Plenary 2: Public-Private Partnerships

Monday, 12:00 to 13:00

Session agenda

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1. What is PPP?
2. When are PPPs appropriate and where have they been used?
3. PPI in South Asia
4. Key terms
5. Summary and further reading

What is PPP?

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- It is easy to get confused by the ever increasing number of definitions and synonyms for PPPs. CEPA define PPPs as:

> "A PPP is a long-term contractual arrangement for the delivery of public services where there is a significant degree of risk sharing between the public and private sectors."

- We believe this definition captures the key features that make PPPs different to other forms of public service delivery:
    - they involve risk transfer;
    - they are long term contracts; and
    - they are partnership agreements.
- This distinction is important as the approaches and expertise needed to see a PPP project through from design to successful implementation are very different from those appropriate for outsourcing contracts or privatisations.

What is PPP? – risk transfer

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- The key element of a PPP contract is the transfer of risk from the public to the private sector.

The principle behind this risk transfer is that risk should be allocated to the party that can best manage it.

- Infrastructure projects have a number of risks relating to the design, construction and operation of the facility. If these can be transferred from public management to the private sector, where there is greater capacity (e.g. financial resources) and ability (e.g. skills and expertise) to mitigate the losses arising from the risks, the expected cost of a project can be minimised.

"The party that can best manage a risk"

is analogous to

"the party that can manage a risk at lowest cost"

What is PPP? – long-term contract

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- A PPP usually follows a 'whole-of-life' approach to the development of the infrastructure.
- 'Whole-of life' typically includes:
    - design;
    - construction; and
    - operation and maintenance for an extended period sufficient to recoup the investment.
- This requires contracts to be long-term in nature:
    - PPPs are typically 10 to 20 years; although
    - some PPPs that may be of a shorter duration of say 3 to 5 years.
- While it is not necessary for a PPP to be long-term, a project is unlikely to involve sufficient risk sharing to qualify as one unless it is over an extended period of time.

What is PPP? – partnership agreement

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- Key to this long term contract between the public and private sector is that it is viewed as a 'partnership.' Both public and private sides of the contract must have a mutual interest and a unified commitment to the success of the contract over its life.
- PPPs represent cooperation between the public and private sectors, drawing on the relative strengths of each party, in order to establish a complimentary relationship between them.

Government objectives:

- service delivery;
- value for money; and
- avoiding realisation of contingent liabilities.

Investors/ lender objective:

- repayment of capital over the lifetime of the project with a suitable return.

Errors in classifying PPP

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- Please be aware that many types of private sector participation in in the delivery of public services (PSP) are not "true" PPPs.

Public procurement and privatisation are not PPP

Misclassification 1

- Governments outsource basic services such as rubbish collection or street cleaning to private sector providers, often on a relatively short-term basis (e.g. two to three years).
- These are not PPPs because in most cases the government retains almost 100% of the risk involved in delivering services to the public, so the commercial arrangement cannot really be described as a PPP.

Misclassification 2

- Privatisations and divestitures where governments transfer responsibility for asset construction and ownership, service delivery and revenue collection to private owners (there are many examples of this in the telecoms sector).
- These are not PPP as the private sector bears most, if not all, the risks involved.

PPP definitions

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"A public-private partnership (PPP) involves the private sector in aspects of the provision of infrastructure assets or of new or existing infrastructure services that have traditionally been provided by the government."

PPIAF

"Public Private Partnership" (PPP) means a commercial transaction between a private party and an institution by which the Private Party:

a. performs an institutional function on behalf of the institution; and/or

b. assumes the use of public property for its own commercial purposes;

c. assumes substantial financial, technical and operational risks in connection with the performance of the institutional function or use of the public property; and

d. receives a benefit for performing the institutional function or from utilising the public property, either by way of:

   i. consideration to be paid by the institution from its budget or revenue; or

   ii. charges or fees to be collected by the Private Party from users or customers of a service provided to them; or

   iii. a combination of such consideration and such charges or fees

IPDF / MoF, Pakistan

"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."

