



CONCESSIONS – PRIVATIZATION OR PPP?

NCP Research Paper

Abstract

Concessions have long been used as mechanisms for private sector participation (PSP). In the 1980s and 1990s, concessions were viewed as a specialized mechanism for privatization. Today they are more likely to be described as Public-Private Partnerships (PPPs). This Research Paper examines whether and when concessions qualify as PPP or privatization, by comparing the key features of PPP, privatization and concessions, both as theoretical constructs and through examination of specific examples. It concludes that concessions are clearly PPP structures. It also examines other concession-type structures and finds that sale plus licensing, and sale plus buy-back approaches do qualify as privatization, while franchising, as often used for railway “privatization”, is more accurately described as a PPP structure.

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List of Acronyms

%	Percent
e.g.	for example
n.a.	not available
ANTT	Agência Nacional de Transportes Terrestres
BLT	Build-Lease-Transfer
BOO	Build-Own-Operate
BOOT	Build-Own-Operate-Transfer
BOT	Build- Operate-Transfer
BTL	Build-Transfer-Lease
BTO	Build-Transfer-Operate
DBM	Design-Build-Maintain
DBFM	Design-Build-Finance-Maintain
DBFOM	Design-Build-Finance-Operate-Maintain
DBOM	Design-Build-Operate-Maintain
ERMAs	Emergency Recovery Measure Agreements
Gw	Gigawatts
GwH	Gigawatt hours
HSS	Hospital Support Services
IPO	Initial Public Offer
KwH	Kilowatt hours
m	million
M&A	Mergers and Acquisitions
MENA	Middle East and North Africa
NCP	National Center for Privatization and PPP
O&M	Operations and Maintenance
OECD	Organization for Economic Co-operation and Development
PFI	Private Finance Initiative
PPP	Public-Private Partnership
ROT	Rehabilitate-Operate-Transfer
SKR	Swedish Krone
SPV	Special Purpose Vehicle
UK	United Kingdom
USD, \$	United States dollars
VFM	Value for Money
vs.	Versus

1. Introduction

Concessions have long been used as mechanisms for governments to tap the private sector to provide what are traditionally viewed as public services. Typically, a concession involves a public authority giving to a private company the right to provide certain services to the public, for a specified period. The private operator may use existing public assets or the concession may include an obligation to invest in new ones. In return, the private company (the concessionaire) has the right to charge for those services.

In the 1980s and 1990s, concessions were viewed as a specialized mechanism for privatizing public assets and services. See, for example, (P. Guislain, 1995), who notes: *“Concession-type arrangements are well suited for privatizing sectors with monopolistic characteristics.”* At the time, any arrangement that involved a long term transfer of public assets to a private operator was viewed as “privatization”.

Public-Private Partnerships (PPP) as a form of procurement for public services did not begin to achieve a separate identity until the mid-1990s. PPP structures were initially viewed as a form of privatization rather than an alternative method for procuring public assets and services. As a result, conceptual differences between PPP and privatization were somewhat glossed over. Contract structures that today would clearly be categorized as PPPs were at the time frequently described as privatizations. Concessions were particularly prone to this mis-labelling.

Today, concessions are generally referred to as PPP structures, not privatization. This is illustrated by the following quote from the OECD: *“the transfer of activities to the private sector through instruments such as concessions ... would normally not be considered privatization”.* (OECD, 2019). The differences between how concessions were described during the 1980s and 1990s and how they are used today could lead to confusion among policymakers, practitioners and the public, particularly in countries that are implementing privatizations and PPPs in parallel.

It is therefore worth examining the question: should concession structures be classified as PPPs or privatization? This paper provides an initial qualitative assessment, aiming to guide future research. It begins by defining the concepts and comparing the key features of PPP, privatization and concessions, both in the abstract and with reference to actual transactions that were considered to be privatizations. It will determine whether this categorization remain valid today or whether the transactions are better described as PPPs. The analysis is also applied to a number of other privatization structures that may be considered variations of traditional concessions.

The remainder of this paper is structured as follows:

- Section 2 provides a brief overview of the history of concessions and how they are used in PPP today;
- Section 3 explores the concepts of PPP, privatization and concessions further, in the light of their definitions and key features and also considers other privatization structures that have common features with concessions;
- Section 4 applies the analysis to real world examples of these structures;
- Section 5 discusses the conclusions arising from the preceding analysis.

2. Background

2.1 Some Key Definitions

Concession

“A concession is generally identified as a system by which a public authority grants specific rights to an organization ... to construct, overhaul, maintain and operate an infrastructure for a given period. This corresponds to a contract, under the terms of which a public authority charges a company with making the investments required to create the service at its own cost and operate the service at its own risk. The company is remunerated in the form of a price paid by the users of the service and/or the public authority.” (F. Bousquet, 2001)¹.

Based on this definition, the key features of concessions are that government allows a private operator to provide certain services that are usually reserved for the public sector, in return for payment and accompanied by certain obligations on the private party (such as investment commitments and quality standards), for a fixed period.

Concessions can be used to build and operate new infrastructure or to operate existing public assets. Usually, but not always, the concessionaire has a monopoly, or “exclusivity”, over the services, which may be national or local. This reflects the fact that concessions are often used for network infrastructure utilities that are natural monopolies. Thus, as with PPPs in general, periodic tendering for concessions creates competition for the market, so the private party is only subject to competitive pressure periodically, when the concession is tendered. This contrasts to the situation of competition in the market, where such competitive pressure is constant. This applies to most commercial markets, where there are numerous suppliers and new entrants are free to join.

Licenses and franchises are sometimes also referred to as forms of concession in this context. As described in Section 2.4 there is a lot of commonality between the three concepts.

Public-Private Partnership (PPP)

“A long-term contract between a private party and a government entity, for providing a public asset or service, in which the private party bears significant risk and management responsibility and remuneration is linked to performance.” (World Bank, 2017).

Key features of PPPs are risk-sharing between the public and private sector, the long term nature of the contract and payment to the private party being linked to performance. The definition is agnostic as to the source of finance for any infrastructure and to who pays the private party. In practice, PPP is most often used as a method of addressing public sector fiscal constraints, with the private party accessing commercial financing to build new infrastructure or rehabilitate existing public assets. However, PPPs can equally be used to procure services alone, where the private party operates existing public assets and/or where investment requirements are minimal.

Privatization

“Privatization may be considered any material transaction by which the state’s ultimate ownership of corporate entities is reduced. This definition includes direct divestment by the state, divestment of

¹ (APMG, 2016) section 3.1, adopts a narrower definition, limiting concessions to user-pays PPPs.

corporate assets by government-controlled investment vehicles as well as the dilution of state positions in SOEs by secondary share offerings to the non-state shareholders.” (OECD, 2009).

This definition is quite narrow, focusing on divesting equity rather than physical assets. In practice asset sales and liquidations can also be considered forms of privatization. However, a broader definition would not alter the analysis or conclusions presented in this Research Paper.

Key features and implications of this definition are that privatization is permanent and there is no requirement for sharing risks. Privatization takes place at a specific point in time, whereas PPP is a long term arrangement. One obvious differentiating factor between privatization and PPP is that privatization can only apply to existing activities and assets. PPP is commonly used for new investments but can also be applied to upgrade existing assets or to procure services alone. Boiled down to their fundamentals, with PPP, government is buying something; with privatization it is selling something.

These three concepts are broken down and compared in Section 3 below.

