DAY 2: October 12, 2012

LECTURE NOTE 2012/10/12: "For and Against PPPs"

Our case study will focus on *PPPs as a framework for infrastructure development in developing and emerging economies*. Despite this focus of the course, however, cases in advanced economies will be reviewed and discussed when appropriate, including in student presentations, to better understand the nature of PPPs.

We can easily find a large number of the literature written on PPPs. Most of them, especially written by government agencies, multilateral organizations, or private consulting firms, seem to be in favor of PPPs, focusing more on their positive features, rather than to aim at objective assessment of the benefits and costs (or the pros and cons) of PPPs.

Having said that, however, there is still a number of the literature written by professionals, from either practitioner or academic perspectives, to give an independent and well-balanced evaluation of PPPs such as those listed as course materials in the syllabus.

In this course, I will try to discuss various issues on PPPs from balanced perspectives.

This lecture note is prepared mainly based on Chapters 1 and 2, Yescombe, E.R. (2007), *Public-Private Partnerships—Principles of Policy and Finance*, Burlington and Oxford: Butterworth-Heinemann.

1 WHAT ARE PUBLIC-PRIVATE PARTNERSHIPS"?

1.1 QUESTION: *What do we mean by "infrastructure" or "public infrastructure"?*

- ✓ "**a** the basic structural foundations of a society or enterprise; a substructure or foundation. **b** roads, bridges, sewers, etc., regarded as a country's economic foundation." (The Concise Oxford Dictionary, Ninth Edition)
- ✓ economic infrastructure and social infrastructure; hard infrastructure and soft infrastructure

1.2 QUESTION: *Who should be responsible for the provision of public infrastructure?*

- ✓ externalities, public goods, public control on monopoly, merit goods[1], high initial investment, direct or indirect provision

1.3 QUESTION: *Why do we talk about PPPs in the provision of public infrastructure?; and what has been the driving force behind the growing interest in PPPs?*

- ✓ "PPPs may therefore be considered a modern way of facilitating private provision to help meet an increased demand for public infrastructure." (Page 2, Yescombe 2007)
- ✓ New Public Management (NPM)

1.4 QUESTION: *How do we define PPPs?*

- ✓ joint public- and private-sector funding, public-private join venture, publicly-funded provision of social services by non public-sector bodies, public funding of private-sector R&D

[1] "Merit goods" are defined, for example, as "a commodity the consumption of which is regarded as socially desirable irrespective of consumers' preference." (The Penguin Dictionary of Economics)

- ✓ policy-based, programme-based, project-based, contract-based
- ✓ "a long-term contract (a 'PPP Contract') between a public-sector party and a private-sector party; for the design, construction, financing, and operation of public infrastructure (the 'Facility') by the private-sector party; with payments over the life of the PPP Contract to the private-sector party for the use of the facility, made either by the public-sector party or the general public as users of the Facility; and with the Facility remaining in public-sector ownership, or reverting to public-sector ownership at the end of the PPP Contract." (page 3, Yescombe 2007)
- ✓ "A PPP is thus an alternative to procurement of the Facility by the public sector ('public-sector procurement'), using funding from tax revenues or public borrowing." (page 3, Yescombe 2007)
- ✓ "In a PPP, on the other hand, the Public Authority specifies its requirements in terms of 'outputs', which set out the public services which the Facility is intended to provide, but which do not specify how these are to be provided." (page 4, Yescombe 2007)

2 BUDGETARY BENEFIT

2.1 QUESTION: *How do PPPs benefit the public-sector budget?*

- ✓ "A PPP allows the capital cost of a public-sector Facility to be spread out over its life, rather than requiring it to be charged immediately against the public budget." (page 17, Yescombe 2007)
- ✓ "A PPP programme thus enables the public sector to break free of short-term constraints on investment in public infrastructure imposed by insufficient tax revenues and limits on public-sector borrowing." (page 17, Yescombe 2007)

2.2 QUESTION: *Do PPPs provide the government with "free lunch" in the provision of public infrastructure?*

- ✓ "…, in the case of the PFI Model the Service Fees are a future annual cost, and thus do have an eventual impact on the public-sector budget in much the same way as borrowing." (page 17, Yescombe 2007)

