

1 Public–Private Partnerships (PPPs)—An Overview

This chapter introduces the concept of the public–private partnerships or PPPs, as well as its key characteristics and rationale.

1.1 Defining Public–Private Partnerships

The term “public–private partnership” describes a range of possible relationships among public and private entities in the context of infrastructure and other services. Other terms used for this type of activity include private sector participation (PSP) and privatization. While the three terms have often been used interchangeably, there are differences:

- PPPs present a framework that—while engaging the private sector—acknowledge and structure the role for government in ensuring that social obligations are met and successful sector reforms and public investments achieved.

A strong PPP allocates the tasks, obligations, and risks among the public and private partners in an optimal way. The public partners in a PPP are government entities, including ministries, departments, municipalities, or state-owned enterprises. The private partners can be local or international and may include businesses or investors with technical or financial expertise relevant to the project. Increasingly, PPPs may also include nongovernment organizations (NGOs) and/or community-based organizations (CBOs) who represent stakeholders directly affected by the project.

Effective PPPs recognize that the public and the private sectors each have certain advantages, relative to the other, in performing specific tasks. The government’s contribution to a PPP may take the form of capital for investment (available through tax revenue), a transfer of assets, or other commitments or in-kind contributions that support the partnership. The government also provides social responsibility, environmental awareness, local knowledge, and an ability to mobilize political support. The private sector’s role in the partnership is to make use of its expertise in commerce, management, operations, and innovation to run the business efficiently. The private partner may also contribute investment capital depending on the form of contract.

The structure of the partnership should be designed to allocate risks to the partners who are best able to manage those risks and thus minimize costs while improving performance.

- PSP is a term often used interchangeably with PPPs. However, PSP contracts transfer obligations to the private sector rather than emphasizing the opportunity for partnership. In the mid to the late 1990s, there was a slowdown in public–private contracting in infrastructure sectors, which was largely precipitated by a social backlash against the perceived preference for the private sector over the public sector in delivering infrastructure services in developing countries. To some degree, the social backlash was rooted in confusion between PSP and privatization. Some PSP schemes were overly ambitious and the social agenda was overlooked, leading to legitimate public concerns. The critical analysis of PSP experience has led to the design of a new generation of transactions, which are now more commonly known as PPPs.
- Privatization involves the sale of shares or ownership in a company or the sale of operating assets or services owned by the public sector. Privatization is most common and more widely accepted in sectors that are not traditionally considered public services, such as manufacturing, construction, etc. When privatization occurs in the infrastructure or utilities sectors, it is usually accompanied by sector-specific regulatory arrangements to take account of social and policy concerns related to the sale, and continuing operation of assets used for public services.

Sectors in which PPPs have been completed worldwide include:

- power generation and distribution,
- water and sanitation,
- refuse disposal,
- pipelines,
- hospitals,
- school buildings and teaching facilities,
- stadiums,
- air traffic control,
- prisons,
- railways,
- roads,
- billing and other information technology systems, and
- housing.

1.2 Motivation for Engaging in PPPs

The three main needs that motivate governments to enter into PPPs for infrastructure are:

1. to attract private capital investment (often to either supplement public resources or release them for other public needs);
2. to increase efficiency and use available resources more effectively; and
3. to reform sectors through a reallocation of roles, incentives, and accountability.

Each of these is discussed below.

1.2.1 *Mobilization of Private Capital*

Governments face an ever-increasing need to find sufficient financing to develop and maintain infrastructure required to support growing populations. Governments are challenged by the demands of increasing urbanization, the rehabilitation requirements of aging infrastructure, the need to expand networks to new populations, and the goal of reaching previously unserved or underserved areas. Furthermore, infrastructure services are often provided at an operating deficit, which is covered only through subsidies, thus constituting an additional drain on public resources.

Combined with most governments' limited financial capacity, these pressures drive a desire to mobilize private sector capital for infrastructure investment. Structured correctly, a PPP may be able to mobilize previously untapped resources from the local, regional, or international private sector which is seeking investment opportunities.