2.2 Brief History of Concessions²

Concessions were used well before the concept of PPP was formalized as we know it today. Their use dates back at least to the Middle Ages and not only as a means of using the private sector to provide public assets and services. Concessions were also used to encourage investment in commercial ventures by bestowing temporary monopolies on specific individuals and organizations. At one end of the scale this was applied to butchers and bakers in France; at the other, to the East India Company, established in 1600 and used by the British Government to extend its economic power and influence from India to the Far East.

As regards public assets and services, through concessions the private sector was instrumental in developing water and sewerage systems, roads, canals, natural gas, electricity and railways, among other sectors. France remains an enthusiastic user of concessions to provide municipal water services. It issued one of the earliest water concessions to the Perrier brothers in 1777, a 15-year contract to supply water to Paris, and also used concessions to finance canals, roads and bridges. In the US, following a similar approach, *“most early public transport systems ... were built by the private sector, under various forms of municipal charter or franchise, with revenues coming from fares and land development.”* (G. Menckhoff, 1999).

Much of Latin America also favored a concession model to finance infrastructure, particularly for railways. This may help to explain why concessions were subsequently adopted as the main privatization method for this sector in the region, since the concept was familiar and often governed by specific laws and regulations.

Throughout the world, countries that reformed and privatized their utilities have adopted concession-type arrangements (in the form of licenses) as one of the tools wielded by sector regulators. The UK, for example, uses licenses for most of the privatized utilities (telecoms, electricity, water, gas). Licenses can create an expectation of continuity, being reissued to the incumbent on expiry unless it has performed poorly or otherwise breached the license terms. However, for the rail sector the UK used franchises. The UK rail franchises are shorter term (initially, 7 years, compared to 15 years for utilities licenses) and were

² This Section draws upon (World Bank, 1998) and (G. Menckhoff, 1999).

originally issued in the expectation of periodic retendering, which, in theory, could lead to the incumbent being replaced by a better bid even if their performance was satisfactory.

In practice whether an arrangement is referred to as a concession, license or franchise in a particular country will largely depend on its history and familiarity with the concept, and the legislative framework.

2.3 Concessions as a Form of PPP

As noted in Section 2.2 above, concessions were used as a means to secure public assets and services from the private sector long before the concept of PPP crystallized. This has led to a degree of overlap and confusion, with different jurisdictions using different terminology to describe what is essentially the same concept. Common PPP structures such as Build-Operate-Transfer (BOT), Rehabilitate-Operate-Transfer (ROT) and Service Contracts are, in effect, specific forms of Concession, not alternatives to it. The recent adoption of the DBXXX (Design-Build-XXX) nomenclature for PPPs (see, for example, (APMG, 2016)) adds to the confusion by introducing further overlapping terminology.

The term “concession” is best viewed as an over-arching concept that can be used to describe various forms of PPP structure. This is illustrated in Table 1 below. In some jurisdictions, however, the term has a specific legal meaning that dictates how it can be used.

Table 1: PPP structures that can be used for concessions

Type of Procurement	Traditional Nomenclature	DBXXX Nomenclature
Greenfield (new assets)	BOT – Build-Operate-Transfer BTO – Build-Transfer-Operate BOOT – Build-Own-Operate-Transfer BOO – Build-Own-Operate BLT – Build-Lease-Transfer BTL – Build-Transfer-Lease PFI – Private Finance Initiative	DBM – Design-Build-Maintain DBOM – Design-Build-Operate-Maintain DBFM – Design-Build-Finance-Maintain DBFOM – Design-Build-Finance-Operate-Maintain
Brownfield (existing assets + investment)	ROT – Rehabilitate-Operate-Transfer Lease Affermage	-
Services (no material capex)	Service Contract Management Contract Operation & Maintenance Contract Lease Affermage	-

Source: Author, (APMG, 2016)

2.4 Concessions as a Form of Privatization

Before the PPP concept was developed, traditional concession structures were treated as a form of privatization. The following quote from (P. Guislain, 1995) illustrates this view: “concession-type arrangements are well suited for privatizing sectors with monopolistic characteristics. ... the state ... delegates to the private sector the right to provide a service, yet retains some control over the sector by incorporating in a concession contract or license the terms and conditions.” As noted in Section 2.3, however, licenses can be used to achieve the same outcomes under privatization modes that involve selling shares or assets, which was the UK privatization model for most utilities.

The real attraction to many governments of using the concession approach as a means of privatization may have been that it allowed them to get the benefits of private sector operation and investment without permanently selling anything. Guislain, for example, explicitly recognizes this, concluding that concessions are: *“...particularly useful in countries in which the law or constitution excludes private ownership of specific infrastructure assets. For the same reason, recourse to a concession is an elegant solution when the sale of the infrastructure company or assets would not fetch the “right price” and would expose the government to accusations of a giveaway.”* (P. Guislain, 1995). Perhaps with the benefit of hindsight, Gaush put it more succinctly, noting that concession structures have *“often been used to circumvent the political problems and sometimes the legal or constitutional impediments linked to the transfers of assets to private, sometimes foreign operators that take place in outright privatizations.”* (J. Gaush, 2006).

Latin America was a particularly keen user of the concession method for privatization. In its report on privatization in Latin America in the 1990s, the United Nations Department of Economic and Social Affairs highlights this, noting: *“another aspect of the privatization techniques adopted in Latin America which deserves specific notice is that there have been many franchises or concessions, under which some kind of a public-private venture comes into being, ... for periods varying between 10 and 95 years.”* (United Nations Department of Economic and Social Affairs, 1999).

A significant concern with the concession approach to privatization is the tendency of concession agreements to be renegotiated. This is far less likely with traditional equity or asset sale privatization methods. In their survey of literature on the issue, Gaush and Straub found that 41% of Latin American concessions in transport, water and electricity were renegotiated. Furthermore, some sectors are more prone to renegotiation than others: *“in water and transport, renegotiations have affected 74 per cent and 55 per cent of the projects respectively, and have occurred 1.6 years and 3.1 years on average after the award, despite most of these contracts having been signed for 15 years or more.”* (J. Gaush, 2006). This is comparable to more recent evidence published for PPPs (Global Infrastructure Hub, 2018), which found that 33% of projects were renegotiated, 20% within four years of financial close. Of these, transport PPPs (41% of projects) were most likely to be renegotiated, followed by water (33%). As is the case for PPPs in general, renegotiation of privatization concessions brings with it the risk of losing Value for Money (VFM), as changes are made to commercial arrangements and risk allocation after the tender process is over, in the absence of competitive pressure.

When used as methods of privatization, concession structures are more open to renegotiation than divestiture methods involving the permanent sale of equity or physical assets. This is because, like PPPs, they involve a much closer long term relationship between the private partner and the contracting authority. Divestiture approaches to privatization such as trade sales to strategic investors and stock market listings (Initial Public Offers (IPOs)) are less likely to involve such close ongoing relationships. The divestment plus license approach to privatization described in Section 2.2, which is commonly used for utilities, transfers most risk to the private party as the asset owner. In such cases the ongoing relationship with the government is usually kept at arms’ length through an independent regulator, whose objectives, responsibilities and powers are clearly defined and delimited by legislation. This applies even when government remains a shareholder in the privatized entity. Establishment of an independent regulator helps mitigate conflicts of interest between government as policy-maker and government as owner.

