UNIVERSITY OF NAIROBI

INSTITUTE OF DIPLOMACY AND INTERNATIONAL STUDIES (IDIS)

PUBLIC PRIVATE PARTNERSHIPS FOR INFRASTRUCTURE DEVELOPMENT: A COMPARATIVE STUDY OF KENYA AND INDIA

KEDE lava ANN ACHEING RACHEL
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SUPERVISOR:
PROF: MARIA NZOMO

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NOVEMBER 2010
DECLARATION

I Rachel Ann Achieng Kidenda hereby declare that this research project is my original work and has not been presented for a degree in any other University.

Signed: ________________________________  Date: 11/12/2010

Rachel Ann Achieng Kidenda

This project has been submitted for examination with my approval as University Supervisor;

Signed: ________________________________  Date: 12 Dec 2010

Prof: Maria Nzomo
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To God, for His infinite mercies and protection through the entire duration of my project. All wisdom and knowledge comes from Him and without him I can do nothing.

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All those who helped me in one way or another. It was not possible without them.

I however take full responsibility for any mistakes in this paper.
DEDICATION

For my parents, Meshack and Mary Clare Kidenda, for believing in me, for
inspiring me, encouraging me, and for sacrificing that I may have access to a better
education and life by extension.

To my siblings; Gideon, Sheila and Eucabeth for being there during the entire
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support.
ABSTRACT

The term “public-private partnerships” has frequently appeared in the media and in the economic development literature in recent years. As an institutional approach, however, public-private partnerships have a long history in local economic development policy. With the structural change of the economy in the developed countries and the development of economic globalization in the last two decades, developing nations have been forced to use a wide variety of incentives to compete for mobile capital and high quality labour.

An exploration of a general framework of public-private partnerships helps to improve understanding of public-private partnerships. Certainly, it is important to recognize that public-private partnerships are not the same across countries, even within the developed countries, in their formation and operation. It is clear that funding of capital projects from the income or finances available to most governments is limited and thus development of infrastructure takes a back foot. With infrastructure that does not support development, it means that the growth of the nation as a whole also stalls as infrastructure is the backbone for development to ride on.

To that end this study looks at Public Private Partnerships (PPPs) for infrastructure development, especially in developing nations. It looks at Kenya in comparison with India as its PPP structure is more advanced than that of Kenya. PPPs are seen as an alternative to the problems faced like lack of funding, skills and man power. The government still retains its role of providing services to the citizens but “outsources” the provision of the same services to individuals or corporations that are specialized in specific area like roads, railways, ports, airports, sewerage and so on.

Chapter one contains the proposal that outlines the statement of the problem, research questions, justification for the study and literature review. It also looks at the theoretical framework which in this case is the market and state failure theory. Chapter two is an overview of PPPS: definitions, types of PPPs; their advantages and disadvantages; the parties involved and the kinds of risks they face in the entire process. It also explores the reasons why governments are opting to go the PPP way. Chapter three is an analysis of what PPPs have done in other developing countries giving examples of projects that have been completed or still undergoing in Brazil, China, South Africa, Mozambique and India. Being a comparative study of Kenya and India this
chapter looks a critical look at the PPP projects in the various states in India and concludes that the approach India has taken has managed to propel it towards developed nation status.

Chapter four looks at the structures that India has put in place to support PPP in comparison with what we as a country have in place. It lists the policy framework legal or otherwise and other steps that have been taken by each country. The final chapter is a summary of the findings and outlines the conclusions are recommendations the paper has come to regarding the best way forward for Kenya to utilise PPPs for infrastructure to achieve Vision 2030 and Millennium Development Goals as well.
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<tr>
<td>APOPS</td>
<td>Asset Procurement and Operating Partnership Systems</td>
</tr>
<tr>
<td>BBO</td>
<td>Buy Build and Operate</td>
</tr>
<tr>
<td>BDO</td>
<td>Build Develop and Operate</td>
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<tr>
<td>BOO</td>
<td>Build Own and Operate</td>
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<td>BOO</td>
<td>Build own Operate</td>
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<td>BOT</td>
<td>Build Operate and Transfer</td>
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<td>Build Operate and Transfer</td>
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<td>BOT</td>
<td>Build Own Transfer</td>
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<tr>
<td>BPO</td>
<td>Build Purchase Operate</td>
</tr>
<tr>
<td>BTO</td>
<td>Build Transfer and Operate</td>
</tr>
<tr>
<td>CBMM</td>
<td>Companhia Rasileria de Metalurgia e Mineracao</td>
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<tr>
<td>CII</td>
<td>Confederation of Indian Industry</td>
</tr>
<tr>
<td>CWAP</td>
<td>Community Water and Sanitation Project</td>
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<tr>
<td>CWSA</td>
<td>Community Water and Sanitation Agency</td>
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<tr>
<td>DBFO</td>
<td>Design, Build, Finance and Operate</td>
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<tr>
<td>DBO</td>
<td>Design Build and Operate</td>
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<tr>
<td>DEA</td>
<td>Department of Economic Affairs</td>
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<tr>
<td>DPC</td>
<td>Dhabol Power Corporation</td>
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<tr>
<td>DPW</td>
<td>Department of Public Works</td>
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<tr>
<td>ECIC</td>
<td>Export Credit Insurance Corporation of South Africa</td>
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<tr>
<td>EIB</td>
<td>European Investment Bank</td>
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<td>EIC</td>
<td>European International Contractors</td>
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<tr>
<td>EUR</td>
<td>Euros</td>
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<tr>
<td>Acronym</td>
<td>Full Form</td>
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<tr>
<td>FDI</td>
<td>Foreign Direct Investment</td>
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<tr>
<td>FGDs</td>
<td>Focus Group Discussions</td>
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<tr>
<td>FY</td>
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<tr>
<td>GCFI</td>
<td>Gross Capital Formation in Infrastructure</td>
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<tr>
<td>GDP</td>
<td>Gross Domestic Product</td>
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<tr>
<td>GOI</td>
<td>Government of India</td>
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<td>GOK</td>
<td>Government of Kenya</td>
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<tr>
<td>IBRD</td>
<td>International Bank for Reconstruction and Development</td>
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<td>IDA</td>
<td>International Development Association</td>
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<td>IFC</td>
<td>International Finance Corporation</td>
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<td>IIFCL</td>
<td>India Infrastructure Finance Company Limited</td>
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<td>IIPDF</td>
<td>India Infrastructure Project Development Fund</td>
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<tr>
<td>IMG</td>
<td>Inter-Ministerial Group</td>
</tr>
<tr>
<td>IT</td>
<td>Information Technology</td>
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<tr>
<td>JNNURM</td>
<td>Jawaharlala Nehru National Urban Renewal Mission</td>
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<tr>
<td>LAC</td>
<td>Latin American and the Caribbean</td>
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<tr>
<td>LDO</td>
<td>Lease Develop and Operate</td>
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<tr>
<td>MGDs</td>
<td>Millennium Development Goals</td>
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<tr>
<td>MOF</td>
<td>Ministry of Finance</td>
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<td>MSEB</td>
<td>Maharashtra State Electricity Board</td>
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<tr>
<td>NCPPP</td>
<td>National Counsel for Public-Private Partnerships</td>
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<td>NDC</td>
<td>National Development Council</td>
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<tr>
<td>NGOs</td>
<td>Non-Governmental Organisation</td>
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<td>NHAI</td>
<td>National Highways Authority of India</td>
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<td>NHDP</td>
<td>National Highway Development Programme</td>
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<tr>
<td>NMDP</td>
<td>National Marine Development Programme</td>
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<td>PAC/GAP</td>
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<td>Power Purchase Agreement</td>
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<td>PPPs</td>
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<td>PRG</td>
<td>Partial Risk Guarantee</td>
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<tr>
<td>PSP</td>
<td>Private Sector Participation</td>
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<tr>
<td>PURA</td>
<td>Providing Urban Services in Rural Areas</td>
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<td>RMB</td>
<td>Renminbi</td>
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<td>SEZs</td>
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<td>SPC</td>
<td>Special Purpose Company</td>
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<td>SPV</td>
<td>Special Purpose Vehicle</td>
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<tr>
<td>SSA</td>
<td>Sub-Saharan Africa</td>
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<td>TRAC</td>
<td>Trans African Concessions</td>
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<tr>
<td>UK</td>
<td>United Kingdom</td>
</tr>
<tr>
<td>UNDP</td>
<td>United Nations Development Programme</td>
</tr>
<tr>
<td>USA</td>
<td>United States of America</td>
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<td>USD</td>
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CHAPTER ONE

PUBLIC PRIVATE PARTNERSHIPS FOR INFRASTRUCTURE DEVELOPMENT: A COMPARATIVE STUDY OF KENYA AND INDIA

1.1 Introduction

In developing countries, Public Private Partnership agreements have grown steadily since the 1990s. According to the World Bank’s Private Participation in Infrastructure (PPI) database, 2750 infrastructure projects involving private and public investment for capital value of USD 786 billion have been implemented in 1990-2003 (in 2002 constant dollars).\(^1\) Around 1000 projects and 47% of the investment took place in Latin American and the Caribbean (LAC) countries, where Chile and Mexico were pioneers in the use of PPPs.\(^2\) In Central and European Countries many PPP projects were conceived in the second half of the 1990s. The PPI lists 217 projects in the region by 2003, with 64 projects for building and operating new facilities amounting to an investment of EUR 22.6b.\(^3\)

PPPs are presently mooted as an alternative mode of developing third world economies where the State is faced with resource constraints. As such it becomes necessary to understand the environment within which this model of development is pursued and the effect it has had on the intended beneficiaries and participants in the process. The private sector has long provided goods and services to the public sector. However, a trend seems to be developing in a number of countries towards increasing involvement of the private sector in the provision of goods and services traditionally provided by, and seen as a function of, the public sector. This entails a shift

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\(^3\) Ibid 9
in the role of the public sector from supplying to buying services, with private firms designing, constructing, financing, operating and maintaining infrastructure, and the public sector paying for these services. Key features of infrastructure PPPs include: the private sector invests in infrastructure and provides related services to the government; the government retains responsibility for the delivery of core services, and arrangements between the government and the private sector are governed by long-term contract. It specifies the services the private sector has to deliver and to what standards. Payment depends on the private partner meeting these standards.

Effective PPP collaboration is born out of necessity. With no formal contracts in place to mandate or provide direction to how private entities should respond or coordinate with public entities, the crises alone promote expedience for both sides to come together to solve a problem and establish order out of chaos. The interest in PPPs is growing because of the demand for infrastructure, limited funds to meet current and future need and acceptance of the private sector in the provision of infrastructure. The underlying principle behind PPPs is that, although the public sector may be responsible for the delivery of a particular service, it does not have to be particularly responsible for actually providing the service or for undertaking the investment themselves. In this way, all actors of a private public partnership can concentrate on what they are likely to do best. Major public infrastructural projects have always been undertaken by the private sector under contract.

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5 Ibid
6 Ibid 4
1.2 Statement of the Research Problem

Most of the industrialised countries are already deeply enmeshed in globalisation and are taking steps both to maximise its benefits and to ease the adjustments it demands. But there are wide differences in the readiness of developing countries to face global economic integration: they are increasingly heterogeneous in their degree of development, productive capacity, human resource base and competitiveness. Some, particularly in Southeast Asia and Latin America, are moving into mainstream global trade and investment flows. Others have the potential to participate more actively in world trade but must persevere with their growing efforts to improve local conditions for entrepreneurship and expand domestic capacities to produce and export.\(^7\)

With the advent of globalisation, it is clear that without improvements in its infrastructure, a developing country will remain underdeveloped with the gains of globalisation passing them by, with the cost of achieving such improvements representing one of the largest items of budgetary expenditure. Investments in infrastructure are closely related to the functioning of ancillary public services so actions have to be co-ordinated if these are to lead to meaningful improvements. Thus investment in a new network of schools to which the pupils and teachers have no easy access because of transport infrastructure problems or which do not have electricity or drinking water supply systems is not going to achieve a meaningful improvement in the country’s educational system. Neither will a new health care system in a country with an unreliable drinking water supply have the anticipated impact in the reduction of infant mortality rates.

But infrastructures are expensive and, as a result, the governments of developing countries face a delicate dilemma: to allocate a high percentage of their scarce budgetary resources to that end,

hoping that in the more or less distant future this will help improve the provision of services to their citizens, or to give priority to other indispensable costs whose non-payment may provoke short-term social problems, such as civil servant salaries, unemployment benefits and the servicing of foreign or domestic debts.

Given the shortage of public funds in most developing countries, the obvious solution is to invite greater private sector participation, but this too is problematic since investing in infrastructure projects in many parts of the world is not financially viable from a private sector perspective. One solution is to expand the use of public-private partnerships (PPP) in utilities, in order to meet these demands by the citizenry, governments the world over are increasingly seeking to develop financing mechanisms which bring the two (public and private) sectors together.

This increased involvement of the private sector in providing services in areas that have traditionally been considered predominantly in the public domain for a long time presents new challenges for developing countries. This research will seek to find out how PPPs have managed to transform economies in other developing nations especially in developing countries. It will then look at the models of implementing PPPs developed in some of the developing countries with a comparative study of the PPP framework in India; and how best they can be implemented locally and whether or not the same have been properly utilised in Africa.

In the course of the research, it has come out that there is not enough research on how to achieve a good prevailing environment in developing countries. This had in turn led to under utilisation of PPPs in the development of infrastructure and/or achieving the Millennium, Development Goals (MDGs) as set out. The reasons why PPPs have not properly taken off in Kenya and other
developing nation’s boils down to; failures in governance and failures in public policy. In too many countries and internationally, the lack of a governing systems and institutions that are accountable, participatory, consensus oriented, transparent, equitable and follow the rule of law are also factors.

Economists and policy makers alike continue to debate whether the provision of public services such as infrastructure should be a public or private sector concern. Although economists in general advocate the superiority of private ownership, recent work by Hart, Shleifer and Vishny, Besley and Ghatak, and Hart emphasizes the virtues of state ownership or public-private partnerships under some incomplete contractual environments. Fiszbein, Ariel, and Lowden argue that empirical studies of public-private partnerships are relatively rare in large part because cooperative agreements between the government and the private sector are a recent phenomenon.

1.3 Objectives

Specific Objective

To review the role of PPPs in as strategy for development in developing countries

General Objectives

1. To identify best practices for PPP frameworks in Kenya.

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2. To propose appropriate structural, legal and policy reforms that should inform the implementation of PPP frameworks in Kenya.

1.4 Justification of Study

Public Private Partnerships have a lot to offer to the national economy in so far as they constitute a new model of public-private collaboration. With the implementation of PPPs, a new boost will be given to the development of the economy and prompt efficient delivery of necessary infrastructure will be guaranteed.

Currently, each PPP agreement has to be decided upon on an ad hoc basis. As such, two problems arise from this procedure\(^\text{12}\). Firstly, the whole process is time consuming, and secondly is no defined set of rules. Parliament decides when and why approval is to be granted. This study will help to provide a clear cut policy framework to govern the process of PPPs in Kenya. This research will be helpful to the government as the policy maker(s) with regard to PPPs; the Kenya Investment Authority; the private sector and the potential donors as a whole as it will seek to point out the best practices with regard to PPPs.

Locally developed literature on PPPs is lacking. A researcher desirous of conducting a study in this area is ultimately left to rely on foreign material which inevitably addresses the specific challenges of the jurisdictions where the author is working from. There is a need to come up with a study that documents and incorporates local trends in the use of PPPs in infrastructure development. This research will help fill out the gap or lacuna that currently exists when it comes to research of PPP implementation locally by reviewing the Public Private Partnership Regulations, 2009 that recently commenced in Kenya. It will seek to point out its strengths,
weaknesses and how best to make PPPs work for Kenya. This will be in comparison to other “success” stories in Africa and India as well.

1.5 Literature Review

There is no single definition of PPPs. PPPs are in general defined as a form of collaboration between the public sector (i.e. the government, local authorities, etc.) and the private sector (i.e. private companies etc.) aiming at providing various works and services required by the public through partnerships with one or more sectors of private economy.\(^\text{13}\)

Under a public-private partnership, a local authority or a central-government agency enters a long-term contractual arrangement with a private supplier for the delivery of some services. The supplier takes responsibility for building infrastructure, financing the investment and then managing and maintaining this facility. The supplier recovers his expenditure from operating the investment. PPP broadly refer to long term, contractual partnerships between public and private sector agencies, specially targeted towards financing, designing, implementing, and operating infrastructure facilities services that were traditionally provided by the public sector.\(^\text{14}\) In a PPP, each partner, usually through legally binding contract(s) or some other mechanism, agrees to share responsibilities related to implementation and/or operation and management of a project.

“The Public-Private Partnership Project means a project based on contract or concession agreement between a Government or statutory entity on the one side and a private sector company on the other side, for delivering an infrastructure service on payment of user charges.\(^\text{15}\)”

\(^{13}\) I.K. Rokas & Partners (Athens) Law Firm Dimitra Kourmatzis & Xara Giannopoulou, Associates; “Public Private Partnerships in Action” An international network of Law and Business Consulting Firms, spreading across the Central & South - East European region

\(^{14}\) See, Government of India, “The Scheme for Financial Support to Public Private Partnerships in Infrastructure”. 

\(^{15}\) Ibid
Elisabetta Iosalh and David Martimort characterize PPPs by three main features: tasks bundling, risk transfer and long-term contract. Bundling occurs where a PPP typically involves the bundling of the design, building, finance, and operation of the project, which are contracted out to a consortium of private firms. The consortium includes a construction company and a facility-management company and is responsible for all aspects of services. The DBFO model (‘Design’, ‘Build’ ‘Finance’ and ‘Operate’), the BOT model (‘Build’, ‘Operate’ and ‘Transfer’) or the BOO (‘Build’, ‘Own’ and ‘Operate’) all account for bundling of building and operation albeit with differences in degrees. Bundling goes hands in hands with higher power incentives: When bundling is optimal, more risk is also transferred to the contractor. This provides the rationale for both bundling and risk transfer to be key features of PPP arrangements. It also explains the greater risk premium that is typically observed in PPP contracts compared to traditional procurement.

Hart (2003) built on Hart, Shleifer and Vishny (1997) provided a model where the sole source of incentives is ownership. A builder can perform two kinds of investment (productive and improductive) which may both reduce operating costs, although only the productive investment raises also the benefit of providing the service. Under traditional procurement, the builder cannot internalize the impact of his effort neither on benefits nor on costs and, as a result, implements too little of the productive investment but the right amount of the unproductive one. A study of

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16 Brunel University and University of Rome Tar Vergata, CEDI and CMPO
17 Toulouse School of Economics (IDEI and GREMAQ) and EHESS
19 Ibid p. 5
the desirability of bundling project phases and giving projects ownership to the investor has been carried out by Bennett and Iossa (2006)\textsuperscript{22}. In their model innovations are non-contractible ex ante but verifiable ex post. Ownership of the asset gives control right to the owner to decide whether to implement quality enhancing or cost-reducing innovation proposed by the investor. It is shown that the hold-up problem is less severe under PPP, compared with traditional procurement, when there is a positive externality between the building and managing stages. With a negative externality the opposite can hold. Further public ownership acts as a commitment for the government to renegotiate and share with the investor the surplus from the implementation of the innovation. Private ownership is however optimal for generic facilities with high residual value.

Martimort and Pouyet (2008)\textsuperscript{23} built a model where both the quality of the infrastructure and operating costs are contractible. Agency costs are lower under a PPP when there is a positive externality between building and managing assets compared with traditional procurement. Granting ownership is an imperfect way of aligning incentives but, to a large extent, the important issue is not who owns the asset but instead whether tasks are bundled or not. That insight is developed in various extensions of their basic model allowing for risk-sharing as a motive for forming consortia, or political economy. Bentz, Grout and Halonen (2001)\textsuperscript{24} showed that the government will wish to buy services (as in PFI) rather than facilities (as in traditional procurement) if the building and service delivery costs are low.


Engel, Fischer and Galetovic (2006)\textsuperscript{25} study the rationale for private finance in PPPs.\textsuperscript{26} They showed that private finance cannot be a means to save on distortionary taxation. Any additional $1 invested by the contractor saves society distortionary taxes but the concessionaire must be compensated for the additional investment through a longer contract term and this costs society future distortionary taxes equal to the initial tax saving. Further, when demand risk is substantial, the optimal contract is characterized by a minimum revenue guarantee and a cap on the firm’s revenues.

The long-term nature of PPP contracts favors incentives for cost reducing effort but it has a cost in terms of reduced flexibility. The trade-off between incentives and flexibility was recently examined by Ellman (2006)\textsuperscript{27} though his focus was on investment by the government rather than by the firm. He showed that a longer contract length helps to protect the contractor from his investment being expropriated by the government but it reduces the incentives of the government to discover new service innovations since changes are costly to renegotiate.

Long-term contracting takes place under major uncertainty on the realizations of future costs and demand. In infrastructure projects and maybe due to competitive pressures in awarding projects, contractors are often overly optimistic in estimating future costs, as empirically shown by Flyvbjerg, Skamris Holm and Buhl, (2002)\textsuperscript{28} and Gannuza (2007).\textsuperscript{29} Based on a sample of 258 transportation infrastructure projects worth US$90 billion and representing different project

\textsuperscript{26} See also the informal discussion in De Bettignies, J.E. and T. Ross (2007), "Public Private Partnerships and the Privatization of Financing: An incomplete Contracts Approach," Mimeo UBC, Vanvouver.
types, geographical regions, and historical periods, the authors found with overwhelming statistical significance that the cost estimates used to decide whether such projects should be built are highly and systematically misleading. Following costs overruns, long-term contracting may be subject to significant renegotiation in those environments. Firms may obtain a tariff increase or an increase in the number of cost components passed through tariffs, a reduction in their payment to the public sector and delays and reduction in investments.

In non-agency settings different insights are obtained. In line with the career concerns literature, Lewis (1986)\textsuperscript{30} shows that reputational concerns lead firms to choose higher effort in earlier stages of their procurement contract in order to send favorable signals to the principal regarding their productivity and avoid that project be terminated too soon.

Dewatripont and Legros (2005)\textsuperscript{31} argue that ex ante competition between potential consortia may limit the extent of cost overruns and that introducing a third-party (typically outside shareholders or creditors) in a PPP contract may improve monitoring which limits cost overruns as well.

Projects within firms often run beyond deadlines and most resources are increased towards the final stages.\textsuperscript{32} Actual costs often significantly exceed cost estimates used to decide whether public projects should be built. PPPs are not immune to cost overruns, though no clear evidence exists as to whether cost overruns under PPPs are more or less likely than under traditional procurement.


Whilst risk allocation in PPPs generally forces the contractor to bear a significant part of the construction and operational risks, the actual risk allocation may differ from what was originally planned. Governments are providers of last resort and contractors are aware that public authorities cannot afford prolonged service disruption. The re-tendering of a PPP contact is a long and costly process. As stressed by The World Bank, “whether PPPs perform better than full provision by state-owned enterprises depends in particular on whether performance risk is effectively shifted from taxpayers to the private shareholders of the company that enters into a concession-type arrangement”\textsuperscript{33}.

Aubert and Laffont (2002)\textsuperscript{34} analyzed the mechanism through which a government can affect future contracting by distorting regulatory requirements to take into account possible political changes and subsequent contract renegotiation. Assuming that the current contract binds all future governments, imperfect commitment yields two main distortions. First, the initial government will delay the payment of the information rent to the second period, thereby free-riding on the cost of producing a higher quantity and leaving higher rents. Second, the degree of information revelation in the first period will be strategically determined to affect the beliefs of the new government.\textsuperscript{35}

A number of political motives have been proposed to explain the interests of the public sector party itself in reneging PPP contracts. The government may increase its chances to be re-elected by expanding spending or by promoting investment in public works that create jobs and boost


\textsuperscript{34} Aubert, C. and J.J. Laffont (2002), “Political Renegotiation of Regulatory Contracts,” Mimeo IDEI, Toulouse

\textsuperscript{35} Other kinds of political risks have been considered in the literature. For instance, Che, J. and Y. Qian (1998), “Insecure Property Rights and Government Ownership of Firms,” Quarterly Journal of Economics, 113: 467-496, use the property rights approach to show that relinquishing firms’ ownership to local governments may help in a context with insecure property rights where a national government may expropriate owners.
economic activity. By reneging, the government may also circumvent the opposition’s scrutiny and reap the political benefits resulting from higher present spending, e.g. a higher probability of being re-elected.

