



Malaysia's Public-Private Partnerships in the Trans-Pacific Partnership Agreement: Alternatives to complete carve-out

Dr David Seth Jones



Introduction

In the ongoing negotiations on the Trans-Pacific Partnership Agreement (TPPA), it is intended to incorporate Public-Private Partnerships (PPPs) in the chapter on government procurement, thereby opening up mutual access to the PPP markets of the member states.

The Malaysian government has adopted a position to carve-out PPPs from its own commitments to the TPPA. The starting point of this position is that PPPs are not properly part of government procurement and involve special features which warrant their exclusion from the procurement chapter of the TPPA. This is reflected in the fact that PPPs are administered by a special unit in the Prime Minister's Office, Unit Kerjasama Awam Swasta (UKAS), and not by the Procurement Unit of the Ministry of Finance. Another factor is the fear of the dominance of foreign players in Malaysia's PPP markets. Considering the importance of PPPs in Malaysia and the potential benefits of opening up PPP markets, the paper recommends the Malaysian government to avoid completely carving out the PPPs from the trade agreement. Instead, it recommends measures to be adopted that can enable Malaysia to: a) take advantage of the opportunities created by including PPPs in the agreement, and b) overcome the perceived harmful effects arising from their inclusion. **The exemption measures proposed here should be kept minimum and for a transitional period only.**

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Types of PPP relevant to the TPPA

Public Private Partnership, in general, can be defined as a public procurement model, in which the government shares risks and responsibilities with the private sector. "The private party will raise its own funds to finance the whole or part of the assets that will deliver the services based on agreed performances. The public sector, in turn, will compensate the private party for these services" (Unit Kerjasama Awam Swasta [UKAS], 2009). There are different types of arrangements in PPPs, depending on the extent of involvement of and risk taken by the private sector. There are at least three types that may be relevant to the TPPA.

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01 Build, Operate and Transfer (BOT)

BOT is a type of PPP that involves a consortium of private sector companies known as a Special Purpose Vehicle (SPV), hired by the government to build, and then manage and operate a new infrastructure facility for a set period of years under a license. At the end of the license period, the facility will revert to the government.

The SPV funds the project through its own finances: borrowing (bond issues and bank loans), new equity issue or retained earnings; although a government subsidy may be available to partly fund development costs. In return, in many BOT projects, the SPV receives income from the charges levied on users of the facility, and also in some cases, from a management fee paid by the government. This enables the SPV to service and repay its debt and earn a profit margin. A variant of this type of PPP is the Design, Build, Operate and Transfer (DBOT) arrangement, in which the SPV is responsible for the design work at the beginning of the project.

02 Operate and Transfer

The Operate and Transfer PPP applies to an already existing facility, in which operational and management responsibilities are delegated to a private company or consortium under a concession licence for a set period of years; at the end of which, the facility reverts to the government. This is called by the World Bank, a concession PPP. The operator pays the government an up-front lump sum, or an annual fee, or lease payment for the concession, but earns revenue from the charges levied on the users to recover its operational and maintenance costs, and achieve a sufficient profit margin.

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03 Build, Own and Lease Back

A further variant of PPP relevant to the TPPA is Build, Own, and Lease Back, in which the private sector builds a facility, owns and maintains it, but leases it to a government agency. The agency uses the facility under lease to provide a public service (e.g. hospitals and government office buildings), with the private owner responsible for maintenance, upkeep and upgrading. The agency pays a lease fee annually or as an initial lump sum, or both. This will defray the costs of building and maintenance, and enable the owner to achieve a profit margin.