In general, concession agreements tend to be project-specific, and are often negotiated with the relevant Ministry as part of the privatization or PPP tender process. This contrasts with licenses, which are issued by independent regulators, and are usually generic to a specific type of activity (for example, electricity generation, water distribution). The aim is to treat all market actors the same and it is difficult for an

individual licensee to negotiate changes. Any changes that are made usually apply to all similar licenses. Making such changes follows a transparent process that involves widespread consultation, which acts as a proxy for competition and helps preserve VFM.

3. Analysis: Do Concessions Qualify as Privatization?

3.1 Comparison of Typical Structures

Key features of PPP and privatization can be identified based on the definitions set out in Section 2.1. These are mapped against the features of a traditional concession structure in Table 2 below.

Table 2: Key Features of PPP, Privatizations and Concessions

Feature	PPP	Privatization (100% divestiture)	Concession (user-pays ³)
Term	Long (15+ years)	Permanent	Long (15+ years)
Govt. role	Regulation, land, (payment)	Regulation, transfer assets	Regulation, land
Risk allocation	Shared	Private	Shared
Management, operations	Private	Private	Private
Construction	Private	Private	Private
Financing	Private and/or public	Private	Private and/or public
Payment basis	Performance and/or demand	Demand	Demand
Who pays	Govt. and/or users	Users	Users
Regulation	Contract	Regulator	Contract or regulator
Asset ownership	Private → public (greenfield) Public (brownfield)	Private	Private → public (greenfield) Public (brownfield)
Legal basis	PPP contract	Company Law, Sector Law	Concession agreement
Type of project	Greenfield, existing assets, services only	Existing assets	Greenfield, existing assets
Key decision metrics	VFM, bankability, commercial viability, fiscal impact	Cost-benefit analysis, valuation, policy	VFM, bankability, commercial viability, fiscal impact
Proceeds	None	Price for the shares/assets	None ⁴
Govt. income during operations	None (unless project “over feasible”)	None	Concession fee (if over-feasible)
Impact on jobs	Increase (greenfield) No change/decrease (existing)	Decrease	Increase (greenfield) No change/decrease (existing)
Private investor	Consortium (construction, O&M, possibly financial)	Single strategic (Trade Sale) Multiple individuals/financial institutions (IPO)	Consortium (construction, O&M, possibly financial)
Tender process	Typically two-stage tender plus financial close	Typically two-stage tender or IPO	Typically two-stage tender plus financial close

Source: Author

Table 2 shows that the features of a typical user-pays concession structure largely match those of PPP. Some of the differences between privatizations and concessions are not material, and there are grey areas where there is flexibility (for example, on how the contracts are regulated). However, concessions are not compatible with privatization in certain key aspects, notably the fixed term of the arrangement, the

³ Govt.-pays concessions are relatively rare. A Govt.-pays concession would match the PPP column for payment basis and who pays.

⁴ Certain concession structures used in early privatizations did provide for initial payments to the Govt.

ultimate ownership of the assets and the extent to which risk is transferred to the public partner. More fundamentally, concessions are clearly a form of procurement, not of divestment.

This supports the hypothesis put forward in Section 1, that standard concession arrangements do not qualify as privatization but are clearly PPPs.

3.2 Concession-Type Structures That Might Be Considered Privatization

Although the traditional concession structure cannot be fully reconciled with the main features required for it to qualify as privatization, there are several privatization structures that are similar to, or extensions of, concessions. These start from a pure divestiture (sale of equity) approach but add features that introduce threats to the privatized entity’s market position if it fails to perform. These threats can take the form of competition for the market through periodic retendering, revocation or non-renewal of its right to provide the services through termination of licenses, or reversal of the privatization through Government buying back the shares.

The objective in each case is to apply periodic competitive pressure (or the threat of competitive pressure) to businesses that are monopolistic. Although periodic competition for the market is less effective than continuous competition in the market in this regard, when combined with pro-active regulation it may be considered a reasonable second-best alternative.

3.2.1 Divestment Plus Licenses

Description

This structure combines features of privatization and PPP. Equity is sold to private investor(s), either through an IPO or a trade sale. The privatized entity is issued a license to provide services, usually through a separate sector regulator. The license has a fixed term; there is no guarantee that it will be renewed at the end of the license period, although there is an implicit understanding that it will be as long as the licensee performs adequately. The regulator may also cancel the license at any time if the licensee fails to abide by its terms.

This is the approach adopted in the UK for utilities privatizations (telecoms, electricity, water, gas). The initial license term was 15 years.

Advantages and disadvantages

The advantages and disadvantages to the public sector of this approach are summarized in Table 3 below.

Table 3: Advantages and Disadvantages of the Divestment Plus License Approach

Advantages	Disadvantages
<ul style="list-style-type: none"> • Govt. receives proceeds. • Periodic competition for the market and/or threat of termination discourage monopolistic behavior. • Private party owns the assets and is responsible for investment, financing and operations; more likely to achieve performance improvements. 	<ul style="list-style-type: none"> • Is loss of the license a credible threat? Strategic utilities may be considered too big to fail. • If the license is not renewed, need a mechanism to prevent disruption to services and deal with stranded assets. • Cost of the regulator.

- | | |
|---|--|
| <ul style="list-style-type: none"> Govt. monitoring is arms' length, via the regulatory body, increasing transparency and reducing the risk of political interference. | |
|---|--|

Source: author's analysis

Privatization, PPP or Concession?

The starting point for this approach is the sale of shares in the operator, and it is generally viewed (and presented by governments) as privatization rather than PPP.

The licenses are similar to concessions in that they bestow to the licensee the right to provide and charge for the services, as well as obligations to achieve technical, quality and other regulatory standards. Licensing does share some features of PPPs, namely the threat of termination (or non-renewal of license) if the operator fails to perform. However, since the assets are owned by a private company rather than part of the franchise itself, the threat of losing a license may be less effective than for a PPP, since transfer to a new licensee is likely to be complex/messy and governments will want to avoid disruption to services.

Licenses generally involve payment of annual license fees to the regulator. This is usually an administrative charge, calculated to cover the costs of regulation, as a way to support regulatory independence.

The licensing approach therefore falls firmly into the privatization category.

3.2.2 Franchises

Description

Franchising is a common business model in the private sector, where individual entrepreneurs purchase the right to operate a particular brand at a specific location. They are usually required to meet certain standards and to purchase inputs from the franchisor. This model is particularly prevalent in fast food.

As used by governments the concept of franchising is somewhat different. A private partner is awarded a franchise which, like a concession, grants them an exclusive right to operate existing public assets for a given period in return for payment, and imposes obligations to meet operating, quality and service standards. The franchisee is typically selected by a competitive tender process. If the services are financially and commercially viable (or "over feasible"), they will pay the government. If not, the financial bid is usually the level of subsidy required. Government retains ownership of the underlying assets.

The franchise is retendered by the government at the end of the period, a higher risk to the incumbent than under a license. If the existing franchisee loses the retender the assets must be transferred to the new franchisee at some measure of market value reflecting any improvements made by the incumbent, and without disrupting services. This is made easier by the fact that the assets are linked to the franchise rather than privatized separately (and permanently) as under the license approach. Franchises also make it easier for governments to change the market model for the sector, since the assets ultimately revert to them. Thus, the UK in 2020 was able to announce the replacement of railway franchising with an interim arrangement (Emergency Recovery Measure Agreements (ERMAs)) without major disruption to operations or legal objections. The ERMA's will be replaced by a more passenger-oriented long term structure (Hawkins, 2021).

