

PUBLIC-PRIVATE PARTNERSHIP AND ITS ROLE IN THE ECONOMY OF A COUNTRY

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ABSTRACT

A public-private partnership is an arrangement in a public sector project involving the private sector. It has been applied in many countries, especially to build infrastructure projects such as transportation systems, sewers, water systems, hospitals, energy, and information technology. This article discusses that public-private partnerships (PPPs) are an effective mechanism which will be successfully used in further development of the business environment, small business, and private entrepreneurship.

Keywords: public-private partnership, types of PPP models, classification of PPP models

АННОТАЦИЯ

Государственно-частное партнерство — это договоренность в проекте государственного сектора с участием частного сектора. Он применялся во многих странах, особенно для создания инфраструктурных проектов, таких как транспортные системы, канализация, системы водоснабжения, больницы, энергетика и информационные технологии. В данной статье рассматривается, что государственно-частное партнерство (ГЧП) является эффективным механизмом, который будет успешно использоваться в дальнейшем развитии бизнес-среды, малого бизнеса и частного предпринимательства.

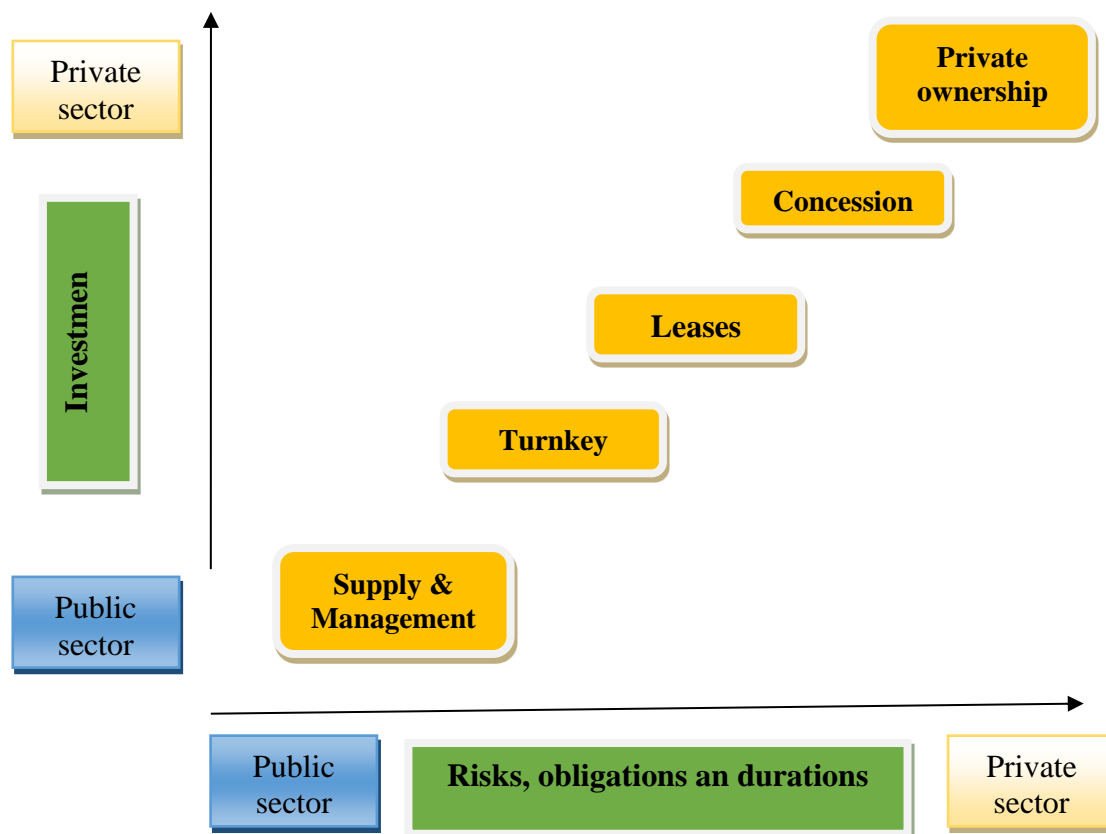
Ключевые слова: государственно-частное партнерство, виды моделей ГЧП, классификация моделей ГЧП.

