

Infrastructure Economics
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Module – 05
Lecture - 17
Introduction to PPP

Keywords: Public Private Partnership, risks, infrastructure

I am going to start a discussion on what is basically Public Private Partnership. I will give you a brief background that how this Public Private Partnership word... PPP became one of the important word today. And there is a history behind this Public Private Partnership. And how it started? what is basically the back ground of such important model?

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Brief Outline

- Background
- Public Private Partnership (PPP)

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Background

- Infrastructure development was considered as Public obligation in almost all types of economic systems- from Europe to Asia and other parts of the world
- In Europe this attitude, however, changed in the 1980s
- The wave of privatization, especially in Britain and France initiated the process of infrastructure development through private participation

The fact is that the infrastructure development was considered as a public obligation in almost all the country in the world. If we can see the background of economic development in last 200 or 300 years, we are finding out that it is not really the private activity... infrastructure development was not really the private activity, but it was really the public activity.

And most of the governments in the world, they were considering the infrastructure development as their prime responsibility and the first and foremost responsibility. So, whether it is Europe or Asia or United States or Japan or other Asian economy, they all have invested huge amount of their income for the development of infrastructure. So, the fact is that this particular type of investment is not really possible without having a proper resource.

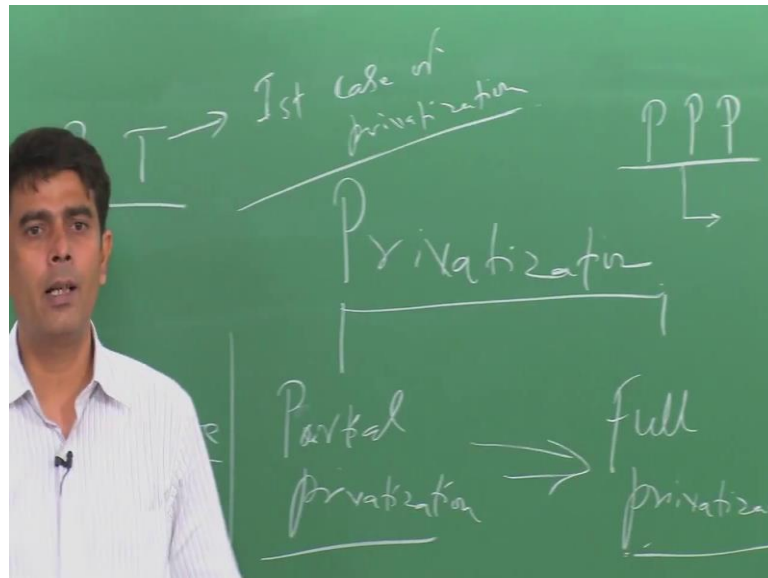
But we have also seen that with the economic development process, the responsibility of the state, the burden of the state, the welfare task of the state has increased leaps and bounds in recent years. And many European countries and many developing countries has added many responsibilities in terms of social development as well as in terms of physical development.

So... but we have seen that during 1980s, even in 1970s, the discussion was being started, being floated by majority of the country in the world that why only government should have this infrastructure development. Why not private parties should be also the partner in infrastructure development? Or why not a complete takeover should be done

from public to private?

So, there was really many argument in favor of shifting from public to private and there were also protest going on especially, when there was a shift from public to private across the country.

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And we have seen that this entire process of involving private parties are nothing except named as the process of privatization. So, this privatization... the privatization maybe divided in two part: it maybe the partial privatization... it may be the partial first, partial privatization and then, full privatization. What is difference between the partial privatization and full privatization? Partial privatization involves the decision from shifting from public to private in a very different way, where private parties are basically searched for a being the partner in the project.

There will not be the complete shift in the ownership of a company from public to private in case of partial privatization. But, there will be a share in the decision making or a share in the ownership of the company. If it is industrialized company, government can allow a private party to become the partner. So, this process is also named as the process of divestiture in the world, which is also named as the disinvestment process.

So, basically majority of the government in... during 1980s, they have realized that with the growing burden of the social infrastructure development, taking the responsibility of education, health, sanitation, water distribution and many other essential responsibilities. Government cannot really take care of all other activities, especially in the physical

infrastructure development.

