PPPs and the SDGs:
Don’t believe the hype

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For a more detailed treatment of the issues raised in this briefing paper, please refer to Hall (2015).
Introduction

The advent of the Sustainable Development Goals (SDGs) has prompted Public-Private Partnership (PPP) advocates to launch a renewed push for their use in providing network and social infrastructure and services. This briefing suggests that claims that PPPs should be a central part of any attempt to address SDG commitments should be viewed with caution. Prioritisation of PPPs may bias governments towards bankable projects rather than initiatives which best respond to social development objectives. Claims that PPPs are more efficient, better transfer risk and therefore represent better value-for-money are not backed up by the evidence. Finally, particularly where institutional strength is weak, PPPs threaten to undermine democratic accountability and make problems with corruption worse, not better.

Hall (2015, p. 39) has argued that states assessing PPPs should compare the alternative of public sector delivery, with value-for-money estimations broadened to include a full public impact analysis. Eurodad (2015, p. 30) have demanded a halt to PPP promotion by international agencies until governments, under the auspices of the UN, have developed “... a set of comprehensive and development focused-principles and criteria for the use and assessment of PPPs.” The UN Department for Economic and Social Affairs (KS et al., 2016, p. 21) has echoed this, calling for a complete re-visiting of PPP guidelines in light of the commitments made by signatory states to the SDGs.

To adopt a cautious attitude towards the use of PPPs is not to abandon the expansion of infrastructure and services so critical to meeting the SDGs.

Governments can take up this challenge by exploiting what fiscal space they have available for domestic resource mobilization and/or drawing upon national and regional development banks. If a project is affordable employing a PPP, ultimately it can be afforded through direct state financing.

Moreover, the public sector may be able to:

- Exploit its cheaper costs of capital
- Capture comparative efficiency gains through reduced transaction costs and uncertainty, and economies of scale and scope
- Improve service design through increased stakeholder involvement, transparency and accountability
- Show greater flexibility to respond to changing public demands.

Charging public sector organisations with delivering these services provides opportunities for secure formal employment and skills training, and can help to build a strong public service ethos thereby cementing a healthy citizen-state relationship. As the example of remunicipalisation shows in the water sector (Pigeon et al., 2012), services returned to public ownership and provision can achieve social objectives and provide good value for money.
This briefing reviews the literature that critically evaluates why PPPs have failed to live up to the promises of their advocates and asks what challenges the use of PPPs may pose to achieving the SDGs. We find that: first, prioritisation of the use of PPPs may bias the selection, design and delivery of services; second, assurances that PPPs are more efficient, better allocate risk and ultimately represent better value-for-money may have been oversold; and, third, that problems of transparency, accountability, governance and corruption may be worsened rather than improved through the use of PPPs. Confronting these issues is critical if developing countries are to make informed decisions about whether and how they should use PPPs to address SDG commitments on health, education, water and sanitation, and energy at the same time as they must fulfill obligations to end poverty and tackle inequality.

**Background on PPPs**

The Addis Ababa declaration on Financing for Development in 2015 emphasised the role of public-private partnerships (PPPs) in helping to deliver the Sustainable Development Goals (SDGs) (2015, p. 12–13). Advocates of PPPs argued that the partnerships get network and social infrastructure built on-time and under-budget, ensure more efficient and sustainable operation of the related services, and help governments to better allocate risk, save taxpayers’ money and deliver on social development commitments.

This revival in support for PPPs as a tool to address infrastructure gaps and social development objectives emanates from a number of sources. Chief amongst these is advocacy from long-time PPP supporter, the World Bank Group. The Bank’s PPP Group includes the Public-Private Infrastructure Advisory Facility (PPIAF), the PPP Knowledge Lab, a PPI database, PPP reference guides, a vast PPP training programme, and even a Massive Online Open Course, or MOOC. World Bank support for PPPs, in the form of loans, investments and guarantees tripled between 2002 and 2012, from $0.9 billion to $2.9 billion (IEG, 2014, p. vi).

There has been a stream of infrastructure funds established at the multilateral, regional and bilateral levels that promote a key role for the private sector, including the DFID-led Private Infrastructure Development Group (PIDG), the World Bank-led Global Infrastructure Facility (GIF), and, more recently, the new Chinese-led Asian Infrastructure Investment Bank (AIIB). Add to this a series of multilateral initiatives involving both public agencies and philanthropic foundations, such as the Global Health Initiative, Harnessing Non-State Actors for Better Health for the Poor (HANSHEP), and the Global Green Growth Forum.

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2 While there is an enormous literature concerned with the finer points of PPP management and centred on a handful of OECD countries (Neto et al., 2016), there is a much smaller literature on development impact.

