

Public Private Partnerships for Poverty Reduction*

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*The views expressed in this presentation are mine, and do not necessarily represent the views of the ADB

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The conclusion

PPPs can and do help to reduce
poverty

The necessary first step is to make
the PPPs work...

... and then to make it work for the
poor

There are **examples** to show the ways in which PPPs convey benefits to the poor:

1. The BENEFITS: (i) generation of fiscal savings, (ii) reduction in the cost of service delivery, (iii) connecting the hard-to-reach poor to essential services, (iv) progressively widen coverage, (v) lowering costs by injecting competition, (vi) creating services tailored to the special needs of the poor
2. From projects in 7 different COUNTRIES: Lao PDR hydropower project, Philippines power project, commercialization of state plantations in Sri Lanka, water utilities in Indonesia, water supply project in PRC, telecoms market in Bangladesh, power project in Bangladesh, urban water supply in Kathmandu valley Nepal, health care project in Bangladesh.

The lessons

1. Complex web of incentives & institutions underpin a successful PPP operation
2. Structuring incentives is at the heart of PPP's institutional equations

The structuring of incentives can be made consistent with good commercial practices

1. View poverty indicators not as problems but as business opportunities
2. Locate PPP strategies and business plans within the context of NPRS
3. Structure the policy setting of PPP to ensure key issues such as affordability, universal coverage are addressed
4. Put in place effective pro-poor regulations
5. Proper allocation of risks and tariff setting to ensure affordability
6. Participatory elements can be inserted to ensure ownership