So, it was also realized that whatever process of industrialization and whatever process of service modernization is going on, a private party is really needed, not only as the owner of the project or as the owner of that particular infrastructure, but as a partner of that infrastructure. And we have seen that varieties of methods of privatization, such as auction, lease, Build Operate Own, Build Operate Transfer and many others were practiced in the world.

And the fact is that it is named as the process of privatization and Public Private Partnership, which is one of the most buzzing word today, it is the part of the process of privatization. British Telecom (BT)... British Telecom was the first case of a privatization in the world. It was the first case of privatization in Britain. During the market structure period and the process which was involved in the BT (British Telecom) was named as the process of privatization.

And Britain and France, if we can see here that this first case of privatization is also the first case of privatization in the world, in the field of infrastructure privatization or we can see here, the case of shifting the ownership from public to private. When we say shifting of the ownership from public to private, it maybe partial, it maybe full, it may be dependent on what type of privatization policy or what type of private participation policy, a government is really looking for.

If government is really looking for a complete takeover from public to private, that is the full privatization or which is also named as the big ticket privatization and which was practiced by many countries in the world including Bangladesh and many Latin American countries and also some of the European countries. So, if it is full privatization, then the complete shift from public to private is happening and if there is a complete shift, then ownership is being completely changed.

And there may be a big impact on the worker, big impact on the quality of the product, big impact on the functioning of the infrastructure form and that way a complete takeover from public to private is a different matter compared to the partial privatization or disinvestment or divestiture which is happening in the world today. So, Britain and France initiated the process of infrastructure development through private participation.

And British Telecom, as we have seen, was the first case of privatization, which is also the process of privatization... was also named as Thatcherization because Margaret

Thatcher has started this particular process. So, British airways and British Telecom as we have seen that initiated the process of privatization. And emergence of many Asian economies also started this massive investment required in infrastructure through the involvement of private parties. The first official Build Operate Transfer project was initiated in Turkey in 1984.

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Public Obligation in Infrastructure

All the investments, design, construction, operation, and maintenance by the government

Direct Budgetary Allocation
Government Debt
Finance by Public Institutions

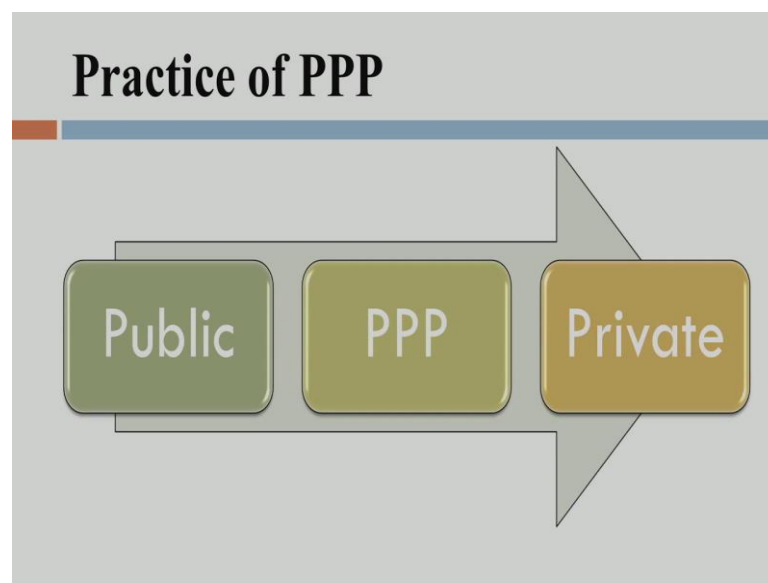
And why this public obligation in infrastructure? Because all the investment – design, construction, operation and maintenance – by the government was really one of the massive task for many government in the world. And they have realized that there is a huge cost involved in maintaining, constructing, operating and designing those projects and that was not really cost effective activity of many infrastructure firms in the world, which was really managed by the government. And because you need to have such public obligations and such public operations with the support from the direct budgetary allocation and government has to have... government should be ready with taking the debt from different sources, maybe the debt from the public or the debt from the international agencies or at the same time financing those activities by the public institutions such as nationalized banks or other financial companies.