INTRODUCTION

Limited public funds, as well as efforts to increase the quality and efficiency of public services, make Public-Private Partnership arrangements attractive. PPPs have been developed in part due to financial shortages in the public sector, and they have demonstrated the ability to harness additional financial resources and operating efficiencies inherent in the private sector. In a general legal context, a PPP can be characterised PPPs are often used in infrastructure projects, e.g. in sectors such as transport, public health, education and national security, and provide a wide range of

public services, like telecommunication, water plants, financial support, innovative financing, general public services, education and research. PPP is a result of the economic effects of globalisation . Globalisation makes it difficult to maintain market power and market share. A company no longer competes only with national companies, but now also with companies all over the world. Because of the Internet, consumers have had access to all kinds of information and all types of products. Companies found new ways to compete by entering into joint ventures and strategic alliances and they explored new types of business strategies by creating the concept of co-operation. The motivation for making a strategic alliance was, and still is, to make a business arrangement that encourages dynamism, collaboration and mutual learning among the parties. Therefore, initial agreements have less to do with success than adaptability to change in the market and in consumer needs . The idea of PPP can be dated back to the 1960s when the US government developed a method of stimulating private investments in infrastructures. The idea was to protect public interest while at the same time bringing investment potential and added value from the private sector. In Great Britain, the first attempts to establish a new type of contract were based on the problems in relation to the high degree of cost, the lack of competition and constructions of poor quality. In 1998 Sir John Egan presented the report, Rethinking Construction, in which partnering was presented as a model for a new type of contract in the construction industry. The Egan report focused particularly on ‘ lean’ production and co-operation, and resulted in the development of the partnering concept. In the report it was proposed that a binding collaborative contract may not be necessary. Today, however, this idea has been abandoned. The first partnering model agreement came in 2000 as a binding contract concept. The aims of a PPP contract are to reduce the cost and price; to increase the quality; to reduce the risks and failures; to improve coordination; and to share responsibility and capacity. Those objectives result in a shift of content in the contract. There is a broad range of options for involving the private sector in public projects, for example, in regard to financing, physical development, operation, transport and environment. In one type of PPP, the public sector may retain all responsibility for financing, constructing, operating and maintaining assets, together with the responsibility for assuming all associated risks. In another type of PPP, the private sector might assume all of these responsibilities. The vast majority of PPP approaches fall in the middle of spectrum, with risks and responsibilities shared between the public sector and its private partners according to their strengths and weaknesses . In a contract where the risks and responsibilities are shared, the private party is often responsible for the funding, design, completion, implementation, service and maintenance of the project . The incentive to build to reduce the cost of service and maintenance in the long run is heightened because the PPP concept provides the

contractor with a compelling reason to create the cheapest building or infrastructure for a period of 20 to 30 years. Normally, a traditional public contract is based on demands and concrete descriptions. To fulfil the objectives the PPP, the contract focuses on needs and functions, and it must be built on trust, transparency by open books, and co-operation between the parties . The basic features of these five categories of PPP models are shown in figure 1.



1-figure. Basic features of PPP models Each of these five categories has many variants. A categorization of the PPP/PSP models together with their main characteristics is shown in table below. While the spectrum of models shown in the table are possible as individual options, combinations are also possible such as, a lease or (partial) privatization contract for existing facilities which incorporates provisions for expansion through Build-OperateTransfer. In fact, many PPP projects of recent times are of combination type. Table 1. Classification of PPP models

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Broad category	Main variants	Ownership of capital assets	Responsibility of investment	Assumption of risk	Duration of contract (years)
Supply and management contract	Outsourcing	Public	Public	Public	1-3
	Maintenance management	Public	Public/Private	Private/Public	3-5
	Operational management	Public	Public	Public	3-5
Turnkey		Public	Public	Private/Public	1-3
Affermage/Lease	Affermage	Public	Public	Private/Public	5-20
	Lease*	Public	Public	Private/Public	5-20
Concessions	Franchise	Public/Private	Private/Public	Private/Public	3-10
	BOT**	Public/Private	Private/Public	Private/Public	15-30
Private ownership of assets and PFI type	BOO/DBFO	Private	Private	Private	Indefinite
	PFI***	Private/Public	Private	Private/Public	10-20
	Divestiture	Private	Private	Private	Indefinite

* Build-Lease-Transfer (BLT) is a variant.

** Build-Operate-Transfer (BOT) has many other variants such as Build-Transfer-Operate (BTO), Build-OwnOperate-Transfer (BOOT) and Build-Rehabilitate-Operate-Transfer (BROT).