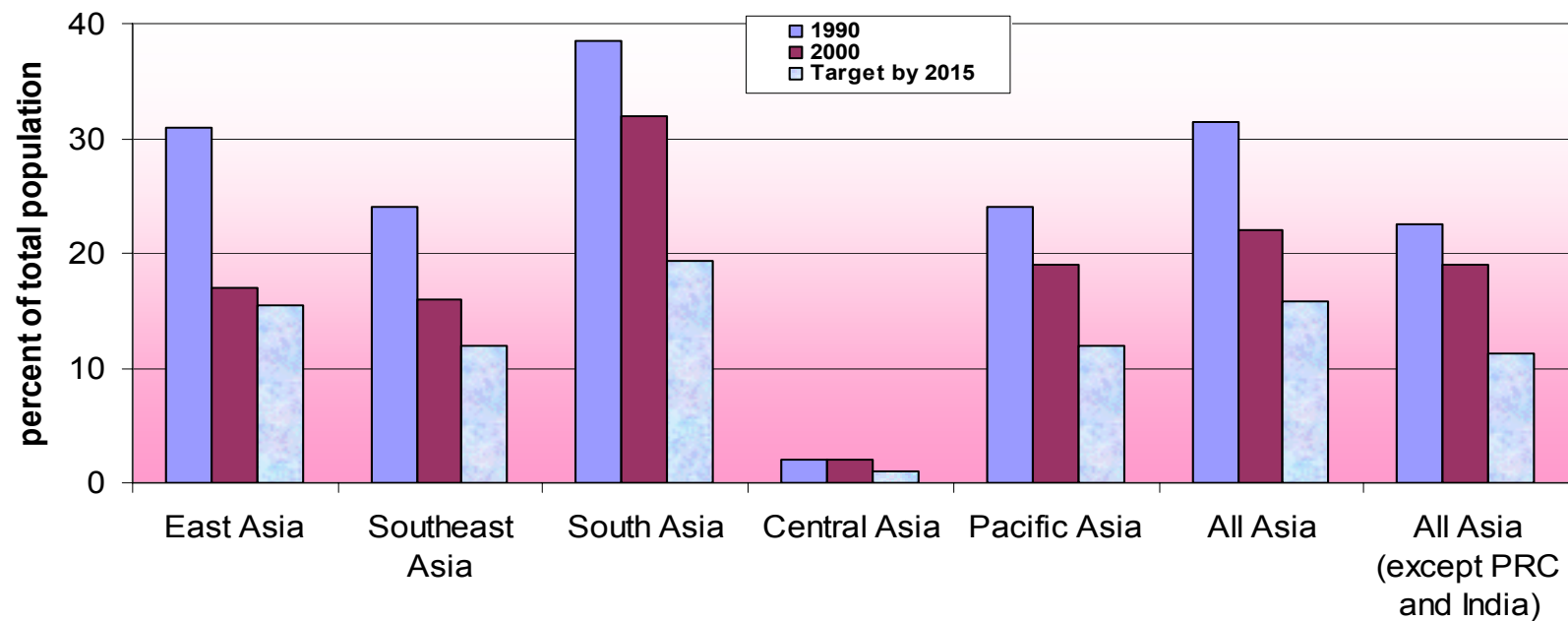
The context

poverty reduction and infrastructural needs

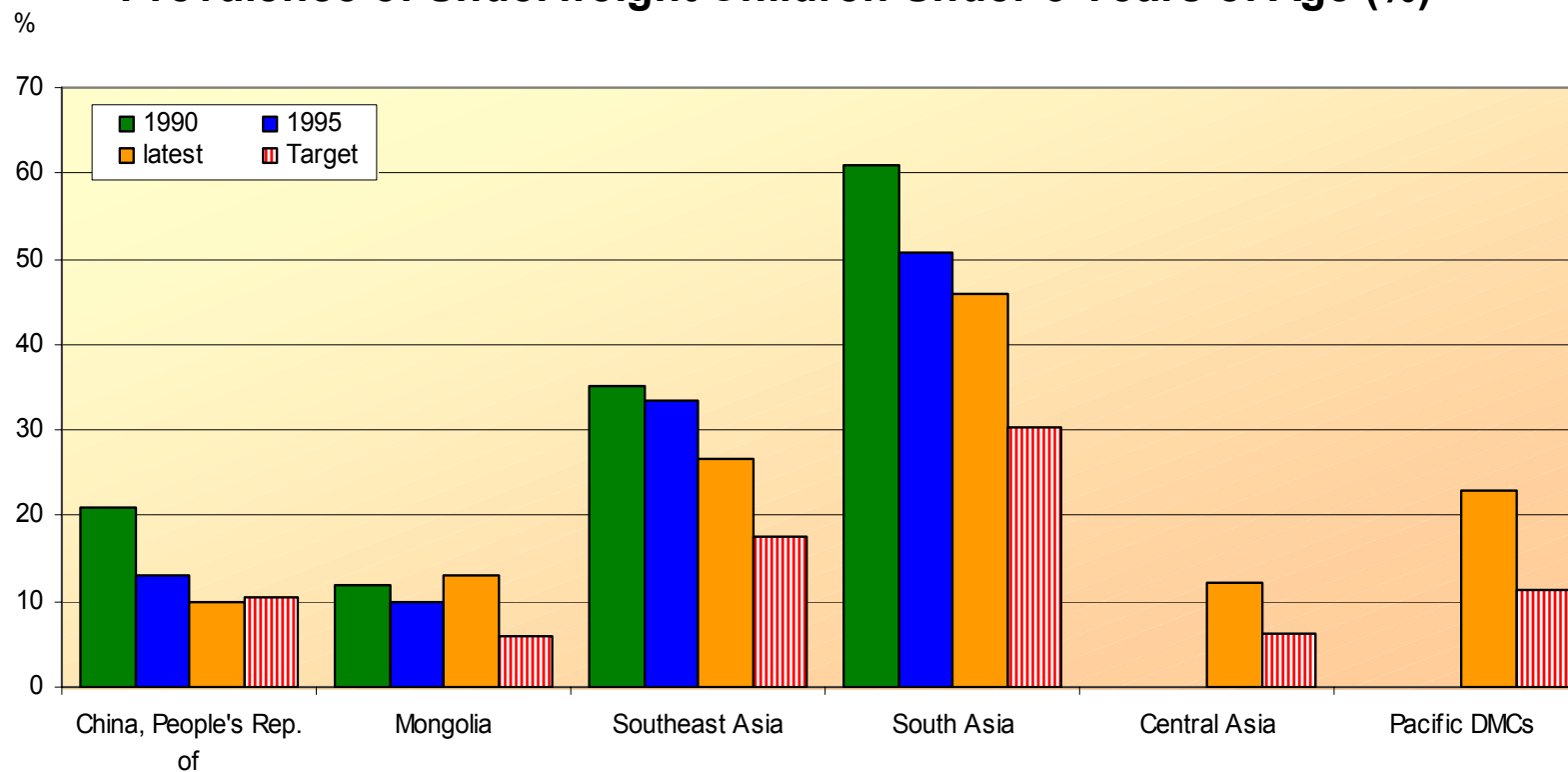


Poverty Incidence (based on US \$1/day)

