Accelerating infrastructure development using PPPs

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Public-Private Partnerships (PPPs) are not recent inventions. Using private funds for public works is not new. In ancient times, many public projects were conceded to the private sector to build and operate. There were even formal concession laws dating back to 530 BC, before the Roman times. These financing methods, however, disappeared during the fifth century with the fall of the Roman Empire and re-appeared in France only in the Middle Ages when there was a need for fortified towns. During the 16th and 17th centuries, many European sovereigns conceded public works to private investors. These works included canal building, road paving, waste collection, public lighting, mail distribution and public transportation.

Over the past two decades, PPPs have gained popularity with governments as a means of procuring public sector infrastructure. Once rare, PPPs are now used as an important tool to improve economic competitiveness and infrastructure services. Today, more than 150 countries use PPPs, many for different reasons. One of the most common reasons is that it allows a country to engage in Parallel Development of its infrastructure – in other words, the country does not have to wait for its National Treasury to be filled up with reserves before it embarks on its development programme (Serial Development). Many countries see PPPs as a means of accelerating their infrastructure development programmes by bringing in private sector funds, though Canada and some Middle Eastern countries have turned to PPPs because of capacity constraints in the public sector rather than for budget-deficit reasons. More infrastructure development means more money for the government in taxes, and more economic activities for the people, and more employment.

Many other countries have also used PPPs to bridge the government funding gaps for projects. Australian state governments, for example, started on their individual state PPP programmes in the late 1990s and early 2000s. PPPs were initially used primarily for tolled roads but have since moved on to fund social infrastructure like schools and hospitals. Today, Australia uses PPPs to fund more than 10 per cent of its total annual infrastructure investment.

In Southern Africa, South Africa and Lesotho have used PPPs successfully to implement many of their hospital projects by raising private capital. Singapore uses PPPs to benchmark the performances of its public sector and to test if the private sector could do a better job in delivery of services over a long period of time.

PPPs are used to fund many types of projects: from student accommodation and community centres to cancer hospitals, universities, street lighting and rural electrification. In fact, PPPs can be used on almost any type of public project provided the risks are clearly identified and properly allocated between the public and private sectors.

What are PPPs?

Though there is no widely accepted definition of PPP, it is generally considered as being an arrangement between public and private sectors to deliver infrastructure that would normally be provided by the public sector. Mauritius’ PPP Unit provides a good, comprehensive, definition of PPP:

‘It is a contractual agreement between a public entity and private entity, whereby the private entity performs part of a government organisation’s service delivery functions, and assumes the associated risks for a significant period of time. In return, the private entity receives a benefit/financial remuneration according to pre-defined performance criteria, which may be derived from:

- service tariffs or user charges
- government budgets or
- a combination of the above.’

Two points worth noting about PPPs:

1. PPPs are long-term commercial partnerships between the public and private sectors. This definition of PPPs matters because it distinguishes PPPs from outsourcing arrangements and privatisations. Viewing PPPs as commercial partnerships rather than purely contractual relationships has wide-ranging implications for how PPP programmes are designed and implemented.

2. The benefits of PPPs are much wider than accessing private capital. PPPs can help governments overcome short-term fiscal constraints; but their long-term benefits should be the delivery of improved infrastructure services at lower cost. Getting the early design of PPPs right is critical to ensuring that these long-term ‘value for money’ benefits are realised.

PPPs should generally embody the following principles:

- **Value for money (VfM) and whole-life costing:** The principle is that the government should seek the best value, and not necessarily the lowest initial price. Bid-comparison is carried out on whole-life costs (including maintenance costs). The bidders must ensure that their costs are the lowest for the whole life of the concession, and not just for the initial construction costs.

- **Risk transfer:** Risks inherent in the project should be borne by the party best capable to manage the risks. For example, the party who designed and constructed the facilities is made responsible for maintaining the facilities, while the government bears the risks of land acquisition and prices. A good example of how the government can be protected from the risks of cost overruns is the Spencer Street Redevelopment Project in...
Australia. Here, the private company ended up bearing the huge cost overruns without significant consequences to the government.

- **Output or performance specifications**: These performance criteria have to be clearly outlined, and once agreed, the private sector should be made responsible for delivering them. There could be penalties for non-performances; for example, fines could be imposed on toll road operators for congestions, water operators for poor quality of potable water, and Independent Power Producers (IPPs, or power plants) for blackouts.