Institutional quality plays a critical role in the provision of public services by the private sector. Hammami, Ruhashyankiko and Yehoue (2006) indeed found that private participation (in the form of PPP, privatization or traditional procurement) is more prevalent in countries with less corruption and with an effective rule of law. For PPP contracts the benefit of whole-life management cannot be realized in the absence of strong governance and minimal risk of unilateral changes of contract terms by the government.

Governments’ failure to honor the terms of concession contracts is a pervasive phenomenon. In Latin America and Caribbean Countries, it is common for a new administration to decide not to honor tariffs increase stated in the concession contract granted by previous administrations.

The impact of regulatory risk in PPPs is significant as it discourages potential investors and raises the cost of capital and the risk-premium (higher tariffs, or smaller transfer price) paid for a PPP contracts. Guasch and Spiller (1999) estimate that the cost of regulatory risk ranges from 2 to 6 percentage points to be added to the cost of capital depending on country and sector. An increase of 5 percentage points in the cost of capital to account for the regulatory risk leads to a reduction of

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39 Ibid
40 Ibid at 41
the offered transfer fee or sale price of about 35% or equivalently it requires a compensatory increase in tariffs of about 20%. Regulatory risk also discourages investors.

Guash, Laffont and Straub (2008)\textsuperscript{42} showed that the probability of firm-led renegotiation is positively related to the characteristics of the concession contract among other things. Firm-led renegotiations on average tend to favour contractors. The role of an experienced and independent regulator (or in general the quality of bureaucracy) is especially important in contexts characterized by weak governance and high likelihood of political expropriation.\textsuperscript{43}

Bloom and Standing (2001)\textsuperscript{44} point out that many countries now have pluralistic systems, in which the boundaries between public and private have become blurred. They cite a number of examples from countries in transition to market economies and countries that have experienced chronic economic and institutional crisis. Several possible explanations have been advanced for the emergence of pluralistic systems. Some emphasise the influence of international ideologies and the policies of donor agencies. Deacon (1999)\textsuperscript{45} suggests that there is a worldwide debate between advocates of ‘European universalistic social expenditure’ and ‘USA residualism’.

Another trend of thought seeks explanations for the emergence of pluralistic systems in local political and institutional realities\textsuperscript{46}. It points to the gap between the language of politics and

\textsuperscript{43} Ibid


policy and the situation on the ground, and challenges the view that low and middle-income countries will necessarily replicate the institutional arrangements of the advanced market economies in the foreseeable future.

The chronic crisis in Africa has led to a much greater emphasis on understanding how institutional arrangements influence development. In testimony to the British Parliamentary Select Committee on Development, the former Secretary for International Development drew attention to the complex nature of the crisis in Southern Africa, where countries with high levels of poverty and high burdens of ill-health have to cope with periodic shocks from crop failures in a context of weak systems of public administration and inadequate mechanisms for public accountability. She warned against over-reliance on short-term measures that do not take into account the underlying institutional and political issues.

Duffield (2001) draws attention to a large gap between much development discourse and development reality. He argues that many donor policies and procedures are premised on the assumption that African countries will eventually be similar to the advanced market economies. He suggests that most support programmes are designed on the basis of this assumption. This has diverted attention from new realities, such as the increasing proportion of economic activity outside the formal economy.

Duffield suggests that local government officials and political actors have become increasingly involved in informal economic activities in many countries. This has led to the evolution of

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institutions outside formal government regulatory frameworks and apart from agreements between governments and donors. He concludes that donors and international agencies should take this economic, political and institutional reality into account. This will involve engagement with a variety of actors outside the regulated formal sector.

The experience of the transitional economies has contributed to our understanding of how trusted and trustworthy institutions become established. Some countries have tried a blueprint approach, involving the enactment of laws in the expectation that institutions and social actors would follow the new rules.

The Chinese experience as a developing country, has led to an understanding of transition as the gradual creation of new institutional arrangements and the behavioral norms that make them work\(^5\). The Chinese leaders describe transition management as ‘crossing a river while feeling for the stones’. This refers to the tentative nature of the process and the inability to predict the endpoint. The central government and Communist Party have kept tight control over national security and political power. But, they have given local administrations, enterprises and individuals a lot of scope to develop innovative institutional arrangements for economic relationships. The government has altered the legal framework from time to time to formalise changes that had already been shown to work locally.\(^6\) This has helped prevent the emergence of unbridgeable gaps between individual livelihood strategies and the law. However, it has delayed


The creation of rules-based decision-making systems. A lot of economic activity takes place in a hazy region not covered by the law.\(^52\)

The African and Chinese experiences suggest that we need to shift our focus from the arrangements in advanced market economies to the situation in low and middle-income countries and to the ways that improvements may be achieved. They draw attention to the influence of appropriate institutional arrangements underpinned by shared expectations and behavioral norms on the performance of health systems. They also point to the need for an understanding of how institutional arrangements are constructed. They raise questions about the realism of the attempt to import institutional arrangements for welfare provision from advanced market economies.

The existence of PPPs leads to private sector investments in strategic operations without sale of assets. With private sector managing maintenance and support services, the Government professionals can concentrate on frontline service delivery.

In Kenya, the pressure to reduce expenditure and cut down taxes has forced the government to resort to the private sector. In the last few years even where adequate competition has not been prevalent and service provision has largely remained monopolistic, e.g. in the telecommunications sector evidence suggests that where private sector bears the risk, it delivers better results than any credible public sector alternative. To make services work for the poor people, Kenya must review its service delivery mechanisms and the institutions that provide the service. New management practices and technologies are changing the way programmes and services are delivered. Rapid development in information and communications technology has

created many opportunities related to service delivery, giving rise to globalisation and intensified international competition.

Kenya has continued to find it more and more difficult to finance infrastructure development and capital expenditure as a whole. To that end in 2008, a committee was set up to look into the prospects of using Private Public Partnerships to achieve this. The Steering Committee was appointed under the Procurement Act and came up with the Public Private Procurement Regulations that were gazetted in February 2009 by the Minister for Finance.

In the process of conducting this study, it has emerged that the body of information with regard to PPPs in Kenya is not well developed. This is mainly because the Regulations under the Procurement Act with regard to PPPs are yet to find its footing. Each contract has to go to the cabinet for approval before it is enforced by the Ministry of Finance. This bureaucracy is a problem for investors.

1.6 Theoretical Framework

Several analysts have drawn attention to the lack of a theoretical framework for understanding the public and private sectors in the reality of many low and middle-income countries. This reality includes fragile and inefficient government bureaucracies, and weak legal and regulatory systems. It may also involve rapid economic and institutional changes associated with structural adjustment, a transition from a command economy or reconstruction after a conflict.

Moore (1999a)\textsuperscript{51} has pointed out that, theories about the relationship between the private sector and the state are often posed in terms of market and state failure. These theories cannot predict the outcome of a particular intervention when there are major failures of both. Toye (1999)

\textsuperscript{51} Moore, M. (1999a) 'States, social policies and globalizations: Arguing on the right terrain?' paper prepared for conference on Revisioning Social Policy for the 21st Century, Brighton
makes similar points in calling for analyses of the actual situation and the identification of realistic strategies for change that take into account weaknesses of institutions and political constraints to change.

A similar conclusion was reached by McCourt (2001) when he rejects blueprint approaches to public management reform and advocating a strategy that takes into account the contextual contingencies that influence the impact of a particular intervention. Rose (2003) points out the need for caution in transferring approaches between countries with different social arrangements. He suggests that some low and middle-income countries resemble the segmented societies of late nineteenth-century Europe more than they resemble the highly organised Europe of today, and they can learn from the historical experience of the construction of the social sector in these countries.

There is a need to explain why public-private partnerships have been developed for infrastructure development at the first place. The literature on private involvement and public intervention in provision of services provides a theoretical foundation for public-private partnerships in economic development. The core of a substantial amount of economic literature is on whether and when private involvement or public intervention is better for the provision of services and infrastructure.57

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According to the Theory of State Failure, competitive markets are essential for efficient resource allocation and service production and for the responsiveness of urban services to consumers. Thus, it is argued that a non-competitive environment, i.e. public intervention, leads to both inefficiency of resource allocation and production and less responsiveness of urban services to consumers. Also, a lack of competition results in a failure to adopt new technology in a timely way. Therefore, privatization or at least private involvement in the production of services and infrastructure is inevitable in order to enhance their quality and efficiency.

The theory of state failure arose as a response to the Theory of Market failure. The theory of market failure was based on the preposition that the market is unable to satisfy certain types of demand, including the demand for law and order, universal education or fundamental research.

According to Musgrave, whenever public goods are accessible to all, as are public highways or clean air, it is difficult for a public demand able to pay for it to be constituted-for who is going to pay if the desired good is available free of-charge?

The theory of state failure originates from Recktenwald and is confined to the fact of uneconomic performances in the state sector. He is concerned with the profligate use made of the revenue by public servants. The reason for the inefficiency set forth in a critique of bureaucracy from a market economy viewpoint. Reference is made to the problem of the separation between users of public goods and services and those who pay for them, to the absence of efficiency monitoring and of material incentives, to efficiency in the administrative machinery, to the cost

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consequences of the autonomous trade union organisation of public servants, to the structural
constraints on increased productivity, to the opaqueness of the budget mechanism and so on.

There are three main arguments for public intervention. The first is referred to as the “Public Goods Argument”: It states that public intervention is inevitable because of non-excludability of the public goods such as police services, street lighting, or street sweeping. The second is the “Market Failure Argument”: the market fails to work well because of the embedded nature of some urban services including a tendency to monopoly, substantial initial investment and huge uncertainty of return, positive and negative externalities, and information asymmetry. The third is the “Equity or Merit Good Argument”: where it is argued that the government has to assure all the people access to certain basic goods and services like education and health regardless of their ability and willingness to pay for such services at market prices.

These theoretical arguments provide fundamental reasons for both private involvement and public interventions in provision of services and infrastructure, and thus provide justification for public-private partnerships because provision of infrastructure and services does not exclusively belong to either the public or the private sectors. However, these arguments do not provide guidance on the extent of or the way that public intervention should be involved and the way that the two sectors interact to achieve optimal solutions. The extent of public presence in public-private partnerships varies across countries due to the differences in the strength of the state. For example, public-private partnerships are usually dominated by the public sector in a country with a strong state.

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1.7 Hypothesis

1. A well structured policy framework for Public Private Partnerships (PPPs) will lead to better implementation of PPP projects in Kenya for development.

2. Adoption of best practices in PPPs will attract more development partners and /or donor funding to developing nations

3. Public Private Partnerships are paramount for infrastructure development in developing countries.

1.8 Methods of Data Collection and Analysis

The primary means used to collect data will be:

*Structured Interviews:* Structured interviews are guided conversations between a researcher and the respondent. To structure this conversation, an interview guide will be used. According to Patton61 an interview guide is a list of questions or issues that are to be explored in the course of an interview. After selecting organizations, the researcher will target leaders and players in PPP to be interviewed. The interview guide has the advantage of ensuring respondents describe their experiences in PPPs in Kenya. The interview guide also provides room for respondents to cite specific activities that relate to the topic under investigation. Furthermore, the use of an interview guide makes the interviewing process systematic. Issues to be covered in structured interviews include the experiences of business leaders in implementing their activities, their relationship with the state as well as outcomes of their activities. Semi structured interviews will be conducted with senior managers from the private sector, PPP stakeholders and government agencies involved in PPP. This will enable the researcher understand the extent and impact of

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PPP in its implementation within the Kenyan State from the point of those actively involved in
the exercise.

*Focus group discussions (FGDs):* FGDs elicit a range of experiences and opinions among
members of the business community, apart from clarifying issues raised through the use of other
research methods. About 3 focus group discussions will be conducted with 6-8 actors in each
group.

*Key Informant or In-depth Interviews:* A major component of the research will be key informant
interviews with investment groups and leaders. In-depth interview take the form of a
conversation where the researcher uses predetermined questions on an interview guide. In-depth
interviews are open-ended and they provide greater breadth for amassing descriptions of
situations because of its qualitative nature. Patton (1990) is an avid supporter of in-depth
interviews. The following quote does well in trying to explain the importance of interviews:

> “Go forth now. Go forth and question. Ask and listen. The world is just beginning to open
> up to you. Each person you question can take you into a new part of the world. For the
> person who is willing to ask and listen the world will always be new. The skilled
> questioner and attentive listener knows how to enter into another’s experience,” Quote
> from Halcolm’s Epistemological Parables in Patton (1990)

*Document Review/ Secondary Data Analysis:* Bryman (1998) asserts that the collection and
examination of documents forms the integral element in qualitative research. Secondary
documents are important for triangulation as they enable researchers to cross-check primary data,
thereby enhancing content validity. These documents include government memorandum on PPP,

newspapers and electronic media articles on the PPP, opinion pieces, and commentaries on the current situation in Kenya in regard to PPP.

The research will look at the history of infrastructure PPPs in Africa with a focus on the steps Kenya is taking as a country to use PPPs for sustainable development. It will also give an up-to-date account by mapping projects that are either completed to date or in the pipeline. The research also describes preliminary findings on additional costs likely to be incurred in bidding for infrastructure PPPs. It is the objective of this research to come up with a detailed outlay of the place of PPP in Kenya, appreciate the implementation of the same and the challenges met in the implementation of PPPs. Adoption of suitable data collection modes is therefore crucial to the realization of these objectives.

Secondary data will be heavily relied on when conducting case studies to collect information and data on PPPs already undertaken in Africa and India, with special attention on how India as a developing country has utilised PPP to spur growth and development.

Other literature on the current practice of PPP internationally will equally be extensively reviewed vide secondary data which will include but not limited to the following to books, journals, magazines, newsletters, proceedings from conferences, workshops, seminars and other sources.

1.9 Scope and Limitation of Study

PPPs are being used for building, operating and financing infrastructure in transport, water, energy, health, education, waste management and so on. Notwithstanding the policy relevance, little theoretical and empirical work has been carried on the topic. The analysis has pointed to the efficiency gain that PPP arrangements can bring over traditional forms of procurement, but it has also emphasized how PPPs may be unsuitable in a variety of circumstances. The bundling
of project phases that characterizes PPPs provides incentives to the private contractor to take into account the long-term project costs, from building to maintenance and operation.

When the externality across project stages is positive, this improves incentives and, through appropriate risk transfer, yields better quality and less expensive projects. This holds under a large class of schemes where complete contracts contingent on operating costs can be signed with both the builder and the operator. But, with a negative externality across project stages, bundling may increase agency costs, making traditional forms of procurement preferable.

PPP contracts also lack the flexibility to adjust to new circumstances, user needs, or technologies, which points to the unsuitability of PPPs in very uncertain environments. The analysis suggests that PPPs are more beneficial when a better quality of the infrastructure can significantly reduce cost at the operational stage (including maintenance cost), when infrastructure quality has a great impact on the quality of the service, and when demand for the service is stable and easy to forecast. This point to the suitability of PPPs in the transport and water sectors, where infrastructure quality is key and demand is relatively stable, whilst it suggests that PPPs are less likely to deliver efficiency gains for nursing homes and schools, where service quality is mainly determined by human capital investment, or for IT services, where demand evolves quickly over time.

In a PPP contract, although this is not specific to PPPs, satisfaction of consumer's needs and better service quality can be incentivized through the allocation of demand risk and the choice of contract length. In particular, the contractor should bear more demand risk in sectors such as transport, where users pay for the service and demand levels are affected by the contractor's effort.
1.10 Chapter Outline

Chapter One: Proposal

This will contain the proposal

Chapter Two: Public Private Partnerships: An Overview

This chapter will be an overview of PPPs, the definitions, advantages, and disadvantages, the parties involved; why governments choose to go the PPP way and the role of development partners and/or donors. This chapter will also look at developing counties with a bias towards India and how they have used PPPs to improve their rankings as developing nation that are on the verge of being declared as developed nations.

Chapter Three: Study of PPP in Africa and other Developing Countries

This chapter will explore the role PPPs have played in Africa and other developing nations to aid in development. This will include Latin America, Brazil, China, Ghana and South Africa.

Chapter Four: The Case Study of Kenya and India

Kenya’s PPPs framework is still developing; this will be an analysis of where we are and where we need to be going, in comparison to India.

Chapter Five: Summary, Conclusion and Recommendations

This chapter will contain concluding remarks and recommendations on the best way forward with regard to PPPs in Africa and Kenya as well.
CHAPTER TWO

PUBLIC PRIVATE PARTNERSHIPS: AN OVERVIEW

2.0 INTRODUCTION

The terminology used to describe the involvement of the private sector in public services has become complicated over the last 20 years. Ideology has been a crucial factor in these linguistic developments. In the early 1980s the Thatcher government in the UK embarked on a political strategy to restructure the private sector, in which privatisation was seen as a positive radical development. The term ‘privatisation’ was used to cover all forms of private involvement, from the sale of national industries to the simple sub-contracting or outsourcing of functions such as refuse collection or office cleaning. As privatisation became politically controversial, even in the UK, new terms were introduced. ‘Public-private partnership’, abbreviated as PPP, was created to present the same forms of involvement of the private sector as more a collaborative, technical exercise rather than an aggressive transformation of relations. A similar term, ‘private sector participation’ (PSP) has also been widely used, especially by the World Bank and others in the context of developing countries. In both cases, the term is not a legal or technically exact phrase, but rather a replacement for the old general Thatcherite use of the word ‘privatisation’.

The vast majority of PPPs, for example, are not partnerships in any legal sense, but simply contractual relationships.

64 "Terminology of Public-Private Partnerships (PPPs)", By David Hall, Robin de la Motte and Steve Davies; March 2003 www.psiru.org website last accessed on 13th April 2010
65 Ibid
66 Ibid
2.1 DEFINITIONS

A public private partnership can thus be described as a co-operation between the public and the private sector, in which the government and the private sector carry out a project together on the basis of an agreed division of tasks and risks, each party retaining its own identity and responsibilities.\textsuperscript{67} PPPs are in general defined to be a form of collaboration between the public sector (i.e. the government, local authorities, etc.) and the private sector (i.e. private companies etc.) aiming at providing various works and services required by the public through partnerships with one or more sectors of private economy.\textsuperscript{68} As per the Scheme for Financial Support to Public Private Partnerships in Infrastructure, of the Government of India, "The Public-Private Partnership (PPP) Project means a project based on contract or concession agreement between a Government or statutory entity on the one side and a private sector company on the other side, for delivering an infrastructure service on payment of user charges."

The World Bank defines PPPs to mean a range of relationship between the public and private sector for the delivery of infrastructure services; generally the public sector enters in to an agreement with a private company to provide a specified public service, exchange for payments based on the service actually delivered.\textsuperscript{69}

\textsuperscript{67} G. W.E.B van Herpen; "Public Private Partnerships, the Advantages and Disadvantages Examined". Dutch Ministry of Transport, Public Works and Water Management Directorate-General of Public Works and Water Management AVV Transport Research Centre at p. 1.
\textsuperscript{68} IKRP (Athens) "Public Private Partnerships in Action", I.K. Rokas & Partners Law Firm Dimitra Kourmatzis & Xara Giannopoulou, Associates
Art Smith, Chairman, U.S. National Council for PPPs says PPP is a method of service delivery that involves the private sector in the provision of traditionally “public” services. He goes further to say that PPPs emphasize the service or capability that the public sector requires rather than the assets used to provide them. A type of performance-based contracting in which the private sector accepts a level of performance risk. PPP arrangements are typically long-term in nature.

2.2 PUBLIC PRIVATE PARTNERSHIP FOR INFRASTRUCTURE

Infrastructure provides services in energy, water, telecommunications, and transport that are fundamental to the activities of all households and businesses. Moreover, infrastructure is a major factor in economic growth, poverty alleviation and environmental sustainability in any country. Infrastructure can be characterised as a large, indivisible and non-rival capital good that produces services for its users. The non-excludability and the large cost of infrastructure causes it to be a public good. However, infrastructure also possesses some characteristics of a private commodity because it facilitates the use of a complementary private commodity, like the use of a car. A couple of decades ago the term infrastructure only referred to the material components of transport and public utility networks like gas, water and electricity. By now, the term has widened to embrace all aspects of public service managed by both the public and private sector.

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71 Ibid
72 Ibid
73 Before this change of pint of view, the realisation of infrastructure was a typical task of the government. In most countries, the government was the initiator, the principal, the financier, the manager, and the exploiter of roads, water systems and other infrastructure. The only reason the private sector was involved in the realization of infrastructure was because of their roles as contractor of the design and construction. The implicit justification of this practice was that infrastructure was so important would, benefit so many people and require so much capital that the private sector could not be entrusted with responsibility- and in any event lacks the resources.
Infrastructure services exist in two service levels. 74

1) The first-level services represent the private use that the commodity is made of the second level. These services belong to the private domain, thus are marketable. They cannot be used without the complementary services on the second level. An example is physical infrastructure.

2) The second-level services are non-marketable services and originally belong to the public domain and include but are not limited to performance measurement and political decision-making process.

The forms public-private partnerships (PPP) in developing countries have taken are legion, ranging from the construction of physical infrastructure, to public administration, to the provision of health and social services. The focus of this research, however, is on physical infrastructure. PPPs have provided a principal vehicle for foreign direct investment (FDI) into public utilities and infrastructure in developing countries. Given the shortage of public funds in most developing countries, the obvious solution is to invite greater private sector participation, but this too is problematic since investing in infrastructure projects in many parts of the world is not financially viable from a private sector perspective. One solution is to expand the use of public-private partnerships (PPP) in infrastructure development.

Over the past two decades governments in developing countries (and several developed countries as well) have embarked on radical structural reforms, encompassing restructuring and privatisation of infrastructure sectors and a new approach to regulation. One prong of this new strategy involves public private partnerships to provide infrastructure. PPPs were responsible for

74 Ibid 1 at p. 2.
USD 786 billion in infrastructure investments between 1990 and 2003.\textsuperscript{75} Some of this money obviously came from the public purse, but the private sector nevertheless contributed significantly to infrastructure development over the period – far in excess of what governments could have financed on their own – and assumed several of the risks (e.g. commercial and currency risk) that would otherwise have befallen the public sector.

If even before the crisis it was necessary to make an effort to avoid PPP application being limited to developed countries at the expense of developing ones, evidence of the difficulties of its application in the context of the financial crisis requires an analysis of ways to make this system attractive under the present challenging circumstances in a sustainable manner going forward.

Possibly one of the ways to deal with this problem given the uncertainty of world growth is precisely to ensure the allocation of resources to such investment projects which, regardless of their location in the world, offer high value-for-money.

The benefit of Public-Private Partnerships is that they represent a special tool for development, not only because they can raise private capital for planned investments, but also due to their capacity to ensure technology transfer and the adequate maintenance of completed facilities in the medium to long run. In fact, current experience shows that acquiring financing for the construction of a certain infrastructure is just the first step in guaranteeing its correct use and longevity. It is easy to come up with numerous examples of transport, energy generation, water treatment and other type of infrastructures which were financed and built but a few years later turned out to be unusable or hardly usable due to low quality maintenance, lack of spare parts or even because the initial concept had not taken into account a project’s life cycle in a given

physical and economic setting. This deficit finds a clear solution in long-term Public-Private Partnership projects. Developers and financiers are mainly interested in projects’ adequate long-term operation, which is the only way to recoup the investments made. Thus it guarantees technology transfer and the creation of project managers and maintenance technicians, which benefits the country.

