PPP Investment Model

Introduction

Public-private partnerships involve collaboration between a government agency and a private-sector company that can be used to finance, build, and operate projects, such as public transportation networks, parks, and convention centers. Financing a project through a public-private partnership can allow a project to be completed sooner or make it a possibility in the first place.

Why in News?

- In recent years, Indian government has given a greater impetus to metro rail expansion. In 2018 itself, 6 new metro rail projects have been sanctioned.
- In recent policy regime change there is a greater involvement of private sector in financing and developing these projects.
- In this context, concerns have been raised due to public–private partnerships in financing and developing metro projects, and the possible implications of these on patterns of urban land use.

Background

- Metro rail projects in India, until 2017, were broadly guided by a consolidated framework decided by the Ministry of Urban Development.
- The consolidated framework had set its preference for executing metro rail projects primarily through government funding.
- This framework duly recognised the limitations of PPP models due to risks associated with the metro rail systems and the limited experience of India in executing metro rail systems on a PPP basis.
- On 16 August 2017, the Union Cabinet approved a **new Metro Rail Policy** which opens a big window for **private investments in metro operations by making PPP component mandatory** for availing central assistance on metro projects.

- Private participation has its own cost because projects are undertaken only if they are able to generate profits in return for their investments.
- Therefore, in the current policy framework it appears that expansion of metro rail projects across the country will only accelerate the process of conversion of land in urban and semi-urban areas for consumer-oriented use.

Types of Investment Models

- **Public Investment Model:** In this model Government requires revenue for investment that mainly comes through taxes.
  - As the world is facing the prospect of an extended period of weak economic growth, by enhancing public-sector investment large pools of savings can be channelized into productivity.
  - Properly targeted public investment can do much to boost economic performance, generating aggregate demand quickly, fueling productivity growth by improving human capital, encouraging technological innovation, and spurring private-sector investment by increasing returns.
  - Though public investment cannot fix a large demand shortfall overnight, it can accelerate the recovery and establish more sustainable growth patterns.
- **Private Investment Model:** For a country to grow and increase its production investment is required. Presently tax revenue of India is not adequate to meet this demand so government requires private investment.
  - Private investment can be source from domestic or international market.
  - From abroad private investment comes in the form of FDI or FPI.
  - Private investment can generate more efficiency by creating more competition, realization of economies of scale and greater flexibility than is available to the public sector.
- **Public-Private Partnership Model:** PPP is an arrangement between government and private sector for the provision of public assets and/or public services. Public-private partnerships allow large-scale government projects, such as roads, bridges, or hospitals, to be completed with private funding.
  - In this type of partnership, investments are undertaken by the private sector entity, for a specified period of time.
  - These partnerships work well when private sector technology and innovation combine with public sector incentives to complete work on time and within budget.
  - As PPP involves full retention of responsibility by the government for providing the services, it doesn’t amount to privatization.
  - There is a well defined allocation of risk between the private sector and the public entity.
  - Private entity is chosen on the basis of open competitive bidding and receives performance linked payments.

- PPP route can be alternative in developing countries where governments face various constraints on borrowing money for important projects.
    - It can also give required expertise in planning or executing large projects.

Models of Public Private Partnership (PPP)

- Commonly adopted model of PPPs include Build-Operate-Transfer (BOT) ,Build-Own-Operate (BOO), Build-Operate-Lease-Transfer (BOLT), Design-Build-Operate-Transfer (DBFOT), Lease-Develop-Operate (LDO), Operate-Maintain-Transfer (OMT), etc.
- These models are different on level of investment, ownership control, risk sharing, technical collaboration, duration, financing etc.
- **BOT:** It is **conventional PPP model** in which private partner is responsible to design, build, operate (during the contracted period) and transfer back the facility to the public sector.
    - Private sector partner has to bring the finance for the project and take the responsibility to construct and maintain it.
    - Public sector will allow private sector partner to collect revenue from the users. The national highway projects contracted out by NHAI under PPP mode is a major example for the BOT model.
- **BOO:** In this model ownership of the newly built facility will rest with the private party.
    On mutually agreed terms and conditions public sector partner agrees to 'purchase' the goods and services produced by the project.
- **BOOT:** In this variant of BOT, after the negotiated period of time, project is ransferred to the government or to the private operator.
    BOOT model is used for the development of highways and ports.
- **BOLT:** In this approach, the government gives a concession to a private entity to build a facility (and possibly design it as well), own the facility, lease the facility to the public sector and then at the end of the lease period transfer the ownership of the facility to the government.
- **DBFO:** In this model, entire responsibility for the design, construction, finance, and operation of the project for the period of concession lies with the private party.
- **LDO:** In this type of investment model either the government or the public sector entity retains ownership of the newly created infrastructure facility and receives payments in terms of a lease agreement with the private promoter.
    It is mostly followed in the development of airport facilities.