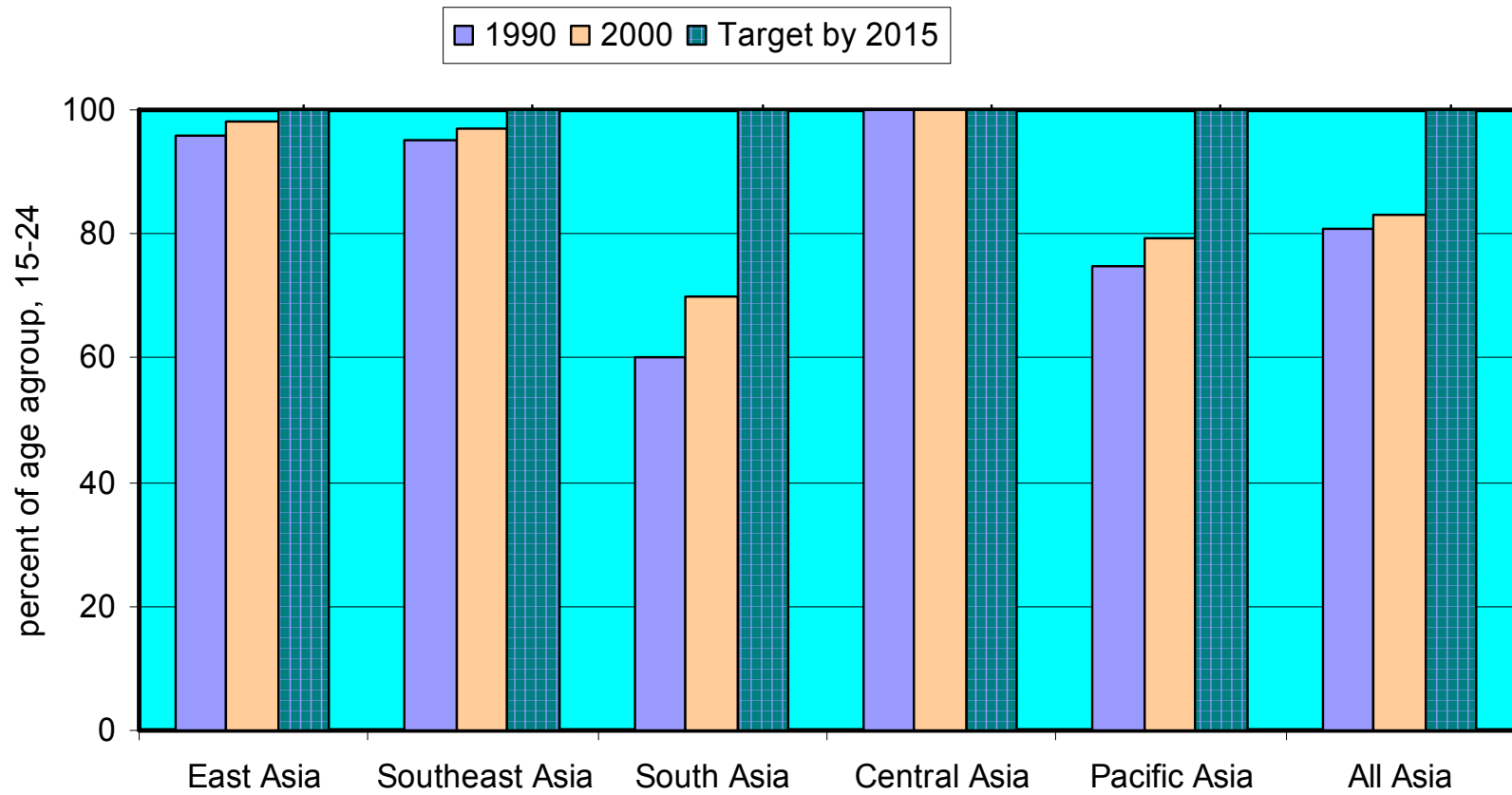
Poverty incidence declined in the region from 32% (1990), to 22% (2000).



