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POLICY BRIEF

Sustainable Development: Is there a role for public–private partnerships?

A summary of an IISD preliminary investigation

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Introduction

The last 20 years have seen the rise to power of public–private partnerships (PPPs) as a means of crowding in investment and expertise from the private sector for the delivery of public works and services. Widely utilised because of their purported advantages in off-budget funding, PPPs are a mechanism that modern governments regularly turn to in the fulfilling of their responsibilities on public infrastructure and services. This trend is likely to continue in the ongoing aftermath of the global financial crisis of 2007/2008 that sees many jurisdictions strapped for cash and seeking alternative methods of meeting the increasing demands for investment in public sector development.

DEFINING PPPS

Operating on a continuum between full privatisation and traditional government procurement, PPP is a generic term used to describe a myriad of structures that facilitate the participation of the private sector in the provision of public infrastructure and services. Given that it responds to the institutional, legal, investment and public procurement setting of different jurisdictions, and considering the contextual nature of individual agreements, the definition of PPP is in a constant state of flux. PPPs can be generally said to include:

- long-term contracts/agreements/relationships
- a private funding component
- provision of services or infrastructure through the private sector
- significant transfer of risk to the private sector, such as investment, design, construction, or operational risks
- complex contractual responsibilities and deliverables that vary over the contract period as the project moves through its phases, such as from finance to construction and operation
- the return of infrastructure/services to the control of the State at the end of the contract term or;
- the provision of services by the private sector on behalf of the State following the fulfilment of design and build responsibilities

Popular among many jurisdictions and with increasing diversification across sectors, the scale and impact of PPPs is considerable. In the 20 years between 1990 and 2009 there have been more than 1,300 PPP contracts worth more than €5 million signed within the European Union (EU), at a combined capital value in excess of €250 billion. The ability of PPPs to provide investment in adverse climates is also demonstrated by the fact that, since 2007, some 350 new projects representing almost €70 billion have reached financial closure within the EU.[1] Moreover, currently accounting for only 4 per cent of total public investment worldwide, figures suggest that PPP has room to grow and the potential to play an even greater role in future public infrastructure investment.[2] Furthermore, considering the rising interest in PPPs in middle and lower-income economies, it is not difficult to envisage that PPP will become significantly popular across the developing world.

[1] Kappeler A., & Nemoz, M., (2010, July). *Public-Private Partnerships in Europe–Before and during the recent financial crisis.* European Investment Bank. p. 7

[2] EU Commission (2009). *Mobilising private and public investment for recovery and long term structural change: Developing public private partnerships.* COM(2009) 615 final, Brussels. p. 3

Sitting, as it were, on the cusp of a potential large-scale take up of PPPs around the globe, it is important to assess the extent to which PPP is an appropriate tool for sustainable public procurement and sustainable development at large. From this standpoint IISD conducted a preliminary investigation into the structure and current practices of PPPs around the world. Our findings indicate that there is a valuable and comprehensive pool of PPP analysis already existing in the marketplace. However, the debate and current practice does not appear to have progressed beyond the "best value for money" principles embedded in public spending.3 Consequently, environmental and social safeguards are yet to be built into the PPP landscape, and instruments are still to be designed to trigger positive externalities across the domestic economy.

IISD is of the view that PPPs are yet to deliver on its potential for long-term sustainability and that a substantial rethinking of the business and contracture models are needed to ensure that it moves in this direction in the future. This includes not only a greater integration of sustainable procurement and sustainable investment principles into PPP agreements and contracting processes, but also a consideration of the potential for PPP procurement to serve as a vehicle and catalyst for green growth across many sectors of the economy.

Although initially restricted to public infrastructure in the form of roads, railways, prisons, government buildings, power generation, or water and waste treatment facilities, PPP has increasingly moved into the provision of so-called "social infrastructure" such as schools, hospitals, and health services.

[3] Best value for money is the baseline principle in public spending and procurement.

Pros and Cons of PPPs

Potential Benefits:

- Increased efficiency, expertise, and innovation from the private sector contribute to better infrastructure and greater cost and time savings across the construction and operation phases, increasing the value for money equation of a project
- Projects risks (e.g. finance, timeframe, planning permits, community consultations) are distributed between the public and private sectors according to the party best equipped to deal with it, both in terms of expertise and costs
- Access to private sector financing allows increased investment in public infrastructure, as governments are able to implement projects without the need to raise or budget additional funds, as is the case in standard procurement.
- PPPs provide the private sector with access to reduced risk, secure, long-term investment opportunities that are underwritten by government contracts. Such agreements ensure private capital flows, provide investment opportunities, and stimulate local industry and job markets.

Potential Disadvantages:

- PPP projects can prove to be more expensive in the long-term than standard procurement, due mainly to the higher costs of private sector borrowing when compared to government rates. Additionally, it is possible for prescribed government payments to the private sector over the length of the project term to exceed the costs of a comparative public sector provision.
- Accountability and transparency issues are distorted under PPP models of financing and agreements, as private sector funding components fail to appear on public spending records. Similarly, evaluation is made more difficult as private sector data on profits, costs, or lessons learnt can be considered issues of commercial confidentiality and less easily accessible.
- PPPs typically involve high tendering and transaction costs, while associated contracts are also complex and long-term. Together, these factors reduce the pool of private sector companies that have the capacity to undertake PPPs, raising issues of competitiveness.
- The inclusion of exclusivity agreements within PPP contracts can have the effect of awarding monopoly markets to private partners, further extending anti-competition issues.
- It is necessary for both the public and private sectors to possess PPP-specific capacity for an agreement to be signed and administered successfully. Such capacity is absent from many jurisdictions, both at a national and regional level, and it takes both time and experience to establish it, making it difficult to scale up PPP procurement quickly.

