

FESSUD

FINANCIALISATION, ECONOMY, SOCIETY AND SUSTAINABLE DEVELOPMENT

Research Brief #6

Public Private Partnerships for Development: An Appraisal

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1. Introduction

This Research Brief draws on Working Paper #140 (Van Waeyenberge 2015), which was written for Work Package #6. It focuses on the promotion of public private partnerships (PPPs) in infrastructure as part of the private turn in development cooperation. Research Brief #7 looks at the private turn in development cooperation in general. This Research Brief broaches some of the theoretical and empirical issues that are implied by the promotion of PPPs for infrastructure provision.

2. The Sustainable Development Goals and the financing gap

In September 2015, the United Nations agreed on the Sustainable Development Goals (SDGs). Much like their predecessors, the Millennium Development Goals (MDGs), the SDGs present a set of targets that the international community has pledged to achieve by 2030. These include no poverty, no hunger, good health and well-being, quality education, gender equality, clean water and sanitation, affordable and clean energy, decent work and economic growth, resilient infrastructure and industry, lower inequality, etc. (see <https://sustainabledevelopment.un.org/?menu=1300>).

SDG 17 puts “global partnerships” at the heart of the sustainable development agenda. It calls for greater efforts of domestic resource mobilisation in developing countries and for these efforts to be combined with those of donors to deliver on the 0.7 percent target for Official Development Assistance (ODA) as a share of national income. It also enshrines the

principle that “additional” financial resources should be mobilised from multiple sources (SDG 17.3). This goal translates more explicitly into a call to “encourage and promote effective public, public-private and civil society partnerships” (SDG 17.17).

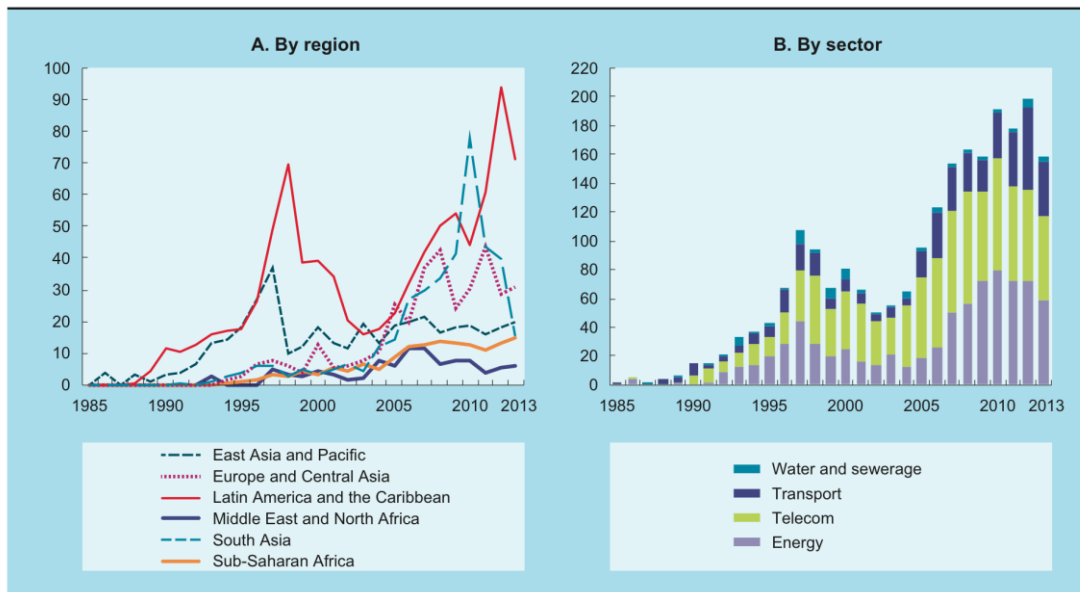
Since the budgets for ODA remain under pressure due to the persistent fiscal ramifications of the Global Financial Crisis (GFC) and ODA continues to fall short of providing the resources necessary to address the SDGs, the donor community seeks to consolidate an approach that increasingly uses the limited ODA resources as leverage for private capital in financing development (see Research Brief #7).

Such reasoning is often presented through reference to the “financing gap”. The argument proceeds as follows. A particular financing need to attain the SDGs is identified. This need is compared to the current public financing of development. The shortfall between the public finance available and the finance needed to attain the SDGs is then used as the rationale for the promotion of an expanded role for private capital in financing development (rather than that the public financing of development should be strengthened through increasing international tax mobilization efforts).

