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Potentials and Challenges for Public Private Partnerships in India

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Abstract:

Public Private Partnerships (PPPs) emerged in India, as elsewhere in the world, as an economic development instrument for mobilizing capital and efficient management resources required for large infrastructural and industrial projects. This happened in the background of the failure of the public sector dominated economic development strategy adopted in India until the late 1988s. The present paper discusses the nature and potentials of PPPs and the socio-structural limitations that the PPP arrangements are likely to face in India given, unlike in the developed countries, that the masses of people of India are not yet capable of bearing the high costs of final products and services produced through the private capital.

Introduction to Public Private Partnership

The Public Private Partnership (PPP) arose as a distinct economic development strategy increasingly being adopted by the different countries of the world in the wake of the macro-economic policy changes at the global that have occurred towards the end of the 1980s. These changes coincided with the decisive supremacy that the liberal capitalist economic development ideology gained with the end of the "cold war" between the socialist model and the capitalist model of economies which was marked by the collapse of the erstwhile USSR.[1] The ascendancy of the liberal capitalist ideology significantly denoted the decline of the concept of and paramount importance given to the "public sector"-based model of economic development.

Although Independent India proclaimed an economic development strategy based on the concept of mixed economy, which meant a role for both the public and private sectors in the economy, public sector acquired a predominant role in the planned economic development of India which began in the early 1950s. The apparent reason for this was the thinking among the political leadership and economic planners that mere private entrepreneurship and operation of a pure market economy will not be able to produce industrial and social development in the country, given the low levels of capital formation concentrated in the hands of a few Indian industrialists, in contrast to the country's large population scattered over a vast geographical territory subsisting in backward economic conditions. Large-scaled industrialisation envisaged by Jawaharlal Nehru and other leaders for the overall economic development of the country required creation and expansion of infrastructural facilities like highways, ports and other transport and communication networks. Investments required for such infrastructural development and large industrial production were not in the capacity of the few private industrialists of the country.[2] In view of this public sector enterprises were established in many areas of the economy to develop basis industries, such as for power generation, building of transport and communication networks, and for producing various goods and services which the private sector was not capable, because of their incapacity to mobilize the require capital, or not willing to undertake because of the fear of low returns for their investments in the basic industries. Thus, it could be seen the development of a large public sector in India was not a choice but a necessity in view of the structural

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bottlenecks that existed during the initial decades of the country's independent economic development.

The role of the public sector in the economic development was also emphasized because of the social security and political concerns. For example, in order to protect employment of the people, many of the sick industrial units were taken over and brought under the public sector during the time of Smt. Indira Gandhi's prime-ministership. The expansion of public sector was also thought to be an appropriate strategy for the socialistic concern with income re-distribution. It also fit into the concept of the welfare state the elements of which were enshrined in the Constitution of India. The economic strategists of India of that time thought the public sector-led economic development to be the most appropriate model for ensuring employment and adequate income to the large numbers of Indian people.[3]

By the end of the decade of 1980s, the currency for public sector began to decline. By this time the public sector model of development had helped t he country to achieve the objectives of development of basic industries and provision of public utilities in different fields such as transport, communication, health and educational infrastructure to a considerable extent. However, the model began to be criticized for its inability to mobilize capital and resources for the larger economic development of the country. For, inspite of the achievements in different areas of socio-economic development, the country was perceived to be stagnating under the conditions of underdevelopment. Large sections of people continued to live under poverty conditions. Inspite of the presence of huge natural resources, the country's economic development was perceived to be suffering from the lack of capital resources needed to be invested in the economic activities in order to take the country to the path of optimal economic development. Public sector-based model was perceived at this time to be incapable of aiding any further economic development for the country for the following reasons:-

(i) Public Sector in India did not in the main operate for the purpose of profit-making, but functioned to protect social concerns and social security by protecting the public from having to pay high prices for the facilities created.

(ii) Therefore, it could not produce high rate of capital formation required for the country in the light especially of its expanding population

(iii) Bureaucratic inefficiency was crept into the working of the public sector system over time

(iv) Public Sector Enterprises became instruments of perpetuation of self-interests of political leaders and parties. This resulted into the expansion of public sector into areas which did not provide any social benefits.

Because of the above failures of the public sector, private investments were thought to be essential for bringing about greater momentum in the economic development of the country, for which much more developmental efforts by way of infrastructure development in roads, railways, ports, airports, power supply and communication were needed in order attain economic growth on par with the developed countries, considering its ever increasing population and its large geographical size. It was felt that persisting with public sector enterprises will not suffice and there is need for developmental efforts to be undertaken through joint efforts of the public and private sectors. Thus, the economic reforms undertaken in India in the early 1990s envisaged a great role for public-partnerships in infrastructure building and industrial development.