This approach has been used in the privatization of network industries, specifically railways, where franchises may be regional, cover specific routes or types of service (e.g., freight). The government

remains responsible for tracks and other fixed infrastructure (or it may be privatized/franchised separately) while the franchisees are responsible for operations and rolling stock. The average franchise term following the UK rail privatization was around 7 years (Mathieu, 2003), although this was subsequently extended to 20 years (Gibbs, 2002).

As for traditional concessions, franchise payments (or subsidies) are established by competitive tender and driven by the market: costs, revenues, tariffs, investment obligations, etc.

Advantages and disadvantages

The advantages and disadvantages to the public sector of this approach are summarized in Table 4 below.

Table 4: Advantages and Disadvantages of the Franchising Approach

Advantages	Disadvantages
<ul style="list-style-type: none"> • Govt. may receive proceeds. • Private party is responsible for operations; more likely to achieve performance improvements. • Under some structures the private party is responsible for new investment. • Periodic competition for the market and/or threat of termination discourages monopolistic behavior. • Facilitates renationalization if performance is below expectations or government policy on privatization changes (e.g., UK railways). • Regulation may be incorporated in the franchise agreement and/or through a separate regulator. 	<ul style="list-style-type: none"> • Govt. takes on more risk than divestment options. • Non-feasible industries will require ongoing subsidies. Under some structures government is responsible for financing investments. • Higher cost of contract management and oversight. • Franchise contracts relatively complex. • Likelihood of renegotiation; risk of loss of VFM. • Incumbent has a significant informational advantage in the retender. Difficult to ensure they are truly competitive.

Source: Author’s analysis

Privatization, PPP or Concession?

When used for public assets, franchises are clearly a PPP structure. There are some similarities with divestment privatization methods, however. Government is likely to have a more hands-off role than for other PPPs, and is more likely to establish a specific regulatory body. However, this may be more to do with the features of the sector (network utility, natural monopoly) than with the specific contractual arrangement.

Nevertheless, common usage of the term “franchising” continues to treat it as a privatization method, regardless of how it is actually used. This may be for political reasons, as this is how franchising was originally presented to the public. For example, the UK government, which is heavily politically invested in the sector, continues to refer to the 1993 railway franchising as “privatization” (see, for example, (L. Butcher, 2020)), even though it continues to own the infrastructure and franchise periods were initially quite short (7 years).

3.2.3 Privatization Plus Buy-Back Option

Description

The starting point for this option is a traditional divestment, by trade sale to a strategic investor. Within the privatization contracts, the Government retains the right to buy back the shares after a specific period, presumably contingent on the performance of the company, and/or if there is a change of ownership. Ideally, there would need to be a mechanism to determine the buy-back value if Government exercises the option, to ensure that the private partner is adequately compensated for its efforts and investment.

This would likely be unworkable using an IPO approach for the initial privatization, because the shareholders would be many and diverse, and because the prospect of buy-back would likely lead to share price volatility and speculation.

Two examples of this approach were identified in the literature, both for hospital privatizations. St Goran’s hospital in Sweden involved a 100% trade sale with a buy-back option after 10 years for a fixed price of SKR275m (see (Nikolic, 2006)). This was Sweden’s first experience with private hospitals, so the buy-back option may have been included as an insurance policy in case performance did not meet expectations.

Spalding Regional Hospital, Georgia, USA, was privatized in 1986. In 1996 the new owner merged with another company. The Hospital Authority used its “right of first refusal”, a common inclusion in privatization contracts, to consider other options. In the end, however, the merger was allowed to proceed (Tradewell, 1998). In this case, the Authority was being opportunistic, rather than planning up front for a repurchase option.

Advantages and disadvantages

The advantages and disadvantages to the public sector of this approach are summarized in Table 5 below.

Table 5: Advantages and Disadvantages of the Divestment Plus Buy Back Option Approach

Advantages	Disadvantages
<ul style="list-style-type: none"> • Govt. receives proceeds. • Private party owns the assets and is responsible for investment, financing and operations; more likely to achieve performance improvements. • Facilitates renationalization if performance is below expectations or government policy on privatization changes. 	<ul style="list-style-type: none"> • Creates uncertainty for the private partner; this will be priced into its bid for the company and may lead to disinvestment or cost cutting if it believes that the option will be exercised. • Government will need to fund the repurchase if it exercises the option. • Negative impact on government reputation, similar to other forms of renationalization. • Setting a fixed price for the buy-back that does not recognize improvements made by the private investor could deter them from making such improvements.

Source: author’s analysis

Privatization, PPP or Concession?

The divestment plus buy-back option approach qualifies as privatization. It is similar to licensing, in the sense that (with the St Goran’s model) the right to provide the services may be withdrawn by government. From the point of view of the investor the buy-back option creates additional uncertainty, since there is a

risk of renationalization, which could affect investor interest and value/proceeds. It is therefore unlikely that this option would be an effective or credible approach to either privatization or PPP, other than to address a specific situation.

3.2.4 Revolving Privatization

Description

The revolving privatization approach may be considered as a combination of franchising and retendering. The approach has been referred to as “Public Services Concession” (see, for example, (World Bank PPP Briefs, 2010)), although it is closer to licensing or franchising. It involves a trade sale to a strategic investor which includes either:

- i. An obligation to offer its shares for sale to the highest bidder after a given period. The incumbent may also bid. This has been used in the electricity sector in Lesotho, for example.
- ii. A franchise that includes an obligation to re-tender periodically. Again the incumbent may continue in place if they submit the highest (or lowest in the case of subsidy) bid. This has been used in Latin America; for example, in Argentina, rail franchises were issued for 95 years but were to be retendered every 10-15 years.

Advantages and disadvantages

The advantages and disadvantages to the public sector of this approach are summarized in Table 6 below.

Table 6: Advantages and Disadvantages of the Revolving Privatization Approach

Advantages	Disadvantages
<ul style="list-style-type: none"> • Govt. receives proceeds from initial sale. • Periodic competition for the market. • Private party owns the assets and is responsible for investment, financing and operations; more likely to achieve performance improvements. • Private investor receives the market value if it does not win the retender, so it has an incentive to invest to add value. • No need for Government to provide compensation if the shares or franchise change hands. • Retendering cost may be borne by the private partner. 	<ul style="list-style-type: none"> • Incumbent has a significant informational advantage in the retender. Potential bidders will know this and may be deterred from participating. • If the incumbent does not bid in the retender this sends a strong negative message to the market, which may deter other bidders. • If there are no credible bids for the retender (including from the incumbent), the Govt. must act as the “buyer of last resort”. This could be a significant contingent liability. • The structure is quite complex and involves significant Govt. influence even after privatization. This may deter potential investors. • Govt. may not be able to control the identity of the owner/franchisee after a retender⁵.

Source: Author’s analysis

⁵ In practice this is a feature of most privatization structures, since the equity may be bought and sold subsequently. Even where the direct shareholder stays the same, its own shares may change hands.

Privatization, PPP or Concession?

This approach is built on the initial privatization of the equity or assets. However, it incorporates features of licenses/franchises, in particular, periodic re-tendering that generates competition for the market. In practice, it is likely that this approach was developed to address specific circumstances. Its origins in Latin America suggest that in that region at least it was adopted as a way around legal obstacles to full privatization.

