Public Financing Model Through Long-Term Contractual Agreements for Public-Private Partnership Projects

Septi Wulandari* & Esa Septian
Prodi Administrasi Publik, Fakultas Ilmu Sosial dan Ilmu Politik, Universitas Bojonegoro, Indonesia

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Abstract

This research aims to analyze alternative models of public financing in the Public-Private Partnership (PPP) scheme involving the government and the corporate sector. This research utilizes a qualitative research method with a content analysis data collection methodology to examine the limitations and shortcomings of PPPs. The findings of this study indicate that Public-Private Partnerships (PPPs) have shown a persistent pattern of failure, leading to continuous renegotiation between the government and the private sector. The implementation of PPPs carries risks that can lead to a loss of public oversight of PPP initiatives. The government's lack of experience in making judgments that can carry political risk also plays a role. The PPP model sets a higher cost of capital, which causes the private sector to charge higher tariffs to customers, possibly resulting in a monopoly by private companies. PPPs have imposed a burden on the state and faced opposition to privatization due to a lack of understanding among parties involved in state-owned enterprises (SOEs). The government lacks transparency in decision-making regarding privatization and fails to provide adequate information to stakeholders involved in SOE privatization. Government decision-making on privatization lacks transparency and does not follow established processes and procedures.

Keywords: Public-Private Partnerships; Privatization; State-Owned Enterprises

INTRODUCTION

Public-Private Partnership (PPP) initiatives include the private sector in funding and delivering public services, especially in infrastructure projects. Reynaers & Graaf (2014), state that PPP is a manifestation of the New Public Management (NPM) concept. PPP transfers the duty of designing and providing public services to the private sector through extended contracts. The private sector is advantageous due to its operation of profit-driven and efficient businesses (Ao, 2018). PPP projects are commonly structured as design-build-finance-operate (DBFO) arrangements. The government outlines the required services for the private sector in a plan. The private partner then designs and constructs an asset specifically for those services, funds the development, and operates the asset to provide the services it generates. PPP is currently being implemented in Korea, the Philippines, Singapore, and Japan. However, progress in other Asian countries like India, Indonesia, and Thailand has been sluggish despite their significant interest in PPP. South Africa, a prominent country in the region, has initiated or is in the process of establishing Public-Private Partnerships in various sectors (Greve & Hodge, 2022).

The private sector has come to provide a new color for the public financing sector, especially those oriented toward infrastructure development. PPPs attempt to transform the public sector into a profit-oriented enterprise, incorporating economics into public service delivery to ensure high productivity. In the private sector’s focus on profit maximization, private involvement has a detrimental impact on the consensus provided by the government. The adoption of the private sector ignores the fundamental differences with the public sector. The private sector is under the control of managers who focus on customer satisfaction. The private sector will be more likely to monopolize public services that are not based on the aspirations of the community and away from the practice of democratic values that should be inherent in the public sector (Mahmudi, 2003).

The private sector has its advantages in managing profit-oriented businesses. In the private sector’s focus on seeking maximum profit, private involvement hurts the consensus provided by the government. The private sector is more likely to control public services that are not based on public aspirations and are far from practicing democratic values. PPP tend to be more expensive than public procurement by the government. PPP have been criticized in practice because the partnerships are often not in line with public aspirations and reduce the role of the public in the policy process. This is based on the complexity of the actors involved leading to dominating vested interests (Ginsburg, 2008). PPP has undergone several transformations in its evolution as a cooperation scheme based on the following criteria: 1) risk allocation between partners; 2) participation and capacity of each partner as stipulated in the agreement; and 3) possible consequences of the quality of services provided. Conversely, a reduction in government involvement goes hand in hand with an increase in the magnitude of potential risks being transferred to the private sector. For example, the government will bear the greatest risk in the operations and maintenance category (Rifai, 2016).

According to Levai (2012), poorly constructed PPP contractual agreements will result in a decline in service quality, inefficient service delivery, or a lack of suitable measures to preserve public utilities. According to research by Brogaard (2021), however, innovation in PPP does not result in products but rather in incremental cost savings. A case study in the Netherlands of the creation and deployment of new technologies that changed labor-intensive and manual business-to-government reporting into efficient electronic operations. The private sector is still looking for a return on a very long investment made over a 15-30-year period. Long-term PPP contracts limit the government’s capacity to adjust to change. According to Ross & Yan (2015), infrastructure projects are complex, with cost overruns and delays that result in additional government costs.

