Economics Class 28

PPP (09:04 AM)

- The government typically has several objectives to perform like infrastructure development, welfare mechanisms, getting good value for money, timely delivery of services, meeting public needs, and so on.
- PP projects have shown their potential as an important tool to meet these objectives and address infrastructure shortages.
- These projects provide new sources of capital for public infrastructure development by shifting the responsibility for arranging the finances to the private sector.
- **PPP** refers to a contractual agreement between government agencies and a private sector entity that allows for greater private participation in public infrastructure projects.
- **For existing projects, PPP models are as follows:**
- **Management or service contract**
- It is a contractual agreement for management or the whole public enterprise. E.g. a specialized port terminal for container handling by the private sector.
- A management contract allows management skills to be brought into service delivery however the public sector retains the ownership of the facility.
- A private contractor is paid a fee to manage and operate and the payment is generally performance-based. Usually, the contract period is a short term which is 3 to 5 years.
- **Advantages**
- Less risk due to a shorter duration
- Least number of the ~~[illegible]~~ Conflicts
- **Disadvantages**
- Almost all risk is taken by the public sector
- Less scope for innovations

-> Less incentive for the private player to invest.

- **Turnkey management project**
- It is a traditional public sector procurement model for infrastructure facilities
- Generally, a private player is selected through a bidding process. Private builds and designs a facility for a fixed fee which is one of the criteria for selecting the winning bids.
- The scale of investment by the private player is generally low and for a short-term period.
- **Affermage/Lease**
- In this category of arrangement, the leaseholder is responsible for operating and maintaining the infrastructure facility that already exists.
- Generally, the operator is not required to make any large investment except for the case where this model is implemented with another PPP model. E.g. Build Lease Transfer.
- The difference between an **Affermage** and a lease is technical.
- Under the lease, the operator retains the revenue collected from the customer and makes a specified lease payment to the contracting authority
- Under an **Affermage**, the operator and the contracting authority share the revenue.
- **Que**- Household-led savings constitute an important part of capital formation in India. In this context, discuss critically the challenges faced by a savings-led investment economy. What are the other sources of capital formation in India? (10 marks, 150 words)

- **Approach-**
- Introduce by briefly mentioning the importance of household-led savings.
- Challenges faced by a savings-led investment economy-
- Inflation
- Lack of Monetary transition
- Lack of confidence in the market- market volatility
- Low Financial inclusion and financial knowledge
- Capital output ratio
- NPA
- Explain other sources of capital formation in India.
- Conclude accordingly.

CONCESSION (10:31 AM)

- In this form of PPP, the government grants specific rights to a private player to build and operate a facility for a fixed period.
- In concession, payments can take place both ways i.e. the government gives concession rights to the private player for fixed payments or the private player pays the government to obtain a right.
- Usually, such payment by the government may be necessary for making projects commercially viable.
- **Area concession-**
- The private player is responsible for the full delivery of services in a specified area including operation, maintenance, construction, and rehabilitation of the systems.
- The operator is now responsible for all capital investment while the assets are publicly owned even during the concession period.
- The public sector role shifts from being a service provider to regulating the price and quality of the service for example water distribution concession for a city or area within the city.

launched in January 2016

HYBRID ANNUITY MODEL (11:15 AM)

- It was ~~proposed in 2015~~ and it is a mix of BOT and EPC.
- Generally, there are 3 models in India for awarding national highway projects - EPC, BOT Toll, and BOT annuity.
- **EPC (Engineering, Procurement and Construction)**
- It requires the government to undertake the total funding of the project while the private partner will provide the engineering and construction requirements.
- The cost is completely borne by the government and the government invites bids for engineering expertise from contractors.
- Procurement of raw materials and construction costs are met by the government. From design to commissioning the EPC contractor is responsible for all activities and the handover of the project to the government

BUILD OPERATE TRANSFER (BOT) (11:26 AM)

- It is a conventional PPP model in which the private partner is responsible for designing, building, operating (during the contracted period), and transferring back the facility to the public sector.
- The private sector has to bring the finance for the project and take the responsibility for construction and maintenance.
- Govt allows private sector partners to collect revenue from the users.
- In BOT annuity, the developer constructs and maintains the roads and gets a fixed payment from the government this model needs frequent government payments that are guaranteed though deferred sometimes.
- Since the annuity contracts are long-term, the model may not be attractive in all places.
- In the case of a BOT toll, the traffic or commercial risk is on the concessionaire and the investment is sustained by the toll revenues.
- Tolls are not feasible in rural and semi-urban areas. Since the collection of tolls depends on the traffic the developer faces traffic risk in this model.
- HAM was seen as an alternative for national highway projects
- HAM is a combination of BOT and EPC models, The government will give 40% of the projects as construction support during the construction period and the remaining 60 % as annuity payments to the concessionaire throughout the operations period plus interest.
- In HAM the company has no right to collect tolls and the revenue is collected by the national high authority of India and refunded to the private players in instalments for 15 to 20 years.

Hybrid annuity model

- **Benefits**
- Compared to the BOT annuity it would ease the cash flow pressure on the government.
- Compared to BOT tolls, the traffic risk is not associated with the concessionaire.
- Operations and maintenance are handled by the private player increasing the efficiency of the project.

SWISS CHALLENGE METHOD (11:48 AM)

- In this method, a private player can submit a proposal to the government for the development of an infrastructure project with an exclusive IPR.
- (Private players can approach without an invitation from the government also).
- **The government has two options:**
- a) After buying the IP rights from the original proponent, it can call for competitive bidding to award the project.
- b) The government may also allow other players with similar capabilities to submit their proposals.
- If any proposal is better than the original proposal, the original proponent is asked to modify the proposal.
- If he fails, the project is awarded to the best bidder.
- Many states in India are using this method for awarding road and housing projects.
- The draft PPP Rule 2011 allows the use of Swiss challenge only in exceptional circumstances, i.e. for projects in rural areas or for projects related to BPL.

TOPIC OF THE NEXT CLASS- INFRASTRUCTURE (TO CONTINUE)