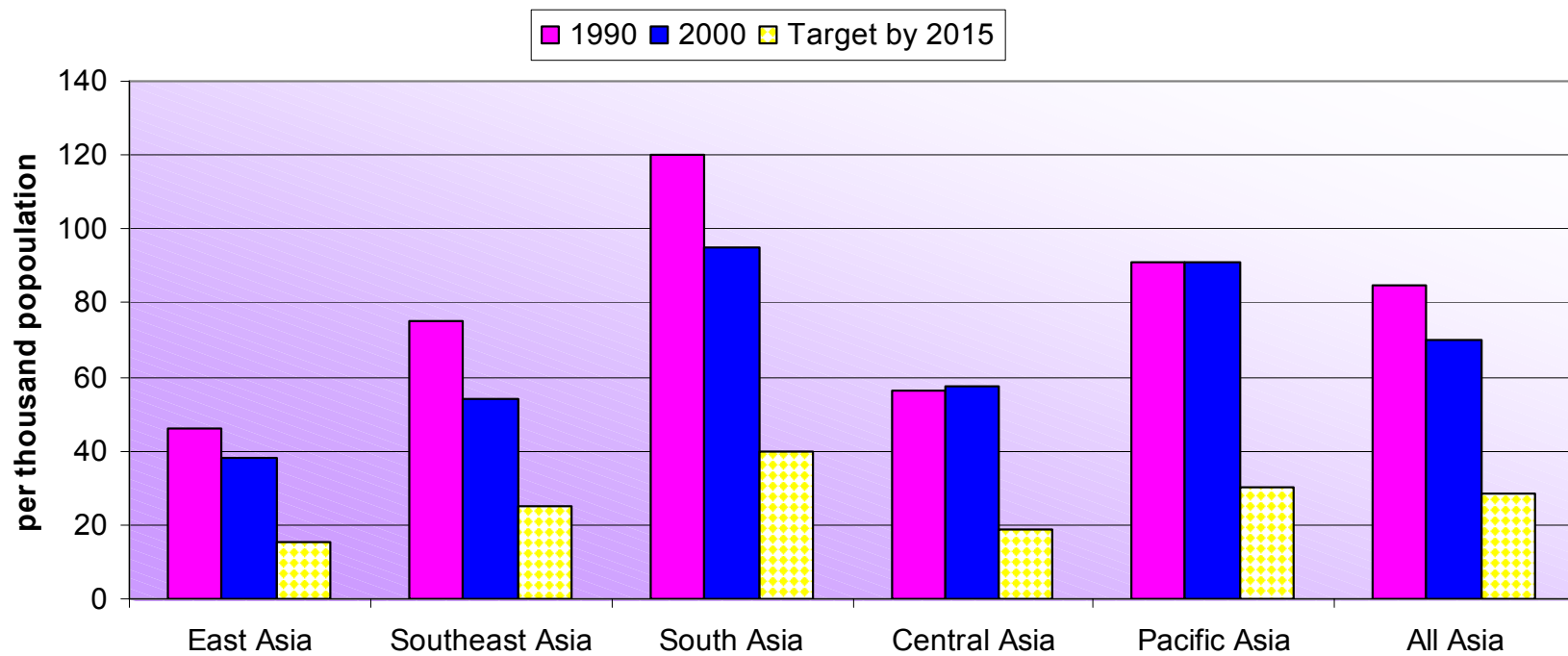
Prevalence of Underweight Children Under 5 Years of Age (%)



