

Public Private Partnership in Development: Lessons in Devising Legal and Institutional Framework from South Korea

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Abstract

Public Private Partnership (PPP) is collaboration between public and private sectors in public service delivery as an alternative solution to the ever-increasing challenges in public service delivery. The success of implementing PPP around the world has been an attractive alternative for procuring public service works to the private sector. Establishing an enabling legal and institutional environment is the basic precondition to establish PPP arrangement in the development process. Accordingly, this study focuses on assessing international best practices as to how rapidly developing countries involve the private sector in their respective development process. This study takes the case of South Korea. Document review method was employed to assess how South Korea institutionalized PPP as part of its development strategy. Some selected government policy-documents, book chapters and articles are collected and consulted to finalize this study. The findings of this study reveal that the legal and institutional systems organized in South Korea are well established. Act on PPP and its Enforcement Decree constitute the major legal framework. Agencies like Ministry of Strategy and finance (MOSF) and Private Infrastructure Investment Management Center (PIMAC) represent institutional frameworks that can be taken as best practice for developing countries. Though most special government support schemes are introduced, some of the components, such as Minimum Revenue Guarantee (MRG) and allowing public property to private partners to use it free of charge, may be adopted with its appropriate controlling mechanisms. Hence, getting lessons from the experiences of South Korea with careful investigation of specific issues and contextualization of objective conditions in developing countries is warranted.

KEY WORDS: *Public, Private, Partnership, legal framework, institutional framework, development, PPP*

1. Introduction

The latter half of the 1990s witnessed a growing number of initiatives involving collaboration between the private and public sectors with the purpose of overcoming public service challenges (Keyter, 2009). Among these challenges, limited financial resources available to the public sector for financing development activities have prompted countries in Asia, Africa, Europe and North, Central and South America to use private investment as a promising alternative (Nyagwachi, 2008, Cheung, 2009, & Binza, 2009). The success of implementing PPP in different countries around the world has been an attractive alternative for procuring public service works instead of the usual traditional methods (Cheung, 2009 & Petersen, 2011). Public Private Partnership (PPP) is not only a mechanism meant to mitigate public service delivery challenges, but also an emerging solution for a new development arrangement. In this regard, Brinkerhoff (2001) asserts that as 'PPP maximizes benefits for development through collaboration' PPP consequently enhances efficiency. Thus PPP can be 'conceived as a very important method of promoting development' and 'a tool for development' (Binza, 2009).

In line with this argument, Urio (2010) further elaborates on the importance of integrating PPP into the development strategy of developing countries. Accordingly the major goal of integrating PPP in the development strategy is to build a society that improves the attainment of the four values, namely – efficiency, equity, sustainability and security (Urio, 2010). That is to mean, 'an economy developing with a level of efficiency compatible with a sustainable pace, human activities (both private and public) organized and coordinated in a way that preserves the environment, and more particularly scarce and non-renewable natural resources, organized in a way that realizes a balanced society with a reasonable, acceptable, and improving level of equity, and security' (Urio, 2010).

Moreover, Ngowi (2006) explains that the use of PPP in production and distribution of some goods and services is 'inevitable for attainment of sustainable development'. Hence, there is a need to forge and promote strong, efficient, effective, sustainable, dynamic and vibrant PPP (Jutting, 1999), so that the public and the private sectors can participate in the process of development.

This being the major conceptual direction of the study, assessing the international experience, as to how successful governments in their respective countries have managed to attract the private sector in the

development process has become an imperative, in view of harnessing the existing potential of the private sector for the attainment of the ever sought objectives of developing countries like Ethiopia – to register fast development and alleviate poverty.

Hence, the purpose of this study is to answer one of the research questions of ongoing PhD dissertation study in PPP policy area. The research question addressed in this study is -What is the international best practice in involving PPP in development process, in particular reference to the experience of South Korea? Republic of South Korea is selected by the researcher purposely due to its tremendous success in involving the private sector in its infrastructure development projects. The study employed exploratory study using document review method following the review protocol designed for the main dissertation study. The guideline which is devised to identify best practices of the international experience requires the assessment of – legal and institutional framework for PPP, availability of specific rules and regulations dedicated to PPP, availability of special public agency with a mandate for PPP activities, PPP procurement methods and selected areas of intervention, and actual contributions of PPP for economic and social development.