The drivers for using this structure are less clear for Africa, but are likely to be a combination of: i) desire by governments to receive proceeds from the initial privatization; ii) lack of government financial resources to finance future investments⁶; iii) initial reluctance by governments to commit fully to privatization, particularly for strategic utilities; and iv) promotion by donors and Multilateral Development Banks. For whatever reason, this approach has had a mixed record of success in Africa. In Lesotho, following the tender process, the government opted to continue with its existing management contract arrangements rather than complete privatization, and the electricity sector remains in public ownership.

⁶ This mitigates against the traditional municipal concessions used in France, for example.

4. Case Studies

This Section applies the framework and structures described in Section 3 to a sample of real world transactions, to consider whether they would be considered as privatization or PPP today. Given the small size of the sample, the conclusions should be viewed with appropriate caution. However, they do support the findings of the theoretical analysis in Section 3.

4.1 PPP by Concession: Nelspruit Water, South Africa

As part of a restructuring of local and regional government in 1995, the population served by Nelspruit Council increased from 25,000 to 250,000, with an eight-fold increase in area served⁷. Many of the new additions did not have water or sanitation services and the investment required to connect them was beyond the Council's capacity to finance. In order to bridge this gap, the Council decided on a concession arrangement.

The tender was launched in December 1996 by inviting bids from eight pre-selected bidders. Five of them submitted proposals and Greater Nelspruit Utility Corporation was selected as the Preferred Bidder. Commercial close was achieved in April 1999, with financial close in November.

The Greater Nelspruit Utility Corporation was a Special Purpose Vehicle (SPV) owned by Biwater Capital BV (Netherlands) (64%), Biwater Operations Pty (South Africa) (26%) and Sivukile (local empowerment partner) (10%). The concession contract gave Sivukile a two-year option to purchase an additional 41%, out of Biwater Capital's stake.

The 30-year concession contract required the concessionaire to provide water and sanitation services within a defined area, including financing the necessary investment, maintenance and rehabilitation. In return it had the right to charge users. Extensions beyond the concession area could be considered on a case by case basis. Existing assets were leased to the concessionaire at rates designed to cover the Council's financing costs for the assets. After 10 years the lease charge was to be reduced to a nominal value. Ownership of all assets was to revert to the Council at the end of the concession. There was also an annual concession fee payable to the Council, fixed in real terms for the first five years, then adjusted to cover the Council's cost of managing the concession.

The concessionaire was to recommend the level of tariffs needed to achieve an agreed rate of return. If the Council set tariffs below this level, it was required to pay the difference in revenue to the concessionaire directly. The concession contract included penalties if the concessionaire did not meet specified performance standards.

The 10 year performance review of the concession concluded that, by and large, it was a success (P. Bender, 2010). In particular:

- 94% of households receive water from the system, compared with 65% in 1999.
- Water and effluent quality is recognized as meeting high standards.
- Tariff levels are similar to, or lower than, other comparable municipalities.

Table 7 below applies the parameters identified in Section 3 to the Nelspruit water concession.

⁷ The information for this Case Study comes from (P. Bender, 2010).

Table 7: Nelspruit Water Concession: PPP or Privatization?

Feature	Nelspruit Water Concession	PPP	Privatization
Term	30 years	✓	✗
Govt. role	Regulation, initial assets	✓	✗
Risk allocation	Shared	✓	✗
Management, operations	Concessionaire	✓	✓
Construction	Concessionaire	✓	✓
Financing	Concessionaire	✓	✓
Payment basis	Demand	✓	✓
Who pays	Users	✓	✓
Regulation	Contract	✓	✗
Asset ownership	Existing = govt., leased to SPV New = SPV, transfer to govt., at end	✓	✗
Legal basis	Concession contract	✓	✗
Type of project	Brownfield (existing assets)	✓	✓
Key decision metrics	VFM, affordability to govt.	✓	✗
Proceeds	None	✓	✗
Govt. income	Lease payments, fixed Concession Fee	✓	✗
Impact on jobs	n.a. (likely increase given service expansion)	?	?
Private investor	Consortium (strategic partner, empowerment partner)	✓	✗
Tender process	Invited single-stage tender	✓	✓

Source: (P. Bender, 2010), Author's analysis

Table 7 confirms that the Nelspruit water concession closely matches the features of a PPP. It is not a close match with the features that would qualify it as a privatization.

4.2 Privatization by Concession: Hospital Support Services, Malaysia

Malaysia was an early adopter of privatization, which was announced as a policy in 1983⁸. The Privatization Masterplan and the first two-year rolling Privatization Action Plan were published in 1991. In the health sector, the initial focus for privatization was non-medical services, aiming to improve the management and operation of public health facilities. Pharmaceutical services were privatized in 1994 and hospital support services (HSS) in 1996.

HSS consists of various facilities management, non-medical services and maintenance activities required to support hospital operation. These are: facility engineering maintenance; biomedical engineering maintenance; cleaning, linen and laundry; and clinical waste management. These were bundled together and a tender was launched in July 1993. 31 companies expressed interest. While the tender was taking place, three companies submitted unsolicited proposals outside of the formal tender process. Government decided to cancel the original tender and negotiate with them directly. As a result of these negotiations, in 1996, concession agreements were signed with each of the three companies, Faber,

⁸ Information for this case study was drawn from (Nambiar, 2009) and (APEC, 2014)

Medivest and Radicare, giving each sole responsibility for providing HSS to one of three zones. Together these contracts covered all 148 public hospitals and non-bedded institutions across the country.

The duration of the concessions was 15 years. In providing the services, the concessionaires had to meet standards set by the government, mainly the Technical Requirements and Performance Standards, Master Agreed Procedures, Standard Operating Procedures and other relevant Malaysian and international standards and procedures. Government was responsible for paying for the services, with the level of payments based on the number of hospitals covered by the concession. Performance of the concessionaires was monitored by SIHAT (Hospital System for the Monitoring of Standards), a private company. SIHAT reported to Kawalselia, a unit in the Ministry of Health that was established in 2008 specifically for monitoring and supervising the concessions.

(Nambiar, 2009) highlights a number of concerns that have been raised over this privatization, including:

- Lack of a competitive tender process.
- The monitoring and supervisory system was not established until after the concessions started and the bodies responsible for implementing it were not independent of the Ministry. Monitoring was reactive, based on complaints from medical staff, rather than measuring performance against the required standards.
- The three concessionaires had no previous experience of providing HSS. All three had to be restructured following the 1998 economic crisis “*due to mismanagement*”.
- The tariff model was never reviewed.
- A 2005 review cited a number of concerns, including: lack of trained staff for clinical waste management, problems with waste separation, lack of planned maintenance and inadequate monitoring of equipment by the concessionaires.

(APEC, 2014) notes that at the time of publication in 2014, government was in the process of renegotiating the concessions with the existing concessionaires. The original term would have expired in 2011, which suggests that the concessions were extended at least once.

Table 8 below applies the parameters identified in Section 3 to the Malaysia HSS concession.

Table 8: Malaysia Hospital Support Services Concession: PPP or Privatization?

Feature	Malaysia HSS Concession	PPP	Privatization
Term	15 years	✓	✗
Govt. role	Monitoring and supervision, making payments, providing assets	✓	✗
Risk allocation	Shared: Govt. responsible for availability of assets; concessionaire for cost and quality of services, and implicitly for demand risk	✓	✗
Management, operations	Private	✓	✓
Construction	Govt. (not part of the concession)	✓	✗
Financing	Govt. (not part of the concession)	✓	✗
Payment basis	Payment based on number of hospitals	✓	✗
Who pays	Govt.	✓	✗

Regulation	Regulator within Ministry; quality assurance outsourced	✓	✓
Asset ownership	Govt.	✓	✗
Legal basis	Concession agreement	✓	✗
Type of project	Services only	✓	✗
Key decision metrics	n.a.	?	?
Proceeds	None	✓	✗
Govt. income	None	✓	✓
Impact on jobs	Not clear; concession replaced existing services	?	?
Private investor	O&M company	✓	✗
Tender process	Direct negotiation	✓	✓

Source: (Nambiar, 2009), (APEC, 2014), Author's analysis

The analysis presented in Table 8 suggests that, by today's standards, the Malaysia HSS concessions would be categorized as PPP, not privatization.