Problems with PPP Projects

- PPP projects have been stuck in issues such as disputes in existing contracts, non-availability of capital and regulatory hurdles related to the acquisition of land.
- Indian government has a poor record in regulating PPPs in practice.
- Metro projects become sites of crony capitalism and a means for accumulating land

by private companies.

- Across the world PPPs are facing problems, performance of PPPs has been very mixed according to study conducted by various research bodies.
- It is also argued that PPP is mere a “language game” by governments who find it difficult to push privatization, or when politically it is difficult to contracting out.
- Loans for infrastructure projects are believed to comprise a large share of the non-performing asset portfolio of public sector banks in India.
- In many sectors, PPP projects have turned into conduits of crony capitalism.
- Many PPP projects in infrastructure sector are run by “politically connected firms” which have used political connections to win contracts.
- PPP firms use every opportunity for renegotiating contracts by citing reasons like lower revenue or rise in costs which becomes a norm in India.
- Frequent renegotiations also resulted into drain of larger share of public resources.
- These firms create a moral hazard by their opportunistic behavior.

Vijay Kelkar Committee Report on Revisiting and Revitalising PPP Model

- Finance Minister in the Union Budget 2015-16 announced that the PPP mode of infrastructure development has to be revisited and revitalised.
- In pursuance of this announcement, a Committee on Revisiting & Revitalising the PPP model of Infrastructure Development was set-up which was chaired by Dr. Vijay Kelkar.

Key recommendations of the committee:

- Contracts need to focus more on **service delivery instead of fiscal benefits**.
- Better identification and **allocation of risks** between stakeholders
- Prudent utilization of **viability gap funds** where user charges cannot guarantee a robust revenue stream.
- **Improved fiscal reporting** practices and careful monitoring of performance.
- Given the urgency of India’s demographic transition, and the experience India has already gathered in managing PPPs, the government must move the PPP model to the next level of maturity and sophistication.
- Cost effectiveness of managing the risk needs to be evaluated.
- An Infrastructure **PPP Adjudication Tribunal (“IPAT”)** chaired by a Judicial Member (former Judge SC/Chief Justice HC) with a Technical and/or a Financial member, where benches will be constituted by the Chairperson as per needs of the matter in question.
- Projects that have not achieved a prescribed percentage of progress on the ground should be scrapped. Re-bid them once issues have been resolved or complete them through public funds and if viable, bid out for Operations and Maintenance.
- Sector specific institutional frameworks may be developed to address issues for PPP infrastructure projects.
- **Umbrella guidelines may be developed for stressed projects** that provide an

overall framework for development and functioning of the sector specific frameworks.

- **Unsolicited Proposals ("Swiss Challenge")** to be discouraged to avoid information asymmetries and lack of transparency.
- **Amend the Prevention of Corruption Act, 1988** to distinguish between genuine errors in decision-making and acts of corruption.
- Set up an institution for invigorating private investments in infrastructure, providing guidance for a national PPP policy and developments in PPP.
- An institutionalized mechanism like the **National Facilitation Committee (NFC)** to ensure time bound resolution of issues.
- Ensure adoption of principles of good governance by the **Special Purpose Vehicle (SPV)**.
- Discourage government participation in SPVs that implement PPP projects unless strategically essential.
- Ministry of Finance to allow banks and financial institutions to issue Zero Coupon Bonds which will also help to achieve soft landing for user charges in infrastructure sector.
- Encourage use of PPPs in sectors like Railways, Urban, etc. Railways to have an independent tariff regulator.
- Set up an **institute of excellence in PPP** to inter alia guide the sector, provide policy input, timely advice and undertake sustainable capacity building.
- Ensure integrated development of infrastructure with roadmaps for delivery of projects.

Way Forward

- New projects especially large-scale transit projects are significant for increasing mobility and for the series of changes in land use patterns. PPPs have the potential to deliver infrastructure projects better and faster. Currently, PPP contracts focus more on fiscal benefits.
- There is need for a serious assessment of the efficacy and the likely benefits of increasing private sector participation in metro rail projects before the adoption of this model.
- NITI Aayog in its document **'Strategy for New India @75'**, targeted investment rates to 36 per cent by 2022-23 from 28 percent of 2017-2018.
- To raise the rate of investment (gross fixed capital formation as a share of GDP) slew of measures will be required to boost both private and public investment.
- Private investment needs be encouraged in infrastructure through a renewed public-private partnership (PPP) mechanism on the lines suggested by the Kelkar Committee.
- A mature PPP framework, along with a robust enabling ecosystem shall enable the Government to accomplish, to a considerable extent, what our Prime Minister, has said “The Government has no business to do business” and thereby promote private sector investments and participation towards the nation building.