

ILLUME

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Q U A R T E R L Y

PUBLIC PRIVATE PARTNERSHIPS
FOR
SUSTAINABLE DEVELOPMENT



- Division of Public Sector and Private Sector Responsibilities under various PPP Models
- Why and What of Pro-Poor Public Private Partnerships
- An Interview with Mr. Shoaib Sultan Khan
- Rays of Hope





Editor's Note

Public Private Partnership recognizes that both the public sector and the private sector have certain advantages relative to the other in the performance of specific tasks. By allowing each sector to do what it does best, public services and infrastructure can be provided in the most economic and efficient manner. For the private sector, PPP projects provide an opportunity to participate fully in the nation's development. PPP also allows for the best of public and private sector management skills to work together in the delivery of services for the benefit of the public. Innovative tripartite partnerships between government, private for profit and private nonprofit sectors can greatly help in improving the delivery and accessibility of basic social services like water, sanitation, health and education.

This issue of ILLUME attempts to examine the concept, promises and challenges of public private partnerships from multiple angles. These pages also feature some real success stories for their inspirational and educative value. Glimpses and major recommendations of the 2nd International HRD Congress recently held in Islamabad on the theme of "Attacking Poverty thru Public Partnership Partnerships" are also included.

As always, I hope that you would find this issue of ILLUME not only informative but also inspiring and we will witness a lot more success stories in 3Ps in the days to come.

Happy reading!!!

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Division of Public Sector and Private Sector Responsibilities under Various PPP Models

Background

Public-private Partnerships (PPPs) have been used throughout the world to improve the performance of public enterprises. Because they are designed to draw on the strengths of both the public and the private sector, PPPs are commonly used in sectors such as water, energy, transportation, healthcare, education, telecommunications, etc. - where there are overriding social, political, or economic goals.

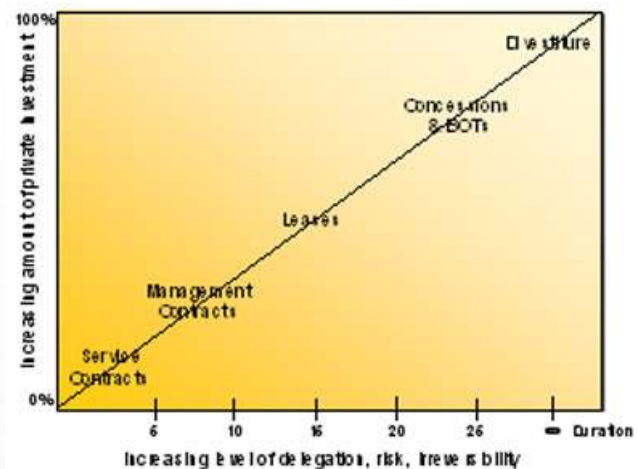
It should be noted that the term 'public-private partnership' is increasingly used in a very broad sense, sometimes including what has traditionally been called privatization or even describing arrangements in which the private sector simply donates money to assist governments in service provision.

PPP Models

Most literature on public-private partnerships identifies five options for structuring the relationship between parties. They are:

- Service Contracts
- Management Contracts
- Leases
- Build-Operate-Transfer Contracts and Variants
- Concessions

These options can be arrayed along a spectrum according to the level of private sector involvement (see Figure 1 below). At one end are arrangements in which the government retains full responsibility for operations, maintenance, capital investment, financing and commercial risk; at the other end the private sector assumes a greater share of the responsibilities and the risks.



It is important to note that, in practice, PPPs are often hybrids of these models. For example, management contracts sometimes include revenue-sharing provisions common to lease agreements, and leases sometimes transfer responsibility for small-scale investment, rehabilitation, or renewal to the private sector, as is characteristic of concessions. The following are brief overviews of the models for PPPs, including examples of where these models are in use.

Service Contracts

Service contracts commonly referred to as "outsourcing" - are legally binding arrangements

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between a government authority and a private sector partner to perform specific, usually non-core tasks, of an enterprise in exchange for a fee. These contracts are often competitively bid, and are for short periods of six months to two years, after which they are re-bid. Responsibility for control and supervision of the enterprise, and any capital investment, remains with the public authority. Examples of service contracting would be a government ministry that contracts out its cafeteria, janitorial or security services. In these cases, the government would conduct competitive bidding for the award of a short (six months to two years) contract for services. The contract would be awarded to the bidder offering the lowest price.

While service contracts require only a limited degree of private sector participation, they provide governments with an opportunity to introduce competition and free up the public entity to focus on its core activities. Because the contract period is short, contractors are subjected to frequent competition, encouraging efficient performance and reducing the cost of the contracts. Service contracting can be an attractive form of PPP where there is strong political or community opposition to wider involvement of the private sector, opposition to price or tariff increases, or

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where shedding responsibility for non-core functions is wanted.

Despite the possible long-term benefits to the population as a whole, service contracting can have a negative impact on those employees working in the operations being contracted out, as they could be made redundant. Governments have addressed this problem by providing support to those employees in forming and financing private companies to compete for the service contract, or by providing retraining and severance payments to support employees in finding work in other locations.