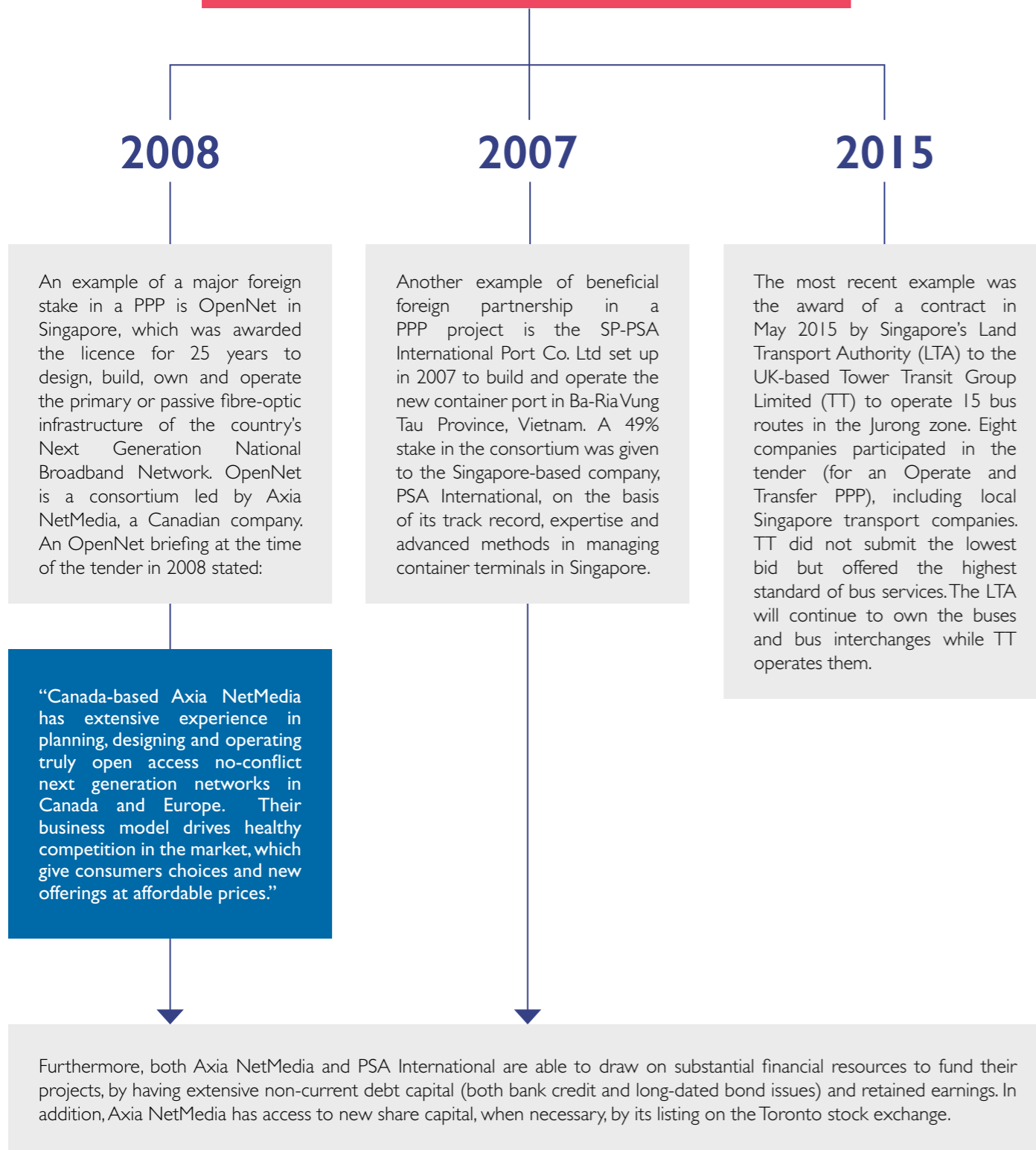
The period under which an SPV can hold an operating licence for an infrastructure facility can vary from 12 to 99 years but is usually between 15 and 35 years. The period may be determined by the rate of depreciation of the assets of the facility, which may be transferred back to the government at the end of their useful life. It may also depend on how long it takes for the SPV to recover its capital costs in building the facility and achieving a profit margin.

Role of PPPs in infrastructure development in Malaysia

In recent years, much of the Malaysian infrastructure has been built and managed through PPPs. Between 1983 and 2012, a total of 592 PPP projects has been implemented. The main projects have been in the energy, water, government services, construction, communications and transport sectors, accounting for over 50 percent of all PPP projects. At the end of 2012, the market capitalisation of the businesses involved in PPPs had reached RM 234 billion.



Examples of beneficial foreign partnership in PPP project



A Benefits and opportunities

The contribution of foreign companies to PPPs

Large and well-established companies from the other member states in the TPP, which have a strong track record in PPP projects, may provide much needed management and technical expertise, as well as valuable experience in the implementation of projects in Malaysia. In addition, they may possess the advanced technology and organisational system vital to the project. This is particularly relevant to large infrastructure projects that require extensive technical know-how and resources.

A further advantage is that large and well-known companies from other TPP countries may be in a better position than local companies to access capital markets and international banks to fund a PPP project. This will, in particular, increase credit availability, lower borrowing costs, allow longer debt maturity, and create opportunities to secure equity funding. An extensive funding base in turn, allows higher quality facilities to be constructed, and higher standards of service and maintenance to be achieved in the long term. It also may reduce the amount of government subsidy needed to help fund the development phases of a PPP project.