DEA, MoF, Government of India

"Public private partnerships (PPPs) are arrangements typified by joint working between the public and private sector. In the broadest sense, PPPs can cover all types of collaboration across the interface between the public and private sectors to deliver policies, services and infrastructure. Where delivery of public services involves private sector investment in infrastructure, the most common form of PPP is the Private finance initiative."

HM Treasury, UK

Clarification: PPP vs. PFI

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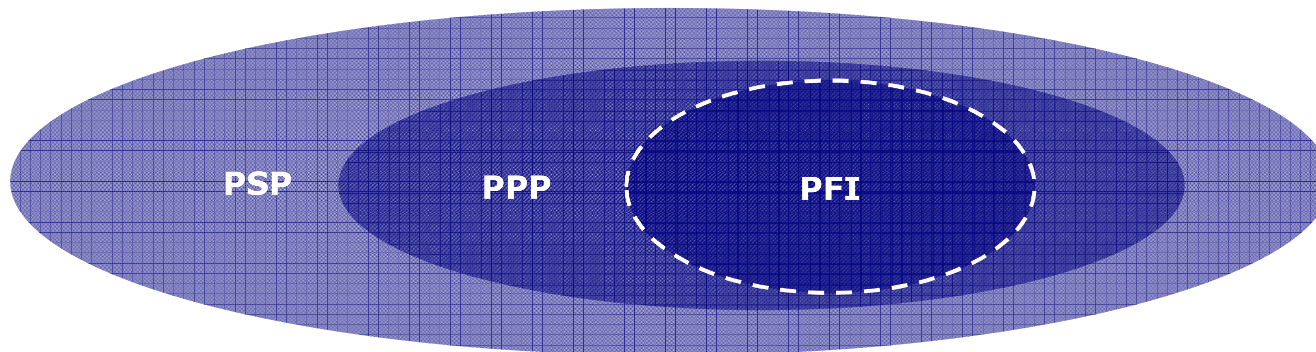
- The Private Finance Initiative (PFI) initially related to the UK initiative towards PPPs.
- A PFI contract is a form of a PPP, where, under its most common form, the private sector designs, builds, finances and operates (DBFO) facilities based on 'output' specifications decided by the public sector.
- Under the PFI contract, the public sector does not own the asset, but pays the contractor a stream of committed revenues for the use of the facilities during the contract period.



- The term PFI has also been used in a misleading manner at times. It has been used to refer to all PPPs, but actually refers to those PPP contracts only where the private sector performs DBFO functions in return receives a fixed payment stream from the government.
- PFI models are mainly used for social infrastructure projects e.g. schools and hospitals.

Spectrum of PPI

		Type of model	Description	Level of risk assumed by the private sector	Length of contract (years)	Capital investment	Asset ownership	Most common sector in developing countries
		Service contract	Contract for infrastructure support services such as billing	Low	1-3	Public	Public	• Water utilities • Railways services
Broad definition of PPPs		Management contract	Contract for management of a part/ whole of the operations	Low/ Medium	2-5	Public	Public	• Water utilities
Broad definition of PPPs		Lease contract	Contract for management of operations and specific renewals	Medium	10-15	Public	Public	• Water sector
Broad definition of PPPs	Core PPPs	Build-Own-Transfer (BOT) contract	Contract for investment in and operation of a specific component of the infrastructure service	**High**	Varies	**Private**	Public/ Private	• Energy sector IPPs • Highways • Sanitation/ desalination plants
Broad definition of PPPs	Core PPPs	Concession	Contract for financing and operations and execution of specific investments	**High**	25-30	**Private**	Public/ Private	• Airports/ ports/ rail • Energy networks
		Divestiture/ Privatisation	Contract of transfer of ownership of public infrastructure to the private sector	Complete	Indefinite	Private	Private	• Telecoms

