

Engaging the Private Sector in Public–Private Partnerships

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Key points

- Private finance can help reduce the huge infrastructure deficits in Asia.
- Public–private partnerships (PPPs) also bring technical and management expertise to public service provision.
- A central challenge of structuring a PPP project is allocating risks.
- Accurately estimating cost and revenue streams requires realistic demand analysis.
- Governments should reduce the expectation that contracts will be renegotiated.

Infrastructure needs in Asia are enormous. Governments can mobilize additional financial resources and gain access to valuable expertise by structuring projects as public–private partnerships (PPPs). However, enticing the private sector into infrastructure requires good policies, expertise in developing well-structured projects, and supportive institutions. Negotiating agreements with a clear allocation of risks and responsibilities across various stakeholders is key to a successful partnership.

Infrastructure: great needs, limited resources

Asia's infrastructure investment requirements are estimated to reach \$8 trillion in 2010–2020 (Table 1). About half that amount will be for energy projects (mostly electricity) with the remainder split among transport (30%), telecommunications, and water and sanitation. The bulk of financing is needed for new capacity, but about 30% is required to finance the replacement of existing facilities. Because infrastructure is considered a public good, the responsibility for its provision falls to the public sector.

However, government revenues are limited and severely constrained in many of Asia's developing countries. Recourse to domestic or international capital markets may be limited. Multilateral lenders such as the World Bank and the Asian Development Bank (ADB) provide finance for infrastructure as a central part of their mandates, yet their resources are also limited. The high demand for finance combined with limited financing capacity encourages governments to find solutions in PPPs. Along with finance, the private sector offers technical, management, and operational expertise for large projects.

Encouraging private investment in public projects was the focus of the Asia Regional Workshop on Public–Private Partnerships held in June at the Asian Development Bank Institute in Tokyo. The event was co-organized with Agence Française de Développement and brought together experts and government officials working on PPPs from the region's developing member countries.

Asia Regional Workshop on Public–Private Partnerships: Engaging the Private Sector

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The event was organized by the Asian Development Bank Institute and the Centre d'Études Financières, Économiques et Bancaires of Agence Française de Développement. Many participants were sponsored by the Central and West Asia Department of the Asian Development Bank.

Presentation materials are available at <http://www.adb.org/news/events/asia-regional-workshop-public-private-partnerships-engaging-private-sector>



Table 1 Infrastructure investment needs in Asia, 2010–2020 (\$ trillion)

Sector/Subsector	New capacity	Replacement	Total
Energy (Electricity)	3.176	0.912	4.089
Transport	1.764	0.704	2.466
Roads	1.702	0.638	2.340
Airports, ports, and rail	0.062	0.066	0.126
Telecommunications	0.325	0.730	1.055
Water and sanitation	0.155	0.226	0.381
Total	5.419	2.572	7.990

Source: ADB and ADBI (2009).

Attractive public–private partnership environment

The government can create the overall policy, regulatory, and institutional environment to attract private agents to public projects. An assessment of 19 economies in Asia and the Pacific in 2014 found only one with a mature PPP environment (Australia) while four others were considered *developed* (the Republic of Korea, Japan, India, and the Philippines) (EIU 2015). A further 11 were ranked as *emerging*, including Indonesia, the People’s Republic of China, and Thailand. Finally, three economies, all in Central Asia, were classified as *nascent*. Economies were graded on such factors as effective PPP selection and decision making, dispute resolution mechanism, public capacity to plan and oversee PPPs, financial facilities, and other elements.

Develop a policy, strategy, or plan for PPPs:

A policy or plan provides a general framework for the government’s approach to PPPs, which is then given more concrete support through a law and regulations. The policy sends a clear signal to investors that the government is serious about the PPP model. Many emerging economies in Asia have approved policies or plans in recent years. For example, in May 2015 Thailand adopted a 5-year PPP Strategic Plan for 2015–2019.

Enact a law on PPPs and provide supporting regulations:

A PPP law provides the legal parameters for PPPs in the country. The strictures of law are enforceable and give further credibility to the government’s commitment for investors. Many countries have older laws that cover some aspects of PPPs. The law can be revised and updated to suit more current approaches and also address institutional changes. For example, the Philippines passed the Build–Operate–Transfer (BOT) Law in 1990, which was a pioneering piece of legislation in the region at the time. It was substantially revised in 1993, along with the implementing rules and regulations. In 2015, a new PPP law is being shepherded through the legislative process. Among other things, the new law will institutionalize (i.e., provide a legal basis for) structures that have been developed over the years, including the PPP Center, the PPP Governing Board, and the Contingent Liability Fund (Alzate 2015).