PPP projects were considered as a panacea for the countries like India which were undergoing severe macro-economic crisis in the form of ever increasing fiscal deficits and internal and external public debts. In fact, the PPP model projects were prescribed by the international national agencies like the IMF in order to ensure cost effectiveness in infrastructure projects and to help governments to avoid public debts.4

The Meaning of PPPs

The concept Public-Private Partnership needs some clarification. There are various definitions given to this term. According to a definition offered by the United Nations PPPs are innovative methods employed by the public sector to contract with the private sector which can bring their capital and efficiency to deliver projects on time and in better quality. The public sector retains the responsibility to provide the public services and to deliver economic development and improve the quality of life of the people. The private parties are involved in the PPP arrangements for financing, designing, implementing and operating public sector facilities and services. Apart from capital investment and designing, the PPP arrangements typically also involve a longer-term contract with a private entity for service provisions by, and transfer of risks to, the private entity.

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Types of PPPs

There are both Institutionalized PPPs as well as Contractual PPPs. An institutionalised PPP generally takes the form of a Joint Venture (JV) between a public sector authority and a private sector stakeholder to carry out a project to provide public services on a long-term basis, by sharing the risks. The contractual PPPs take different forms.

Lease, Operate and Transfer (LOT)

In this type of PPP, a facility which already exists and is under operation is contracted out to a private party for efficient operation for a given period of time, subject to certain mutually agreed upon conditions. During the period of contract, the assets of the project will be with the private party and the same will be transferred back to the public authority at the end of the contract. An example of this type of PPP arrangement is the leasing out of a school or hospital to a private organization, along with all the staff and facilities, for efficient management.

Design, Build, Finance and Operate (DBFO) or Design, Build, Finance, Operate and Maintain (DBFOM)

In this model of PPP, the private party contracted is assigned the full responsibility for designing, financing, constructing and operating the project. While most of the risks involved in the project are transferred to the private party, the public sector authority make arrangements to ensure reasonable returns for the private party. The public authority also helps the private party with the acquisition of land and also facilitate in obtaining statutory and environmental approvals and clearances.

The private party participating in the project can recover its investment either through certain concessions granted or through annuity payments. The concessions given to the private party is usually in the form of the right to levy user charges like road and bridge toll charges collected from the users of such facilities created. The PPP model in which the private party is given the right to recover its investments and expected returns on investments by way of levying user charges is generally known as operations concessions or simply as concessions. The public sector agency which is normally responsible to provide the service to the public and collect revenue in the form of user charges, tolls, tariff etc., surrender its legal or statutory right to the private party in lieu of the latter's undertaking to design, construct and operate the project. The private party is also required to maintain the prescribed quality in the service.

Annuity payments are made in cases where there is no scope for the private parties to levy user charges such as projects in rural development, health and education sectors. For this the governments arrange for payment guarantee mechanisms by means of earmarking budgetary support, creating dedicated funds, letters of credit etc. Larger upfront payments are also made during the initial construction period.

The concession mode of recovering the investments made by the party is also employed in the case of contractual PPPs. An example is the practice in US where the public facilities like highways already built and under operation are given to private corporate organizations to manage and operate in lieu of money. This is a novel way of generating revenues for the Government. The private corporate organizations recover the money paid to the government authority from the users of highways. In the US, the term PPP usually refers to this type of concessions given to the private parties.[5]

Joint Ventures

In India, such concession model of PPP is not generally adopted. The PPP model that is followed in India is in the form of joint ventures. Recently, a number of PPP model joint ventures have been established for airport development in India. In this model, a private sector body forms a joint venture company along with a participating public sector agency. The latter usually holds only a minority shares. Apart from bringing in the required capital investments, the private partner is made responsible for the design, construction and management of the operations of the proposed project. The public sector partner is required to contribute fixed assets like land, buildings etc. The public sector partner is also expected to help the private partner to raise funds through the provision like bank guarantees and assurances and such like instruments. The private party is made liable to provide the public facility fulfilling the specified parameters of quality. The international airports at Hyderabad and Bangalore are examples of successfully completed PPP model joint venture projects.

Important Features of PPP

Conceptually, PPPs are cooperative efforts between the public and private sector for the creation of public sector facility, which normally is expected to be undertaken by the public sector. PPPs are therefore not the same as privatization. PPPs are formed to combine the strengths of both the public and private sectors in the provision of public services which are long-term in nature. The PPP partnerships are therefore long-term arrangements. The specific responsibility of each partner for the delivery of service will vary according to the nature of the project. In most PPP projects, the private sector company plays a significant role in all aspects of delivery of the service, while the overall accountability to the public remains with the public sector.

Advantages of PPPs

PPPs are therefore economic management tools for procuring the factors of production required to provide a specific utility to the public. A PPP arrangement facilitates channelising private sector capital to, for example, an infrastructure project which the Government would otherwise have found difficult to mobilize funds for. This renders affordable those big projects that might not otherwise have been possible for the governments to undertake, given the paucity of state funds from revenues. The PPPs thus remove financial constraints for the Governments in delivering public to the people.