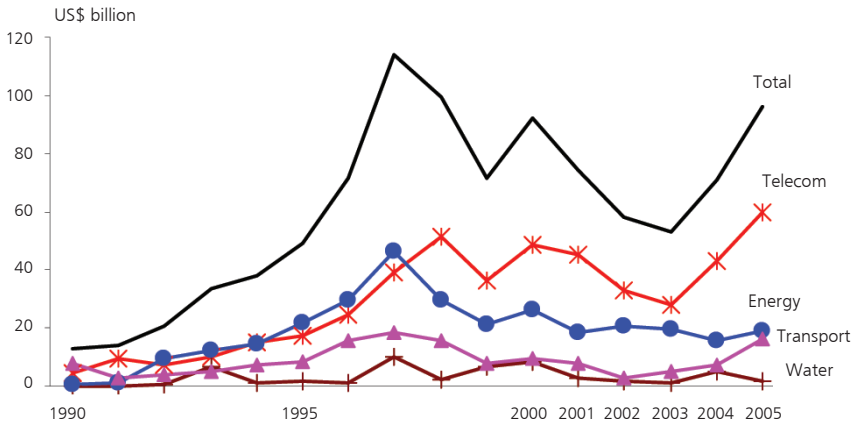
The goal of the private sector in entering into a PPP is to profit from its capacity and experience in managing businesses (utilities in particular). The private sector seeks compensation for its services through fees for services rendered, resulting in an appropriate return on capital invested.

1.2.2 *PPP as a Tool for Greater Efficiency*

The efficient use of scarce public resources is a critical challenge for governments—and one in which many governments fall far short of goals. The reason is that the public sector typically has few or no incentives for efficiency structured into its organization and processes and is thus poorly positioned to efficiently build and operate infrastructure. Injecting such incentives into an entrenched public sector is difficult, though not impossible, as Singapore has demonstrated by developing a government-wide dedication to efficiency while maintaining many critical services within the public domain.

In 2005, investment commitments to private infrastructure projects in low- and middle-income countries grew by over 30% against 2004 to almost \$96 billion.

Figure 1: Investment Commitments in Infrastructure Projects with Private Participation in Developing Countries by Sector, 1990–2005



The World Bank estimates that about 70% of infrastructure investment currently comes from the public sector, 8% from official development assistance, and 22% from the private sector.

Source: <http://ppi.worldbank.org/features/sept2006/currentFeatureSept2006.pdf>

Private sector operators, however, enter into an investment or contracting opportunity with the clear goal of maximizing profits, which are generated, in large part, by increased efficiency in investment and operations. If the PPP is structured to let the operator pursue this goal, the efficiency of the infrastructure services will likely be enhanced. Improving the efficiency of services and operations also increases the chances that those services are economically sustainable and provided at affordable rates—even after satisfying the profit requirements of the private operators.

PPP allows the government to pass operational roles to efficient private sector operators while retaining and improving focus on core public sector responsibilities, such as regulation and supervision. Properly implemented, this approach should result in a lower aggregate cash outlay for the government, and better and cheaper service to the consumer. This should hold true even if the government continues to bear part of the investment or operational cost since government’s cost obligation is likely to be targeted, limited, and structured within a rational overall financing strategy.

1.2.3 PPP as a Catalyst for Broader Sector Reform

Governments sometimes see PPP as a catalyst to provoke the larger discussion of and commitment to a sector reform agenda, of which PPPs are only one component. A key issue is always the restructuring and clarifying of roles within a sector. Specifically, there is a requirement to reexamine and reallocate the roles of policy maker, regulator, and service provider, particularly to mobilize capital and achieve efficiency, as outlined above. A reform program that includes PPP provides an opportunity to reconsider the assignment of sector roles to remove any potential conflicts and to consider a private entity as a possible sector participant.

Implementing a specific PPP transaction often forces concrete reform steps to support the new allocation of sector roles such as the passage of laws and establishment of separate regulatory bodies. In essence, re-examination of the regulatory and policy arrangements is critical to the success of a PPP project.