So, it was a huge task for the government especially for the public sector units and as we have seen in... throughout the world that public enterprises or the public infrastructure firms were one of the major place for rank seeking approach, major place for fulfilling the political agenda overstaffing. At the same time inefficient way of providing those services. Because in our previous discussion, we have also seen that there is a problem

with the infrastructure products, infrastructure goods and that problem is the free riding problem and the corruption involve in producing those products.

So, when we say the huge involvement of the budgetary part from the Government, Central Government or the State Government or Municipal Corporation, we are finding that there are many misusers of those infrastructure projects or the goods and in that case, whatever government is managing, whatever government is trying to manage from their own resources, that is some time not able to really enough for the expenditure, which is involved in financing those activities of the infrastructure development.

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So, the practices of Public Private Partnership, as we have seen that varieties of forms, where in the hand of central government or in the hand of public and then, when we are having the partners from the private, it maybe the partial one, where we are shifting a very balanced model of Public Private Partnership. Or, we may go further, which is indicated in the arrow there in the PPT that we can go further to the level of full privatization. And then, the complete control will be in the hand of the private party not in the hand of the... and the public at all.

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The Rational for PPP

- There has been surmounting pressure on the national governments to provide infrastructure facilities, but they face resource crunch to finance huge infrastructure projects.
- This necessitated governments to look for attractive alternatives to finance infrastructure.
- Partnership with the private sector proved to be one of the best options for financing infrastructure projects.

So, what was basically the rational for the Public Private Partnership? There has been a mounting pressure on the national governments to provide infrastructure facilities, but they faced resource crises to finance those huge infrastructure projects. So, this basically created an atmosphere, this necessitated the government to look for the attractive, alternatives to finance infrastructure.

Partnership with the private sector provided to be one of the best options for financing infrastructure projects. So, the rational basically was the pressure national governments in most of the developing country and the least developed country. They were finding that it is not so easy to facilitate, to maintain, to produce, to have the design and to have the implementation of different infrastructure projects and time. The main reason was the resource crunch and their experiences with the previous infrastructure development projects in which they have incurred the huge cost of producing and maintaining those infrastructures.

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What is PPP

- A Public-Private Partnership (PPP) is a way of delivering and funding public infrastructure projects where project risks are shared between the public and private sector.
- PPPs are basically legal binding contracts that share responsibilities between the government and the private sector.

So, what is basically the Public Private Partnership? Briefly, we can find out that a Public Private Partnership is a... is a way of a delivering and funding public infrastructure projects, where project risks are shared between the public and private. So, when we say Public Private Partnership, when we say PPP, it is not only the private and not only the public activity. But they share the responsibility in terms of... the responsibilities are shared between the private and parties and the risk comes... which the risk of a developing the infrastructure projects, the risk of maintaining the infrastructure project, the risk of charging from the public for the infrastructure. And there are legal risk, political risk, which we are also going to discuss in the current lecture today.