Plotting PSP by risk and duration

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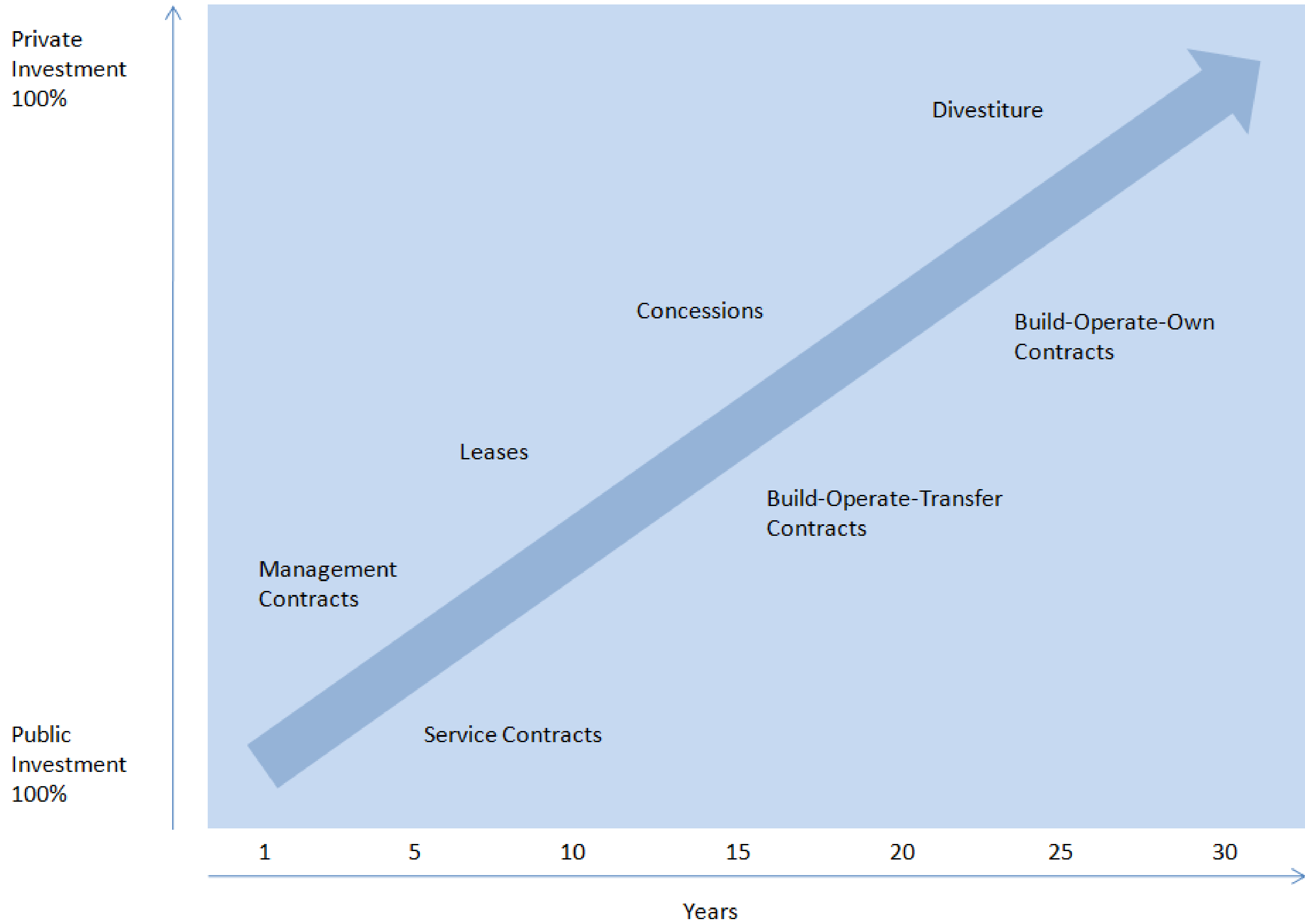

Where PPPs fit in the spectrum

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'Core PPPs'

Models wherein a significant degree of risk is transferred to the private sector such as concession contracts and BOTs. These contracts are usually long term in nature and involve substantial investment by the private sector, and therefore concomitant risk transfer, and are consequently viewed as core PPPs.

There are a number of variants to the BOT contract for project delivery such as:

- DBB (Design Bid Build)
- DBFO (Design Build Finance Operate)
- BOO (Build Own Operate), etc.

Broad definitions of PPPs

Service, management and lease contracts are not core PPPs as the degree of risk sharing is generally low.

Some management contracts with significant risk transfer (e.g. under tough performance incentives) fit into the broader definition of PPP.

