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Public - Private Partnership

Economics

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ABSTRACT

Public–private partnership (PPP) describes a government service or private business venture which is funded and operated through a partnership of government and one or more private sector companies. These schemes are sometimes referred to as PPP, P3 or P3. PPP involves a contract between a public sector authority and a private party, in which the private party provides a public service or project and assumes substantial financial, technical and operational risk in the project.. In other types (notably the private finance initiative), capital investment is made by the private sector on the strength of a contract with government to provide agreed services and the cost of providing the service is borne wholly or in part by the government. Government contributions to a PPP may also be in kind (notably the transfer of existing assets).

INTRODUCTION:

Public–private partnership (PPP) describes a government service or private business venture which is funded and operated through a partnership of government and one or more private sector companies. These schemes are sometimes referred to as PPP, P3 or P^3. PPP involves a contract between a public sector authority and a private party, in which the private party provides a public service or project and assumes substantial financial, technical and operational risk in the project.. In other types (notably the private finance initiative), capital investment is made by the private sector on the strength of a contract with government to provide agreed services and the cost of providing the service is borne wholly or in part by the government. Government contributions to a PPP may also be in kind (notably the transfer of existing assets).

Over the past two decades more than 1400 PPP deals were signed in the European Union, which represent an estimated capital value of approximately €260 billion. Since the onset of the financial crisis in 2008, estimates suggest that the number of PPP deals closed has fallen more than 40 percent. The idea that private provision of infrastructure represented a way of providing infrastructure at no cost to the public has now been generally abandoned; however, interest in alternatives to the standard model of public procurement persisted. In particular, it has been argued that models involving an enhanced role for the private sector, with a single private-sector organization taking responsibility for most aspects of service provisions for a given project, could yield an improved allocation of risk, while maintaining public accountability for essential aspects of service provision. Initially, most public–private partnerships were negotiated individually, as one-off deals, and much of this activity began in the 1990s.

Public-Private Partnership (PPP):

There is no widely accepted definition of a Public Private Partnership (PPP). In broad terms, PPP refers to an arrangement between the public and private sectors with clear agreement on shared objectives for the delivery of public infrastructure and/ or public services. It is an approach that public authorities adopt to increase private sector involvement in the delivery of public services. In many countries, PPPs are now a central feature of ongoing efforts to modernise public services and infrastructure.

The Government of India defines PPPs as:

'A partnership between a public sector entity (sponsoring authority) and a private sector entity (a legal entity in which 51% or more of equity is with the private partner/s) for the creation and/ or management of infrastructure for public purpose for a specified period of time (concession period) on commercial terms and in which the private partner has been procured through a transparent and open procurement system'. (Department of Economic Affairs, Ministry of Finance, Government of India, 2007)

A well-known definition of PPP given by the UK Commission on PPP is that: "a PPP is a risk-sharing relationship between the public and private sectors based upon a shared aspiration to bring about a desired public policy outcome"

Origin:

Pressure to change the standard model of Public Procurement arose initially from concerns about the level of public debt, which grew rapidly during the macroeconomic dislocation of the 1970s and 1980s. Governments sought to encourage private investment in infrastructure, initially on the basis of accounting fallacies arising from the fact that public accounts did not distinguish between recurrent and capital expenditure.

The idea that private provision of infrastructure represented a way of providing infrastructure at no cost to the public has now been generally abandoned, interest in alternatives to the standard model of public procurement persisted. In particular, it has been argued that models involving an enhanced role for the private sector, with a single private sector organisation taking responsibility for most aspects of service provisions for a given project, could yield an improved allocation of risk, while maintaining public accountability for essential aspects of service provision.

Initially, most public-private partnerships were negotiated individually, as one-off deals. In 1992, however, the Conservative government of John Major in the United Kingdom introduced the private finance initiative (PFI), the first systematic program aimed at encouraging public-private partnerships. In the 1992 program, the main focus was on reducing the Public Sector Borrowing Requirement, although, as already noted, the effect on the public accounts was largely illusory. The Labor government of Tony Blair elected in 1997, persisted with the PFI sought to shift the emphasis to the achievement of "value for money" mainly through an appropriate allocation of risk. A number of Australian state governments have adopted systematic programs based on the PFI. The first, and the model for most others, is Partnerships Victoria.