Benefits of increased competition

Creating an open PPP market within the TPP increases the chances of more rigorous competition in tenders for PPP projects. Through competitive bidding and negotiation, the government may secure value for money in terms of prices, standards of construction and better operational arrangements. When there is no competitive bidding, as has happened in certain Malaysian PPPs, the company or consortium earmarked for the contract has a stronger negotiating hand with regard to pricing, quality of design and construction, standards of operation and maintenance, and future investment. Furthermore, the greater need to compete may put pressure on Malaysian companies to become more cost efficient, adopt more advanced technology and operational methods, upgrade the knowledge and skills of management and staff, and ultimately provide higher quality but more competitively priced construction and service standards.

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Opportunities for Malaysian companies

If Malaysia opens up its PPP market under the TPPA, Malaysian companies will thereby have access to the PPP markets in the other member states. There could be a joint venture between a subsidiary of the Malaysian company and a local company of the member state, and could generate substantial overseas business for the parent company in Malaysia. The upshot would be an expansion of the external wing of the Malaysian economy, with overseas investment and services acting as a major source of income for the country.

Opportunities for Malaysian companies (continued)

As an example, Singapore has an open access policy on PPPs, being a signatory to procurement provisions in a number of FTAs including the WTO's Government Procurement Agreement (GPA), allowing foreign company involvement in key sectors such as ITC and electricity generation. It is noticeable how in return, its own infrastructure companies have been able to win contracts for PPP projects in other countries, such as India, China, the Middle East, Australia, Southeast Asia, Latin America, Sub-Saharan Africa, and Europe.

CASE IN POINT

The Singaporean company, Sembcorp, has invested in 48 overseas infra-structure projects through wholly or partly owned subsidiaries in water, energy, urban development and solid waste management. Its global reach includes Indonesia, UK, Chile, Panama, South Africa, UAE, India, and Australia.

Such opportunities could arise for Malaysia's own construction, engineering and utility companies, through access to PPP markets in TPP member states. Of course, their ability to compete for such projects against foreign companies will depend on being cost efficient, technologically advanced, financially robust, and having highly qualified management and technical staff.

B Perceived harmful effects

The benefits of an open PPP market under the TPPA must be weighed against the possible harmful effects upon local companies in Malaysia. There are fears that local construction, engineering and utility companies will lose a significant share of the PPP infrastructure market, which could even drive some out of business.

The reality is that under the TPPA, some special preferences such as quotas, price margins, and giving first consideration to Bumiputera and local companies in tenders would have to be dismantled in the long run. If a government subsidy is available to fund the development phase of a PPP contract, it must be given on a non-discriminatory basis, regardless of the national origins of the bidder.

The key concern here is that in an open PPP market, smaller local companies would struggle to compete against more well-known multi-national companies from other TPP states. The latter may be able to use advantages of scale, superior technology and expertise, greater experience of PPP projects, global name, and greater access to finance, to outbid local companies.