4.3 Privatization With Licenses: Chile Electricity

Chile was one of the initiators of the global privatization program that began in the 1980s⁹. The policy was driven by a view that government involvement in the economy led to inefficiencies, rigidities and poor economic performance. State-owned utilities, in particular, were being used as social policy tools to create jobs and keep tariffs and inflation low. The resulting financial constraints led to cuts in maintenance and under-investment, negatively affecting supply and quality of services.

The reform and restructuring of the electricity sector began in 1978, with the establishment of the National Energy Commission as a policy-making and planning body. The Ministry of Economy retained responsibility for tariff regulation and for issuing licenses. In 1985 the Superintendence of Electricity and Fuels was set up within the Ministry to cover regulation of standards and quality.

Legislation passed in 1982 provided for the unbundling of the existing vertically integrated electricity operators. The largest, Endesa, was split into 5 generators and three distribution companies in the central region, and one generator and three distributors in the north. The name Endesa was retained by one of the generators, and the national grid (transmission system) was allocated to the new Endesa business unit and privatized with it. The other large operator, Chilectra, was split into one generator and two distributors.

The 1982 legislation provided for the licensing of electricity operators. Licenses were open-ended but could be withdrawn if performance fell below the required standard. They were limited to a specific geographic area but were not exclusive – an area may be covered by more than one licensee. Licenses were not compulsory but they did provide rights of way, as well as the right to install power lines on public property, a necessary requirement for the wires businesses (distribution and transmission).

Privatization of the unbundled companies began in 1986, and for the largest entities it was largely completed by 1990 (the final four entities were privatized between 1990 and 1998). For most companies, this was achieved through the sale of shares on the stock market (IPO followed by subsequent tranches),

⁹ Information for this case study was drawn from (Serra, 1998)

combined with sales of shares to employees, other civil servants and small investors. Six smaller companies were sold by public auction to strategic investors.

The performance of the sector improved significantly in the years immediately following privatization. Generation capacity increased from 4 to 6.6 Gw (65%) between 1988 and 1997, and the amount of electricity generated almost doubled over the same period, from 16.9 to 32.5 GWh. Productivity increased as the privatized operators invested and cut overstaffing. Endesa, for example, reduced headcount from 2,980 to 1,674 over the period, and increased productivity by more than 350%, from 2.2 to 8.0 GWh/employee.

Table 9 below applies the parameters identified in Section 3 to the Chile electricity sector privatization.

Table 9: Chile Electricity Sector: PPP or Privatization?

Feature	Chile Electricity Sector	PPP	Privatization
Term	Permanent	x	✓
Govt. role	Regulation, sector policy	✓	✓
Risk allocation	Private	x	✓
Management, operations	Private	✓	✓
Construction	Private	✓	✓
Financing	Private	✓	✓
Payment basis	Tariffs	✓	✓
Who pays	Users	✓	✓
Regulation	Separate bodies for technical and economic regulation, both part of MOE	✓	✓
Asset ownership	Private	x	✓
Legal basis	Sector Law, licenses	x	✓
Type of project	Existing assets	✓	✓
Key decision metrics	Cost-Benefit analysis, valuation, policy	x	✓
Proceeds	USD1.2 billion 1984-89	x	✓
Govt. income	None	✓	✓
Impact on jobs	Negative	x	✓
Private investor	Individuals (IPOs); strategic (auctions)	x	✓
Tender process	Mostly IPOs; public auction (smaller units)	x	✓

Source: (Serra, 1998), Author's analysis

The Chile electricity sector provides a classic example of utility privatization. Starting with sector reforms, regulation and unbundling, most of the assets were divested through IPOs and subsequent secondary share sales. Unlike the UK and elsewhere, licenses were open-ended, perhaps recognizing the benefits of stability to the long term development of the sector and that periodic reissue of licenses would not be much of a threat to existing licensees given their incumbent advantage. In any case, Government retained the threat of removal of licenses for poor performance and can also issue additional licenses to allow new operators into the market.

4.4 Privatization by Franchise: Brazil Railways

The initial development of railways in Brazil during the 19th century used concessions to attract the necessary investment, much of which came from Europe (Britain and France, in particular)¹⁰. Operators received government subsidies to achieve a guaranteed return, which created an increasing fiscal burden for the government. Furthermore, a lack of standardization constrained inter-operability between lines, reducing efficiency and increasing economic costs. Government decided to nationalize and unify the railway network and began the process of purchasing the various lines in 1901, funded through international borrowing. The process proceeded gradually. By 1929 government had acquired nearly 50% of the railway system and did not complete the nationalization process until 1957. Most of the acquisitions (18 regional railways, comprising 22 lines) were consolidated under a single organization, the Brazilian Federal Railway (RFFSA). In 1971 a second company, FEPASA, was created as a regional operator, by merging five railways in Sao Paulo state.

By the 1980s, a combination of economic shocks (falling prices for primary products, oil price shock), with the kind of problems that often face monopoly State-Owned Enterprises (over-staffing, inefficient operations, financial constraints), as well as competition from other modes of transport for the lucrative freight business, meant that the financial burden of the railway system had become unsustainable. (Martin, 2002) notes *“By 1991, the daily loss had soared to US\$1 million and accumulated debt stood at US\$1.2 billion, a figure which rose by 1995 to US\$2.56 billion.”*

In 1993 Government included RFFSA in its privatization program following the completion of railway privatizations in Chile and Argentina. RFFSA was split into six regional businesses, to be privatized individually through franchising (referred to as concessions). The preparation included technical and economic studies to determine investment requirements and to plan for reducing headcount. This reduction was carried out by government prior to the concessions being let: RFFSA employment was reduced from 42,000 to 21,000; FEPASA from 8,000 to 5,000.

By the end of 1997, all six RFFSA concessions for the freight businesses (government retained passenger operations) had been let. A seventh, for FEPASA, was let in 1998. The term of the franchises was 30 years. Franchisees were responsible for operations, maintenance and asset renewal and existing assets were leased to them by the government. The franchisees were typically consortia of local and international strategic and financial investors. There has been some consolidation and M&A activity in the sector, such that ownership of some of the concessions changed over time. By 2002 the six main concessionaires comprised the following:

- Ferrovias Sul-Atlântico: Railtex (US), strategic partner; Ralph Partners (US), financial partner; local investors.
- Ferrovias Centro-Atlântica: Tacuma Consortium, a subsidiary of CVRD, the world’s largest iron ore producer.
- Ferrobán: consortium comprising railway operators, banks and financial investors. CVRD is a major partner. Subsequently merged with Novoeste.
- CFN: local consortium, led by CVRD.
- MRS Logística: consortium of mineral and steel companies led by CSN, which has common ownership with CVRD.

¹⁰ Information for this case study was drawn from (Martin, 2002), (Bruha, 2014), (A. Estache, 2000).