Credible public–private partnership institutions

Set up a capable PPP unit: A key institutional mechanism is a PPP unit, also known as an office, center, or by some other designation. The purpose of the unit is to coordinate the PPP

“It is necessary not only to provide policies, laws, and institutions but also to develop the human capabilities to operationalize them.”

process and provide assistance to line ministries (energy, transport, urban development, etc.). Normally, one PPP unit is established among the central agencies of the national government. Line ministries may also create cells. In large federal states, subnational governments (provinces or states) may establish PPP units to handle projects within their jurisdiction. India has 21 PPP cells within its national and state level structures (Koike 2015). A key part of the PPP unit is a project development facility, which prepares a pipeline of projects for investment.

Indonesia has had limited success in developing PPPs, in part due to weak institutional mechanisms and coordination. An interministerial coordinating committee was set up in 2005 but remained relatively dormant. However, a number of key changes are being made. In 2014, a similar but new committee, known as the KPPIP,¹ was launched to revitalize coordination. A PPP unit was to be established in 2015. Many of the institutional (and other regulatory) reforms were aided by a 3-year technical assistance project of the Japan International Cooperation Agency (Shimokawa 2015).

Structure the governance of the PPP unit: It is important to decide the position of the PPP unit in the government structure. Placing the unit directly within or under the authority of the president or prime minister’s office may provide political commitment at the highest level. However, it can also result in political interference. Many units are now given a degree of operational independence with a

governing board providing overall direction.

For example, in the Philippines, the BOT Center was initially under the Office of the President, but was transferred to the Department of Trade and Industry in the early 2000s. In recent years its name has been changed to the PPP Center and it has become attached to the National Economic and Development Authority (NEDA), the planning agency. It is currently given strategic direction by the PPP Governing Council, which includes broad representation from within the government, primarily NEDA and the Department of Finance, but also the Department of Trade and Industry, Department of Budget and Management, Office of the President, Office of the Government Corporate Counsel, and the National Competitiveness Council (Alzate 2015).

Develop the human resources of the PPP unit: It is necessary not only to provide policies, laws, and institutions but also to develop the human capabilities to operationalize them. Officials are needed who understand the PPP process, can advise the line ministries, and can operate and police the system. A PPP unit needs to employ experts to develop projects, guide the PPP process, and build the knowledge and capacity of line ministries and subnational governments. PPP officials with prior private sector experience are particularly beneficial for government operations.

Capacity development can be provided by multilateral financial institutions, such as the World Bank and ADB, which

“A public–private partnership may be defined as ‘a cost and risk-sharing relationship between the public and private sectors, based upon a shared aspiration to bring about a desired public policy outcome.’ ”

~ Taken from presentation by D. Hautbergue (2015)

have been providing training and other support on PPPs to many countries over the past several years. Indeed, a recent survey of the PPP environment in Asia noted that “[m]ultilateral development agencies have played a leading role in training and technical support for regional PPP programmes, contributing to the capacity of governments and their agencies” (EIU 2015, p. 20). These agencies, as well as bilateral donors in some cases, not only provide training but also suggest amendments and improvements to regulations and practices.

Establish a viability gap fund: Many infrastructure projects are not viable solely with private financing. When the economic or social returns to a highway, power plant, or water system are high but the financial returns are low or negative, the government may provide a subsidy. The subsidy is normally funded out of the government’s general revenues. The best practice is that a specific subsidy fund, often called a viability gap fund, be created (World Bank 2012). This gives confidence to private partners that the funds are available and it ensures that the PPP unit or line ministry does not need to apply to the government’s general budget each time a PPP project with a subsidy is approved (World Bank 2012).

Project preparation

While a good policy environment and good institutions are necessary for PPPs, it is crucial that the government

develop a pipeline of well-structured, bankable projects that both meet policy objectives and are attractive to investors. Developing good projects requires considerable expertise. That expertise can be developed by the government in-house and supported with technical advisory services from development partners such as ADB and from the private sector.

