

# Public-Private Partnership

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## Abstract

*Public-private partnerships are often touted as a “best-of-both-worlds” alternative to public provision and privatization. But in practice, they have been dogged by contract design problems, waste, and unrealistic expectations. Governments sometimes opt for a public-private partnership, for example, because they mistakenly believe that it offers a way to finance infrastructure without adding to the public debt. In other cases, contract renegotiations have resulted in excessive costs for taxpayers or losses for private firms. This paper proposes a series of best practices that communities can undertake to ensure that public-private partnerships provide public value.*

## Introduction

Development of infrastructure and provision of basic civic services has always been considered a very important public sector activity for the following reasons:

- a. Governments have recognised the crucial role of infrastructure in fostering economic growth and reducing poverty.
- b. Because of its ‘public good’ and ‘essential’ nature, Governments have attempted to ensure availability of basic civic services irrespective of market conditions.
- c. For a number of economic, social and political reasons, private sector involvement in these important areas was slow to develop and thus uneven. Provision of public services and infrastructure has traditionally been the exclusive domain of the government. However, with increasing population pressures, urbanisation and other developmental trends, government’s ability to adequately address the public needs

through traditional means has been severally constrained. This has led the Government’s across the world to increasingly look at the private sector to supplement public investments and provide public services through Public Private Partnerships.

## Common defining elements in definitions of PPPs

- a. The primary feature of a PPP is that it is a contract or an arrangement between a government entity and a private entity.
- b. Provision of public infrastructure or public services through the private sector, with substantial risk transfer to meet government or social needs, and rewarding / remunerating the private sector based on outputs appear to be the common elements used in defining PPPs across countries.
- c. The specification whether the private sector will necessarily bring in the private investment has not been specified in majority of the cases. Government of India Discussion Note Ministry of Finance Department of Economic Affairs Defining Public Private Partnerships 5 of 22
- d. In many countries it is the requirement of service delivery by private sector that drives the question of whether and how much of private investment is required for the project. Hence, the focus is on service delivery to meet public service or infrastructure needs rather than asset creation or investments.
- e. None of the definitions have specified that remuneration to private sector or PPP will

necessarily be through user charges. In fact in many countries, such as UK, the majority of PFIs are provided payments by the government agencies.

## Defination of PPP in India

The Guidelines for the Viability Gap Funding (VGF) scheme of Ministry of Finance- 'Guidelines for Financial Support to Public Private Partnerships in Infrastructure' defines PPPs as- 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. The Scheme and Guidelines for the India Infrastructure Project Development Fund, issued by Ministry of Finance, Government of India define PPPs as- 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. The preface of the Guidelines for Formulation, Appraisal and Approval of Public Private Partnership Projects mentions that unlike private projects where prices are generally determined competitively and government resources are not involved, PPP infrastructure projects typically involve transfer of public assets,delegation of governmental authority for recovery of user charges, private control of monopolistic services and sharing of risks and contingent liabilities by the Government. Protection of user interests and the need to secure value for public money demand a more rigorous treatment of these projects.

## Forms of PPP

All forms of PPP, ranging from simple service and management contracts to increasingly complex performance-based management contracts, asset leases, articles of association, concessions and asset divestitures, involve a partnership between the government and the private sector. However, they differ in their allocation of risks and responsibilities, in their duration, and in where they assign asset ownership. Service and fee-based management contracts may be implemented without adequate baseline information, cost-reflective tariffs, or performance monitoring systems in place.

## Challenges in Establishing PPP

Though PPP is widely acknowledged as a possible solution to achieve health goals, there are significant challenges to establish public and private sector partnerships. Underlying these challenges, there are several causes that relate less directly to the achievement of health goals but need to be addressed for effective partnerships. Root causes reflect the lack of information on private sector in developing countries, lack of trust between public and private sector and lack of skills in the public sector to deal with the private sector. Certain challenges that need to be addressed include:

- Tailored contracting so as to take account of the heterogeneity of private sector
- Overcoming mistrust between public and private sector (Laing, 2001).
- Improving information availability and reliability about the private sector service providers, the range and quality of services they offer and treatment outcomes

- Developing management capacity of the public sector to deal with the private sector

- Promoting a more organized private sector, so as to reduce the transaction costs of working with a large number of small, disparate groups. At the same time, strengthening government's ability to manage the vested interests of private sector organizations. The complexity of engaging private sector depends substantially on the nature of the task they are involved. Public Private Partnerships in health sector are extremely diverse in terms of the types of actors that use it, the type of contractual relationships that are established and the purposes thereof. However, one must consider the fact that PPP is a tool that should be evaluated on the basis of the performance of health system and ultimately on people's health. PPP should not be reduced to a mere management tool to cut health costs of the public sector. Continuous monitoring and periodical evaluations are the cornerstones of a successful PPP. Payments have to be, however, linked to performance, which in turn requires monitoring. Performance measurement can be done with respect to measuring 'efficiency' or measuring 'effectiveness'. While measurement of efficiency entails comparing the unit cost of providing the service from amongst the various alternatives, measurement of effectiveness involves comparing the desired outcomes from amongst the various alternatives. Involvement of third party/independent agencies for monitoring appears to be preferable as they leave the government hassle free over the project and minimize government control. The government and the service providers could mutually decide the third party.