On the basis of the document review protocol, data sources pertaining to the case of South Korea i.e., relevant government policy documents, articles published in scientific journals, relevant books and book chapters, appropriate official websites are collected and/or consulted to undertake this study. The organization of the study is compiled into four parts. The first part discusses the enabling legal and institutional framework of PPP, the second one focuses on procurement methods and sectors of PPP interventions in the country's development process, the third one compiles special government support schemes, and the fourth part is devoted to the contributions of PPP for social and economic development. Finally, a conclusion summarizes the lessons learned from the experiences of South Korea.

2. Enabling Legal and Institutional Framework

South Korea has achieved one of the fastest economic and social development in the last five decades. The per capita income grew from 1,342 USD in 1960 to 19,227 USD in 2008 and in the same period, life expectancy rose from 52.4 years to 79.6 years (Sakong and Youngsun, 2010). The achievement made, described as 'miracle', is attributed mainly to the role that government played in mobilizing the public and private resources towards the need of the country. Though the interpretations provided by different authors about the role of government – as market friendly or developmental state - is varying (Kim, 2011a), the fact that all sectors were relatively involved in the development process to their level best may be taken as one of the indicators for the prevalence of high level of commitment from the side of government. Among other things, creating an enabling legal and institutional framework, particularly to attract the private sector to involve in implementation of development projects in partnership with the public sector can be taken as one of the major steps forward. In light of this, an assessment of legal and institutional framework of PPP devised and implemented in South Korea is described and discussed in the following part of this study.

2.1. Legal Framework

After some years of fast economic growth, at the beginning of the 1990s, the Republic of Korea began to experience a serious shortage of infrastructure facilities, like that of roads, railways, airports etc. The incumbent government being aware of its inability to finance the required projects in need of infrastructure had come to recognize the potential of the private sector to work with the public sector as an alternative means of replenishing infrastructure. Then in view of inducing the private sector to participate in construction of infrastructure facilities, the government began to push for PPP projects in August 1994 by enactment of the Act on Promotion of Private Capital Investment in Social Overhead Capital (SOC) (Kim et al, 2011b). As the 'infrastructure gap' was regarded as a bottleneck for economic growth, the PPP system along with transport tax was introduced by August 1994 Act (Park, 2012).

The intention of government to involve the significant potential of the private sector in infrastructure development was not successful in the sense that by that particular time the private sector was not financially able to be involved as it was expected due to the financial crisis that hit the Republic of Korea in late 1997 (Yescombe, 2007). However, later on the government took an action dubbed 'an across the board amendment' and formally called the Act on Private Participation in Infrastructure, in December 1998 (Kim et al, 2011a) with an intention of supporting the private sector, so that it could be more encouraged to get involved in the development process of the country in collaboration with concerned government entities. Accordingly, the amendment aimed at 'reinvigorating PPPs through various government supports, including the minimum revenue guarantee (MRG)¹. As a result of this Act, private parties were encouraged to develop projects in their interest area (Unsolicited PPP Projects) to secure bonus points in the process of bidding (Park, 2012).

In view of expanding the scope of participation in PPP financing and diversifying opportunities, government modified this law again in January 2005 (Yescombe, 2007). As a result of this modification, range of facilities

expanded from economic infrastructure such as transport facilities like roads, railways, seaports, and environmental facilities to social infrastructure, such as schools, military residences, housing and welfare facilities for the aged, and cultural facilities (Kim et al, 2011a).

The PPP Act and the Enforcement Decree are the principal components of the legal framework for PPP. It is stated in the first article of the Act that its purpose is ‘to contribute to the development of the national economy by encouraging the creative and efficient expansion and operation of infrastructure, by promoting the investment of the private sector in such infrastructure’ (PPP Act art (1) 2005). Among other issues regarding PPP projects, eligible infrastructure types, procurement types, procurement processes, the roles of the public and private parties, government policy supports etc, are clearly defined in the Act (Park, 2012). Enforcement Decree of PPP Act on infrastructure, which is instrumental for full implementation of PPP Act, declares from the outset that its major purpose is, ‘to prescribe matters delegated by the Act on PPPs in Infrastructure and those necessary for the enforcement thereof’ (Article 1 of the Enforcement Decree)².

The hierarchy of the legal arrangements for PPP is - PPP Act, PPP Enforcement Decree, PPP Basic Plan, and PPP Implementation Guidelines. It is clearly stipulated that PPP Basic Plan in which PPP policy directions, PPP project implementation procedures, financing options, risk allocation mechanisms, payment schemes for government subsidies etc, are clearly stated saying that these shall be prepared by government agencies, Ministry of Strategy and Finance (MOSF) and Private Infrastructure Investment Management Center (PIMAC) (Kim et al, 2011a).