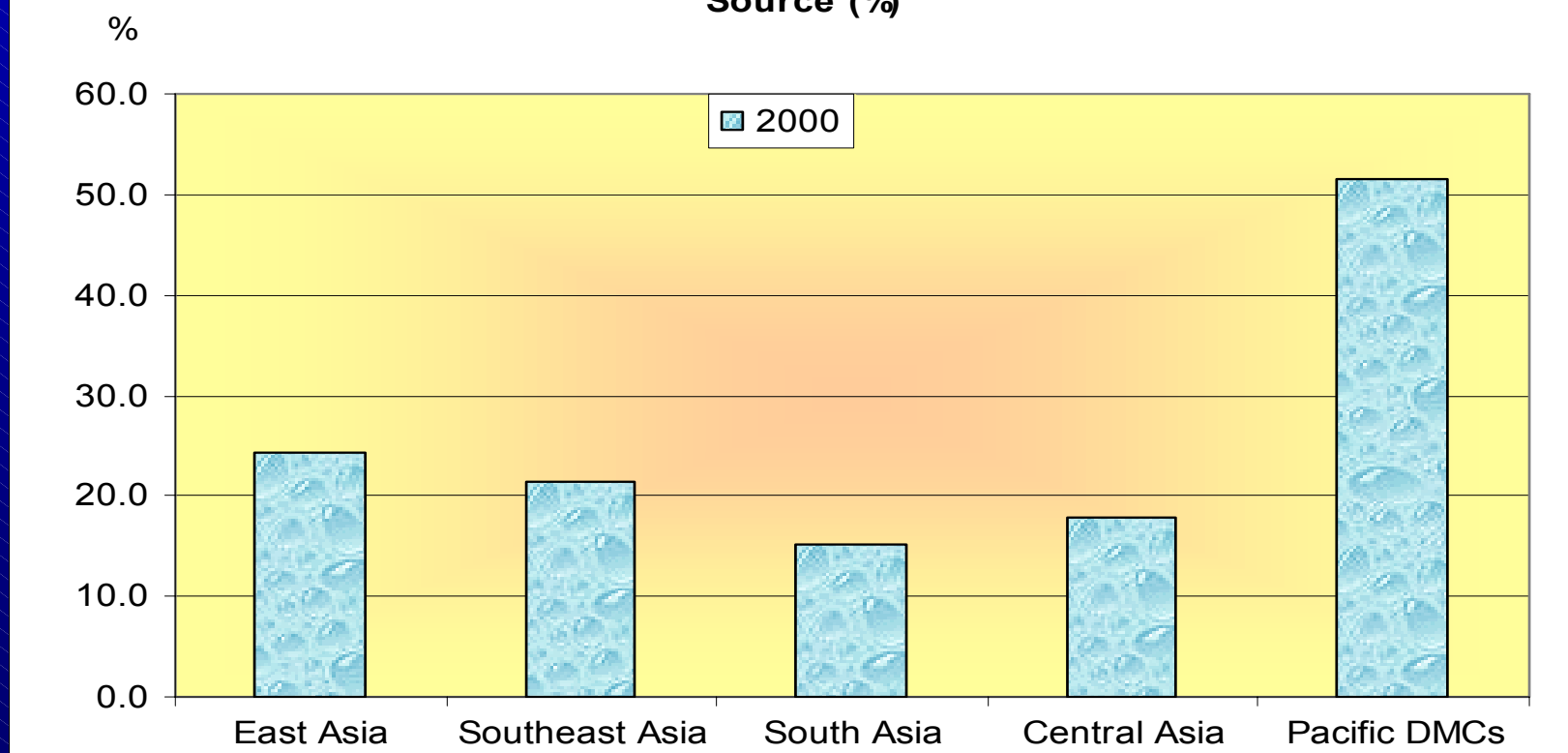
Youth Literacy Rate



Under-5 Mortality



Proportion of Population without Access to an Improved Water Source (%)



The assumptions

1. The link between infrastructure and poverty reduction (there are some evidence)
2. That the poor have some purchasing power, and hence serving them can be commercially feasible (there are evidence)

The rationale

1. High infrastructure demand. For Asia Pacific estimated at US\$250 billion a year
2. Public resources (in the past usually financed some 70% of infrastructure investments) are in short supply

Tight governmental budgets, politically unpopular tax increases

Tax ratio in some Asian countries (2001):

India	9.9%
Indonesia	13.6%
Malaysia	16.0%
Pakistan	12.4%
Philippines	13.3%
Sri Lanka	14.5%
Thailand	14.4%
Viet Nam	16.9%

Source: Tax ratio (tax revenue to GDP ratio) is calculated from Asian Development Indicators (2003), World Development Indicators (2003), Government Finance Statistics (2002)