*** The Private Finance Initiative (PFI) model has many other names. In some cases, asset ownership may be transferred to, or retained by the public sector.

Supply and management contracts

A management contract is a contractual arrangement for the management of a part or whole of a public enterprise (for example, a specialized port terminal for container handling at a port or a utility) by the private sector. Management contracts allow private sector skills to be brought into service design and delivery, operational control, labour management and equipment procurement. However, the public sector retains the ownership of facility and equipment. The private sector is assigned specified

responsibilities concerning a service and is generally not asked to assume commercial risk. The private contractor is paid a fee to manage and operate services.

Pros:	Cons:
<ul style="list-style-type: none"> • Can be implemented in a short time. • Least complex of all PPP models. • In some countries, politically and socially more acceptable for certain projects (such as water projects and strategic projects like ports and airports). 	<ul style="list-style-type: none"> • Efficiency gains may be limited and little incentive for the private sector to invest. • Almost all risks are borne by the public sector. • Applicable mainly to existing infrastructure assets.

Turnkey

Turnkey is a traditional public sector procurement model for infrastructure facilities. Generally, a private contractor is selected through a bidding process. The private contractor designs and builds a facility for a fixed fee, rate or total cost, which is one of the key criteria in selecting the winning bid. The contractor assumes risks involved in the design and construction phases. The scale of investment by the private sector is generally low and for a short-term. Typically, in this type of arrangement, there is no strong incentive for early completion of the project. This type of private sector participation is also known as Design-Build.

Pros:	Cons:
<ul style="list-style-type: none"> • Well understood traditional model. • Contract agreement is not complex. • Generally, contract enforcement is not a major issue. 	<ul style="list-style-type: none"> • The private sector has no strong incentive for early completion. • All risks except those in the construction and installation phases are borne by the public sector. • Low private investment for a limited period. • Only limited innovation may be possible.

Affermage/Lease

In this category of arrangement, the operator (the leaseholder) is responsible for operating and maintaining the infrastructure facility (that already exists) and services, but generally the operator is not required to make any large investment. However, often this model is applied in combination with other models such as build-rehabilitate-operate-transfer. In such a case, the contract period is generally much longer and the private sector is required to make significant investment. The arrangements in an affermage and a lease are very similar. The difference between them is technical. Under a lease, the operator retains revenue collected from customers/users of the facility and makes a specified lease fee payment to the contracting authority. Under an affermage, the operator and the contracting authority share revenue from customers/users. In the affermage/lease types of arrangements, the operator takes lease of both infrastructure and equipment from the government for an agreed period of time. Generally, the government undertakes the responsibility for investment and thus bears investment risks. The operational risks are transferred to the operator. However, as part of the lease, some assets also may be transferred on a permanent basis for a period which extends over the economic life of assets. Fixed facilities and land are leased out for a longer period than for mobile assets. Land to be developed by the leaseholder is usually transferred for a period of 15-30 years.

Pros:	Cons:
<ul style="list-style-type: none"> • Can be implemented in a short time. • Significant private investment possible under longer term agreements. • In some countries, legally and politically more acceptable for strategic projects like ports and airports. 	<ul style="list-style-type: none"> • Has little incentive for the private sector to invest, particularly if the lease period is short. • Almost all risks are borne by the public sector. • Generally used for existing infrastructure assets. • Considerable regulatory oversight may be required.

Concessions

In this form of PPP, the government defines and grants specific rights to an entity (usually a private company) to build and operate a facility for a fixed period of time. The government may retain the ultimate ownership of the facility and/or right to supply the services. In concessions, payments can take place both ways: concessionaire pays

to government for the concession rights and the government may pay the concessionaire, which it provides under the agreement to meet certain specific conditions.

Pros:	Cons:
<ul style="list-style-type: none"> • Private sector bears a significant share of the risks. • High level of private investment. • Potential for efficiency gains in all phases of project development and implementation and technological innovation is high. 	<ul style="list-style-type: none"> • Highly complex to implement and administer. • Difficult to implement in an untested PPP market. • May have underlying fiscal costs to the government. • Negotiation between parties and finally making a project deal may require long time. • May require close regulatory oversight. • Contingent liabilities on government in the medium and long term.