Because of the focus on avoiding increases in public debt, many private infrastructure projects in the early 1990s involved provision of services at substantially higher cost than could have been achieved under the standard model of public procurement. The central problem was that private investors demanded and received a rate of return that was higher than the government's bond rate, even though most or all of the income risk associated with the project was borne by the public sector. A number of Australian studies of early initiatives to promote private investment in infrastructure reached the conclusion that, in most cases, the schemes being proposed were inferior to the standard model of public procurement based on competitively tendered construction of publicly owned assets (Economic Planning Advisory Commission (EPAC) 1995a,b; House of Representatives Standing Committee on Communications Transport and Microeconomic Reform 1997; Harris 1996; Industry Commission 1996; Quiggin 1996).

One response to these negative findings was the development of formal procedures for the assessment of PPPs in which the central focus was on "value for money" rather than reductions in debt. The underlying framework was one in which value for money was achieved by an appropriate allocation of risk. These assessment procedures were incorporated in the private finance initiative and its Australian counterparts from the late 1990s onwards.

Although the general view that governments should seek "value for money" has been widely accepted, there have been continuing disputes over whether the guidelines designed to achieve these goals are appropriate, and whether they have been correctly applied in particular cases. Much of the discussion has been based on debates over the UK private finance initiative.

Sectors in which PPPs have been completed worldwide include:

- power generation and distribution,
- water and sanitation,
- refuse disposal,
- pipelines,
- hospitals,
- school buildings and teaching facilities,
- stadiums,
- air traffic control,
- prisons,
- railways,
- roads,
- billing and other information technology systems, and
- housing.

PPP PROJECTS STATUS REPORT OF INDIA:
Sector Wise PPP Project Report of India
(As on July 31, 2011)

Sector wise figures						
Sector wise	**Total No. of projects**	**Based on 100 Crore**	**Between 100 to 250 Crore**	**Between 251 to 500 Crore**	**More then 500 Crore**	**Value of Contracts**
Airport	5	-	-	303.0	18808.0	19111.0
Education	17	424.2	365.5	460.0	600.0	1849.7
Energy	56	337.6	934.0	3083.0	62890.0	67244.6
Health care	8	315.0	343.0	275.0	900.0	1833.0
Ports	61	86.0	1745.3	4304.8	74902.1	81038.2
Railways	4	-	102.2	873.0	594.3	1569.6
Road	405	4364.6	11696.5	38520.5	122143.3	176724.9
Tourism	50	1132.6	1503.5	800.0	1050.0	4486.1
Urban development	152	2812.0	3136.9	6688.2	16838.0	29475.0
Total	**758**	**9471.9**	**19826.9**	**55307.5**	**298725.8**	**383332.1**

We see that road projects account for 53.4% of the total number of projects and 46% by total value because of the small average size of projects. Ports though account for 8% of the total number of projects have a larger average size of project and contribute 21% in terms of total value. It is noteworthy that if ports and central road projects are excluded from the total, there is in fact a relatively small value of deal flow, at only Rs 125,568.93 Crores in basic infrastructure PPPs to date, suggesting a significant potential upside for PPP projects across sectors where states and municipalities have primary responsibility. It is observed that the potential use of PPPs in e-governance and health and education sectors remains largely untapped across India as a whole, though off-late there have been some activities shaping in these sectors.

State Wise PPP Project Report of India
(As on July 31, 2011)

State wise figures						
State	**Total No. of projects**	**Based on 100 Crore**	**Between 100 to 250 Crore**	**Between 251 to 500 Crore**	**More then 500 Crore**	**Value of Contracts**
Andhra Pradesh	96	1484.0	2197.8	7062.3	56173.7	66918.3
Assam	4	54.0	337.2	-	-	319.2
Bihar	6	77.0	-	769.6	1246.7	2093.8
Chandigarh	2	75.0	-	-	-	75.0
Chhattisgarh	4	70.0	304.0	464.0	-	838.0
Delhi	13	95.0	109.0	738.2	10374.0	11316.6
Goa	2	30.0	220.0	-	-	250.0
Gujarat	63	304.1	2013.2	4138.9	33181.0	39637.2
Haryana	10	125.0	180.0	270.0	10588.1	11163.1
Jammu and Kashmir	3	-	-	-	6319.8	6319.8
Jharkhand	9	131.0	550.0	398.0	625.1	1704.1
Karnataka	**104**	**1080.4**	**1942.6**	**13136.3**	**28499.6**	**44658.9**
Kerala	32	338.7	206.3	1235.0	20501.5	22281.5
Madhya Pradesh	86	1977.6	3930.3	3397.2	5678.3	14983.4
Maharashtra	78	742.3	2988.4	2433.7	39427.6	45592.0

