



CREATING AN ENABLING AMBIENT ENVIRONMENT FOR PPPs:

Tool Kits for Policy Makers Engaged in Designing
and Managing PPP Interventions in the
Infrastructure Sector

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EXECUTIVE SUMMARY

The role of private partnerships in the provision of quality infrastructure cannot be overemphasized considering our growing infrastructure needs and a corresponding lack of expertise and capacity constraints in the public sector to manage large-scale projects. Hence, it becomes imperative to adopt measures that will help institutionalize PPPs as a mode of project and service delivery. A number of research studies have been directed towards deepening the understanding of the institutional and capacity-building needs of PPPs and policy-makers have often drawn from these research outputs to guide their efforts in institutionalizing PPPs.

We believe that our report is an innovative step in this direction, offering a 12-point capabilities-based framework that strongly underscores the core functions that institutions must perform and provides guidelines on how these capacities can be built, within an environment. One of the crucial aspects of our report is that the capability guidelines that are proposed cut across varied institutional and political contexts and can assume specific institutional forms that are relevant to the context within which they are designed. Our assumption behind developing a core set of cohesive guidelines stems from an understanding that capabilities can often be met through various forms of institutional investments. This is a possibility which is quite often overlooked by attempts to encapsulate these capabilities in a prescriptive institutional or policy checklist. Consequently, as a guide for reform, our capabilities framework reduces the risk that recommendations will encourage redundant institutional investments.

What is a PPP? We define PPPs as project delivery arrangements where the private sector takes on risks and responsibilities that are traditionally construed as belonging to the government. Operationally, a pure EPC contract is not considered to be a PPP even though the private sector bears risks in terms of asset creation. However any form of project organization where the private sector bears risks beyond design and construction falls within the purview of our definition of PPPs. PPPs therefore include concession agreements based on the Build-Operate-Transfer (BOT) model or any of its variants, as well as lease and affermage arrangements, operations and maintenance arrangements, and so on.

Programmatic vs. Project-Based Approaches to PPPs

The PPP approach in India in the initial years was largely sector driven with reforms and interventions being introduced at the sectoral level. This approach has indeed yielded impressive results as evinced in the success of private partnerships in several sectors across the country, especially at the national level. It has also enabled the spurt of stand-alone PPP projects across varied sectors at the state level. However, the gap in this approach lies in its inability to address broader challenges such as capacity building, institutionalizing processes, procedures and skills, developing project pipelines at the state and lower levels of governance, mobilizing funding sources. Our comparative study of three states – Gujarat, Tamil Nadu and Karnataka - further corroborate that this is indeed the case. Our study underscores that the project driven approach which is currently being followed can lead to the occasional sector level interventions and reforms but is clearly not a panacea to the key challenges listed above. These challenges need to be addressed to step up the momentum of PPP undertakings across states and to tap into the potential of projects that can be undertaken in the existing sectors and explored in newer sectors.

This change can be brought about only by adopting a programmatic approach towards PPPs since this approach will guide the larger politico-institutional environment needed for successfully scaling up PPPs and will provide a platform for cross-sectoral diffusion of expertise in PPP undertakings. Viewed through this lens, the 12-point capability framework that we present in this report, unarguably draws out the key underpinnings for such a programmatic approach to evolve, and also outlines the institutional forms that manifest these

capabilities. This framework will pave the way for evolving a broader institutional context that enables the undertaking of PPP projects, irrespective of complexity or quantity. A brief summary of the 12 capabilities needed to create a robust ambient environment for PPPs, and ways in which to build them is given below:

Summarizing the 12-point framework

- 1.** *Existence of a Clear, Mature Rationale* for the use of PPPs could be met through a public statement, through law or policy guidelines, of the goals of PPP and the factors that should be considered in choosing PPP as a project framework. This rationale could also be embedded in agencies' standard operating procedures (for example, as a requirement that risk allocation and management gains from PPPs as well as actual cost of capital be evaluated) or organizational forms (for example, as project identification committees with a mandate to consider the management, technical, and financial pros and cons of a project)
- 2.** *Legitimization* of PPPs can be brought about in several ways including drafting laws or policy guidelines that protect against private or public sector abuse of partnerships (for example, guidelines for selection and compensation of private sector participants, for awarding asset contributions (such as land development rights) to the private sector, rules regarding government investments and shareholding). The belief in the potential benefits of partnership can be strengthened by advocacy measures (examples highlighting success stories of PPPs, developing a history of projects with private sector involvement, or networking events between the two sectors) or organizational forms (including setting up an independent auditor for regulation and oversight)
- 3.** *Creating political willingness* among policymakers can be achieved by undertaking training initiatives that educate public sector officials on the potential benefits of PPPs.