3 There is a lack of definitional clarity as to what exactly constitutes a PPP. There is general agreement that it involves a contract between a public authority and a private entity for providing an asset or service. However, the World Bank’s definition (WB PPP homepage), for example, says that the private party bears significant risk and management responsibility. UN-DESA argues that, “... the definition of PPPs varies depending on the degree of ownership of assets and capital expenditure by the private partners.” (KS et al., 2016, p. 5)
A number of key developing country governments have made commitments to expanding their use of PPPs. According to KPMG (2016), China “... has published a pipeline of more than 2,000 public-private partnership (PPP) projects.” This itself reflects the promotion efforts of an army of consulting firms and the private sector companies that are involved in PPPs themselves.

Yet, despite this panoply of advisory initiatives, funds and marketing efforts, PPPs make up a relatively small proportion of infrastructure investment. According to McKinsey (2016, p. 21) PPPs delivered just 6.4% of infrastructure investment in developing countries in 2015, a decline from 2010 levels. Moreover, this investment is highly concentrated geographically (in a handful of upper-middle-income countries), sectorally (in ICT and energy), and in takeovers rather than new investment (UNCTAD, 2015, p. 161). What explains the failure of PPPs to live up to the hype?

Selection, design and delivery: PPPs bias project selection towards profit
Prioritisation of the use of PPPs, prevalent where governments are dependent on concessional finance or have established a dedicated PPP unit, biases governments towards projects, rather than addressing the more complex task of sectoral reform. Even where the discussion is limited to the project level, there may be a bias towards projects which are commercially viable over those which respond to public need. Simply put, private investors in infrastructure make their decisions based on whether or not a project is ‘bankable’ (Della Croce and Makovsek, 2016).

As a mode of service delivery, PPPs may be less open to the involvement of a broad array of stakeholders in project design (Romero, 2015). Once selected, there is the further risk that PPP projects will be designed so as to maximise returns, potentially at the cost of other objectives of public service delivery. Such biases may permanently alter the citizen-state relationship in at least two ways: first, citizens may come to view the state as a profit-maximiser rather than a defender of the public interest; second, service providers, pushed to emphasise financial return over service quality, and laboring under squeezed pay and work conditions, may abandon the public sector ethos which has historically underpinned effective service delivery.

PPPs can lead to a decline in workers’ rights and wages, rising inequality
There are broader risks posed to workers by the introduction of PPPs in public service delivery (Hall, 2015, p. 37). Profit-maximisation incentives often lead to cutbacks and/or increased use of casual contracts. Marin (2009) finds that employment in Latin American water PPPs was cut by one-quarter to two-thirds. Where workers lose their status as public employees, there may be a loss of pension benefits. Breaking up what were once large public sector employers into smaller private sector contractors weakens union organization, making it more difficult to protect and improve pay and working conditions.

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4 Figures include the transport, power, communication, and water & sanitation sectors, notably excluding health, education and housing amongst other sectors.
PPPs – in whose interests?
The question marks raised over the claims of PPP advocates regarding efficiency and risk transfer have led some observers to ask who the promotion of PPPs is designed to benefit. Hildyard (2014, 2012) argues that the real purpose of PPPs is to respond to the needs of investors: “PPPs are about constructing the subsidies, fiscal incentives, capital markets, regulatory regimes and other support systems necessary to transform ‘infrastructure’ into an asset class that yields above average profits.” (2014, 10)

In the increasingly dominant view of ‘infrastructure as asset class’, there are pressures for governments to standardise project preparation and evaluation, and act as a market maker by selling their infrastructure assets in order to increase the liquidity of the infrastructure market (McKinsey Global Institute, 2016).

In a study of 716 UK PPPs between 1998 and 2012, Whitfield (2012) documents the excess profits earned by firms in sales of their equity stakes in PPP project companies via secondary markets. The average annual rate of return on the sale of equity was 29%, twice the 12-15% rate of return reported at the time of the financial close of the projects. While the development of secondary markets in developing countries is only just beginning, he argues that as states “adopt PPP legislation and programmes and the number of PPP projects increases, equity transactions begin to occur in the first batch of projects leading to the formation of a secondary market.” (2012, p. 48)

PPPs often cut services and undermine universal provision criteria
PPPs may also have adverse effects on access to services. This may occur through, for example, the imposition of tariffs on drinking water, fees on health and education services, or user charges on infrastructure. PPP operators, when given room to manoeuvre permits, are likely to choose higher margin markets of wealthier customers. In its review of the World Bank Group’s use of PPPs for the decade 2002-2012, the Independent Evaluation Group (2014, p. 101) finds that there is little data on whether PPPs have benefitted the poor, with monitoring focused on commercial success rather than developmental impact (2014, p. 63). An extensive review of literature on PPPs in developing countries, conducted by the Evaluation Department of the Government of the Netherlands (Ministry of Foreign Affairs, 2013) found the evidence for development outcomes and effectiveness was weak.