Meghalaya	2	-	226.1	-	536.0	762.1
Orissa	27	235.1	211.0	1473.0	11430.6	13349.7
Puducherry	2	-	-	419.0	2947.8	3366.8
Punjab	29	732.8	1552.7	572.0	705.0	3562.5
Rajasthan	59	633.9	783.8	1100.8	12508.8	15027.3
Sikkim	24	175.6	558.0	2669.0	13708.0	17110.6
Tamil Nadu	43	267.9	355.6	8905.2	9100.0	18628.6
Uttar Pradesh	14	-	-	1458.6	25137.2	6595.8
Uttarakhand	2	43.0	-	478.0	-	521.0
West Bengal	30	638.0	965.7	1714.4	3299.1	6617.1
Inter State	14	160.5	195.0	2474.4	6738.0	9567.8
Total	**758**	**9471.9**	**19826.9**	**55307.5**	**298725.8**	**383332.1**

Across states and central agencies, the leading users of PPPs by number of projects have been Karnataka, Andhra Pradesh, and Madhya Pradesh, with 104, 96 and 86 awarded projects respectively and the National Highways Authority of India (NHAI), with about 155 projects. In terms of main types of PPP contracts, almost all contracts have been of the BOT/BOOT type (either toll or annuity payment models) or close variants.

Some of the earliest examples of PPP in India are:- the Great Indian Peninsular Railway Company operating between Bombay and Thane (1853); the Bombay Tramway Company running tramway services in Bombay (1874); as well as the power generation and distribution companies in Bombay and Kolkata in the early 20th century. The Government is actively promoting the PPP mode for developing and operating high-priority public utilities and infrastructure like railways, shipping, power, aviation, telecom, etc. According to certain studies, the largest number of PPP projects are in the roads and bridges sector, followed by ports, particularly greenfield ports. Also, during the Eleventh Five Year Plan, the investment in physical infrastructure has been estimated to be about Rs. 2,002 thousand crore (at 2006-07 prices which is equivalent to about US$ 500 billion: @ Rs. 40/$). This can be achieved through a combination of public investment, public-private-partnerships (PPPs) as well as exclusive private investments. In order to accelerate the implementation of PPP projects and providing them long-term finance, the Government has initiated the 'Viability Gap Funding (VGF) scheme' and established 'India Infrastructure Finance Company Limited (IIFCL)'. The VGF scheme is a special facility created to support those infrastructure projects, which are economically justifiable but not viable commercially in the immediate future. It involves upfront grant assistance of up to 20% of the project cost for the PPP projects. While, IIFCL is the special purpose vehicle (SPV) created for rendering long term financial assistance to infrastructure projects through:-

- Direct lending to eligible projects
- Refinance to banks and financial institutions and
- Any other method approved by Government of India.

Thus, it eases the asset-liability mismatch and sets a benchmark for market borrowings by other organizations.

Such a framework provided by the Government, provides numerous opportunities for investment into the various infrastructural sectors of the country, which have immense untapped potential for further growth and expansion.

Main features of PPPs:
Cooperative and contractual relationships:

PPPs represent cooperation between the government and the private sector. PPPs are not the same as privatization in that both public sponsors and private providers function as partners throughout project development and delivery, and often in operation and maintenance. The most successful partnership arrangements draw on the relative strengths of both the public and private sector in order to establish complementary relationships between them.