The third party involvement could be further supplemented with provision for adjudication by the judiciary.

Conceptually there are three major ways of

establishing partnerships (Elizabeth, 1998)

- Swiss Challenge Approach
- Competitive bidding
- Competitive negotiations

**Swiss Challenge Approach:** The Swiss Challenge approach refers to suo-motu proposals being received from the private participant by the government. The private sector thus provides all details regarding its technical, financial and managerial capabilities and its expectations of government support/concessions. The government may examine the proposal and if the proposal belongs to the declared policy of priorities, then it may invite competing counter proposals from others with adequate notice. In the event of a better proposal being received, the original proponent is given the opportunity to modify the original proposal. Finally, the better of the two is awarded the project/program for execution.

**Competitive Bidding:** This involves a well publicized and a well-designed bid process to ascertain financial, technical and managerial capabilities of the service provider or the developer. The selection of provider depends upon one or the combination of the lowest capital cost, lowest operation and maintenance cost, lowest user fees, lowest support from government and so on.

**Competitive Negotiation:** Competitive negotiation is considered a variant of competitive bidding. The government specifies the service objectives and invites proposals through advertisements. The government then negotiates and finalizes the contract with the selected bidders. Negotiations may, however, be 'simple' (direct) or 'complex' (indirect). In the second case, the government negotiates through a 'master contractor'/mother NGO, who in turn handles all dealings with sub-contractors/franchisees, and monitors the

program by collecting information from the beneficiaries.

### Existing scenario in road sector

Road network in India aggregates to about 3.3 million kilometre. This extensive road network, the second largest in the world, caters to about 65 per cent of the freight traffic and 87 per cent of the passenger traffic. National Highways constitute about 66,590 kilometres which is only 2 percent of the total network. However, it caters to nearly 40% of the total road traffic. Out of the total length of National Highways, 17 percent is four-laned, 53 percent is two-laned and 30 percent single laned. The composition of the road network in India is depicted in Table 1

Table 1: India's Road Network  
Length(In km)  
Expressways 200  
National Highways 66,590  
State Highways 1,31,899  
Major District Roads 4,67,763  
Rural and Other Roads 26,50,000  
Total Length 3.3 million km (approx.)  
Source: [www.nhai.org/roadnetwork.htm](http://www.nhai.org/roadnetwork.htm) (as on 25.06.2009)

This seemingly large road network, however, is inadequate to meet the accessibility and mobility requirements of a country of India's size and population.

### Reccommendation and the way forward

- Capacity building of the roads construction "industry" – technical, technological, financial and implementation. Sector-specific Training Institutions/Centres, duty/tax reliefs/waivers in road construction equipment, and deepening of financial market are some measures;
- Implementation of the recommendations by

the Deepak Parekh Committee with respect to deepening of the Domestic Bond Market to facilitate takers for long term infrastructure bonds;

- Using refinance role of IIFCL more effectively to refinance banks and Institutions involved in PPP lending;
- Provide priority sector status to infrastructure lending, within the 40% required lending currently attributed to agriculture and small scale sector. This will free money from bank/ financial institutions to infrastructure especially the road sector;
- Facilitate securitization and take out financing of infrastructure loans;
- Government may participate as a credit enhancer by (a) providing low cost credit guarantee to banks, and (b) provide credit enhancement of infrastructure bonds to attract insurance / pension funds;
- Permit domestic mutual funds to launch direct infrastructure funds, so that they may be directly able to invest into PPP projects;
- Commence upon the VfM exercise on selected road projects so as to improve the methodology of risk assessment, allocation and eventual risk mitigation especially in road sector PPP projects;
- Liberalize investment guidelines for insurance companies and provident funds so that they may be able to invest into high quality SPVs in road sector.

### Conclusion

There is a broad consensus in India that **Public Private Partnership** is the way forward for development of infrastructure. Since an enabling frame work is a pre-requisite for attracting competitive private

investment, the model documents, the appraisal process and the viability gap funding scheme has been adopted as the supporting pillars of a strong and sustainable PPP frame work.

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