Management Contracts

Management contracts transfer responsibility for the day-to-day management, including operation and maintenance, of an enterprise to the private sector. Under such contracts, ownership of the enterprise and the legal responsibility for service provision remain with the government. Likewise, the bulk of the commercial risk and all the capital and investment risks remain with the public authority. Management control and authority, however, is transferred to a private operator, which applies its expertise to improve management systems and practices. Management contracts are generally three to five years in duration. Compensation may be in the form of a fixed fee, (fixed fee management contract) or it may be linked to performance indicators (performance-based management contract.)

More sophisticated Performance-Based Management

Contracts provide for the introduction of greater incentives for efficiency by defining performance targets or contract milestones and basing remuneration, at least in part, on their fulfillment. One variant of this model provides for a profit sharing incentive, in which the operator's remuneration is a combination of a fixed fee plus a share in any incremental increases in profits. Both the performance-based management contract and the profit sharing variant are effective tools for ensuring that the management contractor shares operating

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and commercial risks. However, under both models, the public authority still bears the financial risk associated with its responsibility for capital investment.

Performance-based management contracting provides the management contractor with incentives to improve operating efficiency and achieve timely compliance with the performance milestones in its contract. An advantage to these contractual models is the ability to create incentives for the contractor to tackle issues (such as staff development) that are not revenue generating in the short term, but that may establish a foundation for more efficient and sustainable performance over the long term.

Management contracts are most beneficial where the

main objective is to rapidly enhance the technical capacity and/or efficiency of an enterprise, or to prepare for a deeper form of PPP. They are also attractive when there is strong political or public resistance to price increases or where there is concern about handing over control of public investments to the private sector.

Because management contracts leave all responsibility for investment with the public authority, they are not recommended if a government has as one of its main objectives accessing private finance for new investments. And because they do not necessarily transfer financial risk to the management contractor, they provide few incentives for the private operator to reduce costs and improve quality of services.

Leases

Under a lease, a private firm (Lessee) leases the assets of a public enterprise from a properly empowered government authority (Lessor) and assumes the responsibility for operations, maintenance, and some limited degree of capital investment (such as asset renewals) for a period usually between ten and fifteen years. Typically under a lease, the enterprise's revenues are used to pay the “Lessee Fee”, which remunerates the Lessee for his costs, plus a reasonable return. The remainder of the revenue goes to the government and is used to fund capital investments, asset repair or rehabilitation, and other

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improvements. As the Lessee's fee is dependent upon revenues, the Lessee assumes much of the commercial risk of the operations.

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concession. Their administrative complexity and the demands they place on governments are nearly as great as those of concessions, so a lease is a much bigger first step than a management contract. Due to their complexity, leases generally require that an independent regulatory body be established to monitor and enforce the private operator's fulfillment of its obligations under the lease.

Build-Operate-Transfer Contracts and Variants

Build-operate-transfer (BOT), build-own-operate (BOO), build-own-operate-transfer (BOOT), rehabilitate-operate-transfer (ROT), and similar arrangements are contracts specifically designed for Greenfield projects or investments in infrastructure that require extensive rehabilitation. Under such arrangements, the private sector typically designs, constructs and operates facilities for a limited period from say 15 to 30 years, after which time the contractor relinquishes all rights or title to the assets to the government. Under a build-operate-own (BOO) contract, the assets remain indefinitely with the private firm.

The government will typically pay the BOT partner a price calculated over the life of the contract to cover its construction and operating costs and provide a reasonable return. Effective implementation of BOT type contracts requires careful attention to the design of tender documents and can involve a relatively

lengthy bidding process. Experience with some BOTs shows that they achieved some savings in capital construction costs and facilitated more rapid investment in infrastructure. However, they can be an expensive way of substituting private debt for public debt if they do not transfer demand risk to the private partner. Additionally, many BOTs have failed to deliver optimal outcomes for government or consumers because the government's agency responsible for negotiating allowed too much of the risk to remain with government, especially where foreign exchange guarantees are provided, or where take-or-pay contracts are signed. A take or pay contract is an arrangement whereby the BOT customer agrees to pay for a pre-determined amount of output (power, treated water, etc.) whether they actually use it or not.

BOT type contracts are in many respects very similar to concessions. The key difference between the two contractual forms is that BOTs entail the building of something new a wastewater treatment plant, a power station, a toll road, etc. and operating it for a period of time, whereas concessions entail the assumption of responsibility for an existing facility.

BOTs have been used throughout the world to fund the construction of new facilities.

Concessions

Under a concession, the private contractor, or Concessionaire, bears overall responsibility for the services, including operation, maintenance, and management, as well as capital investments for rehabilitation, renewal, and the expansion of services. The fixed assets of the enterprise either remain the property of the public authority or revert to public ownership at the end of the concession period. Concession contracts usually have a duration of twenty to thirty years, depending on the level of