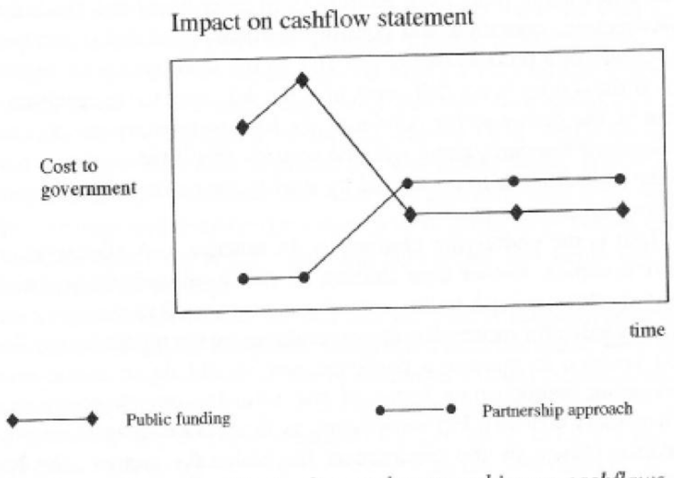

Figure 5.2 Comparison of public funding and partnerships on cashflows

Source: page 105, Grimsey&Lewis 2004.

3 ADDITIONALITY

3.1 QUESTION: *What if PPPs are not introduced?*

- ✓ "Thus the realistic choice, given budgetary constraints, is generally not between a PPP and public-sector procurement of the Facility, but between a PPP and no investment at all." (page 17, Yescombe 2007)

3.2 QUESTION: *Do PPPs allow the government to invest more quickly in public services?*

4 FINANCING COST AND RISK TRANSFER

4.1 QUESTION: *Which is cheaper, public-sector or private-sector borrowing?*

- ✓ Public-sector borrowing is cheaper because lenders to the government are not taking any significant risk with their money, whereas lenders to a PPP are obviously taking a greater risk. But a project's risks do not disappear just because the public sector is funding it—it can thus be argued that these risks are retained by the public sector and constitute a concealed cost of the project, which should be added to the lower cost of public-sector financing to make this comparable with a PPP's financing costs." (page 18, Yescombe 2007)

4.2 QUESTION: *Why does financing cost differ?*

- ✓ better performance, risk control, and …

5 RISK TRANSFER AND VALUE FOR MONEY (VfM)[2]

5.1 QUESTION: *What are risks entailed in PPPs?*

- ✓ project, market, political, *force majeure*, etc.
- ✓ completion, permitting, price, resource, operating, casualty, technology, political environment, exchange rate, interest rate, insolvency, etc.

5.2 QUESTION: *Who should manage particular risks?*

- ✓ A risk should be borne by the party who can manage that particular risk with least cost.
- ✓ "… the risks which are transferred can be better managed by the private sector, and thus the cost of doing this will be lower than if the risks are retained by the public sector." (page 18, Yescombe 2007)

5.3 QUESTION: *What if a PPP fails to provide an essential public service?*

- ✓ "If the PPP fails it is quite likely that the Public Authority will incur extra costs to maintain the public service, so risk transfer will fail anyway to this extent." (page 20, Yescombe 2007)

6 ECONOMIES OF SCALE

QUESTION: *Do PPPs enjoy economies of scale?*

7 WHOLE-LIFE COSTING AND MAINTENANCE

QUESTION: *How could we create incentives for the best (hopefully, least) 'whole-life' cost over the life of a PPP contract?*

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[2] "Value for money (VfM)" is defined, for example, "the optimum combination of whole-of-life cycle costs, risks, completion time and quality in order to meet public requirements." (page xv, Grimsey&Lewis 2004)

8 COMPLEXITY AND FLEXIBILITY

8.1 QUESTION: *How does the inherent complexity of PPPs erode its potential advantage?*

8.2 QUESTION: *How should we evaluate tradeoffs between flexibility and stability/predictability in designing and implementing PPPs?*

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