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Public-Private Partnerships: An alternative financing mechanism for delivering Public Services

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Abstract

What are public-private partnerships (PPPs)? Which projects are suitable for financing through a PPP? What foundations need to be in place for a government to successfully initiate and implement PPPs? This brief seeks to answer these important questions based on discussions at "Successful Public-Private Partnerships", a policy roundtable organised by the UONGOZI Institute in Dar es Salaam on 26 February, 2013.

Public-private partnerships have emerged as a viable institutional arrangement for financing and delivering public services. A successful PPP capitalises on the strengths of both public and private sectors to provide better and more cost-effective public services, and to speed up the rate of implementation or coverage of services. In the context of developing countries, PPPs can help to boost economic growth, reduce poverty and improve well-being. Consequently, governments are promoting the use of PPPs within their national development strategies.

However, while PPPs may have a number of advantages, they are also complex to design, implement and manage. Therefore, governments should only pursue PPPs if certain fundamentals are in place and the objectives of all parties can be met within the partnerships. This brief introduces the concept of public-private partnerships and discusses salient issues in determining the suitability of PPP projects. It then identifies four pillars that need to be in place for PPPs to be successfully initiated and implemented.

What are public-private partnerships?

There is no single accepted definition for a public - private partnership. However, establishing a definition in a given country context can facilitate implementation by indicating which projects are suitable to a PPP process. A government needs to be clear about why it wishes to partner with the private sector, and what forms of PPPs it will pursue.

For the purposes of this brief, a Public-Private Partnership is defined as *"An arrangement between a public sector contracting authority and a private party in which the private party assumes substantial financial, technical and operational risk in the design, financing, building and operation of a public property. The property itself remains in public ownership and it reverts to public sector control at the end of the PPP contract."*

As the definition highlights, a PPP involves locking in long-term collaboration with significant risks borne by the private sector. The assets built, used or managed under the partnership remain in public ownership unlike the situation under full privatisation where a government sells assets to the private sector. PPPs can, therefore, represent an attractive and sustainable alternative for delivering public goods and services. Risks associated with the operation and maintenance of service infrastructure are shared with the private sector but the assets are retained in public hands. Other advantages of PPPs include: i) increasing efficiency in project delivery and operation; ii) reinforcing competition; iii) accessing advanced technology; and iv) reducing government budgetary constraints by accessing private capital.

Which projects are suitable for a PPP?

Public-private partnerships are complex, demanding and time-consuming, but under the right conditions, and in the right sectors, they can offer significant benefits. For a project to be suitable for financing under a PPP arrangement, it will need to have certain characteristics.

First and foremost, a sound business case must be established before any decision is taken to implement a project as a PPP.

Second, the project has to be providing an essential public service which is not desirable to privatise.

An obvious example is a road which cannot be privatised and the public sector remains directly accountable for the service.

Third, the project has to be "self-contained", i.e., built and operated as one or more units, with an identifiable cash flow so that the project can be financed separately.

Fourth, the capital cost of the project should be high enough and the term of the project long enough to justify the substantial set-up and administrative costs of a PPP. If a project does not have a long life, it is not prudent to sign a long-term PPP contract. For example, information and communications technology (ICT) projects might not be suitable for PPPs as the infrastructure and services provided run the risk of rapid technological obsolescence.

Four Pillars for Successful PPPs

The successful initiation and implementation of a PPP program in any country rests on the following four pillars:

i. Firm political commitment and policy foundations;
ii. Sound and predictable legal and regulatory environments;
iii. Strong and capable public sector institutions; and
iv. A vibrant private sector.

Each of these pillars is discussed in turn in the sub-sections below.

i. Firm political commitment and policy foundations

Given the long-term nature of PPPs, a government needs to demonstrate firm political commitment for implementing PPP arrangements and to build political and social consensus for each PPP project. The formulation of a national policy framework is an important first step towards creating an enabling environment for PPPs A policy framework that stipulates the rationale for and the limits to the use of PPPs helps to establish a clear political mandate for a PPP program. This is vital, especially in the early years of a PPP program. A policy framework is also important as it provides the foundation for the legal and regulatory instruments required for implementing PPP projects. Setting policy also encourages the discussion of key issues among stakeholders, which increases the understanding of PPPs, their advantages and their drawbacks.