However, evidence suggests that it is necessary to redesign policies so as to intensify the application of this powerful tool for development. If the difficulties of its application were considerable even before the onset of financial crisis, now they are enormous. As it says in Chapter 5.3.1 of the EIC White Book76,

“Private sector participation holds enormous potential for improving the efficacy of infrastructure services and alleviating the pressure on public budgets, which for a long time were the only source of infrastructure financing. Despite its great potential for developing countries, private sector participation in infrastructure projects is slowing down and activity focuses on relatively few countries. This is largely due to the weakness of domestic capital markets and lack of government creditworthiness. Besides, there’re few financial instruments available in the market designed to participate in infrastructure projects in developing countries. That’s why the intervention of multilateral entities is especially important…”

And further below it is recommended:

“The availability of an adequate risk mitigation system is one of the key elements essential to the success of a project. Highly precise and specialised guarantee mechanisms would help create a climate of confidence and security for borrowers”.

76 European International Contractors (EIC); “White Book on Build Own Transfer/Public Private Partner” published in 2003; www.eicontractors.de
2.3 TYPES OF PUBLIC PRIVATE PARTNERSHIPS

PPPs can take many forms, from simple commercialisation to full privatisation. These new forms of agreements are aimed at optimising the input of knowledge from both sectors. Most of these agreements are not based on equality, but on a principle-agent relationship. The principal is the public infrastructure agency and the agent is that infrastructure operator. PPPs can be classified into various kinds and/or types.

2.3.1 Build-Own-Operate (BOO)

Under a BOO transaction, the contractor constructs and operates a facility without transferring ownership to the public sector. Legal title to the facility remains in the private sector, and there is no obligation for the public sector to purchase the facility or take title. A BOO transaction may qualify for tax-exempt status as a service contract if all Internal Revenue Code requirements are satisfied.

2.3.2 Build/Operate/Transfer (BOT) or Build/Transfer/Operate (BTO)

Under the BOT option, the private partner builds a facility to the specifications agreed to by the public agency, operates the facility for a specified time period under a contract or franchise agreement with the agency, and then transfers the facility to the agency at the end of the specified period of time. In most cases, the private partner will also provide some, or all, of the financing for the facility, so the length of the contract or franchise must be sufficient to enable the private partner to realize a reasonable return on its investment through user charges. At the end of the franchise period, the public partner can assume operating responsibility for the

Footnote: EIC Position Paper on “Facilitated PPPs in Developing Economies”; eicontractors@compuserve.com
facility, contract the operations to the original franchise holder, or award a new contract or franchise to a new private partner. The BTO model is similar to the BOT model except that the transfer to the public owner takes place at the time that construction is completed, rather than at the end of the franchise period.

2.3.3 Buy-Build Operate (BBO)

A BBO transaction is a form of asset sale that includes a rehabilitation or expansion of an existing facility. The government sells the asset to the private sector entity, which then makes the improvements necessary to operate the facility in a profitable manner.

2.3.4 Design-Build-Operate (DBO)

In a DBO project, a single contract is awarded for the design, construction, and operation of a capital improvement. Title to the facility remains with the public sector unless the project is a design/build/operate/transfer or design/build/own/operate project. The DBO method of contracting is contrary to the separated and sequential approach ordinarily used in the United States by both the public and private sectors. This method involves one contract for design with an architect or engineer, followed by a different contract with a builder for project construction, followed by the owner’s taking over the project and operating it. A simple design-build approach creates a single point of responsibility for design and construction and can speed project completion by facilitating the overlap of the design and construction phases of the project. On a public project, the operations phase is normally handled by the public sector or awarded to the private sector under a separate operations and maintenance agreement. Combining all three phases into a DBO approach maintains the continuity of private sector involvement and can
facilitate private-sector financing of public projects supported by user fees generated during the operations phase.

2.3.5 Lease/Develop/Operate (LDO) or Build/Develop/Operate (BDO)

Under these partnership arrangements, the private party leases or buys an existing facility from a public agency; invests its own capital to renovate, modernize, and/or expand the facility; and then operates it under a contract with the public agency. A number of different types of municipal transit facilities have been leased and developed under LDO and BDO arrangements.

2.3.6 Lease/Purchase

A lease/purchase is an instalment-purchase contract. Under this model, the private sector finances and builds a new facility, which it then leases to a public agency. The public agency makes scheduled lease payments to the private party. The public agency accrues equity in the facility with each payment. At the end of the lease-term, the public agency owns the facility or purchases it at the cost of any remaining unpaid balance in the lease.

Under this arrangement, the facility may be operated by either the public agency or the private developer during the term of the lease. Lease/purchase arrangements have been used by the General Services Administration for building federal office buildings and by a number of states to build prisons and other correctional facilities.

2.3.7 Turnkey

Under a turnkey arrangement, a public agency contracts with a private investor/vendor to design and build a complete facility in accordance with specified performance standards and criteria
agreed to between the agency and the vendor. The private developer commits to build the facility for a fixed price and absorbs the construction risk of meeting that price commitment.

Generally, in a turnkey transaction, the private partners use fast-track construction techniques (such as design-build) and are not bound by traditional public sector procurement regulations. This combination often enables the private partner to complete the facility in significantly less time and for less cost than could be accomplished under traditional construction techniques.

In a turnkey transaction, financing and ownership of the facility can rest with either the public or private partner. For example, the public agency might provide the financing, with the attendant costs and risks. Alternatively, the private party might provide the financing capital, generally in exchange for a long-term contract to operate the facility.

2.4 ADVANTAGES AND DISADVANTAGES

2.4.1 Advantages of Public Private Partnerships

2.4.1.1 Value for money

The most important advantage of PPPs is the creation of value for money. This means delivering a project with the same quality as under conventional procurement for less money, or delivering a project with superior quality for the same amount of money. There are six primary value for money drivers:

- **Risk transfer**: - risk will be transferred to the party which is best able to manage this risk and at the least cost. Risk transfer ensures that the parties involved will use conservative

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78 This discussion is based on the following paper by G. W.E.B van Herpen; “Public Private Partnerships, the Advantages and Disadvantages Examined”. Dutch Ministry of Transport, Public Works and Water Management Directorate-General of Public Works and Water Management AVV Transport Research Centre, pp.3-10
assumption in developing their expectations of benefits and costs. PPPs carry out a detailed project risk analysis promoting a shared understanding of the project by all parties involved in order to communicate the complexity and detail of a scheme.

✓ Output based specification: - specifying the project result as output allows innovation to take place. Outputs are the products of a service. In conventional procurement, an input specification is used, therefore describing the asset used to provide a service. The public sector finds it difficult to articulate precisely which outputs they want. They can have whatever they want, but a price. The private sector’s skill in bidding is to offer alternatives that reduce the price, but still deliver reasonable outputs.⁷⁹

✓ Long-term nature of contracts: - investments in the capital assets used to be based upon buying the cheapest. After a long period of time, the maintenance of the assets began to cost a lot and in extreme cases had to be replaced. The long term nature of contracts allows the service provider more time to recover the cost of the investment, enabling the supplier to reduce the annual charges. It also gives the supplier greater depth of experience in running the business which could be a source of efficiency gain. It also makes it easier to transfer technology risk to the supplier by enabling the supplier to make better judgement about when the renewal of assets and capital expenditure is incurred.

✓ Performance measurement and incentives: - linking performance to payment provides the vital incentive to deliver the required standards as defined in the output specification. Performance measures reflect risk transferred to the private sector, incentivised through

⁷⁹ Ibid at p. 4
the payment mechanism. It is important for the government to retain some in house provisions, as that the knowledge base to engage in proper monitoring of the contracts. The payment mechanism in PPPs is usually a payment deduction if the private party fails to perform. This leads contractors to give a higher price than they otherwise would, so that they can afford to get it wrong on occasions. A target cost arrangement would be better, where all costs are agreed on an open-book basis and the contractor and client share the pain or gain when the target cost is beaten or exceeded.

✓ **Private sector skills:** - private sector management skills allows the project to be delivered ahead or on time. By using PPPs for infrastructure investments the government will have access to new skills. The public sector can get both significant research and development and the testing of different approaches at private sector risk. Lower or stable rates over the long-term, equal or improved services levels, better understanding of the utility, lower taxes and improved services are benefits that can be directly transferred to the customer form the from the effective PPP.

✓ **Competition:** - generally the benefits of introduction of competition to an area which is normally dominated by public sector monopolies are: lower prices, greater innovation, increased investment and better services. Governments have a wide range of opinions for creating competitive procurement: services contracting, management contracting, leasing and concessions. The construction and maintenance of public assets have always been dome by the private sector; the difference the PPP has brought is that it integrates all activities, including project management, so that there is a single competition rather than several.
2.4.1.2 Cost effectiveness

PPPs can lead to cost effectiveness, which are the result of increased competition, an improved proportion of risk transfer, a closer integration of the different aspects better whole life costing and improved innovation. Significant cost savings can be obtained in the long run by integrating capital investment and the delivery of service (i.e. servicing the assets), because maintenance will be considered when the asset is designed to maximise efficiency. Another reason for the creation of cost efficiencies is the departure from standards (thus innovation).

2.4.1.3 Time-to-delivery savings

PPPs can also lead to time-delivery savings, caused by a greater private incentive revenue as soon as possible and the increasing experience with PPPs. Another reason for these time-delivery savings is the existence of learning curve for all parties involved. The private sector is driven by profit motives and is accountable to shareholders to ensure that the profit is not diminished by higher interest charges and revenue losses from delays in project completion. In the public sector, project completion delays might not have the same perceived direct financial impacts. PPP projects can be delivered quicker than under conventional procurement because of project management, better management of project risks and because the service provider is not paid until the facility becomes operational.

2.4.1.4 Reduction on the public

PPPs help reduce the capital demands on the public treasury for infrastructure development. PPPs will give the government more freedom to spend on other non-infrastructural investments in the short time. However, one has to realise that PPPs are actually posting bills to the future. After several years, the civil work will transferred from the private sector ownership to the public
sector ownership. The government will have to pay for this transfer. Even if this transfer is free, the government will have additional costs, compared to the concession period before the transfer. For example the maintenance costs. There are also aspects of shadow tolls to consider. PPPs are a clever mechanism that enables public sector schemes to be funded without having to raise taxation levels.

2.4.1.5 Improved responses to market forces

In cases of user-fees, an improved response to market forces will be created, resulting in greater efficiency. Traditionally, transportation facilities are publicly-funded. While users do pay for the facilities they use, price signals are not available to guide demand or supply. These improvements incentives to market forces are the improved profit margins, the long term business, the whole life costing, the payment for performance and the merging of design, build, finance and operation.

2.4.1.6 Improved cost calculations

This is because of the public private comparator or the public sector comparator resulting in improved cost calculations. The sunk cost will become visible. These sunk cost is consisted of the cost of civil servants, maintenance cost during the economical life-cycle of the project and overhead-cost, which the government is not used to take into account when calculating cost estimates. What also becomes more transparent are the real costs of assets, including some internal management costs, the costs, the costs of self-insurance, future maintenance costs and technical obsolescence.

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Footnote:
811 The sunk cost is the cost that the government is not used to take into account when making cost estimates.
2.4.2 Disadvantages of Public Private Partnerships

G. W. E. B. van Herpen discusses the advantages of PPPs. The advantages of PPPs can be defined as follows:

2.4.2.1 Poor value for money

The most important advantage of PPPs is the creation of value for money. However, value for money also consists of some disadvantages:

✓ Higher transaction costs: Williamson defines transaction costs as: “the ex ante costs of drafting, negotiating and safeguarding an agreement, and more especially, the ex post costs of mal-adaption and adjustment that arises when contracting execution is misaligned as a result of gaps, errors, omissions and unanticipated disturbance.”

Higher capital cost: - PPPs will also result in higher capital costs because of private borrowing.

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61 G. W.E.B van Herpen; “Public Private Partnerships, the Advantages and Disadvantages Examined”. Dutch Ministry of Transport, Public Works and Water Management Directorate-General of Public Works and Water Management AVV Transport Research Centre, pp.3-10

Advantages which can turn into disadvantages: these can be summarised as follows. Transferring risks from one party to the other will have its price; over specification and mis-specification of the project result can cause output-specification to be deficient; short term efficiency gains may be at the expense of a dynamic efficiency in the longer term; and having an extreme monitoring process can cause one to miss the fact that the overall service has improved.

2.4.2.2 Insecurity

Whether two or more parties enter into a contract, there is a risk that the administrative efforts on each side will be frustrated by lack of co-operation on the part of the other party(s). Also, when a party enters into the tender procedure, the party may not even be granted the concession. Because of these insecurities, the number of bidders may be limited and thereby reducing the competitiveness of the tender.

2.4.2.3 Ineffectiveness

Long term operating contracts can lead to value for money. However, they can also lead to inefficiencies due to lack of contestability and competition. The tender-procedure at the beginning of the process may have introduced competition; the developer who has signed the contracts will have the exclusive rights to an infrastructure facility, therefore practically enjoying a monopoly. During the operations phase inefficiencies may be created due to lack of contestability and competition.
2.4.2.4 Culture gap

There exists a culture gap between the private and public actors, which may result in a loss of confidence in each other. The private sector’s motive to take part in a PPP is primarily profit-making or image-building; public sector’s motive discount rates used by the private and the public sector, which can be explained by the difference in motives of both parties involved. In order to let the discount rates be comparable, and thus reduce the culture gap, the public discount rate has to be adjusted to the private discount rate. Unfair and realistic cost comparison procedure can contribute to slow implementation or even failure of PPPs, thereby raising transaction costs.

2.4.2.5 Short term rigidities

PPP can be compared to a network. Durable networks create stability and lower the uncertainty of actors. At the same time this also means rigidities, dependencies and instability to adapt to changed conditions.\(^3\) That is why PPP contracts should allow for changes to take place and price benchmarked or market-tested from time to time. The only way to speed up the procurement process is to create stability and certainty through the use of standardised contractual terms. The flexibility should generally be reserved for scheme specific issues.

2.4.2.6 Hold-up problem

Another disadvantage of PPPs is the existence of the hold-up problem, whereby a party may be able to enforce a new cost-revenue-ratio than previously agreed upon. This problem may take place when the negotiation-position of the parties involved change over time and when

\[^3\] Temporary networks represent the opposite; instability and increased uncertainty, but also flexibility, higher independence and ability to change.
2.4.2.7 Public sector staff concern

If a PPP is intended to replace an existing public facility, this may result in concern about the public sector’s staff’s terms and conditions of employment. This fear will have to be dealt with seriously; otherwise it could influence the output of the project negatively.

2.5 PARTIES INVOLVED IN THE PROCESS

2.5.1 The Public Sector

...
As a result, the public sector remains accountable for many aspects of a PPP, including: defining the business and the services required, and the public sector resources available to pay for them; specifying the priorities, targets and outputs; executing a carefully planned procurement process (which includes the selection of the agent); determining the performance regime by setting and monitoring safety, quality and performance standards for those services; governing the contract by enforcing those standards and taking action if they are not delivered; managing community expectations; providing the enabling environment; and reacting, in cooperation with the private sector, to changes in the project environment while remaining focused on predefined objectives.

2.5.2 The Financiers

The financing of a PPP utilises a combination of debt and equity, with the debt-equity ratio being highly dependent on the revenue risks inherent in the project. Arrangements for financing are usually entered into at the same time as the project agreements are being executed between the government agency and private sector and are normally non-recourse. The PPP structure is useful for facilitating capital intensive infrastructure transactions due to project risks being allocated amongst the parties who are best equipped to manage them. Financiers have incentives to make sure that services are supplied on time and to the required standard, as financiers are fully aware of the positively correlated relationship between the repayment of their funds and future cash flows generated from the operation of the project.
With the financier being fully aware of the possibility of project failure, they insist upon, and are granted, first ‘step-in’ rights in the event of operator default, which has provided financiers with the opportunity to find a replacement operator.

2.5.3 Subcontractors

Typically, the contractors will enter into various subcontracts including: a contract with a constructor for design and construction of the asset; and a contract with an operator (facilities maintenance contract) for the ongoing operations of any non-core services that need to be provided, incorporating the whole of life maintenance for the facility.

The contract with the facilities maintenance provider is usually a back-to-back contract imposing the obligations of the contractor or private party, under the concession agreement, on the operator, under the operator agreement. This contract includes the possibility of abatements for non-performance in accordance with the service specifications as prescribed in the concession agreement.

2.5.4 Rating Agencies and Insurers

When projects are financed through the public issue of bonds, rating agencies are consulted to provide credit ratings for the entire project, in preparation for the open market bond issue. Insurers can mitigate the risk of the project, working to produce an insurance package that limits the risk of the project.

2.6 WHY GOVERNMENTS GO THE PUBLIC PRIVATE PARTNERSHIP WAY

Governments the world over have recognised that there are some things which the private sector does best and others where the public sector has more to offer. The governments believe that
they will only deliver the modern, high quality public services that the public want and increasingly expect if they draw on the best of both public and private sectors. The starting point is, therefore, recognition of the contribution that the public and private sectors can each bring to the partnership.

The best way to deliver the government’s objectives may be through some combination of public and private sectors, where the government retains the responsibility and democratic accountability for: deciding between competing objectives; defining the chosen objectives and then seeing that they are delivered to the standards required; and ensuring that wider public interests are safeguarded.

In the case of PPPs introduced into public services, this means that, while responsibility for many elements of service delivery may transfer to the private sector, the public sector still remains responsible for: deciding, as the collective purchaser of public services, on the level of services that are required, and the public sector resources which are available to pay for them; setting and monitoring safety, quality and performance standards for those services; and enforcing those standards, taking action if they are not delivered.

Similarly, in the case of state-owned businesses, while PPPs bring the private sector into ownership and management of the business, the government remains responsible for safeguarding public interest issues. This includes, in particular, putting in place independent regulatory bodies, remaining in the public sector, whose role is to ensure that high safety standards are maintained, and that and monopoly power is not abused.84

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The Government recognises that in many ways the public sector represents a reservoir of potential, including: dedicated and professional staff, who are motivated by a desire to improve public services, and more generally to raise the quality of life of people in this country and beyond; a portfolio of assets and businesses, which are often central to the delivery of key public services; a unique source of data, and a wealth of ideas and intellectual property which are the product of top class scientific research; and a range of trusted brands and marques, which may have unique commercial potential.

PPPs recognise that this potential is only partially released in the absence of the private sector. The private sector can expand opportunity through the following disciplines and skills: commercial incentives; a focus on customer requirements; new and innovative approaches; and business and management expertise.

In summary therefore: PPPs enable the Government to tap into the disciplines, incentives, skills and expertise which private sector firms have developed in the course of their normal everyday business; secondly because they so release the full potential of the people, knowledge and assets in the public sector thus enabling the Government to deliver its objectives better and to focus on those activities, fundamental to the role of Government, which are best performed by the public sector procuring services, enforcing standards and protecting the public interest.\textsuperscript{85}

In bringing the best of the public and private sectors together, the key test of any partnership arrangement is not whether it is classified to the public sector or to the private sector. Instead, what matters is whether it provides the structure most likely to deliver the Government’s objectives. The Government develops public private partnerships with three broad objectives in

\textsuperscript{85} Ibid at p. 12
mind: firstly, to deliver significantly improved public services, by contributing to increases in the quality and quantity of investment; secondly, to release the full potential of public sector assets, including state-owned businesses, and hence provide value for the taxpayer and wider benefits for the economy; and finally to allow stakeholders to receive a fair share of the benefits of the Ppp. This includes customers and users of the service being provided, the taxpayer and employees at every level of the organisation.

2.7 RISKS FACED BY PRIVATE INVESTORS

Risks faced by private investors in developing countries can be summarised as follows:

2.7.1 Design and construction risk

Given the size of many infrastructure projects, cost overruns and delays are common, especially if there are subsequent modifications to the design as a result of political or environmental concerns. The private sector typically bears this risk, even when the project will ultimately be run by a public entity.

2.7.2 Operating risk

When the private firm takes over the assets of a previous provider, usually the public sector, the quality of such assets is never completely known in advance. In the water sector, for example, most assets are underground. This risk can be reduced if the private operator initially enters the market through an operations and maintenance contract with the public sector provider.
2.7.3 Commercial risk

As with any investment, demand might not prove sufficiently robust at price levels necessary to ensure long-run profitability or might be subject to a macroeconomic shock. This risk is greatest in those areas where there has not previously been an infrastructure provider and hence potential demand is unknown or where tariffs were formerly subsidised and collection poor. In some contractual arrangements, the government accepts responsibility for tariff collection or agrees to buy the infrastructure service from the PPP at a fixed price. While this reduces the risk for the investor, it opens the way for almost certain renegotiations if a crisis means that the government can no longer afford its financial obligations.

2.7.4 Regulatory risk

Very few developing countries have a well-established and autonomous regulatory agency to deal with infrastructure. With no track record, such agencies might not apply regulations in a consistent pattern, especially if those laws and regulations are themselves untested.

2.7.5 Political risks

The support of the national government is often cited as a crucial factor in the success of a project. If this support wanes in the face of popular discontent at the cost of private provision or if a new regime disavows certain policies of its predecessor, the private operator might find that contractual obligations of the government are no longer being honoured. Political risks might also involve litigation or bureaucratic barriers.
2.7.6 Currency risk

Perhaps the greatest risk to the profitability of a project involves the risk of devaluation. Infrastructure projects in developing countries are often financed in part through international lending. These debt repayments, together with payments of dividends, must be made in foreign currencies while profits usually accrue in the local currency. As a result, any sudden devaluation can completely modify the profitability of a project. This was the case for many PPPs in the 1990s, notably in Latin America and Southeast Asia, and helps to explain the diminished enthusiasm for such projects on the part of the international investment community.

2.8 ROLE OF DEVELOPMENT PARTNERS IN PUBLIC PRIVATE PARTNERSHIPS

The amounts of needed funding together with the required operational capacities to effectively manage the provision of quality public services are not possible under the sole responsibility of the public sector. This can be attributed to various reasons: Available fiscal space and prudent macro-economic policies that are not conducive for capital developmental projects; infrastructure competes for access to public funds with other pressing needs such as the social safety network and security.

PPs have become one of the few public financial instruments to leverage available public money for infrastructure by mobilizing additional private capita especially because there is private capital available. They have become the procurement tool of choice when allocating scarce public sector resources to infrastructure development. There is need to find effective ways to build and develop partnerships across the public and private spectrum as it is only through
these mechanisms that governments and development partners will be able to channel the needed amount of resources to sustain growth and eradicate poverty in our developing countries.

Mobilizing greater private sector participation in the provision of public services is challenging and requires solid and well steer government leadership. Public private partnerships are by no means a panacea and they require strong government institutional capacities to be able to be effectively implemented. Experience has demonstrated that the best way to mobilize more private capital into infrastructure is to provide a sustainable and credible policy and regulatory framework governing investments in the provision of public services. The provision of risk mitigation financial products and the deepening of local capital markets also play a contributing role in the mobilization of private capital (but second to the need for adequate policies and regulation). Seldom are this institutional capacities present at the launch of a PPP program, results take longer to mature raising concerns regarding effectiveness of private investment. It is important to be patient and “invest” the time and resources to build such capacities.

The Word Bank is committed to assist its client countries in the design and development of their PPP programs as it believes that only through effective partnering and increase mobilization of private resources will developing nations be able to make a “dent” in the growth and poverty reduction agenda. It is not easy and it is certainly more demanding than a pure public or a pure private investment but as scale up the engagement in the provision of public services, in particular to the poor, PPPs need to be mainstreamed as an important policy tool to provide public services.88
There are various ways in which donors encourage private investment in infrastructure. While much of the literature on PPPs in industrialised economies points to the need to transfer risk to the private sector in order to secure efficiency gains, in practice governments and donors in are shaping parameters to reduce the private sector’s risk exposure in order to encourage investment.

Various donors are involved in initiatives to promote PPPs in infrastructure, but the most important is the World Bank. Not only does the Bank provide loans to governments through the International Development Association (IDA)—the division of the World Bank Group that provides long-term, interest-free loans to the poorest developing countries—but the IFC—the division of the World Bank Group that provides support to the private sector—is also involved in many aspects of donor policy to promote PPPs in infrastructure. The IFC focuses on providing finance, equity, guarantees and advice to encourage private investment in “frontier markets”.