Broad definitions include Private Participation in Infrastructure (PPI).

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When are PPPs appropriate?

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- PPPs are appropriate when:
  - they are financially viable – i.e. they are possible; and
  - they are value for money – i.e. they are better than other alternatives (including the alternative of no provision).
- This often means that PPPs are most appropriate for infrastructure projects where there are:
  - particular gains from risk transfer;
  - improved service quality and innovation through use of private sector expertise and performance incentives;
  - synergies from whole-of-life contracting i.e. between design and operation; and
  - project finance techniques can be used to bring in more finance.

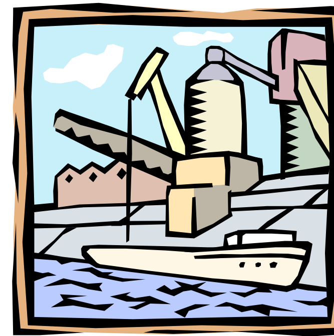
Transaction fees and long lead times are likely to make PPP both financially unviable and poor value for money for small projects.

Common types of PPP project

- The features that make PPP appropriate are reflected in the most common types of project.

Electricity & gas

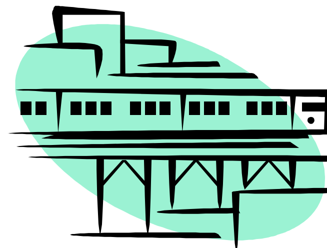
Water & sewerage



Ports

Hospitals

Roads



Rail

Prisons

Airports

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PPI trends in South Asia

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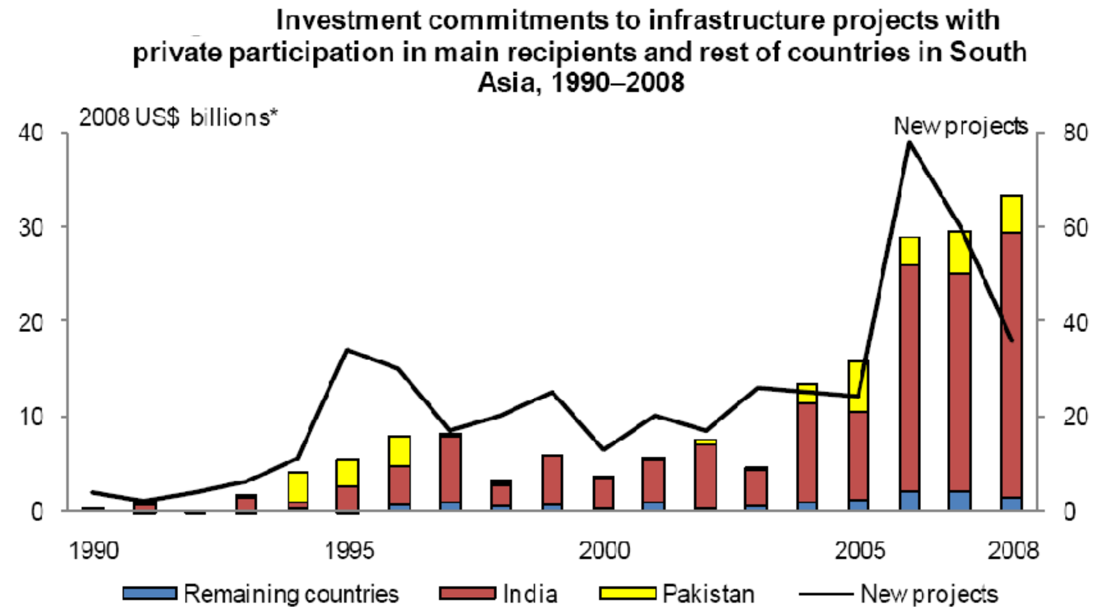
- India and Pakistan are the largest PPI players in the region.
- In 2008, India accounted for most of the regional activity, attracting 84% of regional investment (in South Asia) and implemented 28 of the 36 new projects.
- Investment in the India rose by 21% from 2007, reaching a record US$27.9bn.



- With India excluded, investment in South Asia would have declined by 19% to US$5.5 billion.
- Pakistan was the second most active country in the region, implementing seven new projects in 2008 and attracting 12% of regional investment.