The private provision of a public good can be politically challenging. PPPs are often plagued by misconceptions among stakeholders and citizens. The social acceptability of PPP projects is often a key issue, in part because many infrastructure services and utilities, for example, water supply and roads, are widely perceived as "public goods". Therefore, public education and consultative mechanisms in the initiation and implementation of PPPs need to be in place to ensure transparency in the award and oversight of PPPs.

A PPP policy framework also needs to address issues of equity. Mechanisms can be built into PPPs to protect the interests of disadvantaged groups and promote greater acceptability. A major responsibility of the government is not to allow excessive profits to be made by the private sector. Ideally, prices for services should be set at levels that allow a fair return on investment to recover the cost of financing and to meet contractual obligations. Subsidies may also need be considered when the pricing structure is established. Any subsidies devised need to be transparent, targeted and non-distorting.

Crucially, a government needs to maintain its involvement. PPPs do not imply "less government" but rather a different role for government. Private participation requires the government to play an ongoing active role in planning, policy formulation and regulation. Further, in order to promote private participation, the government will likely need to implement a series of economic, financial and legal reforms which only it can initiate.

ii. Sound and predictable legal and regulatory environments

A necessary precursor to private sector participation is the establishment of a transparent and sound legal and regulatory framework. Legal provisions and procedures related to the implementation of PPPs can be complex, often involving many different pieces of legislation and regulation, for example, company, tax, labour, property, environmental and foreign investment laws. To address this problem, many countries have enacted specific legal and regulatory instruments for PPPs and/ or amended existing laws. These measures act to reduce the uncertainty surrounding PPP projects and to increase investors' confidence.

Since PPPs depend heavily on contracts that are effective and enforceable, clear and consistent legal and regulatory frameworks need to be in place that promote and sustain long-term investment.

iii. Strong and capable public sector institutions

Skills of a diverse nature-including project identification, economic evaluation, financial and risk analysis, and contract preparation, negotiation and management-are required for successfully initiating and administering PPP projects. Therefore, the government needs to continuously build the capacity of public sector institutions to effectively plan, negotiate, implement and monitor PPP projects. In situations where institutional capacity is still weak, it may be advisable to start with smaller PPP projects before progressing to larger initiatives. In this way, public sector institutions can gradually develop the experience and expertise for successfully negotiating and overseeing partnership agreements

iv. A vibrant private sector

PPPs also derive their strength and success from the existence of a vibrant private sector. However, developing countries frequently face constraints in the availability of bankable contractors and long-term service providers, access to long-term equity and debt finance, and the skills and experience in the private sector. Therefore, governments should put in place strategies to develop vibrant private sector ecosystems of industrial and commercial enterprises, financial intermediaries, capital markets and corporate services firms connected by efficient value chains.

In this way, the breadth and capacity of the domestic private sector to engage in partnerships will be enhanced.

Conclusion

The appeal of public-private partnerships as an off-budget financing mechanism for delivering public services in developing countries is growing. PPPs can provide a mechanism for exploiting the comparative advantages of the public and private sectors in mutually supportive ways. Despite the benefits expected, the application of the PPP approach in the context of developing countries faces unique challenges. For PPPs to flourish, they have to be based on long-term political commitment, firm policy foundations, a sound and predictable legal and regulatory environment, strong and capable public sector institutions, and a vibrant private sector.

Finally, while public-private partnerships may offer opportunities for exploiting the comparative advantages of the private and public sector, they should not be treated as a panacea for enhancing the delivery of essential services. PPP projects should be evaluated on their merits, on a case-by-case basis, and initiated only when the ingredients of effective collaboration are in place or can be safely nurtured along the way.

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