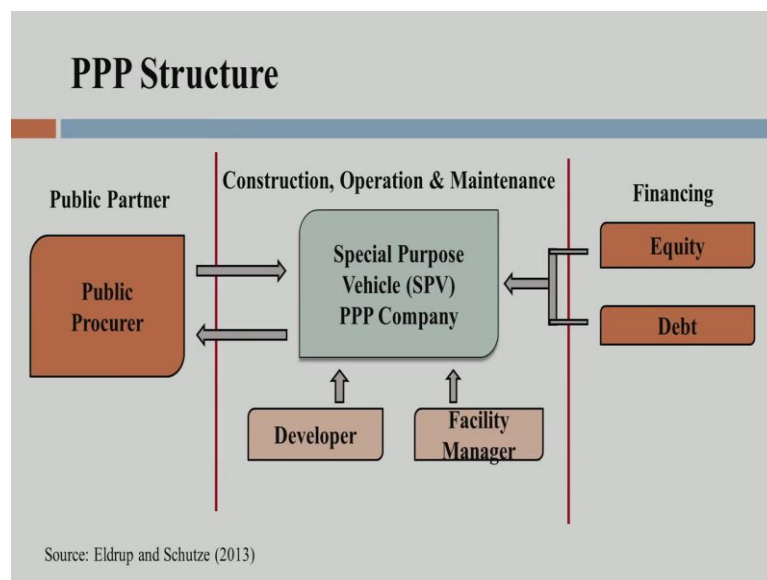
So, the Public Private Partnership is basically the legal binding contracts and shared responsibilities between the government and the private sector. So, why Public Private Partnership is basically working today? Because it is not only the private firm which decides all the ifs and buts, which decides all the problem and solutions of the infrastructure designing and producing it or completing the projects on time. But it is also the government's involvement. And as we have discussed that when government is coming out from the infrastructure development, it does not mean that government has completely walked out from the infrastructure development projects. The fact is that when government is reducing their involvement in terms of financing those activities, it means that government is not only coming out from the... it means government is only coming out from the financial support. But at the same time government has to also provide some basic facilities, some basic level playing field and one of the level playing

field is the law and order condition in particular area where infrastructure development is being provided. So, this law and order is not the service which private parties can really buildup, which a private party can really buy from the market.

The law and order is a public good and that has to be provided, that has to be created and that has to be maintained by the government itself. So, government... as a partner in the project, when government provides the support to the private parties; that supports are really one of the prime support, one of the far-reaching support, which nobody can provide apart from the governments' officers.

So, the responsibilities are shared and that legal bindings are there to have the better contract, to have the a continuity in the contract, to have the fulfillment of the promises of that particular contract and that way, Public Private Partnership is really meaningful. Compared to the monotonous involvement of the government officials and bureaucrats before 1970s, many country were having such infrastructure development only with the government support. And it was not the public, but it was basically the few government officers and few leaders, which... they were deciding the entire future of the infrastructure development in that particular country.

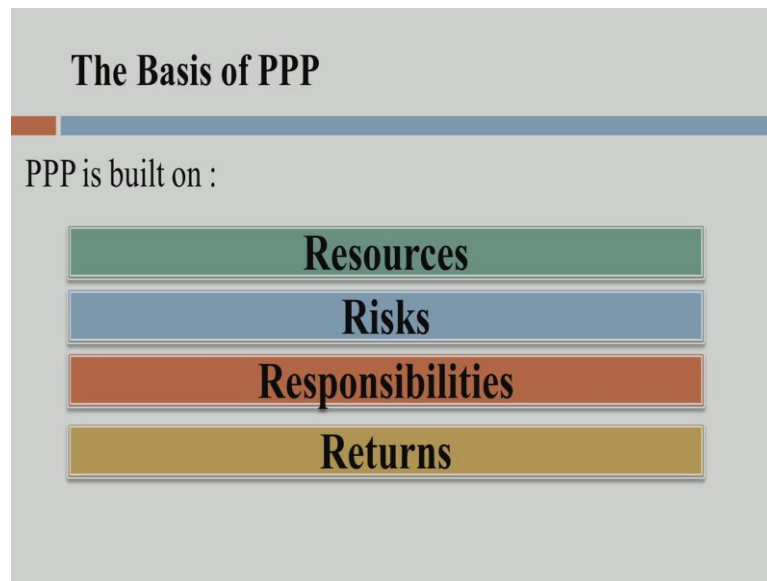
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So, what is basically the structure, PPP structure? In this diagram, you can just find out that, there are public involvement and there are financing companies, which do supports the construction, operation and maintenance of the infrastructure development. So, one is the developer – a particular firm, which has the responsibility to develop and then, they