PPP arrangements are long-term in nature, typically extending over a 15 to 30 year period. This is a factor which helps to which establish productive and lasting relations between the public and private sectors. Demonstrating an enduring public sector commitment to the provision of quality services to consumers, under terms and conditions agreeable to both the government and the private sector, PPPs are used to develop and operate public utilities and infrastructure. These collaborative ventures are built around the expertise and capacity of the project partners and are based on a contractual agreement, which ensures appropriate and mutually agreed allocation of resources, risks, and returns

Shared responsibilities:
While the specific responsibilities for delivery will vary according to each project, a key feature of PPPs is that these responsibilities will be shared between the public body and the private consortium. In some initiatives, this might require the private sector company to play a significant role in all aspects of delivery of the service, while in others its functions may be more limited. However, unlike instances of privatization, the overall role of government remains unchanged in a PPP: it is the government which remains ultimately accountable and responsible for the provision of high quality services that meet the public need.

A method of procurement:
PPPs are instruments for government bodies to deliver desired outcomes to the public sector, by making use of private sector capital to finance the necessary assets or infrastructure. The private company is rewarded for its investment in the form of either service charges from the public body, revenues from the project, or a combination of the two. This renders affordable those projects that might not otherwise have been feasible, because the public body was unwilling or unable to borrow the requisite capital. PPPs allow the private sector to play a greater role in the planning, finance, design, operation and maintenance of public infrastructure and services than under traditional public procurement models. Moreover, where traditional procurement models begin with the question of what assets the public body has as its disposal and how these might be used to deliver required services, PPP arrangements place the emphasis on the desired service or outcome as identified by the public organization and how the private sector might help to make this happen.

Risk Transfer:
A key element of PPPs is their potential to deliver public projects and services in a more economically efficient manner. At the beginning of the relationship, potential risks associated with the project are identified and each party adopts those which it is best equipped to manage.

The public sector can therefore transfer appropriate risks to the private partner, who has the necessary skills and experience to manage them.

For example, overall risk to the public sector can be reduced by transferring those associated with design, construction and operation to the private partner. The incentive for the private body comes in the form of higher rates of return related to high standards of performance.

Flexible Ownership:
PPPs enable flexible arrangements between public and private bodies, where the public body may or may not retain ownership of the project or facility that is produced. In some cases, the private organization may be contracted only to construct facilities or supply equipment, leaving the public body as owners, operators and maintainers of the service. Alternatively, the public sector may decide it is more cost-effective not to own directly and operate assets, but to purchase these instead from the private entity. Services may be purchased for use by the government itself, as an input to provide another service, or on behalf of the end user.

Strengths & Weaknesses:
Strengths:

The major strength of PPPs is their ability to deliver value for money in public service procurement and operation. By utilizing the differing skills, resources and experience of each party, they allow the public and private sectors to complement each other – the public sector provides its expertise in identifying public needs, service requirements and desired outcomes, and the private sector brings its capacity to effectively utilize assets and manage the construction and operation of services.

Benefits to the public sector:
The foremost benefit of PPPs, alluded to above, is the scope such partnerships allow for public authorities to raise capital for high priority works that might otherwise not be possible in the face of budgetary and borrowing constraints. Here, PPPs can draw on private sector expertise in order to deliver services and infrastructure efficiently and cost-effectively, and to bridge the gap between the resources required and those available from the public purse.

Gains in efficiency and effectiveness can be realised in a number of ways. Most importantly, the PPP approach encourages private sector innovation by allowing government to delegate responsibility for service design and construction to the private contractor. This enables the public body to identify desired services, outcomes and outputs, while allowing room for the private contractor to innovate in the search for the most appropriate solution to meet those requirements.

Additionally, PPPs can enable the optimum allocation of public resources in the pursuit of infrastructural development. Whereas traditional models of public procurement focus on achieving the lowest upfront costs in delivering infrastructural projects PPPs concentrate on delivering cost effectiveness over the duration of the asset – including, in particular, those costs associated with operation and ongoing maintenance. This allows the public sector to realise value for money for the entire life of the project or service, rather than just in its initial construction phase

Benefits to the private sector:
Engaging in PPPs offers private sector companies a wide range of business opportunities that were previously confined to public agencies. Given the long term nature of these relationships, undertaking work under PPP arrangements provides a stable foundation for the growth of the business. In addition, PPP arrangements encourage the private sector to engage in a broader spectrum of activities, throwing open the possibility of designing and delivering innovative solutions, rather than merely constructing assets to existing standards and designs.