PPPs are inflexible compared to public provision
Once governments lock themselves in to long-term commercial contracts, payments must be met regardless of whether cutbacks to public spending are occurring in other, possibly more critical, sectors or projects. Hall (2015, p. 36) cites the example of UK hospitals bankrupted by PFI commitments which were forced to merge with other local hospitals leading to cutbacks in services and staffing levels. Oxfam, together with the Consumer Protection Association of Lesotho, (Marriott, 2014) has documented
the impact of a hospital PPP signed in 2009 under the advice of the IFC. The country is locked into an 18-year contract that is using more than half of its health budget, while providing annual returns of 25 per cent rate of return on equity to the private partner.

Efficiency, risk transfer, and value for money: No evidence PPPs save money or attract capital
PPP advocates cite the ability of PPPs to bring much-needed capital, technology and expertise to projects, resulting in more efficient service delivery and ultimately lower costs to the taxpayer. However, at each stage of PPP implementation there are potential problems which undermine a simplistic equation of private provision with greater efficiency.

PPPs are more expensive in the long run
Lease payments to private partners do not replace the debt that would be incurred through direct state financing; indeed, they can be given a present value equivalent to debt. This equivalent form of debt is more expensive because the state can raise funds at lower interest rates than the private sector. Particularly in large infrastructure projects, even a small difference in the cost of capital can add up to an enormous additional bill over the long run. Alternatively, in PPPs where governments save current expenditure by handing over rights to a private firm to charge user fees, they forego the future revenue that would have been derived from public investment in the project. The EIB (Blanc-Brude, Goldsmith and Välilä, 2006), in a comparison of 227 new roads built in 15 European countries, 65 of which were PPPs, found that the “ex-ante cost of a PPP road to be, on average, 24% more expensive than a traditionally procured road”.

Profit motive distorts procurement process
During the procurement process, private companies are incentivised to underestimate costs and overestimate the demand for services. This becomes more problematic where ‘uncompetitive’ bids – including those that have been more realistically costed – are dropped after an initial bidding round, leaving a single or small number of ‘preferred bidders’ to draw up final proposals. Where governments are required to open procurement to foreign firms, this can result in a small number of multinational companies dominating the bidding process. Beyond the loss to domestic firms and national output, governments entering PPP contracts with multinationals (or equally if borrowing internationally) must assume foreign-currency denominated debt and the ensuing exchange rate risk (UNCTAD, 2015, p. 163).

Transaction costs high in PPPs
These problems with transaction costs and lowered competition continue into project implementation. Before initiating a PPP, governments must ensure that an appropriate legal framework is in place, establish monitoring and enforcement systems, and engage in lengthy and complex negotiations. International agencies, such as the PPIAF, have encouraged low- and middle-income countries to invest in these institutions at the cost of reduced spending in other budget lines. In a study of over 1200 water and electricity utilities in 71 developing economies, Gassner et al.
conclude that private sector participation brings performance gains, however a lack of investment “raises concerns about the long-term improvements achieved” (2009, p. 4).

**PPPs are prone to monopoly capture**

Once begun, private providers may have an effective monopoly, giving them considerable power to renegotiate terms where initial estimates of revenues or costs have proven inaccurate. A study by Gausch (2004) found that 42% of 670 PPPs studied in Latin America were renegotiated; in 60-70% of cases, the private operator was able to delay or reduce investment, or extract higher user fees. This reduces governments’ flexibility to respond to changing realities on the ground, and introduces uncertainty regarding any costs of renegotiation. Governments may be placed in a particularly difficult negotiating position where they are under SDG commitments to meet minimum service levels.

**In its evaluation of the World Bank’s use of PPPs, the IEG (2014, p. 97) found that there was little data on long-term performance.** A number of studies have suggested that, in consideration of the kind of issues discussed above, there should not be an assumption of superior efficiency in the private sector (Hall, 2015, p. 43).

**The myth of risk transfer**

Increasingly, even PPP advocates are placing less emphasis on the ability of PPPs to deliver better efficiency on a straight-forward cost basis, and are instead stressing the ability of a PPP to transfer risk 5 from the public authority to the private contractor where it can be borne more effectively. Prominent in this line of argument is that the private sector bears the supply-side risk of delivering projects on time and on budget. However, what is usually not discussed is what price is paid by the government for the private sector taking on this risk? Is that price higher than what would have been the cost of overruns had the project been implemented within the public sector?