In a Build-Operate-Transfer or BOT type of concession (and its other variants namely, Build-Transfer-Operate (BTO), Build-Rehabilitate-Operate-Transfer (BROT), Build-Lease-Transfer (BLT) type of arrangement), the concessionaire makes investments and operates the facility for a fixed period of time after which the ownership reverts back to the public sector. In a BOT modal, operational and investment risks can be substantially transferred to the concessionaire. In a BOT model, the government has, however, explicit and implicit contingent liabilities that may arise due to loan guarantees and sub-ordinate loans provided, and default of a sub-sovereign government and public or private entity on nonguaranteed loans. Which model to select? The answer to this question needs careful assessment of many things. Each model has its own pros and cons and can be suitable for achieving the major objectives of private-private partnership to a varying degree. Special characteristics of some sectors and their technological development, legal and regulatory regimes, and public and political perception about the services in a sector can also be important factors in deciding the suitability of a particular model of PPP. There is no single PPP model that can satisfy all conditions concerning a project's locational setting and its technical and financial features. Figure 2 shows a simplified PPP structure. The actual structure of a PPP, however, depends on the type of partnership model and can be quite complex involving contractual arrangements between a number of parties including the

government, project sponsor, project operator, financiers, suppliers, contractors, engineers, third parties (for example, an escrow agent⁶), and customers (see Chapter 4, ‘ Terms of contract’).

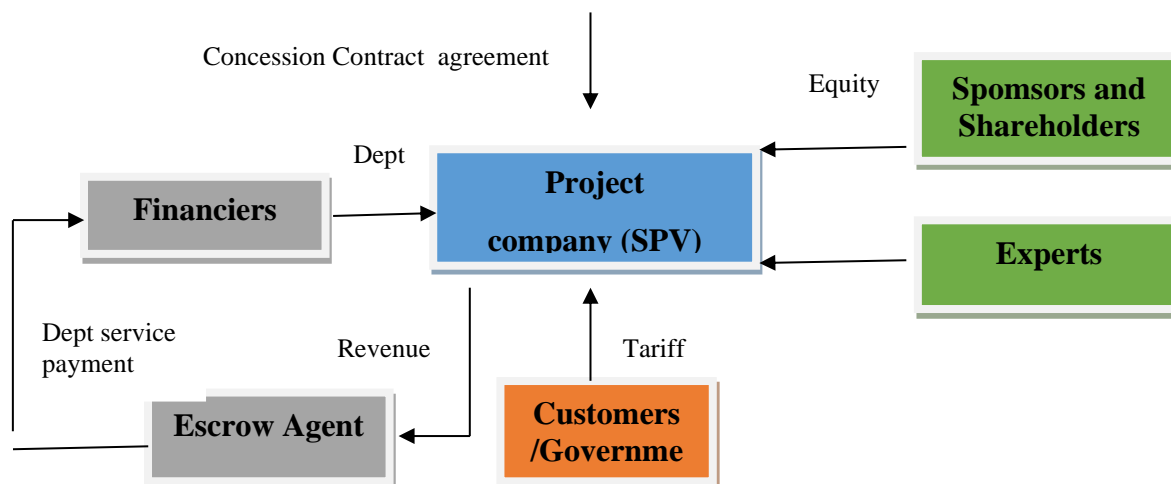


Figure 2. Typical structure of a PPP project

An SPV is usually set up by the private concessionaire/sponsor(s), who in exchange for shares representing ownership in the SPV contribute the long-term equity capital, and agree to lead the project⁸. The SPV may not always be directly owned by the sponsors. They may use a holding company for this purpose. An important characteristic of an SPV as a company is that it cannot undertake any business that is not part of the project. An SPV as a separate legal entity protects the interests of both the lenders and the investors. The formation of an SPV has also many other advantages. Often, an SPV is formed as a joint venture between an experienced construction company and a service operations company capable of operating and maintaining the project. Other than its strategic, financial and economic interest, the government may also like to directly participate in a PPP project. The main reasons for such direct involvement may include: To hold interest in strategic assets; To address political sensitivity and fulfil social obligations; To ensure commercial viability of the project; To provide greater confidence to lenders; and To have better insight to protect public interest. Direct government involvement in a PPP project is usually guided by the legal and regulatory regime of the country and the government policy on PPPs. For example, the government may hold certain defined percentage of the stake in a strategic project such as an airport or a port.

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