This can also be brought about by standard operating procedures (for example, standardisation of PPP contracts) that help ease adoption hurdles.

4. *Predictability of public sector decision-making* is largely embedded in a transparent, reliable and consistent set of standard operating procedures (such as standardized norms and procedures for project identification, approval, bidding and award, project design and management, etc). This is also present in stable and transparent organizational forms (example, regulatory bodies that provide project oversight).
5. Ensuring public sector commitment to decisions can take place via legislation or policies that ensure strong bureaucratic oversight and also via setting up institutional forms such as independent regulatory mechanisms, effective dispute resolution mechanisms, etc.
6. *Ensuring private sector commitment to decisions* can happen via institutional forms such as independent regulatory agencies or standard operating practices such as blacklisting of private contractors renegeing on contract terms, publicizing private sector failures, stringent contract terms with built in financial commitments, etc.
7. *Public sector capability to identify and award projects* can be enhanced by standardizing operating procedures including, creating templates for evaluating PPP opportunities, public sector comparators, checklists for approvals and guidelines for project structuring and bid process management, conducting frequent training programs for public officials, and empowering consultants and other firms to assist the public sector in project preparation.
8. *Public sector capacity to govern projects* can be ensured via creating Management Information Systems practices that help assess service levels and by stepping up the training programs for public officials that help strengthen their contract supervision and enforcement capabilities, while also building institutional forms such as flexible, negotiated contractual agreements and dispute resolution mechanisms.

9. *Capacity of the private sector* to finance and execute projects is primarily embedded in a credible commitment by the public sector towards undertaking programmatic PPPs. This capability can also be strengthened by developing the capacity of small and medium enterprises to undertake PPPs and by opening PPPs to international players who can lend their expertise to infrastructure development.
10. *Risk allocation and mitigation mechanisms* can be strengthened by improving operational practices including strengthening model concession agreements, and incorporating a defined risk allocation framework that is rooted in legislation.
11. *Financing and funding mechanisms* can improve the bankability of projects and can encourage the private sector to participate in infrastructure service delivery. This capability can be enhanced by improving the institutional environment in the form of well-developed capital markets, financial institutions that can invest in infrastructure and easily accessible project development funds.
12. *Advocacy of PPPs and management of stakeholders* is again a factor of an improved institutional environment that has imbibed the rationale for PPPs and reflects it in the form of adopting practices such as training of public sector employees of the merits and nuances of PPPs, improving dissemination of best practices in PPPs, developing a coherent communications and outreach strategy, involving stakeholders at relevant stages of the PPP process etc. This would help quell social protests and increase acceptance and ownership of PPPs.

Prioritizing capabilities within the framework

In evaluating a state's environment for PPPs, one should go beyond looking at the number of PPPs, but rather focus on how these PPPs were achieved and whether that is replicable. The process and underpinnings are equally, if not, more important. Hence, states need to prioritize

PPP-supporting efforts, and work on building capabilities, as opposed to creating short-term project outcomes.

Part 1 of our report elaborates this further by prioritizing the capabilities and simultaneously bringing out their inter-dependencies. Our findings indicate that the capabilities of Rationale, Legitimacy, Predictability, Public Sector commitment, Political Willingness and Capacity to Develop PPPs are mandatory and assume a greater priority and immediacy in bringing about a programmatic outlook towards PPPs. Relatively less important at the current time are capabilities such as Private Sector commitment and Financing which are either already present within the existing environment or are dependent upon higher-priority capabilities evolving in the first place. Our research findings also lead us to argue that legitimacy will lead to a willingness to undertake PPPs while the trust between the public and private sectors will enable transparent and competitive environment for PPPs. Once these ambient capabilities are in place, strengthening the capacity building capability can result in appropriate identification, structuring and governance of individual PPP projects.

Empirical validation of the framework

In terms of our methodology, we attempted to observe outcomes of PPP projects in three selected states – Karnataka, Tamil Nadu and Gujarat. However, viewing project outcomes alone can be misleading, since projects that have been undertaken are only a subset of the total number of projects that have the potential to be executed through PPPs. Also, a PPP is not in and of itself an indicator of a good PPP environment – one has to look at the efficiency of the PPP process or the costs of obtaining/running/initiating the PPP. If these are high in financial, political, or HR opportunity cost terms, or the backing for a PPP is otherwise not replicable, then this indicates a different level of achievement than setting up a process or

institutions to embark on a programmatic approach towards PPPs. We thus supplemented our observations with interviews with key officials, many of whom confirmed the need for our approach in order to step up the momentum of undertaking PPP projects across the sectors. Our interviews validated the capabilities that were identified in our research and also helped prioritize the capabilities as applicable to the current institutional context of PPPs prevalent across most Indian states.

