Pros and Cons of Private Public Partnership

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CHAPTER TWO: Literature Review

2.1 Overview

Public private partnership (PPP) was defined by Rosenau (2000) as the generic term applied to different types of collaboration between the government and private developer to provide support necessary for public sector infrastructural development and provision of public services. This form of partnership involves a contractual agreement between the collaborating partners which seek to bind the parties to discharge their mandate as outlined in the partnership.

There is no precise definition of private public partnership. This is because of the nature and complexity of the relationship between the parties to the contract. Harper and Stein (2003) asserted that the aim of a private public partnership is always to create a public infrastructure that can be shared by all people in a given state or country. The government always seeks to benefit from the external expertise and innovation offered by private developers in an efficient and effective manner. This boosts and improves the quality of services and public utilities offered to the general public.

In public private contracts, the state acts as the main legislator and regulator of laws governing certain activities, while the private developer acts as the main financier and innovator of the project to be undertaken. Thus, a public private partnership is a contractual agreement that involves shared responsibility between the parties to the contract to discharge a project designed to meet the needs of the entire public. There are pros and cons associated with public private partnership and they will be dealt with in the sections below.

2.2 The Pros of Public Private Partnership

Several researchers have underscored potential benefits of engaging in a public private partnership. Private public partnership (PPP) is an alternative mode of financing huge and complex projects which are designed to provide services to the general public.

2.3 The Cons of Public Private Partnership

Bloom et al., (2004), while carrying out an empirical study on the disadvantages of public private partnership in health sectors, identified five main challenges. They are related to higher consumer prices, reduced competitiveness, reduced transparency and accountability and delays in contract negotiations.

2.3.1 Risk transfer to private sector

Similarly, Savas (2000) noted that private public partnership involves transfer of risks from the public sector to the private sector. Since most projects usually involve massive investment of resources, there are fears that some projects may not be completed, thus leading to unforeseen losses. This forces the government to transfer such risks to private sector enterprises. Once risks have been transferred, a private partner becomes solely liable for any loss it incurs in the project execution (Beckett, 1998).

Gaffikin and Bond (2007) supported Bloom et al., (2004) by inferring that when responsibilities are transferred to private entities, higher consumer prices are bound to arise. Wettenhal (2003), however, disputed this by claiming that the high power is justifiable owing to the fact that raising capital by a private entity involves higher interest rates. In government sector, any attempts to raise capital by borrowing loans often have some potential benefits, whereby a government gets a funding at a lower rate. Bailey (1995), however, contended that the private sector may not offer such services at affordable prices, since they are always driven by profit-maximizing motives.

2.3.2 Lack of transparency and accountability

Fowler (1997) offered that PPPs are affected by problems of transparency and accountability. When these parties decide to engage in a common project to benefit the whole public, a consortium created usually gives each partner the right to report on the returns based on the perceivable estimates. Such estimates may not reveal the true picture of the project in terms of actual costs and expected returns. Some parties may try to conceal the information from the public and any effort to access such information may not bear any fruit, as private entities do not freely give their information to external parties not stated in the consortium. It is always expected that public projects will be subjected to public scrutiny to establish how accountable the project developer was. However, once a project is transferred to a private developer with the approval of the government, no person can afford to establish the true costs of a given project, and in some instances a project may be overestimated or even inflated so as to get higher payments (Fainstein, 2000; Bond, 2003; Hailey, 1997).

2.3.3 Delays in contract execution

A research carried out by Squires (1989) into the performance of PPPs indicated that there are considerable delays in such contracts. For instance, to evaluate the completion of a project and the maximum time taken to renegotiate contract is often unpredictable. Governments have strict guidelines and laws that have to be followed based on a certain prescribed bureaucracies and hierarchies which often limit the performance of such contracts. Government departments and ministries are usually held by individuals with political affiliations who can influence the performance of a given private public partnership. This might cause “holding up” of some projects and their being undertaken by a private developer (Harper and Stein, 2003).

Consequently, once projects have been successfully completed by a private partner, the government may decide not to honor the terms and conditions of the contract and forcefully take control of the returns without compensating the private partner (Savas, 2000). It is important to set clear guidelines and regulations that can govern a private public partnership. This is the only way to ensure that both parties in a private public partnership are protected. This has been rampant in cases where governments are controlled by powerful persons who do not obey set rules and regulations. Therefore, a private entity operating in such countries may lose a lot of funds borrowed from other private entities, thereby subjecting it to debt crisis.

2.3.4 Reduced competitiveness

Porter (1995) predicted that private public partnerships often lead to reduced competiveness in service provision. Private sector entities are known for quality service delivery. However, according to Bond (2003), high quality may not be offered when government tenders are costly and involve favoritism of preferred contractors. Therefore, a private and public partnership offers potential benefits that can help bring about change in the provision of public goods and services. However, as Hemson (1998) asserted, the weakness of private public partnerships remain a challenge to full adoption of such engagements in many countries.

A research carried out by Harding (1990) identified that public private partnership often involves higher costs that are too risky to both parties. Beckett (1998) asserted that most governments have a bigger share in acquisition of loans. This is due to the fact that a loan advanced to the government will involve lower interest rates. Governments have power to influence other institutions to support their investment activities. However, Fowler (1997) claimed that it is quite difficult for a private developer to secure a loan, since they are perceived to be riskier than governments.

2.3.5 Higher costs

Plummer (1990) also noted that the high costs involved in private public partnership due to longer time involved in the negotiation of tenders. In most cases, a tender tends to cost higher prices, and therefore investors intending to enter into a private public partnership have to pay higher amounts to secure such contracts. This might in turn limit participation of private developers in public projects. Plummer (2000) further inferred that private public partnership are complicated and involves a lengthy period to negotiate and agree on a common course of action. The complexity of private public partnership limits the performance of the partners, especially the private sector. Innes and Booker (2002) argued that the nature of a public private partnership limits the ability of the party to discharge their mandates. For instance, public projects involve numerous rules and procedures, which impede faster delivery of services.

2.3.6 Creation of Monopoly

Harding (1990), argued that where a government project is transferred to a private entity, there could be cases of monopoly, which reduces efficiency and effectiveness in service delivery. Some private companies have been known to offer high-quality services with greater innovation and creativity. However, these entities may turn out to be ineffective and inefficient once they engage into a private public partnership. This is because public entities are monopoly-based and will always strive to maintain the status quo. Such engagement, as described by Bailey (1995), may not be entered into by private entities. Other researchers have also underscored that private entities are known to be productive and competent, unlike public entities, hence engaging into a private public partnership reduces efficiency of their performance.

2.4 Conclusion

To summarize, it is relative to note that PPPs have emerged at a time when most governments are struggling with crippling economies. This is because private developers are contracted to supplement government efforts in provision of public goods and services. These partnerships have been found by several researchers to contain certain fundamental benefits such as risk sharing, capital availability, and growth of private sector enterprises among others. However, other researchers also established that PPPs have some unavoidable challenges, which face both parties involved in such contracts. Therefore any party seeking to enter into a PPP contract should consider that benefits and risks involved before entering into the contract.

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