are connecting with the public partner. They are... the developer is well connected with the equity and debt, which is available through the market, equity market and debt market. And if they need the government support, then the public partner is also supporting from the government side and that way Public Private Partnership company sustain their projects. Because they have not only to construct, they have to operate, they have to maintain, they have to really come out with a product, which is... which is basically non-excludable in nature. That we have discussed in our previous discussion that since the infrastructure projects are not transferable products, like flyovers cannot be transfer from one place to other place. So, there are huge cost involving in maintaining and operating and constructing those products. So, that way the public support, the support from the government is really needed. Support from the financial institution, backing companies are really needed, because such products cannot be buildup in a very short time. At the same time these products are very difficult to construct, because it requires huge involvement of the financial assets and at the same time technological systems and the local support and political support and social cool. Otherwise, such projects are always delayed and having the problem of... having the problem of a huge cost, which has disappeared during the production. And such cost cannot be really recovered from the market, because once it is in the form of transferable products, when a product is transferable, one can transfer it from one market to other market. But since the infrastructure projects are not basically the transferable product; so, you have to keep it in one place only and that way your entire cost is basically the sunk cost, which you cannot recover if the projects are delayed or if products are... if the project is not really delivered.

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So, there are four different basically bases: the resources, risks, responsibilities, and returns; which basically gives a major boost to the Public Private Partnership. What type of resources are available? How resources are well placed? Whether the resources are in nearby area or the resources are far away from the projects location? At the same time how good a company or the model of Public Private Partnership is to utilize the resources on time?

For example, human resource worker is one of the resources, but if workers are not properly managed, then workers had the tendency, workers are having the tendency to migrate from one area to other area. If the informations are not shared with the workers, the workers may move from one part to other part and in that case, the infrastructure projects which has to be really supported by the workers may have a resource crunch in terms of labour. And then, you have to wait for workers' arrival, because once the worker is going out and the starting a new job in some other project, it is very difficult for them to again come back and to restart the work in a different area.

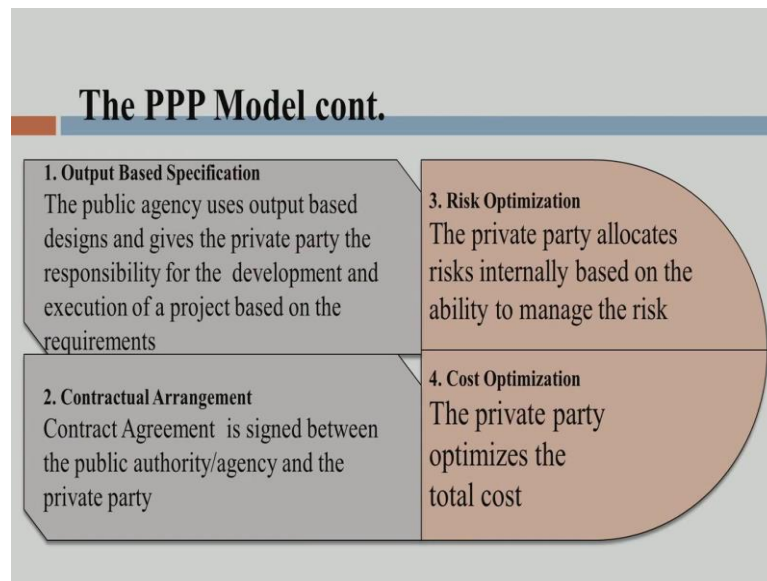
The secondary case, the second basis of successful of the Public Private Partnership or implementation of the Public Private Partnership is the risk. And these risks is not in one word, but the risk is really having the different names and different level – that maybe the political, that may be the social, that may be the financial, that maybe in terms of resource risk, in terms of raw material risk. And ultimately, whenever any projects is being successful, if the risk level is less or the firm is or the PPP model is ready to counter those risks the PPP model is really very successful.

And for such risk maintenance or such risk management, one cannot really deny the importance of the responsibilities of the state, because the state has a very prominent role in managing those risks. At the same time, how responsibilities are shared? How responsibilities between the public and the private parties are shared? How the contracts are really having a meaningful implementation? How the promises by both the parties are really fulfilled, when the projects are implemented?

And ultimately, when it comes to returns, when the... when the private parties are looking for the returns on their investment, the private parties are not really looking for the returns, which will be minimal. But, they are looking for the returns, which they have in their mind in terms of maximizing those resources. So, the fact is that when you have returns coming up in the PPP model, you are really inclined to have the production going on.