The principle and approach Value for money and PPPs

“Value for money” is one phrase used to describe attempts to achieve more service with a given level of resources

VFM can be done in four ways:

1. Doing things a cheaper way
2. Searching for greater productivity and elimination of waste
3. Pursuing the “economies of scale” in the provision of services
4. Introducing efficiency by inviting the private sectors to participate, thereby releasing some spending pressure off the government’s budgets

Learning point: seen from the fiscal context, PPP is only one among several alternative fiscal options

Introducing efficiency, releasing pressures off the budget: private sector's involvement

PPP is increasingly popular. The past 15 years have seen development in the modality of private involvement. Main defining feature is the degree of private control over and involvement in financing...

- 1. Service contracts**
- 2. Management contracts**
- 3. Leasing**
- 4. BOT and its variants**
- 5. Concessions**
- 6. Private divestiture (either complete or partial)**

Learning point: there is no unique model. Each project, given its circumstances, will define what is suitable and what is required. Each model has different impact on the poor

Public Private Partnership: Why governments are turning to PPP?

1. **Responding to socio-economic pressures.** Demand for infrastructure is rising much faster than governments' ability to finance them through the budget. In other words, governments are trying to **achieve the goals that would otherwise go unmet**
2. **Achieving "fiscal gain".** Since PPPs combine the deployment of private sector capital and, sometimes, public sector capital to improve public services or the management of public assets, PPPs can spread the costs of procurement of assets over time and **shift the burden of capital spending** more to private firms', and less to public-sectors', balance sheets
3. **Improving service efficiency.** Much of the improved value for money comes from the fact that when private sector capital is deployed and **is at risk**, the right **commercial decisions** are made about design, operating regime, human resource planning, asset costing, etc
4. **Politically safer option.** In contrast to privatization, PPP operates at the boundary of the public and private sectors, being neither nationalized nor privatized assets and services. Hence, politically, PPP is the **third way** in which governments may deliver some public services

Learning point: these may be used as yardsticks to judge the success of PPP

To get the PPP framework right, basic institutional processes need to exist:

- 1. Institutional changes to assist public sector agencies to prioritize, provide resources for, and approving transactions, for examples:**
 - From input- to output-based contracting (to allow more sophisticated and cost effective approaches to risk management)
 - Relevant procurement process
 - Clear legal structure and legal due diligence (to cater to contractual issues, define constraints to PPP implementation as well as project scope, enable long-term financing)
- 2. Creating effective regulatory institutions, such as:**
 - Well crafted check and balances to create co-dependency, transparency, fairness, proportionality
 - Effective user charge policies to safeguard consumers interest (incl. market design)
 - To reduce imbalances between the government's limited means vis-à-vis capabilities as regulators.
 - To establish proper distribution of risks (ie, financial resources) and responsibilities (ie, financial obligations) between involved parties
- 3. Stable political support:** to allow prediction of the profitability of venture (informed investment decision-making), to ensure stable public support to contract (lesson from the Asian crisis episode)
- 4. Macroeconomic stability:** eg, to mitigate attendant financial risks from foreign exchange instability (lesson from the Asian crisis episode)
- 5. Ensuring VFM, to:** maintain public interest, sustain fiscal rationale of PPP

Is making the PPP work enough?

Link between PPP modality & incentives to serve the poor

Service contracts: retention of ownership in the hands of government; transfer of design and construction risks to private sector; short contract period (eg, between months to a few years); provide limited incentive for whole-life-costing approach; tend to focus more on efficiency; **benefits may not reach the poor**

Is making the PPP work enough?

Link between PPP modality & incentives to serve the poor

Management contracts: retention of ownership in the hands of government; transfer of operating risk to private sector (with a fee, profit sharing); limited (usually around 3-5 years) span of contract period; do not link investment to service provision; **provide more incentive to improve service to existing customers rather than reaching the poor**

Is making the PPP work enough?

Link between PPP modality & incentives to serve the poor

BOT and its variations: transfer back of ownership to the government after a long period; transfer of design construction and operating risks; require strong government guarantee to ensure cash flow; complex contractual arrangements; **has the potential of not benefiting the poor unless the distribution and/or network is upgraded and extended to un-served areas or areas populated by the poor**

Is making the PPP work enough?