PPI trends in South Asia – sector focus

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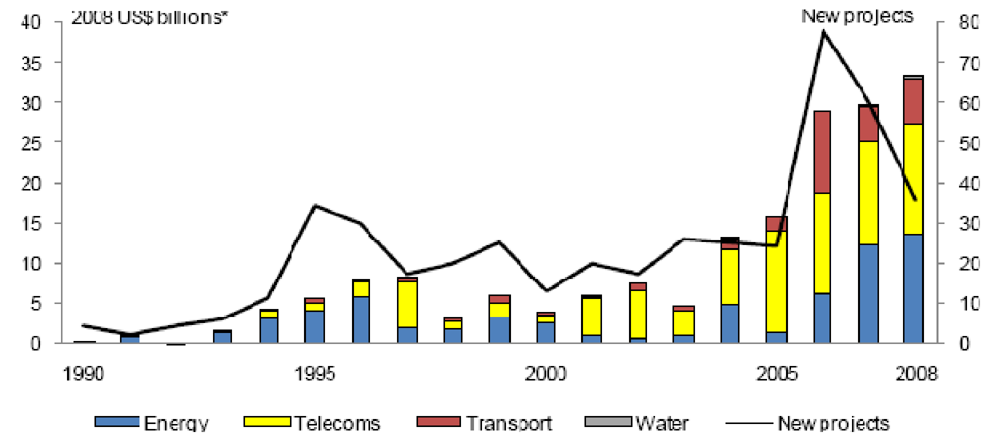
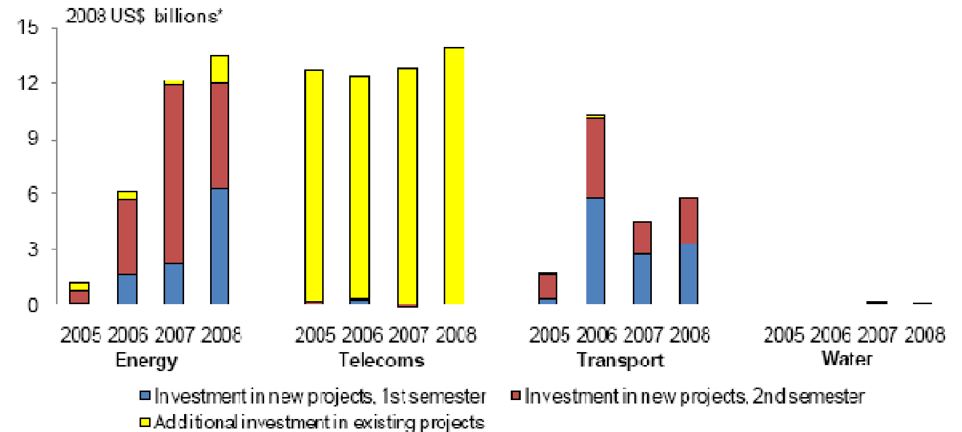
- The two largest PPI sectors in South Asia are telecoms (42% in 2008) and energy (41%).
- In addition to the 36 new projects reaching financial or contractual closure in 2008, at least 41 other projects (US$24bn) were awarded but had yet not reached closure.
- Of these potential projects, 24 were energy projects—23 for power plants (13 in Pakistan and 10 in India) and one for electricity transmission in India.
- There were 16 potential projects transport projects in India (9 roads, 3 railways, 2 airports, and 2 ports).
- There was one potential water project, a contract for a water utility in Maharashtra.

Investment commitments to infrastructure projects with private participation in South Asia, by sector, 1990–2008



Investment commitments to infrastructure projects with private participation in South Asia, by sector and implementation status, 2005–08