In addition, a number of other donor-sponsored initiatives for the private sector have emerged over the past decade as donor support for PPP has grown. There is now a confusing array of donor programmes for PPPs; Appendix 1 provides a list of some of them. Recently, six new facilities have been created under the aegis of the Private Infrastructure Development Group (PIDG), which was established in 2002 by donors from the United Kingdom (DFID), Switzerland (SECO), the Netherlands (DGIS), Sweden (SIDA), Austria (ADA), Ireland (Irish Aid) and the World Bank. The total funding capacity of PIDG is US$ 700m and the Group aims to encourage private sector participation in developing country infrastructure through the facilities set out in Table 1.

Component Facilities of the Private Infrastructure Development Group

<table>
<thead>
<tr>
<th>DevCo</th>
<th>Emerging African Infrastructure Fund</th>
<th>Global Partnership for Output Based Aid</th>
<th>Guarant Co.</th>
<th>InfraCo.</th>
<th>Technical Assistance Facility</th>
</tr>
</thead>
<tbody>
<tr>
<td>Supports transactions, providing consultants to help prepare projects for private sector investment</td>
<td>Lends to private companies for infrastructure projects</td>
<td>Provides output based aid</td>
<td>Provides local currency finance</td>
<td>Project development agent (broker)</td>
<td>Provides technical assistance to attract private capital</td>
</tr>
</tbody>
</table>

Source: [www.pidg.org](http://www.pidg.org)

The World Bank firstly provides concessional loans to developing-country governments through the IDA. These loans are for physical investment in infrastructure and for institutional reform, and often the institutional component is based on some form of PPPs. It may be that efforts to develop PPP have not been successful, or that the country context is so fragile (as, for example, where states are emerging from conflict) that PPP is not possible at this stage, in which case policies often focus instead on creating the right conditions to attract PPPs in the future. Second, donors work with governments on country policies to create an attractive investment climate,
termed the “enabling environment”. Finally, donors provide incentives and support directly to
private investors. ⁹⁰

Donors encourage governments to create a country environment that is conducive to private
investment and better suited to PSP. This involves providing support to governments to draw up
projects that are of interest to investors, as well as wider initiatives to improve the investment
climate more generally. Support can take the form of publications and technical assistance. For
example, a recent publication co-sponsored by the Infrastructure Consortium for Africa (ICA),
the World Bank and the Public-Private Infrastructure Advisory Facility (PPIAF), “Attracting
Investors to African Public Private Partnerships: A Project Preparation Guide”, provides advice
to governments on designing projects and the tendering process to attract PSP. ⁹¹ According to
this publication, there is a need for infrastructure and the growth in telecoms shows that there are
people who are willing to pay for services; hence the problem is not one of demand but of
supply. Policymakers should therefore focus on, improving conditions to attract investors,
thereby easing supply constraints. ⁹²

2.9 PUBLIC PRIVATE PARTNERSHIP IN DEVELOPING COUNTRIES

Since the 1990s, there has been a rapid rise of PPPs across the world. Governments in
developing as well as developed countries are using PPP arrangements for improved delivery of
infrastructure services. Governments are building transport (roads, railways, toll bridges),
education (schools and universities), healthcare (hospitals and clinics), waste management
(waste-to-energy plants), and water (collection, treatment, and distribution)

⁹⁰ Kate Bayliss; “Private Sector Participation in African Infrastructure: Is it worth the risk?” Working Paper number
⁹² Ibid 23 at p 15-16
Infrastructure through PPP. PPP is becoming the preferred method for public procurement of infrastructure and infrastructure services projects throughout the world.

The emergence of PPPs is seen as a sustainable financing and institutional mechanism with the potential of bridging the infrastructure gap. PPPs primarily represent value for money in public procurement and efficient operation. Apart from enabling private investment flows, PPPs also deliver efficiency gains and enhanced impact of the investments. The efficient use of resources, availability of modern technology, better project design and implementation, and improved operations combine to deliver efficiency and effectiveness gains which are not readily produced in a public sector project. PPP projects also lead to faster implementation, reduced lifecycle costs, and optimal risk allocation. Private management also increases accountability and incentivizes performance and maintenance of required service standards. Finally, PPPs result in improved delivery of public services and promote public sector reforms.

The following chapter explores the steps that various countries have taken toward implementing PPPs for infrastructure development with a bias towards India, Brazil, China and a few Examples from Sub Saharan Africa. It will outline some of the projects that they have undertaken under PPP and the successes that they have managed to reap from the same. It will also look at the outline the obstacles that they may have encountered and how best the countries worked them out.
CHAPTER THREE

PUBLIC PRIVATE PARTNERSHIPS IN DEVELOPING COUNTRIES

The global need for infrastructure investments has never been more pronounced as mature economics grapples with the high cost of infrastructure reinvestment to replace aging infrastructure or to maintain economic competitiveness within regional and global markets. Accordingly, a strong consensus prevails that investments in public infrastructure will continue to grow at an accelerated pace. The strong demands stem from four major factors or developments occurring concurrently at the global level:

a) The rapid growth and continuing urbanisation of large emerging economies such as China, India and Brazil.

b) The need of several countries to replace or improve inadequate or dilapidated infrastructure.

c) The need to protect or reinforce one’s competitive position in the face of rapid technological changes and global competition.

d) The urgent need to rehabilitate, renew or replace a substantial portion of the existing infrastructure in Western economies. To a large extent, these infrastructures were built in the 60s and 70s and are now reaching a critical point in their life cycle. These deteriorating essential public infrastructure facilities are often structurally deficient or obsolete. At the same time, congestion and rising demand is putting pressure for additional public infrastructure(s).
3.1 BRAZIL

Since the economic depression Brazil suffered in the 80’s, the percentage of GDP per capita invested in infrastructure fell from 3.6% to as little as 1%, with regard to the inadequate condition of the country’s highways, ports, power plant and sanitation installation.\(^94\) Today, if Brazil aims at bringing its infrastructure standard up to that of other advanced developing economies, he adds that it ought to attract private investment to the business. Furthermore, Yan points out that if Brazil seeks to catch up in 20 years to the level of infrastructure development that can be seen in South Korea or the developed part of China, it must increase both private as well as public investment by 2.4 percent of GDP annually, to 5 to 7 percent of its GDP.\(^95\)

It seems that Brazil is not only eager to reach these high figures but intends to surpass them. At least, that is what the country’s initiative in early January 2007 showed. In order to channel investment in infrastructure development, Brazil launched a new and ambitious program to foster growth and development. The program named Growth-Accelerating Program, when released, had forecasted that at least R$55 billion (US$26 billion) would be invested in transport-logistic infrastructure (roads, railway, airports) in the country by the year 2010.\(^96\) Therefore opening extra space for new highway development and maintenance in the country. The private sector’s share was also expected to reach R$24,3 billions (US$11 billions) in PPP and concessions.\(^97\) The PAC has clear goals, which are: to overcome structure limits, extend its limit geographically through infrastructure projects of transport and decrease the regional inequalities, therefore

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\(^{95}\) Ibid

\(^{96}\) Brazilian Ministry of Planning Budget and Administration 2007.

\(^{97}\) Brazilian Ministry of Planning Budget and Administration 2007.

Growth-Accelerating Programme – “Programa de Aceleração do Crescimento”
inducing development throughout its territory. It is also the biggest strategic investment project Brazil has had in the last four decades. The PPP arrangement and ideas have reached many of the developing regions. In Latin America, it has propagated due to some of the governments’ difficulties in raising urgently needed investments for their enterprise. The situation of low capital and investments resulted in inefficient and poor service provisions, which affects economic development in the areas of competitiveness and equity in the region. Longing for investment channels to finance its infrastructure, the Brazilian government is today a vivid example on the continent, after Chile and Mexico’s engagement in PPP arrangements, of a nation that has embraced the private initiative to foster infrastructure development.

In Brazil, PPP represents an alternative for economic growth and an important investment tool for transport infrastructure, in view of the country’s huge social and economic insufficiencies. The PPP enable a broad range of investments, meeting infrastructure demands among others. The Bill of the Government’s 2004-2007 Multiannual Plan envisages the need for investments amounting to 21.7% of the Gross Domestic Product – GDP by 2007, as a condition for resuming and sustaining the country’s economic growth.

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90 Embassy of Brazil in London 2004.
93 Ricardo Marar -National Land Transport Regulatory Agency and University of Brasilia – Brazil; Breno Figueiredo- National Land Transport Regulatory Agency – Brazil and Joaquim Jose Guilherme Aragao University of Brasilia: IMPLEMENTING PPP CONTRACTS IN TRANSPORT INFRASTRUCTURE IN BRAZIL” Association for European Transport and Contributors 2005 at p. 4.
With the Act 11.079 enacted on December 30th, 2004, Brazil has a new legal framework for the partnership system. One should draw attention to the remuneration and guarantee instruments of the PPP Law. They aim at strengthening the confidence of the private organization that undertakes full responsibility for the investment in the project that is the object of the partnership, as well as at maximizing the potential of the PPP for the development of new financing mechanisms and of the Brazilian capital markets. Another essential element in the partnership relation is the fact that the remuneration of the private sector will be conditioned to the achievement of performance standards established in contract.  

3.1.1 Projects undertaken vide Public Private Partnerships

Although Brazil passed legislation to establish a legal framework for public private partnerships in 2004, the federal government has failed to move ahead with any projects. But the states of Sao Paulo and Minas Gerais have taken the lead in developing a workable model already applied in toll-road and municipal transport projects, with a pipeline that includes prisons, higher education and water treatment. This model reduces risks for private investors by creating mechanisms to guarantee contracts will survive political transitions. The model also protects the states through service agreements guaranteeing that projects will be completed and maintained. Other states governed by opposition parties are watching Sao Paulo and Minas closely and are likely to move ahead with their own PPP programmes to attract much-needed investment.

Sao Paulo Metro Line 4, Brazil: The new Metro Line 4 will be a principal commuter route that runs southwest to northeast through metropolitan Sao Paulo, connecting residential...
neighbourhoods to important commercial districts adding approximately 21 percent in additional capacity to the metro system across low, medium and higher income populations. The project includes two main contracts: (a) a turnkey contract for the provision of civil works and electrification for the 12.8 km of metro line\textsuperscript{106} and (b) a concession to operate the system for 30 years, in exchange for the provision of the rolling stock and systems, financed mainly by the private sector and the State. Total project costs are estimated at US$ 398.55 million with about US$ 82.95 million equity contribution from sponsors (21%). Total debt of US$ 315.60 (79%) is split in two tranches, a $69.2 million, 15-year A loan from the IADB, and a $240 million, 12-year B loan, and led by IADB, from Banco Santander, SMBC, KfW, Banco Espirito Santo, BBVA as lead arrangers and Société Générale and WestLB as co-lead arrangers. The project was not eligible for support from the Brazilian government's development bank, BNDES, because the trains for the project were manufactured outside of the country.

The Project was awarded in November 2006 to a consortium (Via Quatro)\textsuperscript{107} led by Companhia de Concessões Rodoviárias (CCR) pursuant to an international public bidding process with the Government of the State of Sao Paulo. This was a landmark event, and the first PPP signed by any public sector agency in Brazil since the passage of the new Brazil's PPP legislation in 2004. Under the terms of the PPP contract, operator ViaQuatro will be responsible for the provision of rolling stock, trains and technical equipment, and the operation and maintenance of a 12.8 km metro line (Metro Line 4) in Sao Paulo during a 30-year concession term. The state of Sao Paulo's government, under its civil works authority, is responsible for the construction of the required civil infrastructure works which includes various stations, tunnels and railways. The

\textsuperscript{106} This component is financed by the World Bank, JOBIC and State of Sao Paulo.
\textsuperscript{107} The consortium (and sponsors) consists of CCR (58%), Mitsui (10%), Montgomery Participações S.A. of Portugal (20%), Benito Roggio Transportes S.A. of Argentina (1%), and RATP Développement S.A of France (1%).
The concession was awarded on the basis of a low bid for required availability payments; it also benefits from a minimum revenue guarantee and revenue-sharing threshold, protecting the concessionaire from low revenues, but providing the state with revenue sharing if use is higher than projections. Most of the consortium’s income will come from passenger tariffs, but should this fall below the projected levels the government must top it up. However, if income is greater than expected the consortium must share the proceeds with the state.

Minas Gerais: MG 050 private toll highway: For the MG 050 project, the state government has created an escrow account, which will receive royalties payments from the Niobium Mining Company (Companhia Brasileira de Metalurgia e Mineracao -CBMM). Payments to the concession holder from this account will be made directly to Equipav if the state treasury fails to transfer payments to it. Because royalty payments are made directly into the escrow account by CBMM, the contract is less vulnerable to political transitions.

The length of the contract is also important. Before the PPP legislation, public works contracts were limited to five years, with most payments being made to contractors prior to construction. This created myriad opportunities for fraud and corruption. Under the PPP law, the government
can pay for public works only after completion. In the case of MG 050, payment will begin one year after the first phase of construction is concluded.

3.2 China

During the last decade in China, public investments in expressway infrastructure have seen remarkable growth, but only a declining proportion of the total expressway construction costs. The gap between public funding and actual project costs has been filled by raising money from the private sector, while transferring responsibilities of design, construction, operation and maintenance to the private sector by means of public-private partnerships (PPP). Since late 1990s, the growth in the number of PPPs in roads, especially for expressways programmed in the Chinese National Expressway Network Plan (7918 plan), has increased, from 0 to 122 PPP contracts in roads at present. The underlying reason for PPP growth in the Chinese road sector is rising motorization and a concomitant requirement for road reconstruction and extension. As a result, it has become a challenge for the public sector to invest so massively. Therefore, PPP as a solution for alleviating the fiscal pressure on the public sector and for speeding up the recovery process from years’ underinvestment in road infrastructure, is attractive for governments at all levels and is currently part and parcel of China’s continuous institutional reforms.

3.2.1 Projects undertaken under Public Private Partnerships

China has been facing with the realities of a growing large population, an increasing urbanization growth and a present quandary of limited resource, which urgently calls for creative and optimal
use of infrastructures\textsuperscript{111}. To alleviate the negative impact, Chinese government has always shown its active attitude to support the investment and development of infrastructures. In general, the infrastructure development in China since the Opening-up reform could be divided into three phases as presented, i.e. initial development (1978 - 1989), rapid development (1990 - 2002) and stable development (2003 - present)\textsuperscript{112}.

At the early stage of China’s Opening-up, basic infrastructure like roads, ports and power generation facilities were in urgent need and accounted for a large proportion of government funding. During the period of 1982 - 1989, Chinese government put a total investment of 292.7 billion Renminbi (RMB)\textsuperscript{113} in about 261 infrastructure projects including energy and public transportations\textsuperscript{114}. Since 1990, private capital had been encouraged to participate in the infrastructure development, most of which were implemented in the form of Build Operate-Transfer (BOT). With the coming of private participation, there was a rapid growth of China’s infrastructures. It is worth taking notice that the Chinese government issued a total number of 660 billion RMB treasury bonds and invested these to the infrastructure construction\textsuperscript{115}, when the Asian Financial Crisis happened in 1997. In phase 3, in line with its sustaining economic growth and its success in bidding for 2008 Olympic Games, huge capital in infrastructure area has been invested in order to decrease the bottleneck effect of infrastructure shortage. In addition, a


\textsuperscript{113} The Renminbi (sign: ¥; code: CNY) is the official currency of the People’s Republic of China (PRC), whose principal unit is the Yuan. The currency is legal tender in mainland China, but not in Hong Kong and Macau. Hereinafter referred to as RMB.
stimulus package estimated at 4 trillion RMB will be spent over the next two years after 2008 to finance programs in 10 major areas, such as low-income housing, rural infrastructure, water, electricity, transportation, the environment, technological innovation and rebuilding from several disasters. It is therefore understandable that China will continue a rapid development tendency in its infrastructure development after 2008.

Private participation in infrastructure development in China was first seen in the power industry in 1980s. The Shajiao B power plant in Shenzhen, which came to operation in 1988, is regarded as the first BOT project in China. However, government and commercial banks in Shajiao B project took over too many risks due to the lack of BOT experience. Thereafter, several state-approved pilot BOT projects have been awarded in order to introduce BOT on a larger scale since late 1996, such as Laibin B power project and Dachang water project etc.

Since then, the involvement of private investors in infrastructural development of public utilities has improved greatly. However, at the end of last decade, the central government invested huge amounts of treasury bonds in infrastructure, and was determined to clean up the unregulated or illegal projects, which lead to a termination of the first round of private investment. Stepping into the 21st century, the bottleneck effect of infrastructure shortage for the economy emerged and imposed great budgetary pressure on the government. For examples, the forecast of the total investment on rail construction in the 11th Five-Year (2006 - 2010) is 1,250 billion RMB; In Beijing alone, there will be about 2,400 infrastructure projects to be developed during this period.

with a total investment of over 470 billion RMB\textsuperscript{[119]} The huge investment in infrastructure area could not be completed by the government alone, thus provides a good business opportunity for private investors.

It is easy to find that China’s infrastructure market has been opened to the private investors except for some special sectors such as pivotal railway, ports and airports. The highest openness has been seen in toll road and municipal utilities including water, environment, city gas, etc. However, it could be found that the investors in both rounds of infrastructure investment in last two decades have limitations.\textsuperscript{[120]} Foreign investors acting as the major player in the first round usually charge higher and prefer operating projects in more developed regions in China, while state-owned enterprises as the principle player in the second round have relative low operation and management efficiency, which largely restrains the advantages of concession model. Nevertheless, international companies are still the most competitive player.\textsuperscript{[121]}

\textbf{Bringing water to all consumers in Chengdu, China:} The Chengdu Water Supply project involved the construction of a treatment plant and the establishment of a 27 kilometer transmission line to provide the population of Chengdu, an industrial city in southwest China, with an additional supply of 400, 00 cubic meters of treated water daily. Prior to this, urban water supply projects were funded by central or municipal governments, on a grant basis. Insufficient government funding meant that water shortages occurred, particularly in rapidly growing metropolitan areas. As the first BOT water supply project in the People’s Republic of


$^{121}$ Zhang, L. (2009) “Development of infrastructure sectors in China: status quo and trends (Seminar speach)”. Brevamping PPPs: From ‘Revisiting and Rethinking’ to ‘Revamping and Revitalising’ PPPs, The University of Hong Kong, Hong Kong, China, February 28.
China, the Chengdu Project demonstrated that this approach can be successfully implemented at the municipal level, and externally financed without government guarantee. ADB’s private sector operations extended a direct loan of $26.5 million for the project, and through ADB’s complementary financing scheme, ADB made possible commercial debt funding of $21.5 million.122

3.3 Africa

African governments, like most countries in the developing world, face a daunting task in their attempts to provide effective and equitable public services. When looking at the various surveys available, it becomes quite apparent that basic infrastructure in Sub-Saharan Africa (SSA) lags well behind the rest of the world. Poor quality and lack of widespread availability of services like electricity, water and sanitation, and roads are quite common in some SSA countries, and the average for the region is well below others.123

3.3.1 Expansion of Water Supply in Rural Areas in Ghana124

The Ghana Water and Sewerage Corporation, a state company under the Ministry of Works and Housing, was responsible for both urban and rural water supply and sewerage for a population of some 15 million people. Most of the corporation’s staff and resources, however, were devoted to the urban sector, with just two or three staff working in rural services. As a result, donors and NGOs who wanted to work in rural water and sanitation found themselves setting up large
regional projects that were almost independent from the Government, both in their policies and in their implementation.

By the mid-1980s, the Government realized that the water situation was unsustainable and increased the water tariff tenfold. A stakeholder group was established to adopt best practices associated with the International Drinking Water Supply and Sanitation Decade (1981-1990). The result was a draft sector strategy, which was discussed and refined with line ministries, local government, and private sector. Once the national policy for rural water supply, sanitation and hygiene education was finalized, it was implemented as a pilot project in the Volta region, supported by the UNDP and the Dutch Government. It was then scaled up as the First Community Water and Sanitation Project (CWAP-1), a $20 million World Bank-supported programme.

The Community Water and Sanitation Agency (CWSA) was created in stages. First, the functions related to rural community water supply were placed in a separate division, facilitating better monitoring of donors’ grants. Later in 1998, the division was made into an independent agency, whose main tasks were coordination and facilitation (not implementation) of community-managed water supplies. At the same time CWSA was created, the Government devolved certain responsibilities from the national level to districts and communities. The district Assemblies became responsible for processing and prioritizing community applications for water supply, awarding contracts for hand-dug wells and latrine construction, and running a latrine subsidy programme. In order to be eligible for assistance, communities had to establish gender balanced water and sanitation committees, complete plans detailing how they would manage their system, contribute 5% of capital costs in cash, and pay all operational and maintenance costs. The final element of the strategy was an unprecedented private sector provision of goods
and services, covering borehole drilling, operations and maintenance, latrine construction and community mobilization.

By 2000 the reforms were complete and CWSA had settled into its role of helping the district assemblies implement a national community water and sanitation programme. CWSA formulates strategies, standards and guidelines for the sector, coordinates the work of NGOs and donors, and encourages private sector participation in water and sanitation activities. The communities have primary responsibilities for managing their water and sanitation services, while small-scale private sector firms take care of repairs and spare parts.

The success of the project can be attributed to the following factors: Firstly, strong political leadership- The national mood in Ghana in the 1980s was one of general support for reform and innovation. Rural water had been neglected and the sector as a whole was stuck in a downward spiral of inadequate cost recovery and poor service. Politicians made a decision to reverse that trend by increasing tariffs, seeking grants and loans, and separating the urban from the rural sector. Successive governments from different parties have all prioritized water and sanitation as important contributors to economic and social development; therefore, reform of the sector has not been used as a political issue. Secondly, clear legislation was critical, specifically the acts of parliament from 1998 that defined the policies and roles of most sector agencies. Lastly, CWSA demonstrated strong commitment and leadership in supporting devolution of decision-making to local governments to implement their mandate.

3.3.2 South Africa

South Africa like many other countries is faced with the problem of infrastructure backlogs and budget constraints. The government through its Department of Finance recognised the need to
partner with the private sector in order to address this problem. Consequently various PPP initiatives in various sectors were considered as an alternative way of delivering services. One of the initiatives that has been implemented for the provision of public services by the private sector is through Asset Procurement and Operating Partnership Systems (APOPS). The Department of Public Works (DPW) engaged in the APOPS programme in 1996. This programme lies within the broader PPP framework. The Department of Public Works – APOPS Directorate is currently engaged in pilot projects for the procurement of correctional facilities structured along the design, build, finance and operate (DBFO) approach.

The private sector consortium is responsible for the design, build, finance and operation of the facility and at the end of the concession period which is 25 years, the facility will be transferred back to the State. The government pays the private sector (referred to as the concessionaire) periodically for the services rendered. In the APOPS programme, the three main objectives to be considered are to secure value for money, optimal risk allocation and affordability and these objectives have important implications with regards to the financing of the projects.

N4 Toll Road from South Africa to Mozambique: In 1996 the governments of South Africa and Mozambique signed a 30-year concession for a private consortium, Trans African Concessions (TRAC), to build and operate the N4 toll road from Witbank, South Africa to Maputo, Mozambique. After the 30-year period, control and management of the road reverts to the governments. The contract was worth R3 billion (at 1996 estimates). The N4 was financed from 20% equity and 80% debt. The three construction companies who are the sponsors of the project contributed R331 million worth of equity with the rest of the capital provided by the SA Infrastructure Fund; Rand Merchant Bank Asset Management and five other investors. The debt investors include South Africa’s four major banks: ABSA, Nedcor, Standard Bank and First
The National Bank; the Development Bank of Southern Africa; and the Mine Employees and Officials Pension Funds. The governments of South Africa and Mozambique jointly and severally guarantee the debt of TRAC and, under certain conditions, guarantee the equity as well.

At the time it was the biggest project finance deal\textsuperscript{125} in Southern Africa.