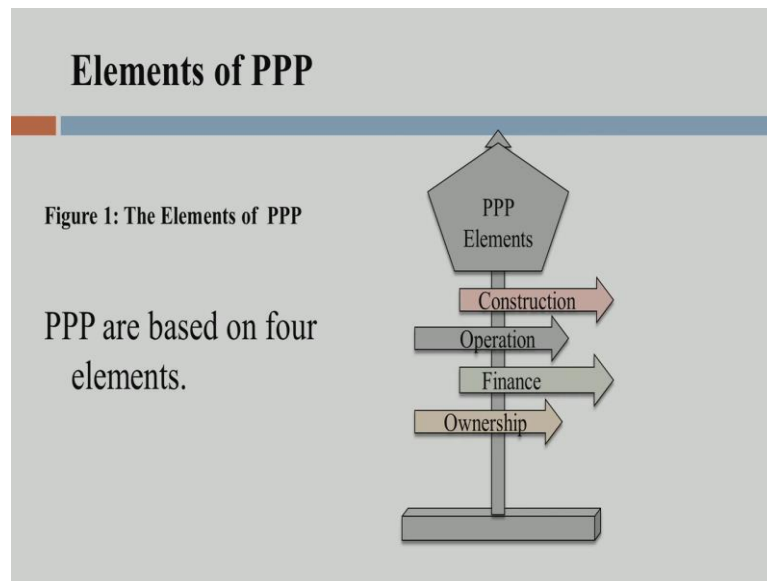
If you don't have returns coming up, you are really uncertain and you do not... some time the firm do not want to continue in the development of Public Private Partnership. More recently, I was having a talk with the infrastructure firms in a state, where they are basically trying to somehow come out from the infrastructure development, because there are no guarantee of returns. And they have taken loan from the bank. And now, bank is also not ready to continue with the further loan, because the projects are delayed due to the different risk involved and some of the risk are the risk related to the raw materials and the resources. So, we find out especially that is one of the case of Atlanta private limited which is really building up the four lanes in one of the state today. And we are finding that, this Atlanta four lanes projects may have certain drawback; they may not be completed because for last six months the project is basically stopped in Bihar. So, ultimately in that case returns may not be as good as it was basically targeted. So, there are certain challenges. One can say that certain basis of the successful of Public Private Partnership if though challenges are properly managed. If the challenges are not properly managed, then there are very less chances of having the successful of the Public Private Partnership.

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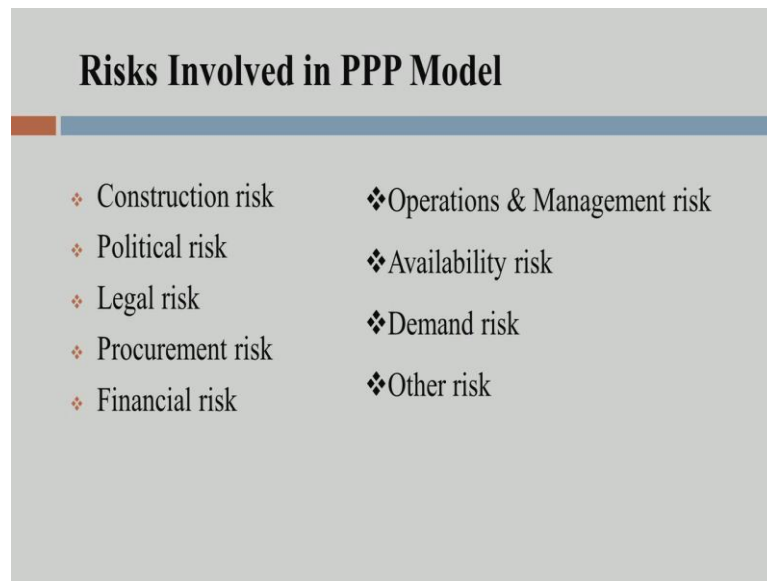
So, the model maybe the output based specification model, the model maybe the contractual arrangement, the model maybe the risk optimization model and the model maybe the cost optimization model. So, different forms are looking for the major thrust on a particular aspects. If that particular area where the infrastructure will be really developed, if the level of risk is very high, then the firm first try to really optimize that risk. If the cost is very in a particular area to have the infrastructure ready, so in that case, they are also looking for the involvement of how to reduce, how to optimize the cost of the production. Some time a public private partner model as to look for not only one risk, not only one aspect of the optimization, but there may be other way of optimizing the cost and risk and the output and also the contractual agreement in a very balanced way.