This expanded role corresponds to a mass of wealth circulating in financial markets that is seeking “stable” investment outlets and combines with unwillingness by major donor countries to tackle illicit financial flows. It is indeed striking that the outcome document of the UN Financing for Development Summit 3 (Addis Ababa 2015) on the financing framework to implement the SDGs celebrated the private sector (see paragraph 48), while it failed to move the discussions forward on the need for a global tax body. The latter has nevertheless been a recurring request from the developing countries, but they are excluded from the Organisation for Economic Cooperation and Development (OECD), currently the only body that deals with international issues bearing on tax regulation.

One sector that has been particularly affected by the private turn is infrastructure. The Figure below gives an indication of the fast expansion of private sector participation in infrastructure. It also indicates how this trend has been particularly strong in energy, telecommunications and transport. Water and sewerage account for a smaller share.

Private Sector Participation, by Region and Sector



Source: United Nations Conference on Trade and Development (2015, p. 161)

3. PPPs for infrastructure: what is at stake?

With the fast promotion worldwide of PPPs as a way to bridge the “infrastructure-financing gap”, it is important to take stock of the existing theoretical and empirical arguments that bear on PPP financing of infrastructure. These arguments relate to fiscal liabilities engendered by PPPs, the lack of a convincing theoretical or empirical case regarding efficiency gains through PPP financing, and a set of theoretical considerations that arise from the transformation of infrastructure into an “asset class” as a result of increasing numbers of investors seeking yields through participation in PPP financing of infrastructure.

3.1 Fiscal liabilities

PPPs create fiscal liabilities. Ultimately the fiscal burden of the provision of basic goods and services remains with the state. PPP revenue has to come from dedicated state funding or from end users or from a combination of these two sources. While governments might defer payment for infrastructure investment when embarking on a PPP, they (or the taxpayers) will ultimately carry the full cost of the project. Yet the original absence in

government accounts of the increase in expenditures or debt has been a potent driver of the political preference for PPPs as a method to upgrade infrastructure networks.

While PPPs do not bring finance at lower cost (see below), they do change the timing of the payment for infrastructure (the funding of the infrastructure). For a PPP, payments are translated into a unitary charge by the private sector, which incorporates all costs (such as cost of construction, maintenance, debt finance, etc.) into a schedule of regular payments over a period of decades. PPP costs are spread evenly over the whole life of the contract.

PPPs then allow creating the illusion of fiscal probity in the short-term: no additional debt or large upfront expenditures are incurred, as would be the case for traditional public procurement. There have, however, been strong arguments for accounting techniques that do bring PPP payments onto government books as liabilities in order to avoid projects being financed through PPPs for only short-term fiscal reasons, or for long-term illusory reasons (see IMF, 2004).

The illusion of fiscal probity, which results from the failure of the cost of a particular infrastructure investment financed through a PPP to show up on a government's books, is exacerbated by the excessive cost of private financing of infrastructure as compared to the cost of public financing. There are several reasons for outcome. First, it is more expensive for the private sector than the government to raise finance. Second, private investors have profitability expectations which will be incorporated in their unitary charge. Third, PPPs imply large consultancy fees for legal, technical and financial advice. Fourth, governments often offer guarantees and various forms of subsidies to PPP investors. Fifth, when a PPP and the private sector withdraws from the project, the public sector steps in either to increase payments to the private sector or to reclaim responsibility for the infrastructure projects. Sixth, PPP contracts have often been renegotiated at a later stage, away from competition through the tendering process, and this leaves the public sector vulnerable to excessive demands by the private sector partner. Seventh, there has been evidence of governments overpricing the risk or overcompensating the private sector for taking on risk.

In view of such considerations, Griffiths et al. (2014), in a report for the European Parliament, conclude that PPPs are the most costly way of financing an infrastructure project, since their financing costs amount, on average, to 150 percent of the value of the investment provided. This compares to zero financing costs for grant financing, below 10 percent of financing costs for official concessional finance and 100 percent of financing costs when the public sector issues domestic debt to finance the project.

3.2 PPPs and efficiency

The above indictment of the financial costs and associated fiscal costs attached to PPPs places a strong burden on the efficiency gains that PPP financing need to produce in order to compensate for their cost disadvantage. However, the evidence on whether PPPs provide infrastructure more efficiently than traditional procurement remains weak (see IMF, 2015; Independent Evaluation Group, 2014; IOB, 2013).

