes	Some	No	No
Concession BOT	Yes	Some	Some	Yes	No
BOOT/BOO	Yes	Yes	Yes	Yes	Yes
Greenfield	Yes	Yes	Yes	Yes	Yes

Table 4.5 - PPP Options Comparison to Factor Priority

Requirement / Option	Political Commitment	Cost-covering Tarrifs	Regulatory Framework	Good Information
Service Contract	Low	Low	Low	Low
Management Contract	Moderate	Moderate	Moderate	low
Lease	Moderate	High	High	High
Concession	Moderate	High	High	High
BOOT/BOO	High	High	High	High
Greenfield	Moderate	High	Moderate	High

Source: Sasi Kumar and Jayashankar Prasad, C. "Public-Private Partnerships in Urban Infrastructure", Kerala Calling, (February 2004).

PPP does not reduce the responsibility and accountability of the government. The government remains accountable for service, quality, price certainty and cost effectiveness; in fact the role of government gets redefined as enabler and facilitator, while private sector plays the role of financer, builder and operator of the service. Under PPP approach, the skills, expertise, and experience of both public and private sector get combined to deliver higher standards of service to the consumers. The public sector contributes in terms of stable governance, citizen's support, financing and also assumes social, environmental and political risks. The private sector brings along operational efficiencies, innovative technologies, managerial effectiveness, access to additional finances, and bears construction, commercial and operational risk of the project.

PPP differs from privatisation as the former refers to private management of public services through long term contracts between a private operator and a public authority; while privatisation involves the outright sale of the public service or utility to the private operator.

Mr. Montek Singh Ahluwalia, Deputy Chairman of the Planning Commission has rightly stated "public-private partnerships should not be seen as public partnerships and private projects. They should rather be viewed as private partnerships and public projects". Since PPPs are long term contracts, they involve complex planning, detailed risk management, cost recovery tariff, construction, financial planning, regulatory, policy and governance issues.[52]

PPPs in Highway Sector in India

Public Private Partnerships are going to be the main mode of delivery for future phases of NHDP. While there are a number of forms of PPP, the common forms that are popular in India and have been used for development of National Highways are:

- Build, Operate and Transfer (Toll) Model
- Build, Operate and Transfer (Annuity) Model
- Special Purpose Vehicle (SPV) for Port Connectivity Projects
- NHAI is also proposing to award projects under a long term Operations, Maintenance and Transfer (OMT) concession.

BOT (Toll)

Private developers/ operators, who invest in tollable highway projects, are entitled to collect and retain toll revenues for the tenure of the project concession period. The tolls are prescribed by NHAI on a per vehicle per km basis for different types of vehicles. The Government in the year 1995 passed the necessary legislation on collection of toll.

A Model Concession Agreement (MCA) has been developed to facilitate speedy award of contracts. This framework has been successfully used for award of BOT concessions. The MCA has been revised recently and current projects are being awarded under the revised MCA.[53]

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52 Dhameja, Nand, "Public Private Partnership for Infrastructure Development: Cross-Country Scenario", *Indian Journal of Public Administration, Vol. LIV no.1, Jan-March 2008.*

53 MORT&H: Revised strategy for implementation of the National Highways Development Project (NHDP) - Framework and Financing OM dated 5th November 2009

BOT (Annuity)

The concessionaire bids for annuity payments from NHAI that would cover his cost (construction, operations and maintenance) and an expected return on the investment. The bidder quoting the lowest annuity is awarded the project. The annuities are paid semi-annually by NHAI to the concessionaire and linked to performance covenants. The concessionaire does not bear the traffic/ tolling risk in these contracts. The period of these concessions is 17 ½ years, out of which 2 ½ years is for construction of the highway and remaining 15 years for operation and maintenance.

Special Purpose Vehicle for Port Connectivity Projects

NHAI has also taken up development of port connectivity projects by setting up Special Purpose Vehicles (SPV) wherein NHAI contributes up to 30 per cent of the project cost as equity. The SPVs also have equity participation by port trusts, State Governments or their representative entities. The SPVs also raise loans for financing the projects. SPVs are authorised to collect user fee on the developed stretches to cover repayment of debts and for meeting the costs of operations and maintenance.

Operate, Maintain and Transfer (OMT) Concession

NHAI has recently taken up award of select highway projects to private sector players under an OMT Concession. Till recently, the tasks of toll collection and highway maintenance were entrusted with tolling agents/ operators and subcontractors, respectively. These tasks have been integrated under the OMT concession. Under the concession private operators would be eligible to collect tolls on these stretches for maintaining highways and providing essential services (such as emergency/ safety services).