It is a cooperative system intended to finance the construction of toll roads, port bridges, and other substantial government infrastructure projects. The case study about the construction of a toll road in Batangas, Philippines serves to underscore the criticality of value capture. Value capture, which considers the period preceding user demand, necessitates a long-term approach (Asian Development Bank, 2021). Although public-
private partnership (PPP) implementation practices are often hailed as an optimal substitute for public provision, they encounter a range of challenges and tensions, including institutionalization, contract design, wastage, inadequate regulation, poor governance, and unrealistic expectations. PPP has been erroneously regarded by governments as a viable financing model that does not result in the accumulation of public debt. According to research by Sharma et al., (2014), PPP has emerged as a new challenge for the government. Difficulties have emerged in the implementation of PPP due to the contract's initial design, while the protracted duration of PPP has engendered a whirlwind of technological, commercial, and demographic transformations.

The lengthy contractual agreements and the numerous stakeholders involved have rendered PPP challenging at best or caused their termination at worst, according to (Lee et al., 2018). An escalation in tensions among contracting parties has compelled the termination of agreements since the early 1980s. PPP contract documents are incapable of foreseeing emergent issues (The World Bank, 2022). It is challenging to identify every contingency during project development. Emerging risks associated with PPP initiatives can compromise the interests of the private sector, the government, and the various stakeholders engaged in the PPP endeavor. The examination of PPP financing models and projects that incur losses to deliver public services is a compelling subject for further investigation.

RESULTS AND DISCUSSION
Public Financing Model in long-term agreements

The PPP financing model has been applied in many countries, especially developed countries, but PPP still makes a small contribution to infrastructure projects. According to Hall (2015), public finance financing is still the dominant model worldwide, providing more than 90% of the investment in infrastructure projects, which is still minimal. PPP has been promoted in Indonesia for 20 years in the electricity sector with a series of contracts signed in the 1990s. Indonesia's current plan assumes that the private sector will provide 51% of the financing for infrastructure investment, but this remains unrealistic. In the past 15 years, despite heavy promotion by the World Bank and others, the proportion of privately financed infrastructure has fallen to just 10%. The Private Participation in Infrastructure database shows PPP failures including stating that 259 PPP projects in developing countries around the world have been canceled, and 67 have run into difficulties, out of 6,273 PPP projects from 1991 to 2015. However, only 216 projects were completed during the period. The cancellation of PPP projects is of great concern, especially in developing countries facing fiscal constraints (Lee et al., 2018). Failure of PPP projects as an image that PPP cannot work well.

Long-term contracts have also led to ongoing negotiations between the government and the business sector. Renegotiation is still a phenomenon in some less developed nations, such as Latin America and the Caribbean, where projects are abandoned due to the incapacity of the private (or public) sector to meet contractual obligations (Lee et al., 2018).
The benefits of PPP contracts for the public and commercial sectors are being lowered in the renegotiation processes (PPIAF, 2018). According to Fouad et al. (2021), contract renegotiation favors the private sector and reduces the effectiveness of PPP. Although PPP procurement is meant to be competitive, renegotiations are typically held without competitive pressure. Poor negotiation skills frequently contribute to the government’s weak bargaining power, resulting in a loss of efficiency in the PPP project.

**High risk transfer and financing**

PPP projects need to address the nature of risk transfer between the public and private sector in a mutual agreement in a long-term contract. The risk of implementing PPP will result in the loss of public control in overseeing the PPP project. It is also influenced by the government’s inexperience in making decisions that may pose political risks. PPP projects will hamper the government’s capacity to deliver innovation, efficiency, and low prices because it is always dependent on the private sector (Levai, 2012). The government needs to address the risks of budget constraints, low transaction flows, and other factors. Construction, operational and commercial risks (Beckers & Stegemann, 2021).