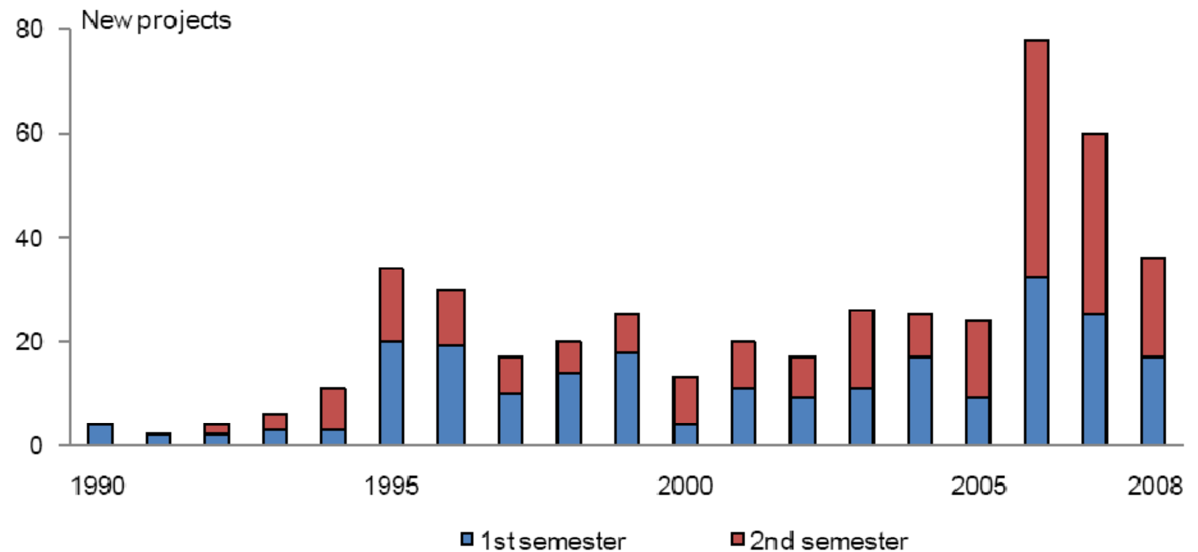


Note: Includes investment in projects reaching financial closure in 1990 - 2008.
Source: World Bank and PPIAF, PPI Project Database.

* Adjusted by US CPI.

The effect of the global economic crisis

- Investment in new projects slowed significantly with the full onset of the global economic crisis.
- Though investment commitments reached a new peak in 2008, this slowdown led to a decline in the number of projects for the entire year.
- Despite Asia being one of the least affected regions by the crisis in terms of damage to economic growth, it was the effects of the crisis on foreign direct investment (FDI) which led to the fall in new investment.



Hub Project, Baluchistan, Pakistan

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- Completed in 1997 at the cost of US$1.8bn. It was financed as a build, own, operate (BOO) arrangement under a term of 30 years, with a deal in place for the state-owned Water and Power Development Authority (WAPDA) to purchase power from the Hub Power Company.
- Negotiations and planning for the project began in 1985, as the Pakistani government recognised severe energy infrastructure problems and began to encourage independent power producers (IPP).
- The government set up a 'one stop shop' to guide investors through a simplified approval process.
- Financial backing came largely from World Bank and commercial banks. US$175m from international and local equity investors and US$689m from international banks - the majority of the balance came via a US$589m subordinated loan provided by the World Bank. In addition, the consortium was also able to incorporate some financing from traditional Islamic banks and Citibank was the lead arranger for over US$686m in commercial loans.
- Contracting work on the project was mainly by French, Japanese, Italian and US firms.