The second key area of risk referred to is demand-side risk. First, it is not clear that the private sector is best placed to assume this kind of risk. It may be, for example, that a decline in road toll fees is a positive development reflecting improved rail infrastructure, with ensuing benefits to the environment and worker productivity. Where borne by the private sector, such risk would entail financial loss and a claim for re-negotiation; where borne by the public sector, the risk can be spread across the larger population which benefits from the structural shift. Second, even where the private sector may be able to bear demand side risk, once again it is not clear how such risk is best priced. The IMF (2004, p. 14) warned that, “It is also possible that the government overprices risk and overcompensates the private sector for taking it on, which would raise the cost of PPPs relative to direct public investment.”

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5 Risks associated with the provision of infrastructure include construction risk, operating risk, market or demand risk, financing risk, environmental risk, regulatory risk, legal/political risk, foreign exchange risk, public policy risk, force majeure and residual value risk (Loxley and Loxley, 2010, p. 35).
Successful PPPs often rely on government regulation, not ‘market efficiency’
The other possibility is simply for the government to provide a series of demand or revenue guarantees, bringing into question the whole purpose of the PPP in the first place. In Korea, following the Asian financial crisis, legislation was revised to sweeten risk-sharing mechanisms such as construction subsidies and minimum revenue guarantees (MRG) (Anon, 2014). In the subsequent decade, Korea witnessed rapid growth in private infrastructure projects. By 2011, the government burden for 36 projects with MRGs was $2.6 billion. After the MRG was abolished, private participation in infrastructure rapidly declined.

Transparency, accountability, governance & corruption: Better or worse?
The introduction of a PPP turns what was once a public enterprise subject to freedom of information legislation (where such exists) into a private company protected by commercial confidentiality. This is despite the fact that the enterprise remains, ultimately, entirely publicly funded.

Governance and accountability become opaque
Monitoring PPP activities becomes nearly impossible in cases where ownership follows a byzantine hierarchy of shell companies, often involving the use of tax havens. NGO European Network on Debt and Development (Romero, 2015) has called on governments to release all documents relating to PPPs following the Open Contract Global Principles.

PPPs hide government debt, create financial risk
It may not be only the private sector partner that seeks to use the PPP to avoid public scrutiny. PPPs have been used by governments to move capital expenditures ‘off balance sheet’, especially useful where states are bound by strict rules or conditionality governing the incurrence of debt. The creation of such liabilities, both direct and contingent, can prove destabilizing to future governments who may not have been party to the original negotiations. If a project delivering a critical service fails, it is almost inevitable that the privately-incurred debts are shifted on to the accounts of the state. The IMF (2014) is so worried about the fiscal and other risks that PPPs pose that it has developed three tools to assess governments’ preparedness, identify potential risks and put in place mitigation measures.

PPPs create the environment and incentives for corruption
Finally, supporters of PPPs argue that the contracts force governments to be more transparent about infrastructure investment decisions, thereby eliminating opportunities for corrupt practices. However, where large, long-term and lucrative contracts are under negotiation between government officials and corporations, the stakes are high, and the opportunities for corruption rife. For example:

- Numerous power station PPPs have been implicated in corruption, including Enron investments in Nigeria and India, and others in Tanzania, Pakistan, Indonesia and Slovakia (Hall, 2015, p. 32). In Tanzania, a 20-year deal was signed in 1995 to provide what turned out to be unneeded electricity at an inflated price (Farlam, 2005, p. 28–9).
- Executives of subsidiaries of French water multinationals Suez and Veolia have been convicted for bribing public officials in the cities of Grenoble and Angouleme, and the island of Reunion (Godoy, 2003). In 2002 an executive of Vivendi (now Veolia) was convicted of trying to win a wastewater treatment contract in Milan through bribing local politicians.

- In New South Wales, a catalogue of violations have surfaced in a series of infrastructure PPPs, including manipulation of tendering and contract arrangements, and incompetence leading to cost overruns. This leads Kouzmin et al. (2011) to label the projects E-SCADS, or economic state crimes against democracy.

**Conclusion and key findings**

**We find that:**

- Prioritisation of the use of PPPs may bias the selection, design and delivery of services;

- Assurances that PPPs are more efficient, better allocate risk and ultimately represent better value-for-money may have been oversold;

- Problems of transparency, accountability, governance and corruption may be worsened rather than improved through the use of PPPs.

Confronting these issues is crucial if developing countries are to make informed decisions about whether and how they should use PPPs to address SDG commitments on health, education, water & sanitation, and energy at the same time as they must fulfill obligations to end poverty and tackle inequality.
V. References


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