PPP Implementation Guidelines, which is also part of the legal framework developed by PIMAC based on the PPP Act, improves transparency and objectivity in PPP implementation (Park, 2012 & Kim et al 2011b).

Generally, the review of appropriate documents in this regard shows that, the South Korean government was so inquisitive and curious about rules and regulations regarding PPP in its system of development or economic management. This can be witnessed by the continuous actions of government in amending the existing regulations and formulation of the new one. For instance, 5 amendments were made in 1999; 4 in 2002, 3 in 2003, 2 in 2004, 6 in 2005, 2 in 2006, 8 in 2007, 6 in 2008, 7 in 2009, 4 in 2010 and 6 in 2011⁶. Hence, the government has made presumably more than 50 legal amendments within a decade of time.

Therefore, the continuous development and amendment of appropriate rules and regulations, establishing, and as well as empowering PPP dedicated institutions demonstrates the earnest commitment of South Korean government in involving the private sector in the overall development process of the country employing PPP arrangement as a major significant tool.

2.2. Institutional Framework

The legal framework specifies the major institutions in the PPP program. The list includes the MOSF and the concerned line ministries. The MOSF is responsible for implementing the PPP Act, PPP Enforcement Decree, and PPP Basic Plan. It is also in charge of preparing the draft budget for PPPs as well. PPP Review Committee (PRC) that considers PPP issues related to the establishment of major PPP policies, vital decisions in the process of launching mega scale PPP projects is organized and managed by the MOSF. The PPP Act describes the membership of the committee. Accordingly the Minister of Finance and Strategy is designated as a chairperson, line ministries in charge of implementing PPP projects and experts from the private sector are included as members (Kim et al, 2011b).

PIMAC is an affiliated body of Korea Development Institute (KDI) that was established as a merger of PIMA (Public Investment Management Center- founded in Jan 2000) and PICKO (Private Infrastructure Investment Center of Korea) by the second amendment of ‘The PPP Act’ in January 2005. Article 23-1 of the PPP Act stipulates the rationale for the establishment of PIMAC as follows: For comprehensive support of PPP as prescribed by the Presidential Decree, such as the review of Solicited Projects, analysis of project feasibility, and evaluation of the project proposals and other matters, the Public and Private Infrastructure Investment Management Center for Infrastructure Facilities is to be established within the Korea Development Institute established under the Act on the Establishment, Operation and Fostering of Government-funded Research Institutions⁷.

According to the Article 20-1 of the Enforcement Decree of the PPP Act, the roles and responsibilities of PIMAC are: support for work relating to the formulation of the Basic Plan; support for work regarding the formulation of the Request for Proposals as stipulated in the PPP Act; support for work regarding the designation

⁷ For the detailed description of this point please see Article 23 (1) of PPP Act January 2005.

of the concessionaire such as review and assessment of the project proposal, and conclusion of the concession agreement; review and assessment of the project proposal by a party in the private sector; processing various applications for such matters as the approval and permission regarding PPP projects for other organizations; support services for foreign private investors such as investment consultation and other activities to induce foreign investment to PPP projects; review of potential PPP projects and feasibility studies thereof; development and operation of capacity building programs related to the implementation of PPP projects; improvement of private investment systems and research of related fields; finding potential PPP projects and support for work related thereto; and other work related to the implementation of PPP Projects (Park, 2012).

2.3. Implementation Procedure

The PPP implementation procedure is designed to secure accountability and conformity of PPP projects with the national infrastructure investment plans and policies, the PPP Act requires the MOSF and the PPP Review Committee (PRC) to deliberate on whether large PPP projects can be implemented as PPP projects before going to the next procurement step (Kim et al, 2011a).

Generally, the PPP Act and the PPP Enforcement Decree regulate general procurement procedures for PPP projects. The PPP Basic Plan formulated under the PPP Act provides detailed implementation processes by project types and initiation and defines the roles of associated parties, such as competent authority, private company, the MOSF, line ministries, and PIMAC for each step in the process (Kim et al, 2011a).

An assessment of a potential project is carried out to ensure value for money (VFM) of PPP procurement in comparison with traditional public procurement during the planning stage. Then competitive bidding is a mandatory step in the process of selecting potential projects in all cases. This is believed to improve VFM of the bidding projects by stimulating the proponents to focus on better service quality and reduced project costs (Kim et al, 2011a). The procedure gives higher attention to secure accountability and conformity of PPP projects with the national infrastructure investment plans and policies. A detailed and clearly organized, standard guidelines of PPP implementation procedure is developed and updated from time to time by PIMAC. In addition, PIMAC undertakes activities related with PPP implementation, such as performing a VFM study and formulating a request for proposals (RFP) and a PPP contractual agreement, to facilitate the procurement process and enhance consistency (MOSF, 2012).