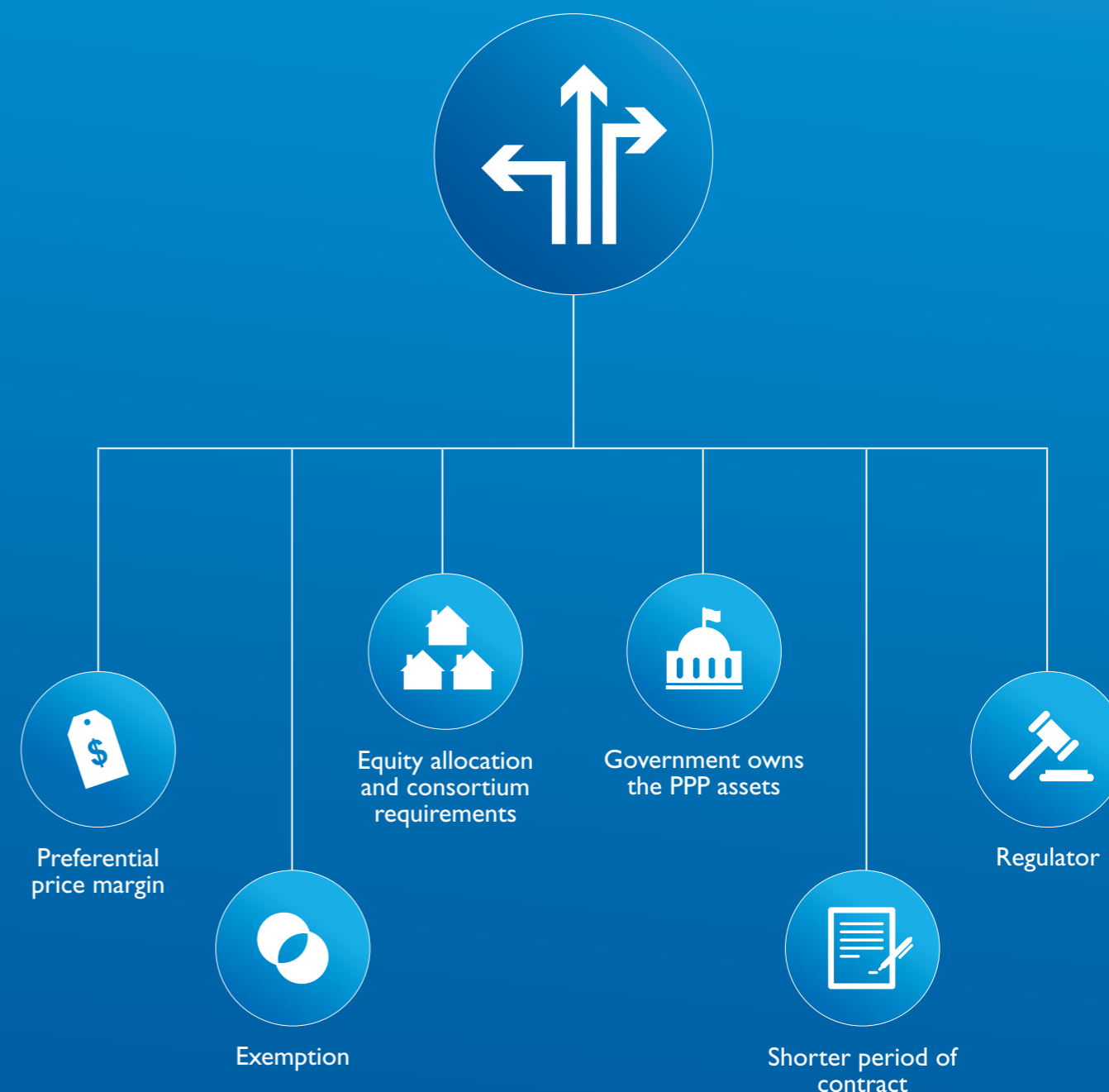
A further concern in an open PPP market is that control of strategic assets in sectors such as energy, water and airports will be passed to foreign companies. The question is how far such companies are committed to serving the national interest and the public good, and responsiveness to public policy in these sectors. Furthermore, profits made by foreign companies in the PPP project will be repatriated, and may not be used to benefit investors and businesses in Malaysia.

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C Alternatives to the complete carve-out of foreign involvement in PPPs by reducing the perceived harmful effects

In the recent revision of the Government Procurement Agreement (GPA) of the WTO, the special needs of developing and emerging countries have been recognised. Article V of the revised GPA affirms that developing countries shall be given 'special consideration' that allows 'special and differential treatment' and takes into account their 'development, financial and trade needs and circumstances'.

Given the precedent set by the revised GPA for developing and emerging countries, it may be possible for the Malaysian government to negotiate a set of TPPA commitments, which would include PPPs, but contain special provisions to mitigate any adverse effects on the local companies and the local economy.








01 Preferential price margin

Malaysia can negotiate to retain a preferential margin on the price factors in the PPP tender for local firms. Depending on the nature of the PPP, the preferential margin may apply to the user fees that the SPV intend to charge, or to any licence fee, or lease payment the SPV is required to make to the government. However, it is likely that a preferential price margin will only be acceptable to the other parties of the TPP on a transitional basis, perhaps for three to five years.




02 Exemption

Certain strategic sectors may be exempted from the PPP provisions of the TPPA, such as water supply and energy transmission. An example is the exemption of natural water supply in Singapore from foreign involvement through a PPP, as it is considered a strategic resource. Instead, it is managed by the Public Utilities Board, which is a statutory board; though recycled and desalinated water are subject to PPPs. However, it should be noted that when such an exemption is granted, the other parties to the TPPA may exercise their right to reciprocate and secure an equivalent exemption on their side on a quid pro quo basis. This will, of course, restrict Malaysia's access to these sectors in the PPP markets of other member states.

03 Equity allocation and consortium requirements


A third possible option is to include in Malaysia's commitments to the TPPA, the right of the government to reserve a certain percentage of the equity of the SPV for Malaysian investors, such as the inclusion of a Malaysian company in the SPV consortium. Apart from protecting local business interests, this may create the possibility of knowledge transfer from the foreign company to the Malaysian company. As a further advantage, the global reputation of a large company from a TPP country may help to raise the profile and reputation of the Malaysian partner company. Having a track record as a partner of large foreign companies may help local companies in their bids for overseas contracts in the future.

