# PUBLIC-PRIVATE PARTNERSHIPS IN INFRASTRUCTURE DEVELOPMENT

## *A Primer*

**Transport Division**

**UNESCAP**

This Primer was developed by Mr. Abdul Quium. It was prepared originally in a different form for discussion at the High-level Expert Group Meeting on Public-Private Partnerships for Infrastructure Development, 2-4 October 2007, Seoul, Republic of Korea, jointly organized by UNESCAP and the then Ministry of Planning and Budget, Republic of Korea. Comments and suggestions were made in the meeting. At different stages helpful comments and suggestions were also received from Mr. John Moon, Mr. Richard Alexander Roehrl and his other colleagues. Subsequently, changes were made in style and format and additional materials were included to accommodate those comments and views expressed.

The views presented in the Primer, however, may not necessarily be considered to represent the official views of the Secretariat of the United Nations.

The Primer has been issued without formal editing.

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# CONTENTS

## LIST OF TABLES



## LIST OF FIGURES



## LIST OF BOXES

# PUBLIC-PRIVATE PARTNERSHIPS IN INFRASTRUCTURE DEVELOPMENT

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## INTRODUCTION

**Why PPPs in infrastructure development**

Governments worldwide have increasingly turned to the private sector to provide infrastructure services in energy and power, communication, transport and water sectors that were once delivered by the public sector. There are several reasons for this growing involvement of the private sector which include:

- Increased efficiency in project delivery and operation
- Availability of additional resources to meet the increasing needs of investment in infrastructure services
- Access to advanced technology
- Sustainable development in infrastructure facilities and services.

As in other sectors of the economy, the policy shift towards a market economy has recently led to a growing interest in public-private partnerships (PPPs) in infrastructure development.

**PPPs are not new**

Private participation in infrastructure is not new, however (see box 1). PPPs[1] in their present forms may be viewed as a relatively new addition to an ever-evolving relationship between public and private sectors. In recent years, more and more countries have come up with their own brand of PPP models for project implementation in line with their legal, social and administrative systems which can help achieve their political objectives.

**Definition of PPP**

In a public-private partnership arrangement, each partner, usually through legally binding contract(s) or some other mechanism, agrees to share responsibilities related to implementation and/or operation and management of a project. This collaboration or partnership is built on

[1] Several other terms such as private sector participation (PSP) and private participation in infrastructure (PPI) are also used. These terms may not always have the same meaning. For the purpose of this primer however, the terms PPP, PSP and PPI have been considered to have similar meanings and may have been used interchangeably.

The use of the term PPP however, is not limited to joint public and private sector infrastructure projects and services. In the international development field, for example, the term is used to refer to joint programmes in the social sector by government, aid agency and the non-profit organizations. This primer is however limited to consideration of PPPs for joint public and private sector infrastructure projects and services.

the expertise of each partner that meets clearly defined public needs through the appropriate allocation of:[2]

**What are shared between the public and private sector**

- Resources
- Risks
- Rewards, and
- Responsibilities

**How the responsibilities and obligations documented**

The allocation of these elements and other aspects of PPP projects such as, details of implementation, termination, obligations, dispute resolution and payment arrangements are negotiated between the parties involved and are documented in written contract agreement(s) signed by them.

**Box 1: Private participation in infrastructure is not new**

The history of private sector participation in infrastructure development is quite old. Private sector participation in the transport sector, for example, dates back to seventeenth century canal and road concessions in Europe and the United States of America. Private companies built the American railways in the nineteenth century. Many early public transport systems in European and American cities were also developed by the private sector under various municipal charters or franchise arrangements with revenues coming from fares and land development.

The situation in many countries in Asia was not very different either. For example, railways in the Indian subcontinent were first introduced in 1853 through private initiatives. The Great Indian Peninsula Railway Company introduced the first railways in India near Mumbai with British capital and organization. Subsequently, other companies built railways in other parts mainly radiating inward from the three major port cities of Mumbai (Bombay), Chennai (Madras) and Kolkata (Calcutta). The then Government in India encouraged the setting up of railways by private investors under a scheme that guaranteed an annual return of 5 per cent. The Government also authorised the companies to acquire necessary land with compensation for the construction of the railway lines and railway establishments. Once completed, the company was passed under government ownership, but the operation remained under the control of the company that built them. This was essentially the build-transfer-operate PPP model of the present times. Most of the early municipal water and power supply systems in the Indian subcontinent were also built and operated by private operators under various agreements with the government.