In managing PPP projects, the government needs to be proficient in risk management including unpredictable risks. This key difference in risk management between the public and private sectors leads to misalignment in PPP resulting in sub-optimal outcomes. The consequences of risk are different for each party, so the sensitivity to risk is also different. For example, the South Korean government had to lower tolls and pay compensation on some highways in a PPP project when the public felt aggrieved because the costs were beyond their means as road users (Fouad et al., 2021). Furthermore, explained that the costs involved in PPP financing are higher than traditional investment financing. The reasons why PPP financing is so high are:

a. Lack of government access to low-cost financing
b. Financial risks depend on the specific risks of a project and company, while the government can pool risks from many projects and support from its taxpayers.

c. Paying higher financing costs is not a problem if those costs are more than compensated by the private sector’s ability to manage the project and its risks and deliver high quality services to users but this is difficult to realize.

d. Funding costs may also be too high if the contract allocates risk to the private sector or tends if the contract does not include satisfactory requirements regarding the bidder’s financial qualifications.

During the contract period, active PPP projects involve higher public expenditure than conventional projects. This is because capital costs are higher and the private sector charges higher prices to users due to the monopoly of private companies (Hall, 2015). Projects that do not meet expectations can be subject to public criticism from governments, news media, user groups, and civil society. A 2006 report by the European Investment Bank (EIB) reviewed the costs of 227 road projects in 15 European countries and concluded that projects undertaken through PPP (out of a total of 65) were 24 percent more expensive than those undertaken through public procurement (Leigland, 2018). It is difficult to identify all possible contingencies during project development and events and issues that may arise that were not anticipated in the documents or by the parties at the time of contracting.

To account for these contingencies, the parties will most likely need to modify the contract. Some projects may also fail or be terminated before the projected project term for a variety of reasons, including changes in government policy, failure of private or government operators to perform their obligations, or external circumstances such as force majeure (The World Bank, 2022). Renegotiation is still a phenomenon in some less developed nations, such as Latin America and the Caribbean, when projects are abandoned due to the incapacity of private (or public) parties to meet contractual responsibilities (Lee et al., 2018). Cost overruns, delays, and governments failing to capitalize on the underlying benefits of engaging private sector stakeholders continue...
to plague PPP project financing. These include the ability to identify, price, and manage specific risks (Beckers & Stegemann, 2021).

Privatization of public services

Transparency refers to the availability and access to information on costs, agreements, and performance of public service delivery. The level of transparency will decrease in PPP because of the neglect of the oversight role and the absence of involvement of public officials. Bloomfi argues that contractual partnerships are particularly vulnerable to transparency issues due to their long-term financial structure (Reynaers & Graaf, 2014). There is thus a lack of oversight as private companies can hide a lot of information based on commercial confidentiality. In Egypt, and many other countries, one of the reasons why PPP and other forms of privatization are not popular with many people is because of the perceived secrecy and partisanship of the parties involved.

Privatization is an attempt by the government to transfer some or all the assets or shares of state-owned companies to private parties. In a broad view, privatization refers to the reduction of the government's role in market competition. According to Nugroho & Wrihatnolo (2008), privatization in the sense of management increases the efficiency of resource management and performance. Privatization has been intensified by the Indonesian government since 1997 after the economic crisis. The Indonesian government's policy of privatization focuses on National Owned Enterprises (SOEs) in contributing to state revenues and creating independence of domestic products. The privatization of SOEs received mixed responses from various groups. This view is a form of improving public services in Indonesia and views privatization as a step that is feared, especially towards guaranteeing the interests of the community. The contribution of SOEs in improving economic growth and community welfare is still minimal and some cases that occur in SOEs experience unhealthy performance conditions and experience losses for the state.

The privatization procedure posed various challenges for the government. Opposition to the privatization of SOEs by the public, SOEs employees, and several stakeholders including SOEs directors, local governments, and the DPR. Certain factions opposed privatization of SOEs because (1) privatization was detrimental to the state, (2) privatization to foreigners was considered unnationalist, and (3) there was no evidence of benefits derived from privatization (Maro’ah, 2008). Mahmuddin Yasin (Jubaedah, 2007), who also sought to reform SOEs, identified three main obstacles to transforming SOEs in Indonesia as follows:

a. The inability of the capital market to support the privatization of many SOEs through initial public offerings due to limited foreign portfolio investment flows and domestic funds.

b. Limited background in overseeing comprehensive SOEs reform initiatives. Considerable time is required to staff, plan, and operate the new regulatory body.

c. Thorough socialization of stakeholders, including management and staff, is required due to a lack of common understanding of SOEs reform initiatives.