The N4 faced demand risk – would cars pay to use this road when less well-maintained but free alternative routes existed? Traffic volumes, which were dependent on increased regional trade and economic growth in Mozambique, have not been as high as the financers projected. But the traffic has been ‘acceptable’ and the latest growth figures show that from 2003 to 2004, the traffic grew in volume by 4.5\%\textsuperscript{126}. There was also considerable user payment risk in Mozambique as the poor communities were unable and unwilling to pay high toll fees. TRAC cross-subsidised the Mozambican portion of the road with higher revenues from the South African side. It also provided substantial discounts to local users and public transport on both sides of the border.

### 3.3.3 Mozambique

The **Southern Africa Regional Gas Project**\textsuperscript{127} is the first large scale energy project to capitalize on Mozambique’s rich natural gas resources, which were first discovered in 1956. It consists of an “upstream project”, which includes the development of the Pande and Temane gas fields in Mozambique and the construction of a central processing facility, and a “downstream project”,

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\textsuperscript{125} A project finance deal shares the financial cost and the project’s risk among various partners through a combination of debt and equity (capital).

\textsuperscript{126} Peter Farlam; “Assessing Public–Private Partnerships in Africa” The South African Institute of International Affairs Policy Focus Series pp. 24

\textsuperscript{127} Jeffrey Delmon; “Understanding Options for Public-Private Partnerships in Infrastructure Sorting out the forest from the trees: BOT, DBFO, DCMF, concession, lease... “; Policy Research Working Paper 5173 The World Bank Finance Economics & Urban Department Finance and Guarantees Unit; January 2010
which includes the construction, operation and maintenance of an 865km pipeline to transport
the gas to Sasol’s Secunda plant in South Africa, with a capital expenditure of approximately
R1bn. Sasol Limited is the primary sponsor of the Project from gas field development in
Mozambique to the end user sales in South Africa. It provides full debt service support to the two
project companies (SPT and ROMPCO) through ship or pay arrangements and therefore assumes
all project related commercial risks as well as a portion of Mozambique political risks. The
Mozambique political risk coverage is primarily provided by the Export Credit Insurance
Corporation of South Africa (ECIC), MIGA – partially reinsured by SACE of Italy and EFIC of
Australia, the World Bank through a Partial Risk Guarantee (PRG), and the European Investment
Bank (EIB).

The Southern Africa Regional Gas Project is an example of a successful cross border transaction
despite its complexity in the design and implementation process and highly diverse stakeholder
groups. The transaction was key to introduce international banks to Mozambique and raise the
country’s profile and set high standards for the government. The project is also an example of
World Bank Group coordination and cooperation involving two IBRD partial risk guarantees
denominated in South African Rand), a MIGA guarantee and IFC equity support.

3.4 India

Despite becoming the second fastest growing and the fourth largest\textsuperscript{128} economy of the world,
India continues to face large gaps in the demand and supply of essential social and economic
infrastructure and services. Rapidly growing economy, increased industrial activity, burgeoning
population pressure, and all-round economic and social development have led to greater demand
for better quality and coverage of water and sanitation services, sewerage and drainage systems, solid-waste management, roads and seaports, and power supply. Increased demand has put the existing infrastructure under tremendous pressure and far outstripped its supply.

The infrastructure shortages are proving to be the leading binding constraint in sustaining, deepening, and expanding India’s economic growth and competitiveness.\textsuperscript{129} India’s global competitiveness remains constrained and is adversely affected by lack of infrastructure, which is critical for improved productivity across all sectors of the economy. Poor infrastructure is also a major barrier to foreign direct investment (FDI). Recent surveys have shown that India’s poor infrastructure (road network, ports, distribution networks, and in particular power supply) is a cause for concern and a major barrier to investment. Upgrading of transport (roads, railways, airports, and ports), power, and urban infrastructure is therefore seen as critical for sustaining India’s economic growth, along with improved quality of life, increase in employment opportunities, and progress towards the elimination of poverty.\textsuperscript{130}

These projected investment requirements cannot be met from government’s budgetary resources. The scope for making improvements is limited by the state of public finances. The combined deficit of the Union and state governments is around 10% of GDP. Governments can also not borrow arbitrarily, since their borrowing has been capped through the Fiscal Responsibility and Budgetary Management Act. The Approach Paper to the Eleventh Plan states that “One has to reach out to the private sector, and private savings, and to the other mechanisms available in the market today to raise funds”\textsuperscript{131}. The National Development Council (NDC) has passed a
which mentions that “increased private participation has now become a necessity” to mobilize the resources needed for infrastructure expansion and upgrading.

Given the large resource requirements and the budgetary and borrowing constraints, Government of India has been encouraging private sector investment and participation in all sectors of infrastructure. It has recognized that while public investment in infrastructure would continue to increase, private participation needs to expand significantly to address the existing deficit in infrastructure services.

India had a few notable PPPs as early as the nineteenth century. The Great Indian Peninsular Railway Company operating between Bombay (now Mumbai) and Thana (now Thane) (1853), the Bombay Tramway Company running tramway services in Bombay (1874), and the power generation and distribution companies in Bombay and Calcutta (now Kolkata) in the early 20th century are some of the earliest examples of PPP in India.

Since the opening of the economy in 1991 there have been several cautious and tentative attempts at PPP in India. However, most PPPs have been restricted to the roads sector. Large-scale private financing in water supply has so far been limited to a few cities like Visakhapatnam and Tirupur. Most PPPs in water supply projects have been through municipal bonds in cities such as Ahmedabad, Ludhiana, and Nagpur. West Bengal has recorded significant success in housing and health sectors. The housing projects coming up on the outskirts of Kolkata City are a good example of what a PPP model can deliver in terms of quality housing and quality living conditions to the lower middle class and the middle class. Gujarat and Maharashtra have had
success especially in ports, roads, and urban infrastructure. Karnataka also has done well in the
airport, power, and road sector. Punjab has had PPPs in the road sector.

However, successfully working PPP models are a more recent phenomenon. The Tirupur project
in Tamil Nadu is a promising example in this regard. It is a BOOT project, the first privately
financed water and sewerage project in India, executed through a Special Purpose Vehicle
(SPV). The project took more than ten years from concept to financial closure. The US$100
million Delhi-NOIDA Bridge Project, implemented on a BOOT framework on the basis of a 30-
year concession, is the other major PPP initiative. The NOIDA toll bridge, Tirupur water supply
project, national highways, port development, and telecom industry are some notable examples
of successful PPPs.

Only 86 PPP projects worth Rs 340 billion awarded till 2004. A study conducted by the World
Bank of 13 states in 2005 found only 85 PPP projects awarded by states and select central
agencies (not including power and telecom). Their total project cost is Rs 339.5 billion. An
optimistic projection of PPPs, growing by five times between 2004 and 2006 to 500 projects, is
not very encouraging. The largest number of PPP projects are in the roads and bridges sector,
followed by ports, particularly greenfield ports. Apart from these two sectors, there are very few
PPP initiatives.

3.4.1 Projects undertaken under Public Private Partnerships

A Regional Workshops of Chief Secretaries on Public–Private Partnership on Facilitating
Public–Private Partnership for Accelerated Infrastructure Development in India facilitated by
Department of Economic Affairs (DEA) Ministry of Finance, Government of India and Asian
Development Bank (ADB) highlighted some of the main projects that India has been able to
Andhra Pradesh is a pioneer in enacting the Infrastructure Authority Act. It covers the infrastructure sectors of highways/bridges, airports, seaports, power, water supply and sanitation, telecommunication networks, gas distribution, and waste management. It also covers urban infrastructure, including housing, urban development, medical facilities, and leisure facilities. The legislation aims to facilitate private developers in securing the mandatory administrative approvals and lays down provisions for arbitration and fiscal regulation.

The major PPP project in the state is the Hyderabad International Airport, being executed under the BOO format. Project cost is Rs 1760 crore. Other major projects are the Kakinada Deep Water Port, being developed on the operate-maintain-share-and transfer (OMST) format, and the Gangavaram Port, in the BOOT mode. Other projects being taken up as PPPs are FAB City (Rs 1.5-3 billion), Hyderabad Outer Ring Road (Rs 3000 crore), Kakinada SEZ (Rs 8500 crore), Integrated Township and Convention Center (Rs 670 crore), Jawaharlal Nehru Pharma City (Rs 88 crore), Hyderabad Integrated Trade and Exposition Center, Hitec City (Rs 450 crore), and several knowledge, IT, and biotechnology parks. Many of these projects have been taken up through the Memorandum of Understanding (MOU) route.
Karnataka’s infrastructure policy has a vision to build strong PPPs for infrastructure development to achieve the twin objectives of high growth and equity. It aims to expand, broaden, and deepen private investment in infrastructure, and establish Karnataka as a role model for infrastructure development, and good governance. The policy applies to township development, commercial development with common-user facilities, water supply and sewerage, wastewater recycling, underground drainage, waste management (solid waste/biomedical/hazardous waste), tourism, energy, industrial infrastructure, agricultural infrastructure, education, and healthcare.

The government has so far bid out more than Rs 3000 crore worth of PPP projects, including the Bangalore international airport. Some of the other major projects are the Hassan–Mangalore Rail Line for Rs 310 crore (completed), the elevated expressway to E-City (Rs 600 crore, under construction), and EWS Housing in Bangalore for Rs 165 crore (bidder identified). The government is close to bidding out or has the bidding underway for PPP projects worth more than Rs 2000 crore. These include the Airport Rail Link for Rs 800 crore, the Inter-modal transit center at Subhashnagar for 500 crore, the Mega Convention Center, the Tornagallu–Kudligi Road and Sandur–Hospet Road (Rs 200 crore), and the Biotech Park at Bangalore. The proposed mega-convention centre is eligible for Viability Gap Funding (VGF), for which a request for qualification has been issued and project studies are underway.
3.4.1.3 Kerala

Kerala, the major PPP projects under way are the Trivandrum City road improvement project and the Vizhinjam International Container Transshipment project. The Trivandrum City road improvement project encompasses ten city road corridors and three National Highway bypasses of around 42 km, and one underpass and two flyovers at junctions of strategic importance. The project is being implemented under BOT scheme on an annuity basis. The total cost of the project is estimated at Rs 145 crore.

The Vizhinjam International Container Transshipment project has been planned as a futuristic port facility which, upon completion, would be able to handle 4.1 million containers of twenty-foot equivalent units (TEUs) and vessels of the order of 12,000 TEU size with a total berth length of 2860 meters. Government equity in the joint venture company implementing the port would be 24%. The private partner has been shortlisted via a bidding process. The government has sought security clearance from GOI for foreign participation. VGF funding of Rs 200 crore has been sought.

3.4.1.4 Tamil Nadu

The priority sectors identified for PPP are: water supply and sewerage, roads (roads, bridges and flyovers), urban infrastructure, ports, and computer literacy in school education. The state government has established several PPP agencies. These are Tamil Nadu Water Investment Company (TWIC); New Tirupur Area Development Corporation Limited (NTADCL) as SPV for

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copies of all project agreements (such as concession agreement, state support agreement, substitution agreement, escrow agreement, O&M agreement, and shareholders’ agreement, as applicable) and the project report.

supply of industrial and drinking water under Tirupur Water and Sanitation Project; Tamil Nadu Road Development Company (TNRDC) to develop road projects; and the Tamil Nadu Urban Development Fund (TNUDF) to implement the World Bank-assisted Tamil Nadu Urban Development Project.

TNRDC is a 50:50 joint venture between the TIDCO and ILFS. It had sponsored the East Coast Road (ECR) project for initial improvement works (Rs 61 crore) and maintenance during the concession period of thirty years. TNUDF aims to raise resources and long-term finance for infrastructure in urban local bodies on a sustainable basis, support and strengthen urban reforms, and institutional strengthening and capacity building. It also promotes PPP arrangement to channel private capital in municipal infrastructure.

3.4.1.5 Jharkhand

The government has identified several ‘thrust areas’ for accelerating the social and economic development of the state. These are infrastructure development, mines and mineral industry, power generation and distribution, IT, automobile/auto components industry, and sericulture. The government is promoting Special Economic Zone (SEZs) in agro processing, IT, multi-product, and automobiles and is also introducing pertinent legislation.

Ongoing PPP initiatives in the state include construction of the National Games housing complex at Ranchi for about Rs 2600 million. The project involves construction of residential and common facilities for 10,000 participants in the National Games in November 2007. The successful bidder will construct about 1800 dwelling units in 54 acres in less than 18 months. The other initiative is establishing more than 4000 common service centres, as part of the...
The centres will provide effective and efficient delivery of eGovernance services as well as offer value-added services such as banking, insurance, micro-credit, tele-medicine, e-education, and entertainment.

Other PPP projects will be identified at the urban local body levels to match the share of grant required from state government and urban local bodies. It expects that around 20% of the projects in the pipeline in Ranchi, Dhanbad and Jamshedpur (estimated at Rs 13,400 crore) will have potential for PPP over the next several years. Prospective PPPs are being visualized in township development, power generation, industrial clusters, water supply and sewerage systems, hotels, mining, roads, and IT.

3.4.1.6 West Bengal

The government notified its Policy on Infrastructure Development through Public Private Partnership in August 2003. The major elements of the policy are to ensure reasonable returns on private investment by way of extending ‘concessions’, tax incentives, VGF (capital grant/revenue grant), government guarantee, shorter period for deferred annuity, and providing possible safeguard against political and social uncertainty.

The major PPP initiatives in the state are Salt Lake City Centre and Hiland Residential Project (under joint venture). Under covenanted lease, the government has undertaken the West Howrah Township, Kolkata Logistics Hub at Kona, Stadium-cum-Commercial Complex at Rajdanga, and the Dankuni Township. In the past, the government has undertaken projects on license (electricity and transport), BOO (leather complex and Vivekananda bridge), and management.
contract (solid-waste and tourist lodges) bases as well. Proposed PPP projects include four-laning of Kalyani–Dum Dum Expressway, Water Park-cum-Entertainment Center along the Eastern Metropolitan Bypass, and transport, residential, commercial, and entertainment/leisure infrastructure at Asansol, Howrah, Durgapur, and Kolkata. The state is also considering urban infrastructure initiatives in these cities.

3.4.1.7 Uttaranchal

The Government of Uttaranchal has identified tourism, energy, IT and horticulture sectors as future drivers of the state’s GDP, and views communication and transport infrastructure as the necessary enablers to achieve it. The major PPP initiative in the state has been the interstate bus terminus at Dehradun, in the BOT format through an SPV, on a concession of twenty years. Another notable PPP has been in the development of twenty industrial estates in various parts of the state. Smaller initiatives have been taken up in micro-hydroelectric projects, education, and horticulture. Bidding procedures have been initiated for ropeway projects at various locations. The government proposes to take up PPPs related to mountain airlines, airport expansion, and tourism destinations. Mandate has been given to the Uttaranchal Infrastructure Projects Company to take these proposals forward. The government envisions world-class urban infrastructure under the JNNURM; mass transit railway system, roads/highways under BOO/BOOT/BOT models with ADB partnership; and airport development, horticultural production and distribution infrastructure, and fisheries. The state also seeks PPPs in micro-hydroelectric projects, unconventional energy, and power distribution networks.
3.4.1.8 Uttar Pradesh

The state has formed an Empowered Authority (EA) to oversee development and provide single-point approvals/clearances; to provide policy guidelines, oversee and monitor project selection, financial approval and implementation; and to resolve interdepartmental matters. The EA will put in place enablers for PPP, prescribe schedules for clearances, and frame rules and guidelines. It will also support the projects in operational matters. The state has proposed an Infrastructure Act to address issues related to nodal agency, project delivery process, state support, user levies, risk issues, MCAs, and safeguards.

The state has initiated policy on promotion of private participation in the development of hi-tech townships. It also has developed policies on roads, IT, power, sugar, food processing, industrial infrastructure, and service sector. The government is providing administrative support in providing land, obtaining statutory and project-specific clearances, financial support through VGF where necessary, non-fiscal concession (guarantees), and project monitoring. The major success stories include the NOIDA toll bridge and NOIDA Power Company. Nine hi-tech townships and an integrated textile park are under implementation. The state has identified roads and state highways, bus terminals, and product-specific parks on PPP basis. Land is under acquisition and project development is in progress for SEZs in Kanpur and Bhadoi. Central assistance has been requested in streamlining the schedule for granting approvals relating to environment and railways etc., in raising funds from international financial institutions for undertaking infrastructure projects, and capacity building in PPPs.
3.4.1.9 Himachal Pradesh

The Himachal Pradesh Infrastructure Development Board (HPIDB) is the nodal agency for processing projects in sectors such as tourism, urban development, industries, power, and roads and bridges. HPIDB processes the proposals and advises various administrative departments about the modalities of co-financing, detailed project preparation, engagement of consultants, etc. Projects considered till now include ropeway, ski village, commercial complex, bus terminals, parking lots, two SEZ projects, and several hydro power and tunnel projects.

3.4.1.10 Madhya Pradesh

A pioneer in PPP projects in the road sector, has developed 1500 km roads under BOT. Other sectors with PPPs are water supply, city bypass, mobile medical units, bus stands, etc. GOI has granted in-principle approval for three roads under VGF. Key PPP projects are the Dewas town bypass, Dewas industrial water supply project, mobile medical units, and SEZ.

3.4.1.11 Gujarat

The Gujarat Infrastructure Development Act, 1999 (GID Act), provides for a regulatory framework for private sector participation in financing, construction, maintenance, and operation of infrastructure projects. The Act accords legal sanctity to the procedure of bidding. Various modes of structuring of projects are recognized, such as BOT, BOOT, BOOM, and lease.
management. Twenty-one projects amounting to Rs 13,672.5 crore have been implemented through the private sector. Eighteen projects have been awarded for implementation by PPP/joint sector amounting to Rs 17,553 crore. Nineteen projects, worth Rs 14,640.5 crore, are at bidding stage. The state has proposed eight projects under VGF scheme: Ahmedabad MRTS; Ahmedabad Bus Rapid Transit system; Rajkot–Jamnagar–Vadinar Road; Ahmedabad Convention Center; Dahej SEZ; Four-laning of Halol–Godhra–Shamlaji Road and Ahmedabad–Yramgam Road; ferry services between Bhavnagar and Surat.

CONCLUSION

Having seen how far India has come in its development of infrastructure putting in on a fast track to be a developing country, the next chapter seeks to do a comparative study of India and Kenya. It will seek to compare the structures, laws, policies, regulations together with all the other steps that India has taken to reach the level of development that is at now.
CHAPTER FOUR

THE CASE STUDY OF INDIA AND KENYA

PRIVATE FINANCE INITIATIVES (PFIs) IN THE UNITED KINGDOM

The surge in the popularity of PPPs has its genesis in the debt crises that enveloped many governments in the early 1980s and the Private Finance Initiatives (PFIs) that were enacted by the conservatively-led administration in the UK to fund major infrastructural projects. The public funding crisis was seemingly created by governments at the political level. The politico-economic pro-Keynesian mood of the post-World War II era, with its comparatively socially-focused attitude, gave way to the market-oriented approach fostered by Friedman. An ideology that supported an increased share of economic activity for the private sector, and a planned diminution in the invasiveness of government, made the step towards tax cutting simpler.

This shift was also accompanied by a significant movement in management ideology in both public and private sectors. The language accompanying these changes is epitomized by the demands for “lean organizations”, “doing more with less”, often achieved by constant restructuring to achieve “cost” and “efficiency” advantages. Since that period, public jurisdictions as diverse as the New South Wales and Victorian state governments in Australia, national governments of Ireland, New Zealand, Lebanon, United Kingdom and Ghana

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Among many others) seem to have embraced the concept of the PPP and the rhetoric that surrounds it.  

Today, the well-established United Kingdom Private Finance Initiative (PFI/PPP) PPP program is perhaps the best developed of all. It started in 1992, under the administration of John Major, when he was looking for alternatives to meet the infrastructure investment challenges posed by a 3% public deficit limit on GDP, as agreed upon in the Maastricht Treaty. Basically, at the time, the main reason that led a government to choose the PPP route instead of the traditional public investment in infrastructure development was the conversion of up-front fixed expenditures into a stream of future obligations. The arrangement had a kind of “off-balance-sheet” treatment. However, the simple motivation of anticipated future economic benefits was not sustainable, given the risk it had for accentuating possible fiscal crises.

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In the Treaty of Maastricht (formally, the Treaty on European Union (TEU) was signed on 7 February 1992 by the members of the European Community in Maastricht, the Netherlands. On 9–10 December 1991, the same city hosted the European Council which drafted the treaty. Upon its entry into force on 1 November 1993 during the Maastricht Treaty has been amended to a degree by later treaties.
As clarifies Li Bing et al, the PPP/PFI is today treated as a case of risk allocation in public infrastructure projects, instead of being perceived as a kind off-balance-sheet route. The UK realized that their PPP is only interesting to the public sector if its overall risks are fairly shared. The main idea is that these risks must be allocated to the party that is more able to control and manage them. The private sector is expected to have an appropriate amount of risk transferred to its hands, making their duty to deliver the product or service with quality, and securing the value for money for the public sector.

The UK uses a series of statements to clarify when it judges PFI/PPP should be:

1. The choice of procurement route is based on an objective assessment of value for money;
2. There is no bias between procurement options;
3. Value for money does not come at the expense of employee terms and conditions; and
4. The use of PFI is consistent with the government’s wider public sector reform.

In the UK, the public sector does not envisage risk transference as an end, in itself, and when it takes place, states the “PFI: strengthening long-term partnerships” publication from Her Majesty’s Treasury, it is “to create the correct disciplines and incentives in the private sector, which then drive value for money through more effective risk management.

Value for money is the trigger idea. Further proof of this space for innovation with environmentally and socially accountable propositions within a PPP framework, are the criteria government uses when practically accessing the PFI/PPP. When Her Majesty’s

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Treasury asked its PFI/PPP project managers what are the important factors that determine a contract award; they have pointed out many that are not price-based. This was not just a strong indication that there are, indeed, other evaluations than simple lowest bid, but that environmentally and socially accountable initiatives that show their benefits can encounter the space to be enhanced in tender negotiation. This important detail of PPP/PFI makes the private initiative very active during the negotiation of PPP development.

Competition and the quality of the outputs specification in UK are directly linked with Special Purpose Company (SPC) ability to innovate. Therefore, the competition can be an important driver of sustainability through private sector, as it allows in UK bid differentiation base on value for Money. Consequently, at the same time that competition forces are securing better bidders in tendering negotiation, it is also promoting the spread of knowledge and consensus among the shareholders of winning strategies, as contributing to raise the business bottom line.

In the UK, deregulation of employment and services starting in the 1980's created the conditions for the different kinds of privatisation that have been a key characteristic of British public services. The latest figures indicate that almost one fifth of public services - worth UK £60 billion are delivered by private and voluntary bodies in 2006. A pioneer in the use of the PPP approach, or the Private Finance Initiative (PFI) as it is sometimes called in the UK; PPPs have proven to be very successful with over 407 signed PFI projects valued in March 2005 at nearly £42 billion. This probably amounts to more than the rest of the world put together. In the UK, the PPP approach is applied across a wide range of services, including transport, education,

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The major types of PPP found in the UK are contracts for services, concessions, joint
ventures and investment programme management.

It is with this in mind that many other countries have developed their PPP structures and/or
policies. This chapter will do a comparative analysis of India and Kenya looking at the steps that
the two countries have taken to implement PPPs for infrastructure development in their
respective countries.

1.1 INDIA

Both the central government and the states\textsuperscript{160} are aiming to use public private partnerships
(PPPs) more intensively to help meet gaps in the provision of basic services. India has seen real
progress over the last 10 years in attracting private investment into the infrastructure sectors, first
in telecommunications, and now in ports and roads, and in individual projects in other sectors.
There is the potential for PPPs to contribute more and help meet the infrastructure gap in
India\textsuperscript{161}

...
4.2.1 Developing Capacities for PPPs in India

Over the years India has managed to implement PPPs for infrastructure development. To do so, the Government of India (GOI) has to come up with ways to ensure maximum output from the PPPs. In shifting away from the traditional methods of procurement and/or service provision it has taken steps to ensure the structures that are in place support the implementation of PPPs in India. Experience to date in India and internationally, shows that there is no unique formula for developing a sound PPP framework. However, successful programs are characterized by clear policy and legal frameworks for PPPs, competent and enabled institutions that can appropriately identify, procure and manage PPPs, and efficient oversight and dispute resolution procedures.