In general terms, the PPP tender process as the major stage of PPP implementation procedure follows seven key steps, namely: designation of the PPP project, announcement of RFP, submission of proposals, bid evaluation and selection of preferred bidder, negotiation and contract award, approval of detailed engineering and design plan for implementation, and construction and operation (Kim and Jungwork, 2011).

3. Procurement Methods and Sectors of PPP Interventions

In relation to procurement initiation, MOSF (2011) prescribes that it could be initiated from the two categories of PPP projects, i.e., solicited and unsolicited, depending on who initiates the project. A solicited project is initiated by a competent authority, either a line- ministry or local government that identifies a potential PPP project and calls for proposals from the private sector. Where as in the case of an unsolicited project, the private sector identifies a potential PPP project and proactively requests a concerned authority to undertake the project as a PPP, as per the existing relevant regulation (Kim and Jungwork, 2011). In both cases, the concessionaire or the private partner in the PPP contract is selected under a competitive bidding process. However, the initial proposer of unsolicited project may be given extra points, as an incentive for the proactive move, in the bid evaluation process (MOSF, 2011).

The PPP Act and its Enforcement Act prescribing eligible procurement methods are divided into build-transfer-operate (BTO) and build-transfer-lease (BTL), depending on the structure of the PPP project. Other procurement methods, such as build-own-operate (BOO and build-operate-transfer (BOT), are accepted as well.

In the case of BTO, the ownership of the infrastructure facilities is transferred to the government upon completion of construction. The private partner is granted the right to operate facility and get profit out of it. The private partner is entitled to recover its investment cost from user fees. Because of this financial feasibility could be taken as a key element for implementing BTO projects on the part of the concessionaire.

The majority of BTO projects in South Korea are engaged in transport facilities such as roads, railways, and seaports (Kim and Jungwork, 2011).

Ownership of the infrastructure facilities constructed by BTL method is transferred to the government upon completion of construction. The private partner is offered the right to operate the facility and receive government payments, known as lease payment in fact on the basis of operational performance. This type of PPP arrangement is applied for those investment areas that are not commercially viable for the concessionaire. BTL is most commonly adopted PPP method for Social Infrastructure, such as schools, welfare facilities, environmental facilities, and military residence, among others (MOSF, 2011).

The PPP Act in infrastructure that was modified in 2005 clearly specifies 48 infrastructure facility types in 15 sectors that are eligible for PPP procurement. It seems the aim of government, in specifying eligible facility types and sectors in the Act, is to stimulate private capital to invest in the highly needed development areas where additional investment is needed for the benefit of the public. What is interesting in this regard is that the government consistently modifies and updates the list of eligible sectors and also other provisions of the Act from time to time as deemed necessary presumably following the need of the national economy.³

4. Special Government Support Schemes

The overall literature review finding reveals that the government of South Korea is highly committed to implementing PPP and to enhance its contribution in development most particularly in infrastructure development of the country. It employed numerous mechanisms to provide support to PPP projects. These among others include the following: Through land acquisition by the concessionaire and granting land expropriation rights to the concessionaire, national or public property in designated areas may be sold to the concessionaire and concessionaires are allowed to use national or public property without charge or at a lower price (Kim et al, 2011a).

The government may grant construction subsidies to the private partner if it is necessary to maintain the user fee at a reasonable level, and provide tax incentives with exemption from acquisition and registration taxes on real estate for BTO projects, exemption from value-added tax on construction services, and tax reduction for infrastructure bond (Park, 2012).

With the MRG a certain fraction of projected annual revenues may be guaranteed when the actual operating revenue falls considerably short of the projected revenue prescribed in the contract. Although it was abolished in October 2009, it is still applicable to projects with concession agreements already completed (Kim et al, 2011b).

Through a newly introduced risk-sharing structure, the government pays the amount of shortfall when the actual operation revenue is less than the level of risk-sharing revenue. When actual operation revenue exceeds the risk sharing revenue, government subsidies are redeemed on the basis of realized payments (Park, 2012).

Through the Social Overhead Capital Credit Guarantee Fund, credit guarantees for PPP project financing are provided to enhance the timely payment of debt service. In addition to these, buyout options are allowed and prepared for force majeure and specific events (Park, 2012).

Generally, the holistic system of government support scheme established for private partners seems convincingly more than sufficient to mobilize the potentials of the private sector into overall development process.