- Novoeste: consortium of local and US investors, led by the US Noel Group. Subsequently merged with Ferrobán.

By 2002, only CFN had not changed hands since the original franchises were let. The key players in the sector have been the major customers (particularly CVRD, itself a privatized entity), rather than railway operators. Railtex is the only operator participating as a franchisee.

There was no regulatory body responsible for railways at the time the franchises were let. The Agência Nacional de Transportes Terrestres (ANTT) was established under the Ministry of Transport as a national transport regulator in 2004 (Bruha, 2014). Its remit includes railways.

Table 10 below applies the parameters identified in Section 3 to the Brazilian Rail Franchises.

Table 10: Brazil Railway Franchises: PPP or Privatization?

Feature	Brazil Railway Franchises	PPP	Privatization
Term	30 years	✓	✗
Govt. role	Lease existing assets, otherwise arms' length; regulation came later	✓	✓
Risk allocation	Shared, but most allocated to the franchisee	✓	✓
Management, operations	Franchisee	✓	✓
Construction	Franchisee (renewal, expansion)	✓	✓
Financing	Franchisee ¹¹	✓	✓
Payment basis	Demand (freight tariffs)	✓	✓
Who pays	Users	✓	✓
Regulation	Regulator under the Ministry of Transport, from 2004	✓	✓
Asset ownership	Government	✓	✗
Legal basis	Franchise document	✓	✗
Type of project	Operation of existing assets plus investment	✓	✓
Key decision metrics	Cost-benefit analysis	✗	✓
Proceeds	Yes; initial payment for franchise	✗	✓
Govt. income	Lease payments; used to pay down RFFSA debt	✓	✗
Impact on jobs	Negative	✓	✓
Private investor	Consortia of major customers, financial investors, operator (2 franchises)	✓	✗
Tender process	Public auction	✓	✓

Source: (Martin, 2002), (Bruha, 2014), (A. Estache, 2000), Author's analysis

The categorization of franchising as it was applied to the Brazilian railway system is somewhat less clear cut than the previous examples. While it includes features that are clearly PPP, such as the fixed term, asset ownership remaining with government and a degree of risk sharing, it also shares features with

¹¹ In practice most is provided by BNDES, a State-owned development bank. This effectively transfers some of the risk back to government.

privatization, including a tender process that raised initial proceeds for the government. On balance, while it is understandable why this was referred to at the time as privatization, the same structure today would qualify as PPP.

5.5 Privatization With Buy-Back Option: St Goran's Hospital, Sweden

By the end of the 1980s public healthcare in Sweden was struggling to meet demand, with long waiting lists for treatment and low salaries/poor morale among staff¹². To address this, in 1991 the Stockholm regional government adopted a policy that aimed to increase efficiency and create competitive pressure for public sector providers by increasing private sector involvement in healthcare. In 1994 Stockholm County Council took the decision to privatize St Goran's Hospital, Stockholm, creating the first privately-owned public hospital in Sweden.

At the time this concept was untested and somewhat controversial, so a cautious approach was adopted. St Goran's was corporatized first, establishing it as a non-profit, limited liability company (Görans Sjukhus AB) and streamlining the services it offered. Specialty care units and clinical laboratories were transferred to other hospitals or spun off to the private sector. In October 1999 the new company was sold to Capiro, a Swedish healthcare company, and converted into a for-profit joint-stock company. Included in the structure was a seven-year revolving Care Agreement with the Council for the provision of services. Payment is linked to performance (delivery of treatments) with caps on volume and prices. The agreement also includes a veto right for the Council in case Capiro wishes to sell the hospital.

The Care Agreement was renewed for further 7 year terms in 2005 and 2012. The 2005 Agreement introduced an option for the Council to repurchase the company for a fixed price of SEK275m, which could be exercised at the end of 2009. That option was not exercised. The 2012 Agreement included an option to extend the term from 2022 to 2026, which the Council exercised in 2018.

Capiro, the private partner, was a Swedish private company listed on the stock exchange. It has subsequently grown significantly, both within Sweden and in other markets. In 2018 it merged with Ramsay Générale de Santé of France, increasing its footprint across Europe.

Following the privatization, St Goran's continued to operate as a public hospital, providing medical services that are free at the point of delivery (other than a nominal charge that applies to all public hospitals in Sweden, regardless of ownership). According to (Montreal Economic Institute, 2003) "*St. Goran's has become the capital's most efficient and least costly hospital, achieving yields 10% to 15% higher than those of other hospitals.*" Another report (The Reason Foundation, 2005) notes that between 1999 and 2005 costs were reduced by 30% while at the same time the number of patients treated increased by 100,000 a year. St Goran's is used as a benchmark to improve performance of other public hospitals that were not privatized.

In 1998 the Council tendered for private provision all medical services other than ambulances, and there are now more than 200 private suppliers providing public medical services and associated support services to the residents of Stockholm. St Goran's privatization structure has come to be known as the "Stockholm Model".

In 2004 the national government banned further privatization of public healthcare. This encompassed the divestment of existing public hospitals and the outsourcing of public healthcare services. Existing

¹² Information for this case study was drawn from (Montreal Economic Institute, 2003), (The Reason Foundation, 2005), (Schumpeter, 2013), (Burgermeister, 2004), (Gillan, 2001), (Nikolic, 2006), [www.capiostgoran/se](http://www.capiostgoran.se).

privatized hospitals were exempt, however. Today St Goran’s remains the only public hospital in Sweden owned and operated by the private sector.

Table 11 below applies the parameters identified in Section 3 to the St Goran’s transaction.

Table 11: St Goran’s Hospital: PPP or Privatization?

Feature	St Goran’s Hospital	PPP	Privatization
Term	Permanent + 7 year renewable Care Agreement	✓	✓
Govt. role	Set standards, monitor quality, payment	✓	✓
Risk allocation	Shared via the Care Agreement	✓	✓
Management, operations	Private	✓	✓
Construction	Existing asset, future investments private	✓	✓
Financing	Private	✓	✓
Payment basis	Demand		✓
Who pays	Stockholm Council	✓	✓
Regulation	Combination of external standards and the Care Agreement (tariffs)	✓	(✓)
Asset ownership	Private (permanent unless the Council exercised its buy-back option)	x	✓
Legal basis	“Sale” plus renewable service contract	✓	✓
Type of project	Existing asset	✓	✓
Key decision metrics	n.a.; driven by policy	?	✓
Proceeds	n.a. ¹³	?	?
Govt. income	None	✓	✓
Impact on jobs	n.a.	?	?
Private investor	Single strategic investor (Capio)	(✓)	✓
Tender process	Competitive tender ¹⁴	✓	✓

Source: various (see footnote 15), Author’s analysis

The structure used for the St Goran’s transaction is essentially a hybrid of privatization and PPP carried out in two stages, an initial privatization followed by a PPP contract for services. The initial sale of the company to a strategic investor qualifies as a privatization, the subsequent medium-term renewable Care Agreement is a PPP structure. The buy-back option that was included in the 2005-2012 Care Agreement would have provided a clean exit route for the government, which had recently walked back from health privatization as noted above. Without this option, if the Council had not renewed the Care Agreement the assets would have remained with Capio, which could have converted St Goran’s to a private hospital.

St Goran’s provides a rare example of the privatization of a Government-pays social infrastructure activity. Normally these might be more suited to PPP structures, where retendering applies competitive pressure

¹³ Some of the sources suggest that the Council retained the assets and leased them to the privatized company, however this would be inconsistent with use of the term “sale” to describe the transaction, which suggests that a purchase price was paid for the shares in Görans Sjukhus AB.