Benefits to the public:
By combining the skills and expertise of public and private partners, PPPs are able to provide services which meet the needs of the public in a more efficient and costeffective manner. When appropriately designed and implemented, PPPs can yield better quality services without compromising public policy objectives or broader public need.

At the outset of the PPP relationship, the desired quality of service to be achieved from the development of the infrastructural asset is clearly specified, and the expectation is that high standards will be maintained throughout the duration of the project. This contrasts with traditional procurement methods, where the construction of assets is formally separated from operation and maintenance, and consequently, levels of service and conditions of assets will frequently decline over time.

Weaknesses (and risks):
PPPs, like conventional service delivery mechanisms, also have disadvantages and drawbacks. In order to minimize or eliminate these, it is vital that public sector managers recognize and understand them in order to better address problems as they arise, through careful contractual arrangements and negotiations.

Firstly, there is the possibility that the public sector may lose managerial control of its services. Under PPPs, the management of outputs is transferred to the private sector, meaning that the public sector has very limited ability to intervene, as long as services are being delivered. The public body has no day-to-day control over the management of the project and is reduced in its capacity to change the project or cooperate with wider public sector services, and indeed may not be able to make use of its own expertise in the area.

Secondly, the process of PPP procurement can be time consuming and expensive. In order for a PPP to be successfully realized, it is vital that before bidding starts, a detailed, clearly structured project appraisal and specification of desired outputs is drawn up. Although this is important to the development of projects that are affordable and provide value for money, it has the potential to make procurement a lengthy and costly procedure.

Thirdly, there is the problem of the higher cost of finance in the private sector. The weighted cost of finance in the private sector, including both debt and equity, is typically between 1% and 3% higher than the public sector's cost of debt on a non- risk adjusted basis. This has the effect of increasing the overall cost of PPP in comparison to traditional procurement methods, unless this can be offset by the increased cost efficiencies that the private sector should deliver.

Fourthly, PPPs can sometimes prove to be rather inflexible instruments – especially given the long term nature of most PPP contracts. While there can be significant financial benefits in setting rigidly defined output specifications for the life of the PPP, these should be weighed against the inflexibility this inevitably brings. Under PPP arrangements, there is limited potential for modifying services or flexible spending. Certain sectors of service provision may require a much greater degree of flexibility and in these cases, an approach which makes use of long-term rigid specifications of outputs may prove difficult or counterproductive.

Fifthly, in some areas of public service provision there may be greater public demand for accountability and responsiveness than in others. This may give rise to public criticism or even hostility towards PPP arrangements. Moreover, under PPP arrangements, lines of accountability can be less straightforward (and transparent) than under traditional methods of procurement where lines of accountability (for example, to government ministers) are more direct and immediate. In these circumstances, there may be a need for greater government involvement in the relationship, to ensure compliance and responsiveness to public concerns.

Reasons of Failure of some PPP projects:
If a contract is inadequately managed, one or more of the following problems may occur and potentially render the project unworkable:

- The provider may assume control, leading to unbalanced decisions that do not reflect the interest of the public sector;
- Decisions are made at inappropriate times; New business processes are unsuccessfully integrated with existing ones, and fail;
- People within either sector may fail to understand their

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roles and responsibilities;
- Disputes and misunderstandings may arise, some of which might be inappropriately escalated;
- Progress may be slow or there might be an inability to move forward;
- The desired benefits may not be achieved;
- Possibilities for improved performance or value for money might be lost.

There are a number of reasons why the public sector may fail to manage a PPP project successfully:

- Poorly drafted contracts;
- Contract managers assigned insufficient resources;
- Lack of experience in either public sector or provider teams;
- A failure to adopt an attitude towards partnership;
- Personality clashes between project team personnel;
- Lack of understanding of complexity, context and dependencies of contract;
- Unclear identification of authority and responsibility in relation to commercial decisions;
- Lack of measurement of performance;
- Focus on existing arrangements rather than emphasis on potential improvements,
- Inadequate monitoring and management of statutory, political and commercial risk.

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