Hub Project, Baluchistan, Pakistan

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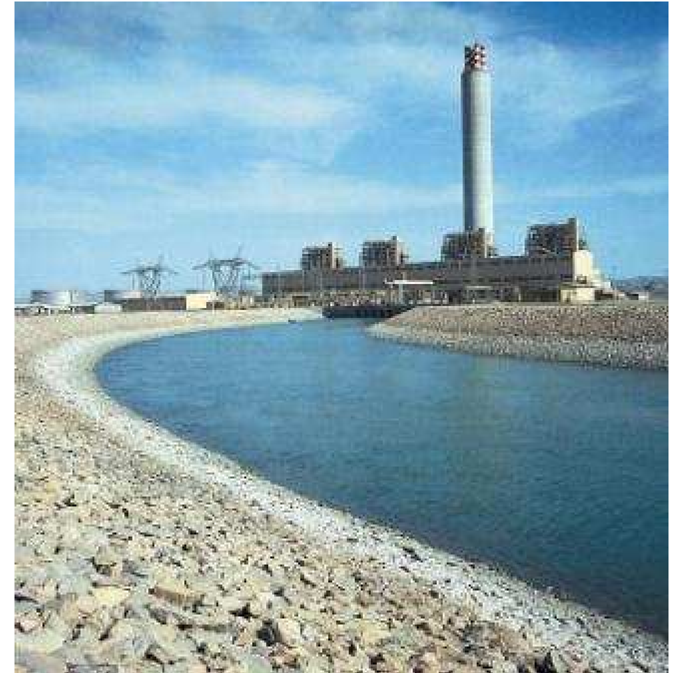
- The project is very popular in Pakistan and former Prime Minister Bhutto described Hubco as the "cornerstone" of her government's energy policy aimed at attracting foreign investment.
- It also makes substantial profit (2009 profit was Rs 3780,991,000) and is attributed to having attracted increased numbers of private investors into Pakistan's infrastructure industry.
- The main criticism of the project comes from overseas, and is that Hubco makes no real effort at sustainability or environmental consideration.



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Key PPP terms a

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Term	Definition
BOT, BOO, DBO and DBFO	Build Operate Transfer (BOT) arrangements refer to PPPs where the private partner builds and operates a facility over the contract duration, at the conclusion of which it transfers the assets to the public authority. Under Build Operate Own (BOO) arrangements the private partner instead retains ownership of the assets at the end of the contract. Design Build Operate (DBO) and Design Build Finance Operate (DBFO) are similar PPP models which do not specify asset ownership at the end of the contract.
Concession PPPs	Arrangements where revenue is raised directly from members of the public as user charges (e.g. toll fees) rather than having the government as the buyer. These arrangements involve significant demand risk transfer to the private operator. Concession PPPs may involve substantial new investment. However franchise PPPs, a subset of concessions may involve the rehabilitation or extension of existing state-owned assets.
Lease contract	A private operator leases government-owned assets for a fee over a fixed term. Operational risk is transferred to the private party, but they are not responsible for any significant capital investment.
Management contract	A short-to-medium term performance contingent contract covering certain operational function of a public facility and also some management functions. The private party contributes working capital but will not necessarily be involved in any significant investment programme and operational risk remains with the government. Management contracts may provide a segue to further private involvement. However it is rare for management contracts to involve sufficient risk transfer to be considered to be PPP.
Private Finance Initiative (PFI)	A UK PPP procurement programme starting in the 1990s. PFI projects tend to be a certain type of PPP rather than providing a distinct model. Most contracts would be defined as DBFOs, typically last between 20 and 30 years and would be clearly identified as PPP. There has historically been a strong emphasis on provision of social infrastructure such as schools and prisons.

Key PPP terms b

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Term	Definition
PSP and PPI	Several acronyms are used to categorise private participation that extends beyond PPP. Private Sector Participation (PSP) categorises private sector participation in the provision of public goods, but also includes privatisation of state-owned enterprises. Private Participation in Infrastructure (PPI) labels PSP in infrastructure sectors.
Privatisation	The sale of state-owned assets to private sector parties. This may either be full (where the full equity stake is transferred to the private sector) or partial (where only a portion thereof is sold). Partial privatisation does not necessarily result in the transfer of operations to the private sector. It is an important distinction that privatisation is never PPP even if heavily regulated.
Project sponsors	Investors who bid for, then develop and lead the project through their investment in the project or through a project holding company.
Public procurement	The public sector frequently transacts with private companies to deliver a range of goods and services. However typical public procurement is based on delivery of defined inputs over a relatively short period of time with little to no risk transfer.
Service contract	A short-term contract for a private party to undertake specific operational tasks for a state owned enterprise. Responsibilities are limited but the contract may include performance related payments. These contracts involve little risk transfer and so should not be considered as a core form of PPP.
Whole-life costing	An allocation of responsibilities such that one party is accountable for coordinating all aspects of a project across its whole life from design to contract maturity. This harmonises incentives to minimise all costs (upfront and ongoing), not just each component in isolation. In particular it encourages consideration of ongoing costs at the design stage.

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Summary

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- PPPs are appropriate when:
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Further sources

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Online

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