- **Competition**: PPP projects are for open competition from all bidders. The procedures and bidding processes are transparent and clearly spelt out. Short-listed candidates are given invitations to negotiate. A case of ‘best man or best value wins’. Competition is meant to induce efficiencies. In some cases where it is not feasible to have open competition, artificial competition can be induced through a strong, independent regulator. This has been used successfully in some countries, though finding such a regulator can often be a real challenge. PPPs also require the mobilisation of private sector funds and liquidity for national and development projects. In order for a PPP programme to really take off, there must be a mechanism for the private sector to leverage its equity investment to mobile more funds for these projects. Ideally, it is the local bond market that provides the debt financing, and the stock exchange that provides the channel for fresh equities for these projects, either through initial public offerings (IPOs), rights issues or Infrastructure Listings. Without a developed local capital market, the rapid progress of any PPP programme will be hampered. Generally, it is not prudent to borrow in foreign currency to finance projects that give revenues in local currencies, unless this foreign currency risk is borne by someone else without recourse to the government. It is also risky to borrow short (5–7 years) for long-term infrastructure projects.

Until these issues are addressed satisfactorily, we will continue to see the dearth of financial closes on many PPP projects. Whether Islamic or conventional financing is used, the projects must still be viable.

**Required prerequisites for a successful national PPP programme:**
- Political support
- Enabling environment (legislations and champions)
- Expertise (centralised expertise; e.g., a PPP Unit)
- Project prioritisation and preparation (e.g., central planning)
- Deal flow and standardisation of agreements.

A PPP programme needs to incorporate at least the following actions:
- Setting clear and transparent procedures for awarding PPP projects
- Improving the general skills of the public sector in identifying, evaluating and monitoring private finance initiative (PFI) projects.
This is done mainly through systematic capacity-building processes that include formal classroom lectures as well as site visits to foreign countries that have successfully implemented sectoral projects. The Commonwealth Secretariat has been conducting a series of ten-day PPP Leadership workshops for member countries in addition to in-country ministerial briefings.

- Standardising, as much as possible, the contracts to reduce bid costs and to ensure a consistent approach to risk-sharing between the public and private sectors. There are already many examples of model concession agreements that can be modified to suit local conditions.

- Giving regulators the power to check and follow through on abuses. The Secretariat’s work in member countries has shown that any regulatory framework must take into consideration national interests while at the same time have the flexibility to be fair to the private sector to enable it to earn a reasonable rate of return for its investment.

- Setting up a Centre of Support (or PPP Unit) to provide technical and non-technical support to the various stakeholders involved in a PPP. The Centre must be able to pool the expertise of not only the financial and legal experts, but also the procurement specialists, including designers, engineers, quantity surveyors and buyers. These procurement specialists should preferably include some original thinkers.

**Good governance in PPPs**

Good governance is important in any PPP programme to ensure its success and sustainability. The objectives of good governance in PPPs should refer to:

- A fair and transparent selection process of private sector partners
- Assurance of the principle of VfM (Value for Money) has been adhered to
- A focus on pro-poor elements to ensure that the socially disadvantaged group is taken into account
- Clear and transparent dispute-resolution procedures.

These objectives are normally translated into actions through policies embedded in the PPP programme. Good governance is needed to ensure that PPP agreements do not favour one party over the other. Fail-safe mechanisms can be built into these agreements to ensure that agreements are fair to both parties. All PPP projects must incorporate VfM, which is achieved through:

- Competition via an open bidding process that provides the best prices
- Risk transfer that allocates risks optimally between the public and private sectors (no more ‘privatising the profits and nationalising the losses’)
- Long-term contracts that embody whole-life costing and maintenance culture (no more shoddy workmanship or crumbling highways)
- The use of a well-structured output specification (or statement of needs – SON) that allows bidders to innovate
- A performance-based payment mechanism that provides incentives for good performance by the private sector, as well as penalties for poor performance.
With the fundamentals in place, it is just a matter of creating awareness among the public and private sectors on what can be done through PPPs. Both the public and private sectors must be allowed to exercise creativity within a broader framework, and to propose practicable solutions to some of the infrastructure needs of the country. There are already many good case examples in the world.

**Support by the Commonwealth Secretariat through the CP3N**

It is recognised that since the political, constitutional, legal economic and social circumstances of every country differ, there can never be a single blueprint of how to make a PPP programme work. Each government has to devise its own programme to suit local conditions. The Secretariat has been very active in providing member countries with advisory and capacity-building support, covering the five phases of PPP implementation, namely:

- Policy development
- Capacity-building
- Development of enabling environment
- Identification of partners
- Evaluation and selection of partners.

One of the Secretariat’s primary strategies in its work on PPPs in member countries is developing and nurturing the synergies among the Commonwealth PPP Units, leveraging each other’s strengths. As part of this strategy, the Secretariat has created the Commonwealth PPP Network (CP3N) – a useful platform for PPP Units in member countries to link together, sharing experiences and tapping into resource centres and private sector investor pools (see box).