¹⁴ The literature is not clear on the process, but one source refers to public auctions for other health services that were privatized around the same time, so it would be reasonable to assume the same for St Goran’s.

periodically. In the case of St Goran's a similar outcome was achieved through periodic renegotiation of the Care Agreement, albeit without the competitive pressure that would arise from a full retender.

5.6 Revolving Privatization: Electricity Distribution, Argentina

The first major wave of privatizations in Argentina began in 1989, driven primarily by economic and fiscal pressures but also by a desire to improve the performance of State-owned utilities¹⁵. The sector was first unbundled, separating generation, transmission and distribution into a number of State-Owned Enterprises, and a new regulatory body was set up. Three large electricity distribution companies were established, EDENOR, EDESUR and EDELAP, which together had 44% of the market. The remainder of the population was served by municipal/regional distributors.

EDENOR, EDESUR and EDELAP were privatized by means of trade sales to strategic investors between 1992 and 1996, along with 12 of the regional distribution companies, together amounting to 66% of the market. Proceeds from EDENOR and EDESUR alone accounted for more than one third of privatization proceeds from the entire sector (J. Delfino, 2001). A 1996 US Government review of privatization in Argentina (United States General Accounting Office, 1996) notes that in this phase of the privatization program, the government typically retained a non-controlling stake, to be floated later on the stock market.

The distribution companies were granted 95-year concessions. The term was divided into 10-year "management periods" (other than the first, which was 15 years). At the end of each management period the concession was re-tendered; if the incumbent submitted the highest bid, it would retain the concession for the next 10 years; if not, the highest bidder takes over the assets and the concession, paying the proceeds that it bid directly to the former concessionaire. (P. Guislain, 1995) argues that by using this approach the market provides a more accurate valuation of the assets, including any improvements made by the incumbent, incentivizing concessionaires to invest in the business. Alternatively, (Ministry of Economy, 1999) suggests that the purpose of the periodic retendering is to allow the concessionaire an exit route. In practice, both are correct. Furthermore, periodic retendering ensures that the incumbent faces competition for the market, helping to curb any monopolistic tendencies.

In terms of economic benefits, the privatizations are generally considered a success. The privatized companies invested in expanding the network (the two largest companies increased customers by 11% between 1993 and 2002, including the new connection of 650,000 shanty town households). Consumer tariffs fell in real terms, reaching 2.5 US cents/kWh by 2002, compared with 9.5 cents in the United States in the same year. Profitability in the sector improved; EDENOR achieved a post-tax return on equity of 10.9% and EDESUD 9.5% in 2000. Productivity also improved, partly as a result of headcount reductions, from less than 2 GWh/employee in 1993 to 5.7 GWh in 2001. Based on this, in his 2008 review Pollitt concluded that *"the reform was very successful prior to the collapse of the Argentine peso in early 2002."* (Pollitt, 2008).

Table 12 below applies the parameters identified in Section 3 to the Argentina Electricity Distribution concessions.

¹⁵ Information for this case study was drawn from (Estache, 2002), (J. Delfino, 2001), (Ministry of Economy, 1999), (United States General Accounting Office, 1996), (Pollitt, 2008)

Table 12: Argentina Electricity Distribution: PPP or Privatization?

Feature	Argentina Electricity Distribution	PPP	Privatization
Term	Permanent; 95 year concession; retendered every 10 years	✓	✓
Govt. role	Initial transfer of assets, regulation	✓	✓
Risk allocation	Private	✓	✓
Management, operations	Private	✓	✓
Construction	Private	✓	✓
Financing	Private	✓	✓
Payment basis	Demand	✓	✓
Who pays	Users	✓	✓
Regulation	Independent regulator	✗	✓
Asset ownership	Private	✗	✓
Legal basis	Company and sector laws, concessions (operations)	✓	✓
Type of project	Existing assets	✓	✓
Key decision metrics	Valuation, policy	✗	✓
Proceeds	Price paid for the equity	✗	✓
Govt. income	No direct income; proceeds on subsequent share sales, tax revenue	✗	✓
Impact on jobs	Decrease	✗	✓
Private investor	Strategic	✗	✓
Tender process	Competitive tender	✓	✓

Source: various (see footnote 15), Author's analysis

This structure is similar to the privatization plus licensing approach adopted in the UK, the key difference being the periodic retendering of the concessions. In practice it is uncertain how effective that provision might be as no information was identified on whether the first retenders (due in 2007) actually took place. A major economic and financial crisis in 2001 led government to change the regulatory framework, shifting more currency and inflation risk onto the private operators. This included a tariff freeze and removal of exchange rate indexation (World Bank, 2016).

Although it shares some key features with PPP, this structure is best described as privatization. In practice, however, it is a relatively complex approach and few successful examples were identified¹⁶.

¹⁶ The tender for the Lesotho electricity concession mentioned in Section 3 that used the very similar Public Service Concession approach was not completed and the sector remains in government ownership.

5. Conclusions

While this Research Paper very much represents high level view, focusing on theoretical and qualitative aspects rather than detailed quantitative analysis, it is possible to draw some quite firm conclusions. In particular:

- Traditional concessions are clearly PPP structures, not privatization. This may explain their limited success in “privatizing” public assets.
- As a corollary, references to concessions as methods of privatization in the older literature, while in line with the practices of the time, are no longer accurate. The development of PPP as a tool for procuring public assets over the last 25 years has clarified the differences between PPP and privatization, several of which are fundamental.
- The rapid growth of PPP as a tool for the procurement of new assets and services has driven a significant increase in the use of concession-type structures such as BOT/DBFOM. However, concessions appear to have lost their appeal as tools for “privatization” of major utilities and infrastructure. This is an area that may benefit from further research.
- As regards concession-type privatization structures, only the divestiture plus licensing approach has had any sustained success. It is the most common option for privatizing utilities, especially those with monopolistic aspects.
- Franchising should be considered a PPP structure, rather than privatization. Even when the franchise includes “ownership” of assets, this is not permanent since the franchise may change hands, or revert to government, along with the assets.
- The sale plus buy-back option can be considered to be a privatization technique, although its use is likely to be limited to certain specific circumstances (see, for example, (Nikolic, 2006)).

Concession-type approaches to privatization have been justified using a number of arguments. These include the following:

- To retain government control of “strategic” industries.
- To protect consumers from predatory behavior by privatized utilities in industries that have significant natural monopoly features.
- To use periodic retendering to introduce competition for the market after privatization.
- To get around legal obstacles to other privatization methods.

In practice, there are other ways to achieve these outcomes while still divesting the assets. In particular, independent regulators have become well established as an alternative to competitive markets in monopolistic industries, and the impact of their scrutiny is full time, rather than the periodic competition for the market arising from retendering concessions or franchises.

A further consideration for governments considering how best to introduce private sector participation in existing public sector assets is whether privatization is the best solution, or whether a PPP might provide a better alternative. The privatization decision is frequently driven by ideology and policy, often part of a wider strategic reform of the sector. Conversely, a decision on whether to use PPP or another procurement route can be more objective, driven by VFM calculations. In some situations, PPP approaches (including concessions and franchising) may provide greater economic benefit than full privatization, and PPP should be considered as part of the options analysis. Similarly, PPP can be

considered for sectors or subsectors that are not considered suitable for full privatization as a way to inject private capital and expertise.

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