The central government's role in developing capacities for sub-national PPPs needs careful consideration taking into account the size of the country, centre-state fiscal and other relations, as well as the variety of experiences so far, with some states having made considerable strides and others having made very little progress.\(^{163}\)

India has managed to develop the following areas to support PPPs for infrastructure development according to a World Bank Report done in 2006.\(^{164}\)
4.2.1.1 Institutional frameworks for PPPs

A wide range of institutional structures and capacity approaches have been adopted for conceptualizing and procuring PPPs across states and central agencies, different variants of which have had some degree of success. At the state level, the three main approaches have been combining dedicated institutions with cross-cutting legislation; establishing and using cross-sectoral PPP advisory units to help line departments in the absence of overarching legislation; or relying on line departments and sectoral agencies to build capacities.

Haryana, AP and Punjab have developed specialized institutions and legislation. Each of these states has constituted an agency and passed acts to promote private sector participation in infrastructure projects across sectors. A second category of states, including Karnataka, Uttaranchal and West Bengal, have developed cross-sectoral facilitation entities, but have not passed comprehensive legislation. Finally, a third category of states, including MP, Maharashtra and Tamil Nadu, have relied on sectoral and line agencies to develop and implement PPPs. Fundamentals such as political commitment towards the use of PPPs, sufficient staff, and strong links between built-up capacity and implementation responsibility in the respective line departments are probably the most important ingredients of success.

4.2.1.2 The development of policies and standardization of contracts

Though some states have developed policies that advocate the use of PPPs, the underlying rationale is by and large one of using PPPs to substitute for capital investments by the PPPs have therefore been used more in situations where substantial capital investments are

\[\text{R}\text{.30/72343/2008: Public Private Partnerships for Infrastructure Development: A Comparative Study of Kenya and India.}\]
required, and where user fees can be accessed to defray much of the costs. To the extent that it is possible, user fees should be used to pay for projects.

In some cases, PPPs are overseen by regulatory agencies. In most cases however, the PPPs are regulated through the contract between the government agency and the service provider. Here the method for settling the disputes between the contracting parties that are likely to arise in even well-designed contracts. Monitoring by consumer and stakeholder groups of the performance of PPPs has been tested in India and is one way of supplementing the capacities of the government to oversee contractor performance.

4.2.1.3 Training and other information dissemination initiatives

Information dissemination is the key to successful PPPs - whether it adds to execution clarity of the sponsoring entity or information to investors on PPP schemes and incentives. It also provides data on existing PPP life cycle. www.pppinindia.com promoted by Department of Economic Affairs (DEA) is a one-stop shop on information of PPPs in India including policy guidelines. The site carries a link to database on PPP projects in India. The website posts all policy issues on PPP projects. It indicates the status of the proposals received by the PPP cells under the VGF scheme and PPP Appraisal Committee. It acts as a marketing tool for private sector companies to market their PPP schemes through advertising or listing in the website. A one stop site for all information relating to Public Private Partnership initiatives in India. The site carries a link to database on PPP projects in India, that:
Indicates the status of the proposals received by the PPP Cells under the VGF scheme and PPP Appraisal Committee as well as all policy issues on PPP projects.

Provides information about the possible vendors and financial institutions on the website. Various investors and financial institutions have already advertised in the site.

Disseminates information on best practices for PPPs worldwide, latest guidelines relating to PPP projects, policies by the Centre and State Governments and case studies of major PPP projects.

Enables preparation of quality proposals by disseminating the above information as well as promoting investment in PPP both by domestic or overseas parties by highlighting the opportunities of the investment in the sector.

Provides a platform to Government of India, State Governments as well as Financial Institutions, investors and stakeholders to detail various PPP engagements.

Provides contact points and referrals in Government agencies. The website regularly provides updates on all PPP related matters. Data on India/infrastructure sectors in India is collated and provided.

Private sector players could market their company through advertising or listing in the website. The site is populated with relevant and latest information.

In terms of formalized individual capacity building, the number of specialized courses offered on PPPs in India has been limited. There are some training programs at central or state level, as well as organized industry organizations such as Confederation of Indian Industry (CII). Many government organizations – both at the senior levels and middle levels – take part in these programs. However, with civil servant staff in general shifting position every few years, most of the training imparted can be quickly lost.
Perhaps more importantly, there is relatively little information on PPPs either in the public domain, or commonly available to government officials developing PPPs. This includes examples of contracts and clauses, and assessments of the success of different approaches both in terms of contracting structures as well as institutional frameworks for PPPs.

4.2.3 Government of India Initiatives

Growing recognition of the prevailing infrastructure deficit in the country and its impeding impact on sustaining economic growth as well as poverty reduction made development of social and economic infrastructure among the highest priorities of the GOI. The GOI recognized that with better infrastructure India’s growth could be higher, with the benefits reaching a much larger section of the population. It thus increased its spending on infrastructure through a series of national programs such as the National Highway Development Program (NHDP), Bharat Nirman, Providing Urban Services in Rural Areas (PURA), Jawaharlal Nehru National Urban Renewal Mission (JNNURM), the Prime Minister’s Rural Roads Program, National Rail Vikas Yojana, National Maritime Development Program (NMDP), airport expansion programs, etc.

The government acknowledged that investment in infrastructure would have to be at the same rate as the economic growth that was being targeted. In other words, gross capital formation in infrastructure (GCFI), which has remained around 4\% of GDP during 1997-98 up to 2003-4, needed to be increased progressively and rapidly.

Given the large resource requirements and the budgetary and borrowing constraints, the GOI has been encouraging private sector investment and participation in all sectors of infrastructure. The government has recognized that while public investment in infrastructure would continue to increase, private participation needs to expand significantly to address the existing deficit in
The government is actively promoting and increasingly adopting the PPP mode of developing and operating high-priority public utilities and infrastructure such as roads, ports, power, water supply, and solid-waste management services.

The PPP approach is being preferred to overcome the public sector constraints in budgetary resources and borrowing capacity. Governments have realized that accelerating infrastructure development requires large-scale investments, which are not possible out of governmental budgetary resources alone, and new institutional and financing mechanisms are required to meet the gap. PPPs are also being encouraged since they allow a mutually beneficial allocation of skills, resources, risks, and returns between the public and private sectors. While the public sector offers expertise in governance, citizens’ support, access to public funding and assumption of social, environmental, and political risks, the private sector is able to bring in financial resources, cost savings, operational efficiencies, innovative technologies, managerial effectiveness, and commercial risk sharing.

GOI has established a Cabinet Committee on Infrastructure (CoI) and a high level Committee of Secretaries, in addition to sectoral task forces, to streamline rapid decision-making and operationalise PPPs in highways, airports, and sea ports, power generation, railways, etc. It has initiated the Viability Gap Funding (VGF) scheme and established the India Infrastructure Finance Company Limited (IIFCL) to provide long-term debt finance to PPP projects, and has intensified its efforts on strengthening public sector capacity and enabling environment for attracting private sector participation in infrastructure. Overall, the government sees PPPs as an important tool for producing an accelerated and larger pipeline of infrastructure investments and catching up with the infrastructure deficit in the country.
4.2.3.1 Cabinet Committee on Infrastructure (Col)\textsuperscript{168}

The GOI constituted, on August 31, 2004, the Committee on Infrastructure (Col), chaired by the
Prime Minister. The Col is tasked with steering initiating policies that would ensure time-bound
creation of world-class infrastructure delivering services matching international standards,
developing structures that maximize the role of PPPs, and monitoring progress of key
infrastructure projects to ensure that established targets are realized. The Col is supported by the
empowered Subcommittee, which formulates, reviews, and approves policy papers and
proposals for submission to Col, and monitors and follows up on implementation of the
decisions of Col. The Col has also formed a Committee of Secretaries to prepare and implement
an Action Plan for providing adequate road and rail connectivity for India’s major ports.

4.2.3.2 Viability Gap Funding (VGP)\textsuperscript{169}

The Viability Gap Funding Scheme of the Government of India provides financial support in the
form of grants, one time or deferred, to infrastructure projects undertaken through public private
partnerships with a view to make them commercially viable. The Scheme is administered by the
Ministry of Finance.\textsuperscript{170} This facility is housed in the DEA. Infrastructure projects are often
economically justifiable but not viable commercially, at least in the initial years, due to long
reservation periods and economic externalities. In large-scale infrastructure projects, the
commercial viability is difficult to establish, especially at the beginning of the project. Therefore,
There is a need for providing some upfront assistance to make the project commercially or financially viable if it is otherwise economically viable or desirable for the state. The GOI therefore has operationalised VGF to provide grant support to such PPP projects.

Sectors eligible for VGF are Transportation (roads, railways, seaport, airport); Power/Energy; Urban Infrastructure (water supply, sewerage, solid-waste disposal); Tourism (international convention centres); and Special Economic Zones (SEZs). Any other sector can be added with the prior approval of the Finance Minister. A wide variety of PPP proposals have been provided by the states under the VGF scheme. These include Roads and Bridges, Airports and Seaports, Commuter Rail, Urban Transit and Parking; Water Supply and Wastewater System; Electricity and Gas Distribution; Municipal Solid Waste/Biomedical Waste Collection and Disposal; Convention Centre; and Waterfront Redevelopment.

To avoid shortcomings in project proposal and thereby avoid delays in the approval process, the VGF has the following criteria:

I. Government or a statutory entity should make the proposal and not the private party. The key to making PPPs acceptable is to create an environment where PPPs are seen to be a way of attracting private money into public projects, not putting public resources into private projects.

II. The proposal should be made to the PPP cell of the DEA in prescribed proforma.
III. The project needs to be implemented, i.e. developed, financed, constructed, maintained, and operated for the project term, which is the concession period, by the private sector company.

IV. The private sector company is to be selected by government or a statutory entity through a transparent and competitive bidding process; which means that the project has to be identified by the state as desirable and then bid out.

V. The project should provide service against a predetermined tariff or user charge.

VI. The government/statutory entity concerned should certify within reason that; the tariff/user charge would not be increased to eliminate or reduce the viability gap; the project term will not be increased to reduce the viability gap; the capital costs are reasonable and based on standards and specifications usually applicable to such projects; and the capital costs will not be further restricted to reduce the viability gap.

The central government is also working on a number of initiatives to assist and encourage capacity building at the state and central level. An Inter-Ministerial Group (IMG), under the Finance Secretary, has been formed to determine prequalification of bidders under PPP to avoid fly-by-night operators. A PPP Cell has been established in the DEA to administer various PPP proposals and coordinate various activities to promote PPPs. The GOI is also working to streamline the approval process for PPPs in the central sector.

4.2.3.3 India Infrastructure Finance Company Limited (IIFCL)\(^{173}\)

India Infrastructure Finance Company Limited (IIFCL) has been set-up with the specific mandate to play a catalytic role in the infrastructure sector by providing long term debt for
financing infrastructure projects in India. IIFCL raises funds both from the domestic as well as
government markets on the strength of government guarantees. An off shore SPV, Indian
Infrastructure Finance Company (UK) Limited has been set up to utilise part of foreign exchange
reserves for infrastructure development.¹⁷⁴ The IIFCL has been set up to fill the gap for long-
term infrastructure finance that banks are not in a position to address, owing to concerns relating
to mismatches in assets and liabilities. It caters for the burgeoning gap in long-term financing of
infrastructure projects in the public sector, PPP, or the private sector.¹⁷⁵

Infrastructure projects have a long gestation and often need long-term debt (+10 years) which
financial institutions are unable to provide due to asset liability mismatch and the long-term debt
lacks being at a nascent stage. IIFCL will ease this asset-liability mismatch through refinance;
lower long-term debt cost due to sovereign guarantees; and set benchmarks for market
borrowings by other organizations. IIFCL will borrow long-term funds on GOI guarantees from
multilateral organizations and others and lend to identified infrastructure projects in six sectors
either directly or through refinance of long-term debt.

Sectors eligible for IIFCL funding are: Roads and bridges, railways, seaports, airports, inland
waterways, and other transportation projects; Power; Urban transport, water supply, sewerage,
solid-waste management, and other physical infrastructure in urban areas; Gas pipeline
infrastructure projects in SEZs; and international convention centres and other tourism
infrastructure projects. Any project awarded to a private sector company for development,
financing, and construction through PPP will have overriding priority under the scheme. IIFCL

¹⁷⁴ Government of India; “Public Private Partnerships: Creating an Enabling Environment for State Projects,”
Ministry of Finance Department of Economic Affairs, July 2007 p.9

¹⁷⁵ Ministry of Finance Department of Economic Affairs (DEA), Government of India and Asian Development Bank
Regional Workshops of Chief Secretaries on Public-Private Partnership Facilitating Public-Private
Partnership for Accelerated Infrastructure Development in India;” Workshop Report December 2006 p. 35
ordinarily undertake any appraisal, which would be done by the lead bank. Loan
assistance from SPV will not exceed 20% of the project cost. All disbursements and recoveries
would be undertaken through the lead bank. The lending norms of IIFCL are: IIFCL may render
financial assistance through direct lending to eligible projects or refinance to banks and financial
institutions for loans with a tenure of ten years or more.

4.2.3.4 India Infrastructure Project Development Fund (IIPDF)\(^{176}\)

The Finance Minister in the Budget Speech for 2007-08 announced in the Parliament the setting
up of a India Infrastructure Project Development Fund (IIPDF) in Department of Economic
Affairs, Ministry of Finance, Government of India with an initial corpus of Rs. 100 crore for
supporting the development of credible and bankable Public Private Partnership projects that can
be offered to the private sector.

The IIPDF will be available to the Sponsoring Authorities for PPP projects for the purpose of
meeting the project development costs which may include the expenses incurred by the
Sponsoring Authority in respect of feasibility studies, environment impact studies, financial
structuring, legal reviews and development of project documentation, including concession
agreement, commercial assessment studies (including traffic studies, demand assessment,
capacity to pay assessment) etc. required for achieving Technical Close of such projects, on
individual or turnkey basis, but would not include expenses incurred by the Sponsoring
Authority on its own staff.

The following terms and conditions must then be observed:

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\(^{176}\) Government of India; "Public Private Partnerships: Creating an Enabling Environment for State Projects,"
Finance Department of Economic Affairs, July 2007 pp. 13-14
1) The Sponsoring Authority will, thus, be able to source funding to cover a portion of the PPP transaction costs, thereby reducing the impact of costs related to procurement on their budgets.

2) The proposals for assistance under the Scheme would be sponsored by Central Government Ministries/Departments, State Governments, Municipal or Local Bodies or any other Statutory Authority.

3) To seek financial assistance from the IIPDF it would be necessary for the Sponsoring Authority to create and empower a PPP Cell to not only undertake PPP project development activities but also address larger policy and regulatory issues to enlarge the number of PPP projects in Sponsoring Authorities' shelf.

4) The IIPDF will finance an appropriate portion of the Transaction Advisor costs on a PPP project where such Transaction Advisors are appointed by the Sponsoring Authority through a transparent system of procurement under a contract for services.

5) IIPDF will contribute up to 75% of the project development expenses to the Sponsoring Authority as an interest free loan. 25% will be co-funded by the Sponsoring Authority.

6) On successful completion of the bidding process, the project development expenditure would be recovered from the successful bidder. However, in the case of failure of the bid, the loan would be converted into grant. In case the Sponsoring Authority does not conclude the bidding process for some reason, the entire amount contributed would be refunded to the IIPDF.
4.3 KENYA

4.3.1 Kenya Vision 2030

Kenya Vision 2030 is Kenya’s new long-term development blueprint that aims at transforming Kenya into a “newly industrialized, middle income country providing high quality life for all its citizens by the year 2030”. The Kenya Vision 2030 is anchored on 3 pillars namely; the economic pillar, the social pillar and the political pillar. The economic pillar seeks to improve the prosperity of all Kenyans through an economic transformation programme covering all the regions of Kenya and aims at achieving an average Gross Domestic Product (GDP) growth rate of 10% per annum for the next 23 years. The social pillar seeks to create and build a just and cohesive society with social equity in a clean and secure environment while the political pillar aims at realising a democratic political system that nurtures issue based politics, respects the rule of law, and protects all the rights and freedoms of every individual in the Kenyan society.

Infrastructure has been identified as the vehicle that will drive the achievement of vision 2010.

The Kenya Vision 2030 is to be implemented in five-year Medium Term rolling plans with the first such plan covering the period 2008 – 2012. A total of 98 Vision 2030 Flagship Projects have been identified for Implementation in the period 2008-2012. Out of this, 21 Flagship Projects will be implemented in the 6 priority economic sectors of Agriculture, Manufacturing, Tourism, Wholesale and Trade, BPO, and Financial Services while the rest will be implemented in the sectors in the social and political pillars. Flagship projects will be implemented in partnership with the private sector through a PPP framework. During the life of the Vision,
strategies and action plans will be systematically reviewed and adjusted every 5 years in order to effectively respond to the changing global, regional and local environment.\textsuperscript{178}

In Kenya like in most developing countries, the role of government in the economy is still quite substantial. Whereas total government expenditure as a proportion of GDP at market prices was 42\% in 2000/01 Financial Year (FY), it stood at 34\% in 2004/05 FY. However, there has been hardly any change in the proportion of government expenditure towards social as compared to economic services. Total government expenditures for social services as compared to economic services has remained fixed at 30\% and 10\% of total expenditures for each of the last 4 FYs\textsuperscript{179}. However proportion of public services contracted out to be delivered by private companies is still very low. Hence there are still opportunities to deepen social expenditures and increase the use of the private sector in financing economic and services in Kenya.

In Kenya, the pressure to reduce expenditure and cut down taxes has forced the government to resort to the private sector. In the last few years even where adequate competition has not been prevalent and service provision has largely remained monopolistic, e.g. in the telecommunications sector evidence suggests that where private sector bears the risk, it delivers better results than any credible public sector alternative. To make services work for the poor people, Kenya must review its service delivery mechanisms and the institutions that provide the service. New management practices and technologies are changing the way programmes and services are delivered. Rapid development in information and communications technology has

\textsuperscript{178} Ibid
\textsuperscript{179} According to Economic Survey 2005, in 2001/2002 total expenditure was Kshs. 311 billion of which Kshs. 90 billion was allocated to social services and Kshs. 39 billion to economic services. By 2004/2005 the comparative figures were Kshs. 431 billion, Kshs. 135 billion and Kshs. 56 billion respectively (Republic of Kenya (2005a), Table 107.
4.3.2 STATUS OF PPPs IN KENYA

One of the justifications of PPPs is the government's lack of adequate financial resources for providing the service or facility that the public needs. This allows a well-resourced private entity to partner with the concerned public body to provide the needed public services or facilities, especially those that require huge capital investment such as construction of roads, railways, water treatment plants, energy generation plants, and sports stadia. PPPs agreements often contain mechanisms for a private partner to recoup its investment by for example charging and collecting user fees for a specified period. The question then becomes whether Kenya has the necessary policy, regulation and legislative framework to facilitate PPPs that will help both the government and private sector derive benefits from the implementation of PPPs.

Like many other developing countries, Kenya faces significant financial gaps in infrastructure and utilities to attain Vision 2030. Transport has a financing gap of US$ 0.14 billion per annum.\(^1\) This is further enhanced by the inability of state corporations to mobilize adequate resources to fulfil their national mandates.\(^2\) The diminishing external resources in form of loans and grants which the Government had accessed earlier to finance infrastructure services through donors have continued to reduce. This is because; donors are mainly supporting privatised utilities due to their perceived operational efficiencies from the private sector operations which

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\(^1\) http://www.tikenya.org/default.asp site last visited on 20\(^{th}\) August 2010
\(^2\) M. M. Kittolo, "Kenyan Experience on PPPs", Ministry of Transport
enhance project sustainability.\textsuperscript{183} The existence of PPPs leads to private sector investments in strategic operations without sale of assets. With private sector managing maintenance and support services, the Government professionals can concentrate of frontline service delivery.

PPPs in the transport sector so far can be highlighted as follows: In December 2006 the Governments of Kenya and Ugandan jointly concessioned the Kenya-Uganda railways. Since then the operational performance has not improved with the concessioning due to absence of a strong rail operator. The concessionaire has effectively defaulted on payments of concession fees, agreed investments and improvements in cargo haulage. The two governments have given notice of terminating the concession.

The Government also, advertised the tolling of a section of the Northern corridor in year 2007. The concessionaire was to add an extra lane-a distance of 107km-maintain the section, then charge a toll to recoup his investments. The response was not encouraging as only one firm returned the bids. It should be noted that then; there was no PPP framework in place.

### 4.3.3 Legal Foundations for Private Public Partnerships in Kenya

There are two pieces of legislation that provide some foundation for PPP arrangements. The Privatisation Act 2005 which defines privatization as a transaction that result in a transfer, other than a public entity of; (a) Assets of a public entity including the shares in a state corporation (b) Operational control of assets of a public entity (c) Operations previously performed by a public entity.

The second is the Public Procurement & Disposal (PPDA) Act 2005\textsuperscript{184} which defines public-private partnership as \textit{an agreement between procuring entity and a private party under which:}
(a) the private party undertakes to perform a public function or provide a service on behalf of a procuring entity (b) the private party receives a benefit for performing this function, either by way of (i) compensation from a public fund (ii) charges or fees (iii) combination of compensation and charges. Section 64(4) of the Procurement Act states that the Public Procurement Oversight Authority shall issue detailed guidelines for concessioning or PPPs.

Public Private Partnership Regulations 2009 defines public private partnership agreement as a written contract recording the terms of Public private partnership concluded between a procuring entity and a private party. Under the regulations, the Government has established a Public Private Partnership Steering Committee whose functions among others are: (i) establishing PPP standards, guidelines and procedures (ii) Serving as a resource centre for best PPP practices in Kenya (iii) providing final approval/disapproval for PPP projects, after ensuring that there has been quality analysis of the PPP project to aid decision making and testing the PPP project for affordability, risk allocation and value for money. A Public Private partnership Secretariat within the Ministry of Finance (MOF) headed by the Public Private Partnership Secretary is also established to support and act as a Secretariat to the Steering Committee. One of the members of the Steering Committee is the Permanent Secretary for the Ministry responsible for Planning, National Development and Vision 2030.
A procuring entity may enter into a PPP whereby a private party performs part of a procuring entity’s service delivery or administrative functions and assumes the associated risks, provided that in doing so the procedures strictly adhere to the guidelines. In return the private party may receive a fee according to predefined performance criteria, which may be from service tariffs or user charges or from government budget. The Public Private Partnership Regulations at Section 3 identifies the following PPP arrangements which can be entered into: A service contract, a concession, a lease, a Build Own Transfer (BOT), a Build Own Operate (BOO) or any other scheme as may be prescribed by the PPP steering committee and approved by the Cabinet.¹⁹¹

Most Sessional Papers for various sectors have also recognised PPPs as the way forward in meeting the infrastructure deficit and to improve on the quality and quantity of services. This will have the following attendant benefits:¹⁹²

a) The PPP will assist the private sector to invest the much needed funds by the government and in turn make returns.

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¹⁹¹ These arrangements are defined as follows in the Public Private Partnership Regulations, 2009.