Conduct an expert feasibility study and project preparation: Project feasibility is important and should be carried out by the government with its own staff and/or with the assistance of outside experts. Good advisors can be expensive but worth the cost of providing a good feasibility study. The government’s feasibility study should be compared to the analysis provided in bids, to ensure the latter are accurate and realistic. Bidders may be tempted to lowball a project bid to obtain the contract but will then run into problems later during implementation.

Forecast demand: Assessing future demand accurately is difficult. It is unclear how much a new road, water supply system, or social service will be used by the public. Overestimating demand will result in low revenue and will undermine the financial feasibility of the project for the private investor. It may lead to demands for renegotiation and a subsidy increase. Conversely, underestimating demand can result in an unnecessarily large windfall for the private partner. Some bidders may try to overestimate demand to bid low and win the contract—but this will result in

problems down the road. Governments should be vigilant and suspicious of bids based on unrealistic demand scenarios.

The PPP for the Cross City Tunnel in Sydney provides an example of overestimated demand that forced the operating company into receivership within 2 years. Actual road traffic was less than 50% of the forecast level. This was affected in part by a toll (A\$3.56) that was higher (on a per kilometer basis) than any other toll in the Australian city and significantly above the toll originally proposed (A\$2.00) (Torres 2015).

Choose a PPP structure (with risk sharing): The public and private sectors engage with each other across a spectrum of modalities. At the extreme left is simple procurement and at the extreme right is full privatization (Figure 1). In the former, the private sector bears no risk; in the latter, it bears full risk. In neither case is risk shared. PPPs occupy the space in between. Indeed, a PPP may be defined as “a cost and risk-sharing relationship between the public and private sectors, based upon a shared aspiration to bring about a desired public policy outcome” (Hautbergue 2015, slide 5). The public policy outcome alluded to here is for the provision of infrastructure or other services. It is optimal if the risks are

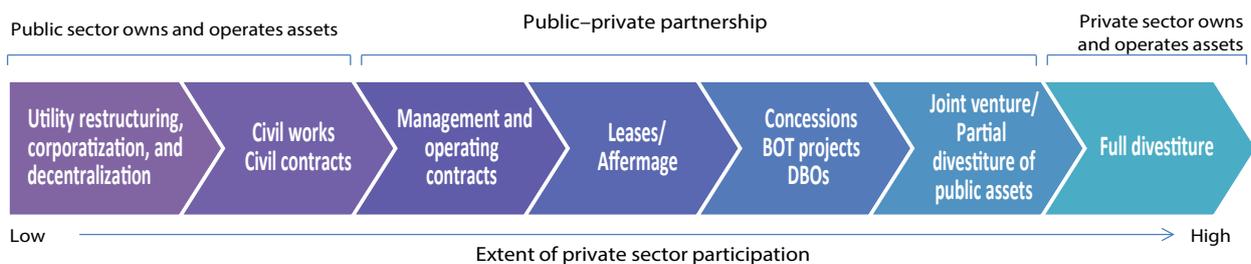
taken by the parties who can best control them.

During project preparation, the government needs to decide on the type of PPP model it will use. The key generic model is build–operate–transfer (BOT), in which the private partner builds and operates the infrastructure (or other facility) and then turns it over to the government after a set period (e.g., 20 or 30 years). Other models modify some aspects of BOT. Design might be added for a design–build–operate–transfer (DBOT) project. Or the government may provide all capital financing, retain full ownership, and therefore there is no final transfer; this is design–build–operate (DBO). Management or operating contracts may provide a form of PPP in which the private partner does not build the asset. The government must decide which model works best for each project in securing its objectives.

Clear procedures

Develop clear bidding procedures: To ensure a competitive selection process, it is important to set clear bidding procedures. A two-stage process allows firms to prequalify based on their expertise and capacity and then

Fig. 1 Continuum of private sector involvement in public–private partnerships



BOT = build–operate–transfer, DBO = design–build–operate.

Source: PPPIRC (2015).

Table 2 Renegotiated public–private partnerships: share of projects, time, and origin of request

Sectors	Share of renegotiated PPPs (%)	Average time to renegotiation (years)	Initiated by both government and operator (%)	Initiated by government (%)	Initiated by operator (%)
All sectors	68	1.0	13	26	61
Electricity	41	1.7
Transport	78	0.9	16	27	57
Water and sanitation	87	0.8	10	24	66
Social sectors	39	1.2
Other sectors	35	1.0

... = data not available, PPP = public–private partnership.