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So, the elements of the Public Private Partnership is basically the: what type of ownership, what type of finance, what type of operation and what type of construction. So, if the ownership is in the hand of government, government will have the monopoly over deciding the projects. If it is in the hand of private, if the government is just the small partner or maybe the silent partner like 5 percent, 10 percent, the decision will be taken by the private partners. And government will certainly have certain role in terms of financing that project, but government may have to look for another supportive arrangements, such as law and order, reducing the risk of a implementing that projects. And the finance will be again the matter related to the ownership. Operational activities of that Public Private Partnership model is again based on the whosoever is participating in that project. Construction will be again cost effective and very much optimized, if the various private firms are working together and because they have to look for the profit and they have to look for the further return. So, they cannot really look for the very cost inefficient construction model.

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So, there are certain risks involved, which we have also discussed little bit before. The construction risk: construction maybe delayed because of the labour unavailability, because of the raw material unavailability. There maybe political protests in that region that is tweeted as the political risk. Political parties do try to take advantage from the infrastructure development projects. If it is all successful, then a certain political party may take the benefit of such development. If the things are not going properly, then they can really say that the projects are not really going up properly and they can really make these issues as the political issues. There are certain legal risks, because you don't know whosoever will come on the way as a obstacle in the infrastructure projects. They may ask for the further compensation, they may have to go for the legal rights, litigation and ultimately projects has to be stopped or it has to be delayed.

Procurement risks: as we have seen in some of the cases, raw materials are not available or far away from the area. Financial risk: you are waiting for the projects or waiting for the funding from the bank or from other financial resources. But financial resources are having different parameters to give the loan and if they are seeing that projects are not running on due to any reason, they may stop lending to the firm.

Operational and management risk: a very common risk involved in most of the projects; managing the resources, managing the labour, managing the electricity, internal security, it is not so easy. At the same time various other risks such as the demand risk and availability of everything on time... is not really possible for most of the countries, most of the economy for the PPP... successful model of the PPP.

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Benefits of PPP Models

- Provides finances for the infrastructure facilities
- Exposure to private sector technology and innovation for better public services
- Exploits operational efficiency
- Projects delivery on time and within the budget
- Helpful for the government in setting present and future costs of infrastructure projects
- Makes country more competitive by increasing infrastructure stock
- Supplements the limited capacity of the government to meet the growing demands of infrastructure facilities

But there are benefits of PPP models such as it provides finances for the infrastructure facilities, exposure to the private sector technology and innovations for better public services. Because, when PPP starts and if the foreign partners do intervene in the projects, you will get the idea of the new technology and new innovations in the infrastructure development.

It exploits the operational efficiency; it delivers the projects on time with the proper budget. It is helpful for the government in setting of present and future cost of infrastructure projects, because we are finding that when we are involving private parties... private parties, when they are looking for their profit, they are really worried for how to reduce the cost, how to optimize the projects.

So, make country more competitive by increasing infrastructure stocks and it supplements the limited capacity of the government to meet the growing demand of infrastructure facility. So, there are risks involved, but there are benefits of public private models. And to sum up, we can just say that the Public Private Partnership today is one of the buzzing word in the world and why it is – because no government in the world is in the position capable to run the entire infrastructure development by their own resources. Today, government has to depend on the private parties and private parties are also not in the position to continue the entire growth by their own means, because they have to depend on the various supports from the government in terms of political, legal, law and order and other managerial level support. So, in such a condition there isn't better model than the Public Private Partnership. And this type of partnership between

the public and private is not only the truth of one economy, but it is a truth in many economy of the world today.

Thank you.