Service Contract: whereby a procuring entity awards a private party the responsibility to manage and perform a specific service, within well-defined specifications for a specified period of time not to exceed five years and the procuring entity retains ownership and control of all facilities and capital assets and properties;

Concession: for a period not exceeding thirty years whereby the private party maintains, rehabilitates, upgrades and enhances the facility in question;

Lease: whereby the private party pays the procurement entity rent and manages, operates and maintains the facility and receives fees or charges from consumers for the provision of the service for specified time not exceeding fifteen years;

Build Own Transfer (BOT): whereby a private party designs, constructs, finances, owns, operates and maintains the infrastructure facility for a specified time period not exceeding thirty years, or such longer period as may be agreed, after which the facility is transferred to the procuring entity; and

Build Own Operate (BOO): whereby a private party designs, finances, constructs, owns, operates and maintains the infrastructure facility and provides services for an agreed time period.

b) PPPs transfer certain risks to the private sector and provide incentive for assets to be properly maintained.

c) PPPs can lower the cost of infrastructure by reducing both construction costs and overall lifecycle costs.

d) PPPs encourage a strong customer service orientation.

e) PPPs are built on the premise of outcome rather than the process and this enable the public sector to focus on the outcome-based public value for the assets they create

f) Experience in the other countries show that PPPs have a solid track record of on-time, on-budget delivery

g) PPPs must meet-Affordability and Value-for-money (cost, price, quality, quantity, timeliness and risk transfer.

4.3.3 Steps the Government of Kenya has taken

The Government of Kenya (GOK) in its efforts to implement the PPP regulations has set up various institutions.

4.3.3.1 PPP Steering Committee

The Public Private Partnership Steering Committee consist of; the Permanent Secretary to the Treasury-Chairman; the Attorney-General or his representative; the Permanent Secretary, Office of the Prime Minister; Permanent Secretary for the Ministry responsible for Planning, National Development and Vision 2030; and other three members not being public servants appointed by the Minister from a list of nominees from private sector bodies approved by the Cabinet.
The functions of the Steering Committee are:

a) Spearhead the public private partnership process and promote understanding and awareness of Public Private Partnership among key stakeholder groups;

b) Review challenges constraining participation or realisation of full benefits expected from Public Private Partnerships and formulate time bound solutions to address the challenges and to create an enabling environment;

c) Establish public private partnership standards, guidelines and procedures including the development of standard procedures for conceptualization, identification, prioritization, development, assessment of Public Private Partnership projects and development of standardized bid documents;

d) Review direct and indirect liabilities and assess contingent liability risk exposure of the Government and advice on the acceptable levels of direct and indirect liabilities;

e) Ensure that all proposed public private partnership projects are consistent with the country’s national priorities outlined in various policy documents;

f) Coordinate with the Public Procurement Oversight Authority to ensure all tenders phase activities of PPP projects conform to procurement best practices

g) Approve PPP projects submitted to the Committee in accordance with the provisions of the regulations for PPP.

4.3.3.2 PPP Secretariat

There is established a Public Private Partnership Secretariat to be within the Ministry of Finance and headed by the Public Private Partnership Secretary which shall support and act as Secretariat
The Public Private Partnership Secretariat shall be to serve as a resource centre for the best public private partnership practice in Kenya including supporting capacity building in public partnership projects' planning, co-ordination and contract monitoring and working as the focal reference point for public private partnership advice; and to carry out any other functions as the Steering Committee may determine.

4.3.4 Keys to Successful PPPs in Kenya

The National Counsel for Public-Private Partnerships (NCPPP)\textsuperscript{195} has identified six keys to successful PPPs.\textsuperscript{196}

1. A supportive legal and political environment, implying a law that regulates PPPs and high-level political commitment to PPPs. In Kenya, PPPs are regulated by the Public Procurement and Disposal (Public Private Partnerships) Regulations of 2009, made under the Public Procurement and Disposal Act of 2005. The PPP Regulations establishes a PPP Steering Committee, which sets PPP standards and procedures. Further,\textsuperscript{197}

\textsuperscript{195} The National Council for Public-Private Partnerships (NCPPP) is a non-profit, non-partisan organization founded in 1985. The mission of The National Council for Public-Private Partnerships is: (a) to advocate and facilitate the formation of public-private partnerships at the federal, state and local levels, where appropriate, and to raise the awareness of governments and businesses of the means by which their cooperation can cost effectively provide public with quality goods, services and facilities. The objectives of NCPPP are To serve as an advocate of public-private partnerships; (b) to provide complete, objective, timely and useful information on the utilization of public-private partnerships to provide services and facilities to the general public; (c) to facilitate communications between public- and private-sector members with respect to issues related to the implementation of public-private partnerships; (d) to conduct educational, training and other activities on public-private partnerships; (e) to provide input to the public dialogue in support of the use of public-private partnerships and removal of obstacles to their implementation and (f) to facilitate an international dialogue on public-private partnerships.

\textsuperscript{196} http://www.ncppp.org/howpart/index.shtml site last visited on the 20th of August 2010

\textsuperscript{197} http://www.tikenya.org/default.asp site last visited on 20th August 2010
the PPP Regulations require the Cabinet to approve PPP projects worth US$10 million and above.¹⁷

2. A successful PPP is an active public sector partner. In this regard, a public entity in a PPP must actively monitor its partner private entity to ensure that it effectively and efficiently delivers on its obligations. In fact, PPP Regulation 23(1) requires a public entity party to a PPP to establish a unit of senior staff to oversee the day-to-day management of a PPP. Further, PPP Regulation 23(3) mandates a public entity to ensure that its properties are protected from forfeiture, theft, loss, wastage and misuse under a PPP.¹⁹⁸

3. A watertight PPP contract. The minimum contractual provisions of a PPP under PPP Regulation 21 include: duration of the contract, which is important to avoid a public entity being cheated by its partner private entity into granting it an unreasonably long timeframe for recouping its investment; description of the good, works or services to be provided; payment arrangements; clear allocation of risks and responsibilities between the parties; a monitoring and evaluation framework; dispute resolution mechanisms; and remedies available to an aggrieved party.

4. A successful PPP is guaranteed revenue stream to the partner private entity. Obviously, a private entity will invest its resources through a PPP only if it will be sure to recover its investment. However, a public entity must watch out for exploitation of members of the public through exorbitant user charges levied by its private partner in the name of

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¹⁷ Many have wondered if lack of political will have driven Sports and Youth Affairs Minister Prof. Helen Sambili's decision in early 2009 to scuttle the US$ 1.5 million, three-year deal between the Sports Stadia Management Board and the Coca-Cola East and Central Africa, in which the multi-national company was to exclusively brand, and

¹⁸ With regard to the non-performing RVR, which was to invest in, operate, modernise and maintain the Kenya-Uganda 5-year deal signed in 2006, the vexing question is: Why did it take the governments of Kenya and

¹⁹ Why did it take the governments of Kenya and Uganda over three years to realise that RVR had terribly failed to honour its concession obligations, particularly payment of concession fees and modernisation of the rail infrastructure?
recouping its investment. In fact, **PPP Regulation 27** requires all PPPs to be audited annually.

5 Stakeholder support of the PPP. This may only be guaranteed if key stakeholders participate actively in the whole project cycle, that is, conception, design, monitoring of implementation, and evaluation of a PPP. However, other than three private sector nominees to the PPP Steering Committee, the PPP Regulations are silent on the participation or consultation of other stakeholders such as interested or affected members of the public and civil society. For example, after the signing of a PPP agreement, **PPP Regulation 21** requires the publishing of information about the concluded PPP tender—such as name of the project, the winning bidder, the PPP price and the duration of the PPP—in at least two newspapers of national circulation, or on the public entity’s website. With Kenya lacking a freedom of information law, many stakeholders, especially those initially locked out from the PPP process, may not effectively participate in debating, monitoring or evaluating planned, ongoing, or concluded PPPs because of lack of access to crucial information about those partnerships. Without stakeholder support, a PPP may face opposition from aggrieved interest groups.

6 A carefully chosen partner. This implies that a public entity must procure its partner private entity openly and fairly by first circulating and receiving PPP invitations from a wide pool of potential private partners. For example, only one private firm responded to the government’s 2007 advertisement for tolling of a section of the Northern corridor road, in which the concessionaire was to build a 107-km road and recoup its investments through tolling. **PPP Regulation 16(1)** mandates a public entity to advertise PPP...
invitations in not only at least two national newspapers, but also on its website so that information about planned PPPs is not shared only among a small cartel of bidders. PPPs are relatively effective in developed countries because of those countries’ strong transparency and accountability mechanisms. Therefore, Kenya must strengthen checks and balances in its PPPs, including stakeholder participation, to reap the benefits that successful PPPs may provide to the public in the context of the massive infrastructural development planned under Kenya’s Vision 2030.

4.4 CONCLUSION

Having done an analysis of the structures that exist in Kenya and India, the following chapters seeks to draw conclusions and recommendations for Kenya and other developing nations in their quest to develop infrastructure vide public private partnerships. It is clear from the research and data in this chapter that infrastructure is key for the development growth of any nation and as such it must be given the due consideration in terms of finances and skills.
CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

SUMMARY

Governments have the difficult task of protecting the public’s interest while meeting the diverse needs of the citizen. The peoples’ expectations continue to rise as they demand more and better government services at lower costs. What is more, their confidence in their government and leaders, hinges on the quality of these services. Governments are thus continually challenged to deliver existing government services faster and cheaper, as well as make use of them to create new services and new roles for government to enhance social progress and foster prosperity for its citizens.

Thus the advent of Public Private Partnerships: This has been the core subject of this research. It has come out clearly that for any economy to survive the infrastructure in place must be suitable to enable whatever sort of development occurs. Without the proper infrastructure, the rate of growth and/or development cannot be assured. This has to be coupled up with the right skills and/or manpower to handle the development of the said infrastructure. Mega projects such as roads, rail, ports, transport systems-subways, airports and so on require funding which in most instances governments, especially in developing countries is scare or missing.

This is what has pushed governments to get into PPPs as seen in chapter two with the pro’s and cons the same discussed as including but not limited to delivering value to the public through lower cost, higher levels of service and reduced risk; delivering value for money through synergies combining private sector skills across the service delivery contract; creating long term approach to provision of public resources; new facilities and services provided efficiently and
PPPs have been hailed as the new approach to infrastructure service delivery because: they maximize on the value of private sector involvement in infrastructure development; coordinate infrastructure planning and development; develop market capacity; educate the community and shift mindsets regarding the government's role in service delivery.  

PPPs have been deemed to be effective where there is: an effective enabling environment; properly resourced and committed government team; an effective procurement process; when it is used where it makes sense; effective management and allocation of risk; clear specifications of outputs; project affordability; understanding that private sector needs to make an appropriate level of return and appropriate performance levels and incentives.  

The role and responsibility of the government in PPPs then changes to become that of supplier to buyer of goods.  

"...the public sector pays for services on behalf of the general public and retains ultimate responsibility for their delivery, whereas the private sector's role is limited to that of providing an improved delivery mechanism for the services."  

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The important shift is from the role of supplying services to buying them:

"The essential role of the public sector in all PPPs is to define the scope of business; specify priorities, targets and outputs; and set the performance regime by which management of the PPP is given incentive to deliver and ... also to pay for the service." \(^\text{204}\)

3.2 CONCLUSIONS

Time and effort spent laying the right foundations by establishing a clear public-private partnership (PPP) policy rationale, a legal framework, an investment framework (including an approval process), along with a well-organized operating framework and then informing potential investors of their existence will ensure a much better private sector response when project procurements are launched.

One immediate difficulty is that public sector resources are often made available only at the later stages of project preparation, usually at or near the tendering or procurement phase. Resources are usually much less readily available at the early stages of program or project preparation, often because the outcomes are less well defined or certain at this stage. However, investing time and effort up front in laying the right foundations can have a positive impact on the project’s success and be an efficient use of public resources. In countries where public sector processes and institutional capacity are weak, managing the relatively complex PPP process is especially challenging and should not be underestimated. Governments and donors should seek to ensure that such early-stage activities are sufficiently resourced.

5.2.1 Policy Rationale

Establishing a clear policy framework helps both the public and the private sectors to understand the core rationale for PPPs and how the public sector will go about making them happen. PPPs are difficult to deliver in an unstable policy environment. When assessing a PPP market, the private sector expects to see a PPP policy that sets out the following:

1. The rationale for using PPPs
2. The guidelines that the public sector will use to assess PPP projects in a consistent way
3. The determination of who approves what and when throughout the process of project selection, preparation, and procurement
4. The process of resolving disputes (often set out in legislation).

The private sector will also want to know about the process and what is involved, to assess how much it will cost to prepare and submit a bid for projects (such as whether and when detailed designs will have to be developed), how long the bidding process will take, how workable and transparent it will be, how the public authority will manage the partnership in the long term, and, above all, how committed is the government to the project. The more transparent the objectives,
targets, and consequences of the PPP, the more effective the partnership will be. Governments should expect to establish a clear evaluation and process map that sets out the following: key decision points along the process, timelines, criteria for project selection and eligibility, and principles or criteria for evaluating bids.\textsuperscript{2}

5.2.2 Legal Framework

Private sector investors always examine the legal framework and its ability to ensure the effectiveness of long-term PPP contracts. Legislation may be needed to allow a private sector company to charge and collect user fees under a concession PPP. Specific laws may also be required to allow the public sector to contract with private bodies for the delivery of services hitherto provided only by the state.

The private sector may be expected to ask the following key questions of either the law or the PPP contract itself:

1. Does the public sector have a robust, forward-planning program and allocation process to ensure that payments can be made when due, such as obligations against future budgets?

2. Is combined procurement of construction and long-term operation and maintenance permitted (or do these phases have to be procured under separate contracts)?

3. What are the investors’ rights (what happens if a contract is terminated early)?

\textsuperscript{2} For example, the South African Treasury’s Public Finance Management Act regulates and sets out the responsibilities to ensure efficient and effective government financial management. Under this act, Treasury Regulation 16 specifies the required approvals and responsibilities, and detailed guidance, in the form of a PPP manual, have been developed to cover the range of processes involved.
4. How will repatriation of profits be treated for overseas investors, and what restrictions, if any, will there be on the use of expatriate personnel?

5. What are the lenders’ rights (for example, the lenders’ ability to take security over the contract—lenders do not usually have security over the underlying infrastructure asset, as this ultimately belongs to the public sector—or to take over management of the asset when enforcing their security)?

6. How will contract disputes be resolved, and what rights and obligations are required of either party in the event that the project does not go according to plan?

7. How will payments be taxed under the project (for example, sales or value added taxes on construction costs or service payments)?

8. What forms of government support are likely to be available for certain risks (for example, minimum-traffic guarantees on a toll road)?

9. How will changes to the contract be handled, and what compensation mechanisms will be used?

10. Are unsolicited proposals permitted, and, if so, how will they be treated?
There is often a balance to be struck between a fixed legal framework and a flexible one that is able to respond to developments in best practice over time. Investors have a strong preference for certainty, detail, and clarity in the legislative framework, so long as it is a good framework. However, as a note of caution, highly detailed PPP legislation has sometimes been developed from an early stage of a program without input from the experience of actual projects (functioning either domestically or internationally). This legislation has sometimes proved to be unworkable and difficult to change. It may be preferable to set out core principles (based on international best practice) in framework legislation and to use administrative rules to set out more detailed law that may respond in a logical and consultative way over time to inevitable changes in policy and the market.

5.2.3 Investment Framework

PPP programs often start with one-off projects that deliver experience and build confidence in the ability of government to develop programs later. In many countries, there may simply be only one or two projects in a sector, too few to constitute a program. Wherever possible, an infrastructure investment plan is a good way for government to present its approach to investment to the private sector and to demonstrate top-level political commitment. Investment plans, however, must be presented carefully and in the proper context so that they are not perceived as a wish list of projects lacking credibility and coherence. Such plans generally do not commit to using the PPP process for the entire program, but instead set out the level of investment required, the links between private and public investment, and areas within the plan where government expects PPPs to play a role.

Wherever there is the opportunity, it makes sense to develop programs in specific sectors, with the benefits of replicability for both the costs and the quality of the PPP process can be
significant for both the public and the private sectors. Well-prepared investment plans also help
the private sector to understand the general environment for individual projects. A port project
may make little commercial sense unless, say, there is connecting rail transport infrastructure or
reforms in transit and customs clearance.

The other useful role of investment plans, and the project pipelines that these may set out, is to
encourage more bids from high-quality investors: given the costs of bid preparation, investors are
more likely to take an interest in a program than in a one-off project. In a program with a series
of bids they will have more than one chance to submit a winning bid and can spread some of the
general costs of bid preparation over the series. As the viability of many projects may depend on
regional as well as local factors, the role of regional economic communities in facilitating
projects may also be important.

5.2.4 Operating Framework

While many governments understand the need for a sound policy rationale and for strong legal
and investment frameworks, investors want assurances that the operating framework within
government is capable of managing the PPP process and that policy makers and the parties
implementing projects have a realistic understanding of the complexity of PPP projects. In
particular, public procurement authorities often fail to appreciate the significant differences
between PPPs and traditional forms of procurement and the implications of these differences for
the level of resources, the unique skills, and the new processes and institutions required. Indeed,
implementing a PPP program may often lead to fundamental changes in the way a public
authority perceives its role and the way it goes about its business.

However, projects are usually better being “owned” by their respective public authority
throughout their life rather than being centrally procured. A PPP unit, therefore, usually only
plays a supporting role: it helps the public authority to prepare the project and, where necessary, select and manage specialist advisers; in addition, it ensures that the project fits into the overall PPP policy. A PPP unit may also play a role in project approval and quality assurance throughout the process of project development. Conflicts of interest between these roles can be resolved by making decisions outside the unit, even when a decision is supported by the unit’s evaluation.

An important principle, however, is that, in developing operational rules and processes, government must also create mechanisms to help the public authority to follow the rules. Nevertheless, balancing the roles of project support and approval is often difficult, as it requires achieving the right level of engagement between the unit and the project team. This calls for high quality, credible staff led by someone who commands respect across government and enjoys strong political support at senior levels. In cases where the program is sufficiently large, a sector-focused unit may also be found within the line ministry itself.

The importance of having a competent PPP unit that is staffed with highly qualified individuals able to work across government cannot be overemphasized, if a successful PPP program is to be delivered. Yet resourcing a PPP unit is often one of the most difficult challenges for governments in the early stages of program development.

Equally, the importance of reusing or retaining the experience of public officers who have been through a PPP transaction is often poorly recognized, as individuals return to their previous position or depart for the private sector. The experience of these officers is invaluable to the public sector as well implications of these differences for the level of resources, the unique skills, and the new processes and institutions required. Indeed, implementing a PPP program may often
lead to fundamental changes in the way a public authority perceives its role and the way it goes about its business.  

Given the institutional weaknesses and challenges that exist in Africa, it may be possible to support project delivery by leveraging the project management capacity of major resource development companies, which are increasingly active in Africa. Such companies could be asked to consider delivering and managing social infrastructure services such as schools and health infrastructure alongside their commercial investment activities.

### 5.2.5 Summary

In summary, time and effort must be spent laying the foundations for successful public-private partnerships:

1. Establish and clarify the policy framework, as the private sector needs to understand the drivers that lie behind the projects.
2. Establish a clear legal framework, as PPPs depend heavily on contracts that are effective and enforceable.
3. Ensure consistency, as well as clarity, of the policy and legal framework, which reduces uncertainty for investors.
4. Use legal terms and approaches, where possible, that are familiar to the international private sector.
5. Draw up investment plans, which can be useful to demonstrate high-level political support, to indicate the potential flow of future projects, and to explain how projects fit together, even regionally.
6. Avoid sending out wish lists of disconnected projects that are not part of a coherent program.
7. Establish a clear PPP process map

8. Create a PPP unit within government, with relevant commercial and legal skills, which is a key source of support for policy makers and project developers. It helps to ensure consistency and credibility. Credibility can send a powerful signal to the private sector about the public sector’s competence and seriousness of intent

9. Capitalize on the experience of others who have managed the process, as the private sector takes considerable comfort from working with public officials who have been through the process before

10. Consider involving private sector resource companies that are engaged in other investment activities in the delivery and management of infrastructure projects.

RECOMMENDATIONS

Kenya is looking to set up its PPP framework, for it to be successful it must be characterized by clear policy and legal frameworks for PPPs; competent and enabled institutions that can appropriately identify, procure and monitor PPPs; and efficient oversight and dispute resolution procedures. To do so the following areas become key for the government to focus on:

1. Strengthening the monitoring of fiscal costs;

2. Policy and legislative frameworks;

3. Information dissemination;

4. The development of guidance material;

5. Setting up a PPP unit to serve as a pool of expertise;

6. Project development funds for the preparation of PPPs; and

7. Funding for PPP payments made by state governments.
The government’s role in developing capacities for PPPs needs careful consideration taking into account the size of the country, fiscal policies and other relations and the variety of experiences. Its role also depends on the extent to which the government wishes to proactively catalyze the increased use of PPPs by counties and municipalities. Information dissemination and guidance efforts can be expected to lead to results. However, a catalytic role by the government is likely to be needed to expand the usage of PPPs, particularly in municipalities/counties and sectors where they have been less used so far. This would consist, in addition to information dissemination and guidance, of resources to develop PPP projects and frameworks, and to fund government commitments under PPPs. This would help address important constraints to further development of PPPs in the country – namely, weak capacities to identify realistic PPPs and bring them to the market; a lack of willingness to pay for project development; and a lack of creditworthiness on the part of municipalities/counties to provide their financial contribution to PPPs. However, there are considerably more risks in this catalytic role than in more limited information dissemination and guidance roles.

5.3.1 Strengthening oversight of the fiscal costs of PPPs

Regardless of whether or not the other actions listed above are taken, if there is to be an increased use of PPPs the government should work to strengthen oversight of their fiscal costs. Fiscal Responsibility should include statements on fiscal prudence and treatment of contingent liabilities that are relevant to PPPs; legislation limiting total liabilities as a percentage of GDP includes provisions related to contingent liabilities; off-budget borrowing and other debt-equivalent instruments within the annual borrowing (consolidated fiscal deficit) cap.
Nonetheless, implementing this may not be straightforward. More generally, while debt guarantees are often published, the values of other kinds of guarantees are not. Nor is it clear that governments value or calculate in kind support provided to many PPPs, for example real estate development options, which can be a further source of fiscal costs as well as an important factor in deciding whether a PPP offers value-for-money.

There are only emerging practices and models internationally since this is also new for most other countries. In general, reporting and disclosing PPP contracts and government guarantees and reporting the stream of future payments under existing PPP contracts would be good practice and, where a PPP program is of fiscal significance, a report on PPPs covering these areas should be included as part of the budget documentation.

The government should work to strengthen oversight of the fiscal costs of PPPs, including assisting local governments in this area and enhancing analysis of the fiscal costs of PPPs in central government monitoring of the fiscal position of the municipalities/counties. Capacity-building efforts should be led by the Government of Kenya (GOK) Finance Ministry, with involvement from other agencies as necessary. This capacity building effort should go forward regardless of any other steps taken by the government.

5.3.2 Policy frameworks

GOK has had the Public Procurement and Disposal (Public Private Partnership) Regulations in place since 2009 that can now be used in some of the projects in session for example in the transport sector –in December 2006 the GOK and Uganda jointly commissioned the Kenya-
Uganda Railway; GOK took a decision to replace the current driving license with second
Generation Driving License vide BOT scheme; and GOK advertised the tolling if a section of the
Northern Corridor in 2007.

New policy initiatives would however be useful in an effort to scale up and broaden the PPP
program. Importantly, this would have the government concerned set out clearly why PPPs are
being pursued and the benefits sought; and indicate that they will only be pursued where these
benefits can realistically be expected. The problem is the emphasis on PPPs as raising additional
capital, rather than only being pursued where services will improve and taxpayers and consumers
will get value-for money. This could be addressed by a clear policy statement which would make
clear both the rationale and also the limits to the use of PPPs. This would help to give the PPP
program a clearer political mandate.

Broad policy initiatives would also enable governments to announce more clearly the
institutional framework for PPPs. This could include the regulation, oversight and evaluation of
PPPs, all areas which need strengthening, as well as the role of any new cross-sectoral units in
developing and implementing PPPs. Another important area to be addressed would be
procedures for the procurement of PPPs, in particular the use of competitive processes, and
approaches to be adopted towards unsolicited projects.