Case Studies

Chosen for their representation of a particular sector, context, or sustainability issue, what follows is a summary of the case studies detailed in the full investigation report.

Integrating Environmental Criteria into PPPs: The case of a desalination plant in the State of Victoria, Australia. This case study illustrates the avenues by which an experienced PPP jurisdiction sought to integrate and specify environmental considerations into a large infrastructure project, both in consideration of environmental regulation and also as a means of introducing balance to a project with a large environmental footprint.

The Importance of Comprehensive Evaluation and Detailed Specifications to Achieving Sustainability within PPPs: Lessons from the Arlanda Express, Sweden. The Arlanda Express is important not only because it was Sweden's only PPP before 2010, but in that it also represents a project that was in part motivated by, and desired, specific environmental outcomes. It illustrates the need for a greater strategic understanding and strong specifications that limit the ability of projects to negatively impact on prescribed aims.

The Need for Regulation and Accountability in Dedicated Units: An example from the Dublin Docklands Development Authority, Ireland. The fallout and inquiries that followed the collapse of the Irish property market and banking sector in 2008/2009 led to the illumination of operational gaps in the Dublin Docklands Development Authority, specifically in terms of regulation and accountability. Although not a PPP itself, this case study is useful as a parallel for the potential pitfalls that will hound dedicated PPP units, an increasingly popular institutional structure around the globe.

Innovative Private Sector Solutions to Waste and Power Generation: The story of the Vancouver Landfill, Canada. In a strong example of the potential for PPP agreements to act as a vehicle for environmental and sustainability outcomes, the city of Vancouver secured a sustainable use of solid waste landfill that facilitated value-added power solutions and supported local business through a private sector design-build-operate-finance structure.

The Ability of PPPs to Contribute to Rural Development: The Global Rural Electrification Program, Morocco. Designed to roll out a rural solar electrification programme in Morocco, this PPP illustrates the need to adjust methodologies and incentives to suit the rural context of middle-income economies.

Observations

PPPs can be used as viable mechanisms for the public sector to crowd in private capital. However, there are various issues associated with capacity, motivation, legal, institutional and regulatory frameworks, that need to be addressed to enable PPPs to deliver on their potential as vehicles for sustainable development:

- **The public sector value for money equation of PPPs is not secure, especially since the global financial crisis 2007/2008.** Recent analysis by the United Kingdom's National Audit Office[4] and as reported by the *Financial Times*,[5] suggest that the long-term costs of using PPPs to finance public projects is far beyond that of a solely state-funded project.
- **PPPs should embed environmental and social safeguards in their goals, designs and specifications, along with tender evaluation, supplier selection, and monitoring and contracting functions.** The focus needs to move away from conducting environmental impact assessments as purely a part of the licensing and construction permit requirements, and towards integrating sustainability across the PPP life cycle.
- **PPPs should be framed to support and stimulate green growth.** In much the same way as green procurement has been driven by public policies and practice in regards to the procurement of goods and services, similar action through PPPs can drive green growth, support fledgling green sectors and green industry more generally.
- **PPPs internal sustainability demands greater focus on "front end" due diligence.** To mitigate the risks associated with the premature failure of a PPP agreement, there must be an increased focus on effective planning and structural appropriateness.
- **PPPs can play a part in the development of infrastructure and services in low-income and emerging economies.** With consideration of specific contextual conditions, development and PPP are not mutually exclusive concepts, and the greening of developing country infrastructure can be supported through appropriately structured PPPs.
- **The onus is on government to design appropriate PPP models to provide the private sector with the right incentives to invest, innovate, and provide optimum solutions that will promote sustainable development.** Framed correctly, PPPs can provide the means and opportunity to stimulate the private sector to innovate and create effective solutions to infrastructure and service related challenges.
- **Increased public sector capacity and education is a compulsory component of developing sustainable PPPs.** PPPs involve complex and long-term planning and contracting, and, as with all long-term investment decisions, "getting the mix right" requires multidisciplinary and highly specialised expertise. Governments of industrialised countries are still in the processes of developing this expertise, and similar efforts need to be scaled elsewhere.
- **There is a risk that governments are using PPP as a default procurement option due to attractive budgetary optics.** While initially a large percentage of project finances are off the balance sheet, this benefit is reversed as the PPP matures and government payments become activated, whereby long-term costs may actually exceed those of the initial budgetary "savings."

The ongoing use of PPPs across many jurisdictions is an implicit acceptance and endorsement of its shortcomings and continues to put off much-needed debate around the overall value for money and missed opportunities afforded by the procurement model. As reported by Nicolas Timmins in the *Financial Times*, "There is a role for private finance. We just have to find a better way to do it."[6]

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[4] National Audit Office (2011, April 28). *Lessons from PFI and other projects*, HC920
[5] Timmins, N. (2011, August 8). A divisive initiative. *Financial Times*, pp. 7-8
[6] Timmins, N. (2011, August 8). A divisive initiative. *Financial Times*, p. 7

International Institute for Sustainable Development

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