Case studies and reflections on the framework

First, our data highlights the significance of scale in applying the framework - On the one hand, PPPs can happen in the absence of a generalized high-capability environment. The example of Chennai Metro Water's pumping stations in its early years illustrates a success story that happened because the requisite capabilities for a technologically simple project were available at the scale of a particular agency. On the other hand, the PPP environment at the agency level can be poor even when there is state-level support. This is evidenced in the case of Karnataka, where the rationale for PPPs includes non-financial benefits and considerations for choosing PPP (i.e a mature capability), but actual operating procedures in the sector do not incorporate these factors. Our report also highlights the need for decision-makers to consider how investments in the broad state or multi-sector environment will translate to specific agencies.

Second, there is some commonality in the strategies followed across the states that we studied. For instance, Karnataka, Tamil Nadu and Gujarat all had competitive bidding processes governed by Transparency Acts. The non-availability of funds was the primary driver for PPPs. External consultants and transaction advisors were often hired for project structuring and financial planning. However there was also significant variance in the strategies at the state level - Tamil Nadu appears to be taking a reactive stance, amending policies to accommodate specific projects, for example. Systematic approaches are in some

cases visible at the line agency level (for instance with regards to pumping stations in the water and sanitation sector) but not at state level. This is somewhat in contrast to Karnataka, which seems to follow a strategy of having state policies that provide broad clarity on PPPs. However, these philosophies have not percolated through to the line agencies and lower levels of the state's bureaucracy. Karnataka appears to recognize the significance of capacity building within the public sector and has invested strongly in training programs and knowledge dissemination workshops for public sector officials. In contrast, the capacity building measures taken by Tamil Nadu are quite poor. In comparison, the stated strategy towards PPPs, as well as its acceptance and understanding, and the implementation of PPPs are all in consonance in Gujarat. Political Will is a differentiating factor among the three states, which Gujarat scoring high on this dimension. There are also differences across sectors. There appears to be some initial evidence that decentralized decision making is correlated with larger numbers of PPPs, which might explain why PPPs in urban water and sanitation are prevalent in Tamil Nadu, where the ambient environment for PPPs is relatively weak.

Third, the study highlights similarities in response to infrastructure demands. All three states responded to sustained pressure to get infrastructure in place, with approaches involving PPPs. This is evidenced in Karnataka in the case of water supply for Bangalore, and in Tamil Nadu in the case of the east coast road. When demand exists, when the alternative to building good infrastructure is politically or financially costly, projects are undertaken. In most cases, therefore, PPPs are undertaken through necessity. This underscores a lack in systematic, programmatic thinking with regards to PPPs.

The study also highlights the penetration of PPP cells into the state PPP environment – In Karnataka, the PPP cell constitutes an important institutional form to create and develop a pipeline of PPP projects as well as in skills institutionalization. Prior to the creation of this

PPP cell, very few PPP projects were undertaken by the state. The cell is adequately staffed and performs functions spanning all stages of a PPP project, from identification, approval, development and monitoring. The PPP cell in Gujarat is similarly vibrant. Contrast this to Tamil Nadu, where the role of the PPP cell is limited to a few training programs to senior public officials and line departments.

Conclusions – Recommendations for state governments

1. PPP incidence is different from PPP success. The success of a PPP program is likely to be measured based on the ability of the ambient environment to initiate and deliver projects that provide societal benefits. The institutional underpinnings for PPP may take time to evolve. State governments must invest in these institutions in addition or as opposed to structuring ad-hoc projects.
2. A clear rationale for PPPs, Legitimacy, Predictability of award processes, Public Sector commitment to decisions taken, Political Willingness and Capacity to Develop PPPs are high priority capabilities that states must focus on first, as they embark on strengthening their institutions.
3. State governments must balance the types of PPPs that they undertake with the maturity of the institutional environment that is present in their state. A programmatic approach to complex PPP projects is a noble ideal, but can only be achieved if institutional capabilities are built up. On the other hand, simpler PPPs can be taken up in the early stages of a state's PPP evolution, thereby building capabilities for expansion in PPPs later on.
4. Well-designed project monitoring systems are likely to have an enormous impact. Most states have not invested in such systems. However, these systems could be a key driver in

a) creating transparency, b) reinforcing the rationale for PPPs, and c) enabling more efficient transfer of lessons across agencies and states.