The structure of a typical PPP project[54] is given in the figure III below. Similarly typical financial structure of BOT (Toll) and BOT (Annuity) projects are given in Appendix III.

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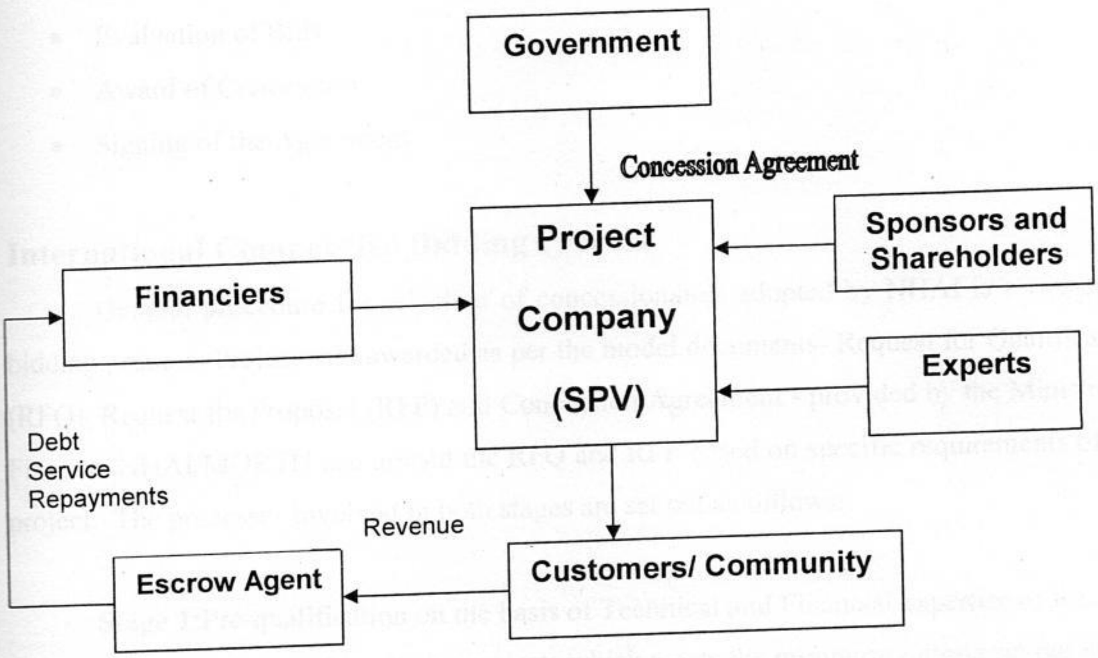
[54] Cherian Thomas,(2009), "Domestic Financing and Special Financial Institutions for PPP Projects", *Paper presented at UNESCAP Inter-regional Expert Group Meeting on Public Private Partnerships in Infrastructure Development*, Bangkok

Figure III: Typical Structure of PPP Projects



Mode of Delivery under NHDP

As per existing Government policy all projects are to be first bid out as BOT Toll and on failure are to be then offered under BOT Annuity and if this also fails, then they are to be taken under EPC after taking specific approval from CCEA. The above mentioned 'water fall' of bidding process envisages that all projects identified under the seven phases are expected to be built using one of the three modes of construction. Not only does this process take several months but also the existing Financing Plan of NHAI envisages BOT Toll as the primary mode of implementation therefore resources for building the highways through Annuity or EPC would be limited.

The implementation of the projects involves following steps:

- Completion of preparatory works for the identified projects
- Finalisation of Bidding Documents

- Invitation of Bids
- Pre bid Conference
- Evaluation of Bids
- Award of Concession
- Signing of the Agreement

International Competitive Bidding Process

General procedure for selection of concessionaires adopted by NHAI is a two-stage bidding process. Projects are awarded as per the model documents- Request for Qualification (RFQ), Request for Proposal (RFP) and Concession Agreement - provided by the Ministry of Finance. NHAI/MORTH can amend the RFQ and RFP based on specific requirements of the project. The processes involved in both stages are set out as follows:

Stage 1: Pre-qualification on the basis of Technical and Financial expertise of the firm and its track record in similar projects which meets the minimum criteria set out in the RFQ Document. In the current process of pre-qualification, NHAI shortlists the top six applicants with highest technical score, based on the pre-qualification criteria. Notices inviting tenders is posted on the web site and published in leading newspapers.

Stage 2: Commercial bids from pre-qualified bidders are invited through issue of RFP. Generally, the duration between Stage 1 and 2 is about 30-45 days. Wide publicity is given to NHAI tenders so as to attract attention of leading contractors/ developers/consultants.

The detailed framework of PPPs in highways programme has been discussed in next chapter.