Source: http://en.wikipedia.org/wiki/History_of_rail_transport_in_India
http://banglapedia.search.com.bd/HT/E_0007.htm and various other sources.

[2] Adopted from the definition of PPP provided by the Canadian Council for PPPs (see the Council's PPP definition at http://www.pppcouncil.ca/aboutPPP_definition.asp)

**Advantages of PPPs to government**

PPPs have become attractive to governments as an off-budget mechanism for infrastructure development as this arrangement may not require any immediate cash spending. The public sector's other main advantages include the relief from the burden of the costs of design and construction, the transfer of certain risks to the private sector and the promise of better project design, construction and operation. The private sector considers an optimal whole life cycle costing for the project, which allows the government to get better value for money from the project. This is not possible in a conventional procurement as in such a case the design, construction, maintenance and operation are undertaken usually by different agencies.

There are significant differences between a conventional construction procurement project and a PPP project that need to be clearly understood. The main differences include:

**Differences between PPPs and conventional projects**

- A PPP project is different from a conventional construction project and should not be developed and managed like a construction project.
- A PPP project is viable essentially when a robust business model[3] can be developed.
- The focus of a PPP project should not be on delivering a particular class/type of assets, but on delivering specified services at defined levels.
- The risk allocation between the government and the private sector provider is much more complex than that in conventional construction procurement. Both parties should, therefore, clearly understand the various risks involved and agree to an allocation of risks between them.
- A PPP contract generally has a much longer tenure than a construction contract. Problems may arise over the long contract tenure. Managing the relationship between the private provider and the contracting government agency over this long contract tenure is vital for the success of the PPP project.

In a developing market, PPPs are often plagued by common misconceptions in the peoples mind, most of which arise due to lack of information. Some of the common misconceptions and the truth are mentioned below.

**Misconceptions about PPPs**

- Government has no stake in PPPs. The truth is whether or not government has any direct participation in a PPP project, it always has a stake in it (see section IIIB).
- PPP is privatization. The truth is privatization in the sense of full transfer of ownership is only one of the many models and is not commonly applied.
- Public sector has no control over the project. The truth is government always retains various forms of control through regulatory, legal and other measures.
- PPP projects are large. The truth is PPP projects do not always have to be large.

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[3] The term business model is used for a broad range of informal and formal descriptions that are used by enterprises to represent various aspects of its business, including its purpose, offerings, strategies, infrastructure, organizational structures, trading practices, operational processes and policies, and financial performance.

- PPP projects cannot be implemented by local bodies. The truth is in many countries local bodies have the legal authority to implement PPP projects and they have implemented such projects (in the Philippines, for example).
- PPPs are panacea to infrastructure development. The truth is meeting all infrastructure needs through the PPP mechanism may not be feasible as they have many limitations (see below).
- PPP projects are less expensive. This may not be true if the higher cost of borrowed finance cannot be offset through efficiency gains (see Section III C).
- The poor do not benefit from PPPs. The truth is the poor may or may not directly benefit depending on the project design itself (see Section III D).
- Governments can always finance at a lower cost. In such a case, governments may not consider to implement the project through the PPP mechanism.

Higher growth of national economies in recent years has led to unprecedented demand for infrastructure services for the purpose of producing goods and services and maintaining supply and distribution chains efficient, reliable and cost-effective. PPPs have become important to meet the growing demand for infrastructure services in view of the fact that available funding from traditional sources in most countries falls far short of the financing needs of their infrastructure sectors.[4] However, availability of private funding or interest of the private sector should not be the sole criterion in considering a PPP project. There are additional costs involved in private financing. See further discussion in Section IIIC and Chapter IV on this subject.

Also, there are underlying fiscal costs and contingent liabilities of PPPs on the government that may arise in the medium and long term. Besides, there are many important economic, social, political, legal and administrative aspects, which need to be carefully assessed before approval of PPPs are given by the government. PPPs have various limitations that should also be taken into account while considering this modality. The major limitations include:

**Limitations of PPPs**

- Not all projects are feasible (for various reasons: political, legal, commercial viability, etc.).
- The private sector may not take interest in a project due to perceived high risks or may lack the capacity to implement the project.
- A PPP project may be more costly unless additional costs (due to higher transaction and financing costs) are off-set by efficiency gains.