While broad policies provide an important signal of political commitment, it may also be
necessary to translate this into action plans and policies for individual sectors. These could
provide a more precise orientation to encourage ministries and agencies to pursue and implement
PPP programs.
5.3.3 Legislative frameworks for PPPs

Cross-cutting PPP laws and sector specific legislation are the options available and have been used to restructure industries, introduce competitive markets and set up new institutions, such as sector regulators. It has been argued that one of the benefits of cross-cutting PPP legislation is that it allows the consolidation of relevant legal provisions into one law, and also allows the government to legislate the use of certain processes for the development, procurement and regulation of PPP projects. While not strictly necessary, the use of new processes might be better enforced if given the force of law. This might be more important at the local government, where checks and balances and oversight are not as strong as at the government.

Particularly at the local level, therefore, consideration should be given to the development of cross-cutting PPP legislation. The legislation should provide possible models for other municipalities/counties. One important aspect that could be addressed by such legislation is mechanisms for dispute resolution. Legislation could also establish alternative dispute resolution procedures that could be used to efficiently settle differences between the parties.

The development and passage of legislation also allows for consultation and open debate about the government’s policy for pursuing PPPs, including the expected benefits and rationale. This could be an important mechanism to help increase the public legitimacy of PPPs.

5.3.4 Information dissemination

Despite the fact that PPPs in Kenya are a new phenomenon, there is still no publicly accessible database providing even the most straightforward information on them. There is no organized forum for state level PPPs, or even central agencies, to share experiences, and it is difficult to compare contracts for similar services since these are not in the public domain. Improving the
flow of information would help government officials planning and developing PPPs, the private sector interested in participating in PPPs, and stakeholders interested or concerned about PPPs.

One main component of an information dissemination program would be a web-based portal that would feature: a publicly-accessible national database that would contain on a project level basis information on its basic structure including sector, expected/actual contract award date, capital cost, executing government agency and private developer, and method of tender; links to websites of both Kenyan and foreign PPP agencies and contact information for agencies in India developing PPPs; and PPP pipelines for different counties and municipalities. Sufficient resources for ongoing maintenance of the database must be provided to ensure continued relevance.

A second major component would be the development of training materials. The main target group would be project teams in contracting authorities, but training could also be targeted at more senior government officials, as well as those in other ministries, such as Finance, that interact with the contracting authorities and have an oversight role. The private sector may also benefit from such training. Substantive evaluation efforts, for example analysis of successes and failures of individual projects, and case studies would assist in the development of training materials and help both in designing new PPPs and managing existing ones. Over time this could be broadened into the provision of data on the performance of PPPs to improve decision making on the use of PPPs versus traditional public procurement.

Finally, efforts could also be made through workshops and other information dissemination mechanisms to reach politicians, consumers and other stakeholders, so that they are better informed about the nature and structure of PPPs. This would also be helped by greater transparency including placing PPP contracts in the public domain (see box 1). There may be
concerns over disclosure. However, there is relatively little that is genuinely commercially confidential in PPP arrangements, and though these are complex documents, this does not seem to be a valid reason not to allow citizens to access them.

BOX I: Encouraging Transparency in PPPs

Public disclosure of PPPs promotes consumer rights, helps enforcement of obligations, and reduces incentives for corruption and special treatment of certain private providers. A number of countries have taken the initiative to place contracts for public services in the public domain. In some situations, more general policies and legislation on access to information motivate this. In the UK, the Freedom of Information Act, now in force since January 2005, will allow people to access information on PFI and other PPP contracts, including provisions relating to payment terms, incentive mechanisms, performance standards, dispute resolutions, and other procedures. It will also be possible to obtain information on evaluations and compliance reports under PFI projects. To help promote the practice of routine disclosure, the World Bank maintains an Infrastructure Contracts & Licenses Database that provides links to government and regulatory agency web sites that contain the main instruments – contracts and licenses – used to regulate public and private provision of infrastructure services. This can be found at [http://ppi.worldbank.org/icl/](http://ppi.worldbank.org/icl/) institute and/or think tanks, with delivery supported by a number of regional governments for PPP training. These could also undertake outreach efforts outside of the government.

The public good nature of information dissemination means that it would make sense for this to be led by a unit located within a single ministry with cross-sectoral responsibilities, such as Finance. Most of the work would be contracted out and delivered by others, including the development and maintenance of the portal and database on PPPs, and training material and case studies could be developed by a national training

5.3.5 The development of guidance material for PPPs

Guidance material can offer a number of benefits, including more rapidly diffusing good practices and lowering transactions costs. The standardization of contract clauses can help reduce both the complexity of PPP arrangements and project preparation costs. Another possible role
for the government would therefore be to develop guidance materials to support the development and implementation of PPPs. This could cover issues related to contract design, procedures for identifying, procuring and managing PPPs, and even model PPP legislation. It could also cover short guidance notes on focused topics of interest. Such notes could be a helpful complement to case studies, allowing for the discussion of nuances and recommendations for differing local contexts.

A government’s effort to produce guidance material clauses could lead to the more rapid adoption of good practice approaches by ministries, reducing learning and transactions costs for private companies and their advisors. This is probably true in most countries, but will likely be as applicable, if not more so, in Kenya where the mechanisms for sharing information and experiences are still limited. Some of the risks associated with guidance being seen as mandatory could be addressed by having guidance indicate a range of options wherever appropriate – for example different options for using particular formulations for contractual clauses, or processes or methodologies for estimating affordability to the government or value-for-money of a PPP.

This relatively limited role could be led by a single central agency, though would benefit from input and oversight from a public-private advisory group to guide where this central government effort could add most value, and what types of materials are most needed. On the public sector...
side, this should contain representatives from state governments as well as the government. Much of the actual preparation of material should be contracted out to consultants experienced in the field.

5.3.6 PPP units to provide a pool of expertise

Most countries engaged in a broad-based PPP program have felt the need to develop a cross-sectoral PPP unit although the role that this unit plays is sometimes restricted to information dissemination and the preparation of guidance material. The design response to two key issues – the role of a cross-sectoral unit vis-à-vis ministries and the role of a national unit in sub-national PPPs – will be driven by the business practices within governments and the fiscal, and other, relations between the government and the municipalities/counties. This means that some models which are more centralized, such as those in the UK and South Africa where national level units have a prominent role in sub-national PPPs, will not be workable approaches in Kenya.

At the counties or municipal level level, a dedicated PPP unit can both broaden the PPP program by transferring lessons and experiences across sectors, as well as improve the quality of PPPs by bringing to bear better transactions skills. Particularly where there is not a track record of PPPs, skills are probably best brought in from the private sector to supplement available capacities in the state government. This can be done through a public-private company. While this may be a straightforward route for bringing in expertise, the possible conflicts of interest have to be addressed and dealt with.

A national PPP unit could undertake the information dissemination and guidance roles described above. It could also usefully play an active role in identifying areas where PPPs could be undertaken by central agencies and ministries, and working with these agencies to conceptualize and bring to the market individual PPPs. To do this, it would need the right transactions skills,
most likely brought in from the private sector. There might also be concerns that the ministries and agency would, for turf reasons, not work or cooperate with this unit in the development of its PPPs. These concerns would be reduced both if the unit was seen to be highly skilled and its contribution valued, as well as if there were requirement for the vetting of central agency PPP proposals by this unit, prior to their clearance.

It is not so clear that this unit should have an active transactions advisory role with respect to state and municipal PPPs, in the manner, for example, that Partnerships UK does. This would directly substitute for the development of state-level capacity. It may also be challenging to do this for a large number of deals, and there might need to be some form of prioritization most likely for sectors Kenya because it has seen fewer PPP deals. This unit would however build up state level capacities through information dissemination and guidance, and also by furthering the national level PPP program.

However, if the government were to provide additional funding for PPPs (see below) then this unit could review these PPPs to assess whether the contractual structure proposed is robust, that risks are efficiently allocated and that projects to be supported by the government are sound. This oversight role may eventually develop into a prescriptive role, with municipalities/counties interested in accessing the central fund having an incentive to use the national unit’s approaches and recommendations to increase the likelihood of acceptance of their project. It would be important therefore that if this clearance and oversight is done that the national unit make clear its guidance and approaches on contract design, risk allocation, affordability and value for money assessment, and provider selection.

The two main options for constituting the national unit are either as a cell or group within an existing ministry or agency, or as a company, either owned solely by the government or a joint
The right choice depends in part upon what role the unit is to fill. The first option is likely to be the best approach if it is to play primarily an information dissemination and guidance role. Within this set-up, whatever transactions skills may be needed could be secured through hiring consultants on long term contracts. The second option would be preferable were the unit mainly to focus on transactions and undertake a bigger volume of deals, as setting it up as a company will facilitate paying salaries to attract staff with financial and legal skills, and make it easier to provide monetary incentives for closing deals. However, it is likely to take more time to implement and establish compared to creating a unit within an existing agency. There is a third possibility, a separate agency or authority but this would perhaps not offer the benefits of speed of establishment and integration with existing budgeting and approval processes that a unit within an existing ministry would have, nor the flexibility that a company would have in terms of pay scales and incentives.

The need for such a unit, and the roles it will play over the life cycle of PPPs, should be agreed and accepted by ministries, especially Finance and Planning. Up-front agreement would help ensure that it serves a well-defined purpose and at its inception neither is perceived as a threat nor suffers from unrealistic expectations.

5.3.7 Project development funds

A number of PPP units manage funds which defray some of the costs of developing PPPs. There are two arguments for the use of these funds. The first is that many governments new to PPPs do appreciate the need to spend more on preparation of PPP projects than was spent on the procurement documents for civil works projects in the same sector. The second is that since PPPs are relatively new, the costs of preparing initial projects may be higher and that with learning some of these will come down.
One important issue is the terms on which this fund would be accessed. A purely grant based fund would maximize chances of uptake, but would bring with it risks that it was not being used for priorities. This could be mitigated to some extent by having clear eligibility criteria for accessing these development funds – for example in particular pre-specified sectors, or sectors where the state concerned had done no previous PPPs, or projects serving mainly the poor. Having municipalities/counties borrow these funds would reduce the need for this but may negate the rationale for the funds, as given above. An alternative may be to have some form of matching grant scheme, with the municipalities/counties providing some financing to complement what comes from the project development fund. A national PPP unit could oversee the project development fund.

5.3.8 Funding of PPPs

The use of PPPs for the delivery of basic services by the government would be stimulated by the provision of funds to support their payments under PPPs. Any additional funding of PPPs should be complemented by a more rapid development of capacities to monitor the fiscal costs of PPPs.

The detailed design of such a PPP fund, including the type of support, project eligibility criteria, selection mechanism and how the quantum of support for a project is determined is beyond the scope of this research. A significant effort would have to go into this to ensure that it is well-targeted and efficiently used. There is considerable experience internationally with the use of subsidy funds for the expansion of infrastructure services such as telecommunications and power, where government funds complement user fees. These are relatively straightforward, with competition for funds typically being done on a minimum subsidy basis, for example per new connection to be made. A fund that spans different sectors and also allows for different structures ...
(for example where governments are the sole purchasers of PPPs under contracts rather than
government funds being used to supplement user fees) would be more challenging to implement.

Consultation with lenders, sponsors and county governments will be an important step in
improving the design whilst at the same time ensuring that key central government concerns are
met.

It will be important to ensure that projects supported by the fund are priorities for the contracting
governments. A substantial matching contribution from the state/municipal government
contracting for the PPP would be important to provide commitment to the project and indicate
that the project was a priority. It would however be important to clarify what, out of different
possible forms of government support (e.g. land grants, tax breaks, risk-bearing, cash subsidies),
would represent a matching contribution.

It will be equally important to ensure that competition is used to reduce the demands for public
funds. It would be far more difficult to size subsidies – and also less transparent – were projects
first awarded by state governments on the basis of particular criteria and then subsequently
developers approached the fund for support. Otherwise a promoter could “low-ball” on the tariffs
for a project to succeed in getting a project awarded, and then access monies from the PPP fund
to make up the difference.

Project design, risk allocation, affordability and value-for-money should also be assessed for
these projects to ensure that the government is supporting well-designed PPPs, as noted above.

This could be done by the central PPP unit – though there might be conflict of interest concerns
if this unit received a success fee from working on transactions, in which case the involvement of
others would be necessary in clearances.
WAY FORWARD: A ROLE FOR THE GOVERNMENT IN DEVELOPING KENYA'S PPP PROGRAM

There are a number of steps the government can take to expand the role that PPPs play in basic service delivery at both the national, state and municipal levels. The main components of a strategy to catalyze the broader use of PPPs would be:

1. A clearly articulated policy statement on the use of PPPs at the national level, including their rationales and the benefits expected, backed up by concrete plans and targets for increasing the use of PPPs in national programs;

2. The creation of a national level PPP unit that would undertake information dissemination and guidance functions as discussed above, and provide advisory support to the central PPP program;

3. A project development fund to reduce the transactions costs to state and local governments of preparing and bidding out PPPs; and

4. A fund to partly cover the cost of state and local government commitments under PPP contracts.

The primary responsibility for developing county and municipal level PPPs lies at those levels of government. The actions outlined above can encourage the development of capacities and PPP programs at sub-national levels, but should not substitute for needed actions by the governments contracting for these PPPs. Perhaps most importantly, the scale and quality of the national PPP program provides a model for state and local governments. This includes not just the transactions themselves, but also commitments to disclosure of agreements and transparency and also the regular ex-post review of PPPs to assess whether the hoped-for benefits had been realized in practice.
The activities outlined above will need some form of coordinated effort. A PPP unit set up within a single ministry or agency with crosscutting responsibilities, for example Finance or Planning, could readily undertake information dissemination and guidance roles, given budget, staff and oversight. It could also provide transactions expertise to a limited set of projects by buying-in expertise from the private sector on long-term consulting contracts. However, a broader transactions role across a range of central agencies and ministries and in particular developing sub-national PPPs will require more human resources. Were these activities to be pursued on a larger scale then this might better be done through a separate authority or company than a unit within an existing ministry or agency.

Regardless of whether or not the steps outlined herein are undertaken, the government should work through existing approaches to improve the monitoring of the fiscal costs of PPPs entered into by central agencies and state government.
APPENDIX I

DONOR INITIATIVES RELATED TO PRIVATE SECTOR

INVESTMENT IN INFRASTRUCTURE

Some are sources of information and some support the private sector generally rather than specifically investments in infrastructure. But in this complex area, which is full of sometimes confusing abbreviations, this is a brief guide to some of the organisations and operations involved.

I    Africa Infrastructure Country Diagnostic (AICD)

www.infrastructureafrica.org

This is a research project that aims to create a comprehensive infrastructure database on African infrastructure. The project is sponsored by the Infrastructure Consortium for Africa, the African Union, the New Partnership for Africa’s Development (NEPAD) and regional economic communities (such as the East African Community, the West African Economic and Monetary Union and the Southern African Development Community). The project covers 24 countries and all major economic infrastructure: energy, information and communication technologies, irrigation, transport, and water and sanitation.

II   Africa Infrastructure Trust Fund

www.eib.org/projects/regions/aep/infrastructure_trust_fund

In the context of the 2005 Gleneagles Declaration and the establishment of an EU Strategy for Africa, the European Union and African counterparts established a Partnership for African Infrastructure. The EU-Africa Infrastructure Trust Fund is an innovative financial instrument launched in 2007 to support the implementation of the Partnership. The Trust Fund benefits cross-border and regional infrastructure projects in SSA. It channels grant resources from the European Commission and member states in such a way that they can be blended with the lending capacity of the European Investment Bank and member state development financiers. The target infrastructure sectors are energy, water, transport and telecommunications.
III Africa Progress Panel

www.africaprogresspanel.org

"The objective of the Africa Progress Panel is to focus world leaders’ attention on delivering on their commitments, particularly the good governance and economic support which is imperative for achieving the Millennium Development Goals."

IV Business Action for Africa

http://www.businessactionforafrica.org/

Business Action for Africa (BAA) was launched at the G8 summit in July 2005. Its aims are to positively influence policies needed for growth and poverty reduction; to promote a more balanced view of Africa; and to develop and showcase good business practice. The current sponsors and Oversight Group members of BAA are (according to BAA website on 15.9.08): Anglo American; British American Tobacco; De Beers; DFID; Joint International Unit of the DWP/DfES; Diageo; UK Foreign and Commonwealth Office; IBLF; Merck & Co; Royal Dutch Shell; SABMiller; UK Trade and Investment; Unilever; Visa.

V DevCo

www.ifc.org/ifcext/psa.nsf/content/Devco

Full name: Infrastructure Development Collaboration Partnership Fund.

Established: June 2003.

Capital: US$ 15.7 million.

Managed by: IFC.

Funding: donors make an annual contribution.

The aim is to provide technical assistance in support of PPI initiatives. No activity in the water or energy sectors in SSA. The main use of resources will be to fund the cost of specialised consultants associated with the design and implementation of private sector infrastructure transactions.
DevCo is an untied multi-donor facility established by the IFC and the United Kingdom's Department for International Development (DFID) to support IFC's privatisation advisory work in infrastructure as part of its involvement with the Private Infrastructure Development Group (PIDG). The Dutch Ministry of Foreign Affairs, the Austrian Development Agency and Sweden's International Development Agency have also contributed funds to the facility.

DevCo supports transactions in the poorest nations (DAC list columns I–III) to increase private sector involvement in the provision of infrastructure structure services. The additional funds help defray the costs of expert consultants who work with teams lead by the IFC's Advisory Services to prepare infrastructure projects for private sector investment. DevCo funds also help defray the IFC's project development costs associated with identifying projects for DevCo to support.

VI Emerging Africa Infrastructure Fund

www.emergingafricafund.com

An initiative of the PIDG.


Capital: $365 million.

The Emerging Africa Infrastructure Fund (EAIF) is a public private partnership able to provide long-term US dollar-denominated or euro-denominated debt or mezzanine finance on commercial terms to finance the construction and development of private infrastructure in 45 countries across SSA. EAIF can provide between US$ 10 million and US$ 36.5 million (or its equivalent in Euros) to projects across a wide range of sectors including telecoms, transport, water and power, among others. EAIF offers US dollar and euro lending to private companies (or soon to be privatised companies) for greenfield projects or for the refurbishment, upgrading or expansion of existing facilities.

VII GPOBA

www.gpoba.org

Full name: Global Partnership for Output Based Aid.

Established by: DFID and World Bank.

Managed by: World Bank.

The 2008 Annual Report records a portfolio of active projects of US$ 72 million. GPOBA provides grants for subsidy funding as well as technical assistance. Under OBA, a service is delegated to a third party under a contract that ties payment to the performance of outputs and delivery of results. The aim is to transfer performance risk to the private sector, thereby providing an incentive to deliver results. These are public subsidies supported by donor funding. In some cases, concessionaires bid for a project on the strength of the subsidy they require rather than the fee they would charge.

VIII Guarantco

www.guarantco.com

Owned by the PIDG Trust and managed by Standard Infrastructure Fund Managers (Africa) Limited.

As most infrastructure projects are paid in local currency, GuarantCo was conceived to support local currency financing for such projects and to more closely match the debt currency and terms with its payment. Thus the key criterion is that the guarantee should aid the availability of local currency. Guarantco cannot cover equity participations. It can only cover senior and subordinated or mezzanine debt.

It can provide a variety of contingent products, including partial credit and partial risk guarantees, first loss guarantees, tenor extension or liquidity guarantees. It can also provide joint guarantees or counter guarantees as may be required for a particular project. GuarantCo can support projects in the following sectors: energy supply, including generation, transmission and distribution; water/waste services; transport; telecommunications; gas transportation, distribution and storage; urban infrastructure; mining, provided the financing is for related infrastructure services with access by third parties; other activities that positively affect the development of the relevant country’s basic infrastructure and promote the objectives of Guarantco.
IX International Finance Corporation

www.ifc.org

The IFC provides an extensive array of products to private enterprises investing in developing countries including loans (A-loans), syndicated loans (B-loans), equity investment, quasi-equity investment (C-loans), structured finance, hedging products, local currency financing, subnational finance and advice.

IFC was established with a special mandate to support and catalyse private sector development in developing countries. Its purpose is to further economic development by encouraging the growth of productive private enterprise in member countries (articles of agreement).

It shall not undertake any financing for which in its opinion sufficient private capital could be obtained on reasonable terms (articles of agreement). IFC’s investments should, where possible, have a catalytic component.

IFC has been expanding its business rapidly—the volume of new investment operations has more than doubled and advisory services expenditures have quadrupled in the last five years.

X InfraCo

www.infraco.com


Funded by: PIDG donors—Netherlands, Sweden, Switzerland, the United Kingdom and the World Bank.

Aims to stimulate greater private investment in African and Asian infrastructure development by acting as a principal project developer, focusing on lower income countries. InfraCo funds early-stage, high-risk costs by taking an equity stake in the project and making decisions that will lead to a socially responsible and successful construction and operation.

XI Infrastructure Consortium for Africa (ICA)

www.icafrica.org
Established: 2005 after Gleneagles.


G8 Bilateral agencies: Canada, United Kingdom, France, United States, Germany, Japan, Russia, Italy.


Aim: the Consortium addresses national and regional constraints on infrastructure development by sharing information, project development and good practice.

The ICA is not a financing agency but it acts as a platform to catalyse donor and private sector financing of infrastructure projects and programmes in Africa.

**XII IPPF**

www.nepad.org

Full Name: Nepad Infrastructure Project Preparation Facility.

Established: 2003, with seed funding from Canada.

The key objective of the NEPAD-IPPF is to assist African countries, regional economic communities and related infrastructure development institutions to prepare high-quality, viable regional infrastructure projects in energy, trans-boundary water resource management, transport and ICTs, which would be ready to solicit financing from public and private sources in support of the objectives of NEPAD.

**XIII PIDG**

www.pidg.org

The Private Infrastructure Development Group (PIDG) is a multi-donor organisation established in 2002. Its objective is to encourage private infrastructure investment in developing countries that contribute to economic growth and poverty reduction. The PIDG has established a range of facilities and investment vehicles providing varying types of financial, practical and strategic support in order to realise this objective.
Current members include DFID, the Swiss State Secretariat for Economic Affairs, the Netherlands Ministry of Foreign Affairs, the Swedish International Development Agency, the World Bank, the Austrian Development Agency and Irish Aid. As PIDG is not a legal entity in its own right, it has established a trust (the PIDG Trust) to perform many of its functions. The PIDG Trust is located in Mauritius but is managed by a London-based trust company in conjunction with two Mauritian trustees.

IV PEP Africa

http://www.ifc.org/ifcext/africa.nsf/Content/PEPAFRICA

IFC Private Enterprise Partnership for Africa is the primary vehicle for delivering IFC advisory services in Africa. Established in 2005, IFC PEP Africa works in partnership with multilateral agencies, governments and the private sector to deliver programmes and advisory services that improve the investment climate, mobilise private sector investment, and enhance the competitiveness of private enterprises in Africa.

XV Public-Private Infrastructure Advisory Facility

www.ppiaf.org

PPIAF was launched in 1999 as a joint initiative of the governments of Japan and the United Kingdom, working closely with the World Bank. It was built on the World Bank Group's Infrastructure Action Program and designed to reinforce the actions of all participating donors. PPIAF’s members include bilateral and multilateral development agencies and international financial institutions. Owned and directed by its participating donors, PPIAF is managed by the World Bank through a Program Management Unit. It is funded by donors: the Asian Development Bank, the World Bank, the European Commission, and the governments of Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland, the United Kingdom and the United States.

PPIAF assists developing country governments and other public bodies to improve the policies, laws, regulations and institutions that allow them to better harness private participation in infrastructure where they wish to do so. PPIAF helps developing countries improve their
infrastructure through specific technical assistance. It also identifies, disseminates and shares best practices in the field of public-private partnerships in infrastructure in developing countries.

XVI  Technical Assistance Facility

The overall objective of the Technical Assistance Facility (TAF), which is part of the PIDG, is to enhance the ability of public and private sector clients to attract private capital to the financing of infrastructure and related services. TAF achieves this by helping PIDG clients to evaluate, develop and/or implement risk mitigation, financial and regulatory mechanisms, standards, systems and procedures essential to raising funds in the capital markets. This will enable developing countries to make a strong and positive contribution to growth and poverty reduction.
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