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04 Government owns the PPP assets

In certain transport infrastructure PPPs, the physical assets of the facility may be owned by the government; in others, they may be owned exclusively by the operator for the period of the licence. In some cases, the ownership may be divided between the two. It may be possible to include in the Malaysian government's commitments to the TPPA, the right to retain ownership of the physical assets in any transport PPP covered by the TPPA. This would mean that the government would be responsible for any replacements and major upgrading, but day-to-day maintenance would still reside with the operator. Ownership of the physical assets allows the government that extra measure of control over how the facility is operated and managed.



In the PPP to operate Singapore's Mass Rapid Transit (MRT), there is currently a shift away from operator ownership to government ownership of both the operating and non-operating assets (e.g. operating assets - trains, power supply equipment, cables, and signalling systems; non-operating assets - tunnels, viaducts, tracks, and station structures).

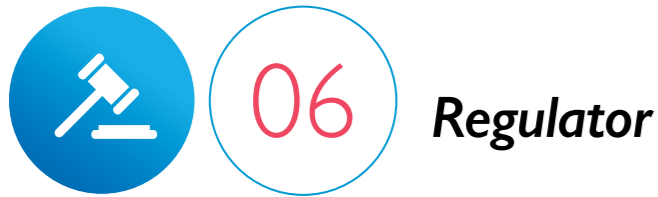
This could be the model to adopt, should Malaysia include PPPs in its commitments to the TPPA, but it would only be applicable to the transport infrastructure.




05 Shorter period of contract

As already indicated, the licence period under which the SPV operates a facility can vary a lot. If a company from a TPPA country participates in a PPP, it may be prudent to limit the licence period to 15-20 years, given the fears mentioned above of handing over control of important infrastructure assets to foreign interests for a long period. A shorter licence period may help to allay some of these fears.

C Alternatives to the complete carve-out of foreign involvement in PPPs by reducing the perceived harmful effects (continued)



Regulator

Although regulatory bodies exist in the major infrastructure sectors, they may be given additional powers to regulate PPPs involving companies from TPP states. Their remit would be to ensure that public policy is adhered to with respect to recruitment, conditions of work, occupational safety, and environmental protection, and that delivery schedules, service standards and other contractual obligations, such as asset upgrading and continuing investment are being met. There would also be a need for an appeals mechanism in PPPs to adjudicate on grievances of failed bidders in PPP tenders (including appeals by local bidders), and to review complaints over service standards.

D Limits to the carve-outs

However, it should be pointed out that there are limits to the carve-outs that Malaysia can expect. Measures such as retaining a preferential price margin in favour of local companies, and requiring local company involvement in SPVs and so limiting the foreign stake in PPPs, should only be for a transitional period of three to five years. Likewise, exempting certain sectors of the economy from foreign access to PPPs should be kept to a minimum and for a transitional period only, with the exception of only those infrastructure facilities, which are the most vital to the strategic and security interests of Malaysia. Moreover, the retention of government ownership of physical assets in PPP facilities may make sense in the

transport infrastructure, but may not always be applicable to other sectors such as industrial facilities and electrical energy generation.

The danger is that if too many carve-outs or exemptions are incorporated on a permanent basis into Malaysia's commitments to the TPPA, reciprocal carve-outs and exemptions will be claimed by other parties to the agreement in relation to Malaysian companies. This will naturally prevent Malaysia from taking full advantage of the opportunities to access the PPP market in other TPPA states.

The important fact to bear in mind is that Malaysia is a significant trading economy,

whose present and future prosperity relies on access to global markets. The opening up of the PPP market in the TPPA states would provide a valuable opportunity of gaining a major foothold in an increasingly important sector of the global economy. This would have significant net benefits to Malaysian companies and the Malaysian economy.

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Transitional period of three to five years
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Conclusion

Malaysia has resisted the incorporation of PPPs in the TPPA.

This is based on concerns that harmful consequences affecting local businesses and national interest may arise. However, it should be possible for Malaysia to negotiate flexible arrangements for PPPs on a transitional basis that may go some ways to mitigate the perceived harmful consequences. These may include preferential price margins, exemption of certain infrastructure sectors of strategic importance, a local equity stake and a local business component in the SPV consortium, retention of asset ownership in the transport sector by the government, shorter operating licence periods, and a system of regulation and adjudication in respect of PPP tenders and implementation, which include companies from TPP states. **However, such measures should only apply for a transitional period of 3 - 5 years.**

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