Data are for Latin America and the Caribbean.

Source: Guasch et al. (2014).

for the government to engage with a small number of quality firms. Investor sessions are a critical part of the process in which potential investors can obtain information on the nature of the project and the risk-sharing options. These sessions can also identify flaws, inconsistencies, or weaknesses in the project proposal and help the government make modifications before tender documents are finalized. Also, it is useful to meet individually with prequalified bidders to understand their concerns and fully explain the project. This will increase the quality of bids and reduce the need to re-tender.

Set limits and other criteria regarding subsidies: Subsidies tend to come in three types: (i) a discrete up-front payment to cover part of the capital costs, often called viability gap funding; (ii) availability payments paid on a regular and ongoing basis; and (iii) shadow tolls, where the amount of subsidy is linked to the level of public use. Subsidies should not be offered by the government but included in the private investor’s bid. The competitive bidding process will then reduce the subsidy requested in the bid or give rise to negative subsidies.² In addition, the government can set clear, nonarbitrary

limits on the level of subsidy per project. For example, subsidies for PPP projects in India are limited to 20% of project costs from the viability gap fund and another 20% from other sources. Brazil sets the overall limit at 50% (World Bank 2012).

Provide alternative dispute resolution mechanisms: Given the inherent problem of incomplete contracting and the intertemporal nature of cost and revenues, it is inevitable that disputes between parties will arise. If possible, it is preferable that these disputes not be addressed through the courts where verdicts may not provide flexibility. Instead, alternative dispute resolution mechanisms, where the parties can negotiate solutions, are preferable. Providing the details of such a mechanism (i.e., who will arbitrate, what procedures will be followed, etc.) in the contract will reassure potential investors and help ensure that disputes are addressed quickly and with minimal delay to the project.

Pressure to renegotiate

Subsequent to project initiation, there is often a request, usually on the part of the private party, to renegotiate

the terms of the agreement. The government must be cautious in entertaining such requests and should avoid creating, over the longer term, an expectation that it will easily accede to renegotiation.

The incidence of renegotiation is high. While consolidated figures for Asia are hard to come by, the topic has been more studied in Latin America and the Caribbean. About 68% of PPP contracts in that region are renegotiated, ranging from 41% in the electricity sector to 87% in the water sector (Table 2). Developed countries also record high incidences of renegotiation with a rate of 55% in the United Kingdom, and 50% for highway contracts and 73% for parking concessions in France (Guasch et al. 2014). In the majority of cases, the private partner seeks to renegotiate with the view to receiving better terms. However, the government may also want to renegotiate a successful project. For example, a year after Beijing’s Line 4 opened as part of the city’s urban rail network, the government reopened negotiations to get a larger share of the higher than expected revenue (Sudgen 2015). Renegotiation often occurs quickly after the initial contract is signed—on average only 1 year after the initial award (Guasch et al. 2014).

Quick resort to renegotiation can be part of a longer-term strategy on the part of the private investor to undermine the competitive bidding process. A private firm may submit a low bid to obtain a contract knowing that its bid is not profitable, but with the intention of soon renegotiating better terms. This process is unfair to other bidders who are submitting realistic bids and not considering renegotiation.

Conclusion

The PPP model provides a valuable vehicle for governments to secure financing and expertise for infrastructure development. However, the private sector will hesitate to join partnerships without a clear and stable environment of policies, laws, regulations, institutions, and procedures. These will reduce uncertainty and provide clear procedures for structuring viable PPP projects and for addressing unforeseen or unexpected outcomes. Asian governments are gradually accumulating the experience, expertise, and institutions to create a supportive environment for engaging the private sector.

Notes

1. KPIP stands for Komite Percepatan Penyediaan Infrastruktur Prioritas (Committee for Acceleration of Priority Infrastructure Delivery).
2. A negative subsidy is often referred to as a “premium” or “premium payment.” In such a case, the private partner finances the capital cost of the project and, in addition, provides a payment to the government. A premium is offered when a project is expected to be highly profitable. In effect, the investor is paying for the rights to (and benefits from) a concession for building and operating an infrastructure facility.

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