A positive aspect of the PPP model of service delivery is the cost effectiveness of the projects. The PPP model delivers the project outcomes in an economically efficient manner. One way in which this is made possible is that most risks involved in the projects are allocated to the contracting private party, which possesses the necessary skills and experience to manage the risks. The incentive for the private party to own up the risks comes from the prospect for good returns if the project performs well.

Another plus point for PPP arrangements are their ability to deliver value for money in public service procurement and operation. PPPs make it possible to combine together the best of skills, resources and experiences of each party and invest them in the projects to produce the desired outcomes and thus to satisfy the public needs. The efficiency of private entrepreneurship for bringing about innovative methods in the design, execution and management of projects is considered the most important beneficial factor in the PPPs.

PPP provide the private sector companies additional business opportunities. Given that the projects undertaken under PPP model are of long-term in nature, the private investors also gains from the stability factor which is in contrast with the risks involved in the fluctuating situations involved in the normal competitive market conditions.

The benefits that accrue to the public from PPP projects are the better quality and regularity of services.

Limitation of PPPs

In embarking on PPPs projects, the Governments runs the risk of losing control of the management of the services provided to the public as the management of assets and services are usually transferred to the private parties during the period of contract. During this period, the Government will have very limited say and power in the management of service delivery. This may adversely affect the interests of the general public, who may be compelled to pay higher prices for the services delivered. This is because of the high cost of finance in the private sector, leading to the escalation in the cost of the projects. The PPP project costs also escalate because the procurement process is often time-consuming and expensive. It involves a detailed and clearly structured project appraisal and specification of desired outputs before the bidding for selecting the private party starts.

Although it is often argued that the higher cost of private finance is offset by the advantages of quality and efficiencies in project completion and delivery of services, this often does not happen because of the lack of control of the governmental authority over the private party. Experience in India has revealed that the private parties often do not conform to the specified standards. A case in point is the cracks developed in the Delhi airport metro line pillars because of the low quality of materials used for the construction by the private party given the contracts. The responsibility for such mishaps lies in the nexus of corrupt practices resorted to by the elements in both the governmental authority and the private bodies. This scenario of corruption makes project costs artificially higher and the project outputs below the standards expected from PPP arrangements.[6]

The highest costs of the PPP model projects often lead to public resentments and protests. The PPP arrangements also lack from transparent accountability, leading to the blame games between the governmental authorities and the private parties involved in the project.

There are many other factors that will result in the failure of projects created under the PPPs. If the private party takes over the full control of the project, it leads to unbalanced decisions inimical to the interests of the public. For, the private capital always tends to seek maximization of benefits. Because of this motive of the private parties, on the one hand, and the need on the part of the governmental authorities to safeguard the public interests, especially in the provision of services on affordable terms and prices, there is an inherent contradiction in the PPP arrangements. Therefore, there are always chances for disputes and misunderstandings.

From the perspective of private investors, the important requirements the Governmental authorities have to ensue for the success of PPP projects are standardization of bidding and procurement procedures, project pipeline creation, transparent and enabling policy and institutional frameworks for PPPs, especially in the granting of environmental and other clearances and raising of funds from international financial institutions.

Challenges for PPPs

Growing recognition of the prevailing infrastructure deficit in the country and its deterring impact on sustaining economic growth as well as poverty reduction has made

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development of social and economic infrastructure among the highest priorities of the Government of India. The GOI has recognized that with better infrastructure India's growth can be higher, with the benefits reaching to a much larger section of the population. The government acknowledges that investment in infrastructure will have to be at the same rate as the economic growth that is being targeted. In other words, gross capital formation in infrastructure (GCFI), which has remained around 4% of GDP during 1997-98 up to 2003-4, needs to be increased progressively and rapidly. However, estimated investment requirements far exceed government resources. Recognising the gaps between the existing infrastructure investment and the projected requirement in India, the Government in India has been focusing attention on developing projects under PPP model.

However, the non-resolution of the inherent contradiction in the concept and practice of PPP has resulted in the slow progress in establishing projects under PPP. The private investors are not forthcoming for investment in PPP projects in adequate measure. Public protests over collection of road and bridge tolls by private parties involved in PPP projects have dampened their enthusiasm in participating in PPP projects.

It becomes apparent that because the average people of India still do not have adequate income levels, they cannot afford to pay for the new and/or increased prices for the facilities created through private partnership. This leads to the conclusion that, largely India is not fully ripe for embarking on PPP model of economic development in full-scale. Public sector investments have to be continued for the creation of public utilities especially meant for mass consumption. There is clearly wariness on the part of private investors in investing funds for such projects which do not offer prospects for high returns commensurate with the risks involved. The forthcoming Budget 2015-16 will give a clear picture of the Governmental plans for harmonising the role of the public sector and the private sector investments for realizing the high growth path envisaged for the country.

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