Link between PPP modality & incentives to serve the poor

Concessions: assets legally remain the property of the government; operators pay a fee to use them; transfer the risks of capital investment, operation, O&M to private sector; covering a very long-period of time (20-25 years); **have the potential of benefiting the poor IF certain conditions are satisfied (eg, clear coverage toward universal service, consumers orientation, effective monitoring). But experience suggests that in many developing countries such conditions not commonly met, hence the poor don't necessarily benefit**

Is making the PPP work enough?

Link between PPP modality & incentives to serve the poor

Divestiture: assets and operations are transferred to private sector (partially or completely, and may not be indefinitely depending on the design of the license); **the poor may or may not benefit** -- **depending on the license conditions and the design of regulation** (eg, specification on universal coverage target, differentiation of services to meet the needs of the poor, affordability of tariff)

Making PPP work for the poor: Key institutional areas

- 1. Accurate and balanced allocation of risks**
- 2. Tariff structure**
- 3. Pro-poor regulatory regime**

Allocation of risks

1. Risk allocation is the most difficult institutional area of PPP and few country studies found, yet this is key to making PPPs work for the poor
2. Risk influence the overall cost of project through premium demanded by contractors, and will affect the Value for Money. The objective of making allocation is to achieve cost-effective risk transfer, and not simply risk allocation for its own sake
3. Risk should be transferred to the party best able to manage it in the most cost-effective manner

When do we see problems associated with suboptimal allocation of risk?

1. Utility connection charges are too high for poor communities
2. New capital investment in un-served wealthier (high margin) areas is given preference over un-served poorer areas
3. The problem of supplying areas without secure land tenure is a classic one. Yet, in Asia the poor often live in either squatters or in land without title. **Question: what's the best risk allocation mechanism to get around this particular problem?**
4. Operators' reluctance to provide stable customer services to the poorer community groups or areas

Tariff structure

1. Affordability to pay is key
2. The poor has very low threshold when it comes to affordability to pay for utility services
3. Affordable tariff structure often implies subsidy, which when not calculated properly, ends up draining the budget and dilute the very pursuit of the Value for Money (VFM)

When do we see problems associated with tariff setting?

1. Tariffs or user-charges become too high
2. Graduated tariffs (eg, stepped tariffs) end up negatively impacting on the poor. There was a case where for any amount above certain liters of water consumption, poor households in a poorer area are charged more than middle income households living in the neighboring area
3. Customer management costs become too high due to low consumption
4. Blanket utility subsidy ended up disproportionately benefiting the high income households -- due to their high level of utility consumption

Pro-poor regulation

1. The objective of regulation? To protect the general public, especially poor customers, against the risk of abuse of a dominant position
2. What to regulate? (a) Tariff; (b) allowance for deviation from quality standards to improve access for the poor since the poor have different circumstances; (c) product market
3. How to regulate? Establish mechanisms of accountability to, and control by, principals. This requires: (a) clarity about who the principle is and who the agents are; (b) appropriateness of powers and responsibilities, or appropriate institutional locations; (c) existence of necessary skills
4. What to do about subsidy?

When do we see problems related to inexistence of pro-poor regulations?

1. Subsidy policy and regulations, agreed at the start of contract, become inappropriate after short period of implementation time
2. Inefficient and inequitable use of subsidies
3. Tariff structure not reviewed on a periodic basis, becomes obsolete, and provides neither financial incentives to operators nor protection to the poor

Issues and challenges

1. To make PPP works for the poor, efforts should be made to make institutional and implementation arrangements, and project design, benefit the poor
2. At the design stage: risk allocation between involved parties is key to ensure low cost financing of PPP project
3. At the design stage: affordable tariff structure combined with wider, differentiated access can help ensure that the services being produced will meet the needs of the poor
4. At the implementation stage: pro-poor regulation is key in order to sustain mutual interests to, and benefit from, the PPP projects

Final notes

1. Much remains to be done in order to strengthen the poverty reduction impacts of PPP arrangements
2. Learning opportunities are vast: since 1990, more than 500 hundreds PPP infrastructure projects been undertaken throughout Asia Pacific (involving investments of more than US\$250 billion; WB report)