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Public-Private Partnership no panacea

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Public-Private Partnership (PPP) is a favoured fashion. Its newly discovered virtues, both at the Centre and the states, endow it with almost magical qualities to resolve the multiple ills which plague our infrastructure. Therefore, the recent 'Workshop on PPP in Infrastructure Industries and Regulation', hosted by the National Council of Applied Economic Research (NCAER), was quite timely.

It brought together leading experts from reputable European institutions to interact with academics and policy makers. They covered a wide gamut of subjects, like institutional capacity, forms of private partnership, regulatory regime, financial engineering and problems in the electricity sector. The visiting experts included Professor Paul Grout, Emmannuelle Auriol, Jerome Pouyet, Richard Portes among others.

This project when completed will enhance domain knowledge on a complex set of issues where our experience is limited. The PPP is perceived to avoid the inadequacies of both the public and the private sector; public sector is inefficient while private corporates are greedy. Excessive reliance on the former fosters inefficiency while the latter is iniquitous. In the European context, it is a mechanism for delivery of public services where the Government buys services from private operators, whereas in a conventional arrangement, it is the Government which buys the assets and jointly builds them.

In India, the press release of the Finance Ministry defines it as ''a project based on a contract or concession agreement between a government or statutory entity on the one side and a private company on the other side for delivering an infrastructure service, on payment of user charges''. Similarly, the viability gap funding has been defined as ''a grant, one-time or deferred, provided under this scheme with the objective of making a project commercially viable''.

Typically, this mechanism supports green-fields investment and goes beyond mere hiring of private delivery services, without outright privatisation, which implies full transfer of ownership. The virtues of this arrangement inter alia include:

• Creating fiscal space, leaving adequate resources to finance other inescapable commitments on schemes which do not lend themselves to such partnership;

• Attracting private investment which may be otherwise hesitant;

• Securing efficiency gains through improved private management;

• Fostering more equitable distribution of access to output and services at affordable cost;

• Creating a more competitive environment, resulting in improved governance.

None of the aforesaid objectives can be pursued independent of the other, nor divorced from improving the overall climate for investment and sectoral reforms designed to address policy deficiencies. The scheme for support to PPP in infrastructure, along with the features of a Special Purpose Vehicle for funding infrastructure announced by the Finance Ministry in July and November 2005, broadly lays down the coverage, eligibility criteria and the approval procedures for securing the financing of infrastructure projects.

Clearly, the Government recognises that ''the development of infrastructure requires large investments that cannot be undertaken out of public financing alone, and that in order to attract private capital as well as the techno-managerial efficiencies associated with it, the Government is committed to promoting PPPs in infrastructure development. It is also felt that infrastructure projects may not always be financially viable because of long gestation periods and limited financial returns, and that financial viability of such projects can be improved through government support''.

Within the infrastructure category, supporting the road sector would be the easiest, while in other areas like power, gas pipeline and Special Economic Zones, the pace of progress would be conditioned by the sectoral reforms. However, excessive enthusiasm for a PPP approach must recognise the complexities of several issues:

• First, intrinsically, tis is a sub-optimum solution. It recognises that public consensus for outright privatisation remains elusive but partnering the private sector is socially more acceptable. However, these special arrangements are no substitute to ongoing sector reforms. There is inherent danger that redressal of endemic sector-specific issues, particularly on subsidies and tariffs, gets postponed under the pretext that investments are being secured by this special mechanism. For instance, implementation of mega power projects is no substitute to resolving issues of open access, enhanced competition, elimination of distortionary cross-subsidies, to name a few.

• Second, evolving a model concessionaire agreement in which risk assignment and unbundling combine the virtues of equity and efficiency needs to be benchmarked with the best international practice as well as the stage of the sector-specific reforms. There could be wide variations across sectors, regions and states.

• Third, ensuring the quality of service as stipulated in the concessionaire agreement is always problematic. Assuming adequacy of monitoring mechanism, short-term contractual arrangements may not secure financial closure while longer-term contracts make ensuring assured service quality and penalty imposition more difficult.

• Fourth, the application of user charges which combines financial viability with distributional and equity considerations makes tariff rebalancing a complex issue. The timeframe for application of market-based user charges and its calibration during the transition period needs consultation and consensus of stakeholders. Given market imperfections, asymmetry of information and information rent making in public sector can create serious moral hazard concerns.

• Finally, regulatory and legal issues are critical. While some of this is embedded in the broader context of our legal reforms, alternative measures of dispute resolution and contract enforcement would remain a precondition for securing large private flows.

PPP is at a nascent stage. We must get these issues right for making it a powerful tool for infrastructure improvement. Enticing private investments and improving managerial efficiency would be dependent on how credibly these concerns are addressed. PPP is not a panacea for our multiple infrastructure ills. There are no fixed paradigms on the most preferred modes of such arrangement. We can shape it to meet our needs and more broad-based reforms would make the transition more acceptable.

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