Further, although supporters suggest that PPPs are efficient, the mechanisms through which this efficiency is achieved are unclear. It is often suggested that efficiency gains derive from competition but this effect tends to be limited since the markets in which PPPs operate are less contestable. PPPs usually operate in areas with significant social impact and involve large sunk costs. Some supporters insist that innovation promoted through PPPs can sometimes achieve major cost savings when the PPPs induce the radical redesign of a project or construction technique. However, the evidence on such benefits of PPPs also remains sparse and the rigid contractual specifications of a PPP might, in fact, hamper such prospects (Perkins, 2013).

These considerations raise the pertinent underlying issue of the type of analytical foundations that support an extended role for the private sector in infrastructure provision. For the *Washington Consensus*, which characterised development policy during the 1980s and early 1990s, the notion of 'perfect markets' prevailed, except in the case of readily identifiable market failures such as the existence of externalities, large sunk costs (natural monopolies) or public goods. This view was supplanted by the *post-Washington Consensus* in the late 1990s, which broadened the scope of market failures and posited a paradigm of imperfectly working markets (see Van Waeyenberge 2006). However, currently, as we

witness the strong advocacy efforts in support of PPPs, there is no clearly identifiable set of analytical propositions that can account for the prevailing preference for private sector provision in sectors traditionally calling for extensive state intervention.

The superiority of private over public sector provisioning seems to have acquired canonical status, with reiterations of alleged efficiency benefits or risk-absorption capacities ringing rather hollow in the context of a large and growing body of inconclusive evidence on the benefits of private sector involvement in the provision of basic needs and services (see UNDESA 2016 for a recent account). The mantra of superior performance of the private sector has combined with arguments of scarcity of public resources to finance public investment, against a backdrop of plenty of private wealth. So, rather than devise better taxation coordination policies internationally in order to enable the public mobilisation of resources for investment, the logic is turned towards the private mass of wealth as a resource for development. But, as development is a risky enterprise, the public sector needs to enable the private sector's appetite for it. This need necessitates both indirect interventions through changes in the investment climate that favour private investment as well as direct interventions through PPPs.

3.3 Infrastructure as an asset class

The promotion of PPPs to deliver infrastructure has turned infrastructure increasingly into an "asset class". This has a set of important implications. First, by turning infrastructure into an asset class, its provision becomes driven by the need to generate competitive returns for private investors. This implies that the infrastructure service needs to generate revenue streams--a requirement that often translates into fees or tariffs conditioning access.

Second, infrastructure's non-commercial outcomes or purposes easily become marginalised, with access often regulated by the capacity to pay and the multiple purposes that could be attached to infrastructure reduced to guaranteeing profitability for investors. Such multiple purposes could include: enforcing standards in service delivery and employment; skills development of the workforce; development of auxiliary services or activities; the exploitation of economies of scope; development of new technology to

accommodate externalities, including those bearing on climate change; alternative use of physical assets to serve the public good; etc..

Third, the reliance on private investment will dictate the location and design of an infrastructure project that attracts private investment. This factor implies that the public sector loses its capacity to cross-subsidise infrastructure investments that present less attractive commercial features while the private sector can cherry-pick infrastructure activities that are attractive business opportunities.

Fourth, with the increased private financial involvement in infrastructure provision, the state assumes a set of new roles. Rather than intervening directly through the provision of infrastructure, its role becomes redefined in terms of its capacity to create assets and manage private sector risks. Further, as a result of the rigidity of particular contractual specifications implied in a PPP, infrastructure provision is removed from the sphere of the democratic process that could seek to determine its use, the conditions governing its access and the conditions under which it is produced.

4. Conclusion

The proclamation of the SDGs as the new framework to guide development cooperation has been accompanied by the celebration of PPPs as the preferred way to upgrade infrastructure across the world. This approach raises a host of issues, including the fiscal liabilities generated by PPPs, their lacklustre efficiency record and the implications for public policy making of the increased participation of private profit-seeking capital in infrastructure delivery. The way these issues will translate in practice in a concrete setting will depend on a host of factors, including the institutional environment, the organization of the labour force and the organization of user groups. The outcomes of the private sector's involvement in infrastructure will emerge as the result of a host of complex and often conflicting relations. These relations need urgent further study in specific developing-country and sectoral settings so as to contribute to the critical evidence base that is needed to clarify the policy bearing on infrastructure provision.

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