One of the strategies used by the government is to address the specific challenges faced by privatized SOEs to establish systems and procedures. Due to a lack of understanding on the part of those associated with the SOEs to be privatized about aspects of the SOEs privatization process, resistance to privatization is common. However, the government’s decision-making process regarding privatization is not transparent and does not involve relevant parties in the socialization process of the SOEs to be privatized. Lack of transparency and the absence of well-defined systems and procedures are attributes of government decision-making regarding the privatization process (Yusroni & Restiyanto, 2007). On the Labornotes.org (2013), there is a case of rejection of the PPP project in the country of El Salvador, which is about to issue a PPP law. However, this was criticized by the public, there was a massive campaign: “On May Day 2012 more than 80,000 workers, students, indigenous people, feminists, and social movement activists marched under banners that read "No More Privatizations, No to Public Private Partnerships with Thieves" as follows:
PPP projects are detrimental to the country and a den of thieves exploiting the resources owned by the country. The dangers of PPP have come under scrutiny for corrupt practices. El Salvador's attorney general has charged 21 former government officials and members of the Salvadoran business elite with embezzlement and falsifying documents in a deal for a public-private partnership (PPP) contract that won Italian energy company Enel Green Power a takeover of the country's geothermal energy company. The case marked one of the largest corruption investigations ever conducted against former government officials in the country's history; the Attorney General has calculated state losses of $1,824,929.05 because of the state contract with Enel (Hall, 2015). The presence of the private sector in government projects will result in more and more government functions being privatized. Thus, patronage rights (privileges) for relatives, friends, and family will emerge as a form of Corruption, Collusion, and Nepotism (KKN) practices that harm the state.

CONCLUSION
Implementing PPP has a significant drawback for the government. The long-term contract agreement between the government and the private sector has caused conflicts of interest among the parties concerned. PPP projects are impractical, expensive, and of worse quality due to frequent corruption cases. When this occurs, it results in rejection from different groups like laborers, students, and public service users because of projects that fail to satisfy public expectations. The finance approach presents a significant risk that could jeopardize the PPP project and ultimately result in project failure. Renegotiation of a project leads to decreased cost efficiency, ambiguous risk management structure, inflation of project costs resulting in increased expenses, and instances of corruption in PPP projects. PPP projects require government governance to be prepared to conduct planning, monitoring, and evaluation operations.

Implement best practices to enhance the value and sustainability of the company by these guidelines. Transparency involves conducting decision-making processes openly and honestly and disclosing relevant and material information about the organization. The development of accounting systems based on accounting standards and best practices, advances in information technology and information management, and the development of enterprise risk management all contribute to the implementation of this principle. Accountability relates to the clarity of functions, execution, and responsibilities of organs to facilitate the efficient operation of the organization through the preparation of timely financial reports, the establishment of Audit and Risk Committees, and the formulation and development of the Internal Audit function and role. Accountability is the adherence of the organization's management to applicable laws, regulations, and corporate standards. This principle is manifested in the form of maintaining a healthy business environment, adherence to ethics always, professionalism, and awareness of the responsibilities arising from a position or positions that have authority.

Efforts to accelerate government development, especially in infrastructure projects through public financing, namely investment and encourage the improvement of the capabilities of public sector organizations. This provides benefits related to flexibility, control, and efficiency. Thus, the government can respond to changes in needs or technology and relatively low costs. PPP projects as an alternative financing model need to be supported by institutions, risk management, and clear regulations. However, it is necessary to anticipate weaknesses that can jeopardize a project in serving the public, so that PPP has access and sustainability of prospective projects and has a positive impact for the future. Future research can look at the impact of PPP on the utilization of public resources at large and the challenges in implementing the model.
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