5. Contribution of PPP for Economic Development

According to Kim et al (2011a), South Korea has secured its position as the front-runner among Asian countries in the use of the public-private partnership (PPP) system as well as implementing and managing PPP projects.

Involving PPP projects in the development process is expected to have positive impact on the national economy. According to Kim et al (2011b), this can be explained through three channels: economic growth resulting from the inflow of private capital, increased social welfare resulting from the timely delivery of social services and the early realization of social benefits, and reduction in the government's fiscal burdens through better VFM.

In light of this private financial resources of more than Won20 trillion (won is Korean currency) had been invested through PPP projects, resulting in estimated GDP growth of 0.198% based on the 2008 standard

price in South Korea (Kim et al, 2011b). It is recognized that the early realization of social benefits worth about W1.45 trillion was obtained as a result of implementing 14 road projects 2 years ahead of schedule (Kim et al, 2011a). The obtained benefit makes sense when we compare it with the fact that, the completion and operation would likely have been delayed, if the 14 PPP road projects had been implemented with government financing alone. Thus, PPP projects have made the early realization of social benefit possible.

Another notable contribution of PPP projects is related to VFM. With regard to this, according to Kim and Jungwork (2011), VFM enhancement from 66 BTO projects was estimated to reach about W891 billion, while VFM from 30 BTL projects was estimated to be W89.6 billion. In the case of BTO projects, it was estimated to have secured an additional ex-post VFM worth W142.5 billion from the selected 11 projects. The analysis of BTL projects found that they were reducing both cost and time overruns, which worked to enhance the efficiency of investment in social infrastructure facilities. In the case of BTL projects, the total project cost was reduced by 10.18% and the construction period shortened by 8.04%, resulting in an advantage over government-financed projects in terms of efficiency. In general, the above-mentioned evidences show that contributions of PPP projects for national economy could not be undermined. Here we can see that there was significant number of new jobs created as a result of implementing PPP projects throughout the country.

6. Conclusion

The literature review made and discussed on some selected areas of PPP reveals that, the government of the Republic of Korea has given significantly higher attention to the collaborative effort of the public and private sectors in bridging the gap created as a result of limited capacity of the public sector to address the ever-increasing public demand. The role played by the committed South Korean government in creating a well-organized system of enabling environment particularly in the legal and institutional framework is extraordinary. The South Korean PPP experience can thus be considered best practice for the benefit of other developing countries. Institutionalizing PPP dedicated legal regime such as Act on PPP and its enforcement decree with all supporting sector-based rules, regulations and directives, establishing and empowering PPP dedicated government agencies like MOSF and PIMAC with all supporting collaborative committees and PPP units are lessons that can be readily contextualized in other developing countries like Ethiopia.

Even though the special government support scheme established and applied appeared to be affordable in the context of South Korea, some of its components such as MRG, allowing private entities to use public property free of charge, should be seen with great care and caution when it comes to the context of developing countries. In this regard, two points need to be considered. First, the private sector is not well developed in developing countries, relative to that of South Korea. Because of this, large majority of the private partners may, as a matter of course, demand government support in terms of free use of public property or facilities. Understandably, this condition would encourage private enterprises to focus on seeking 'free use of public property', derailing the main focus of building a PPP relationship for development purposes. Hence, when developing countries, want to incorporate 'use of public property free of charge' as one of the tools of government support schemes for PPP projects, in their respective legal regime, they should consider to stipulate effective controlling mechanisms as provisions in PPP regulations to mitigate or minimize possible abuse of public property by private partners. In this sense, allowing the private partner to use public property free of charge without effective control mechanism in developing countries may, presumably, create breeding ground for rent-seeking and corruption.

The second reason is simply, governments in developing countries can hardly afford to provide public facilities for use of private partners for free. This is so primarily because the expected high demand from the private partners for free use of public facilities, as a major condition for PPP negotiations, would put the already meager public sector capacity into scantier situation.

Therefore the South Korean experience in involving private sector into its development process offers much to learn from. This study concludes that there is great positive lesson for developing countries from the review and considered adoption of the success achieved by the Republic of South Korea.

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Endnotes

1. Through MRGs, the government guarantees private investors a fraction of expected revenue for a project. If revenue falls below the guaranteed level, the government pays the investor the difference. As of the end of 2008, about W390.3 billion in MRG subsidies had been paid to private project companies. In October 2009, the MRG was abolished and replaced by the government support measure of compensation of base cost where the government shares investment risk within the limit of government's cost in case the project was conducted as a public project (Kim 2011, Park 2012)
2. For details please see Law and Regulation of PPP, particularly Act on PPP in Infrastructure. [Available at: http://pimac.kdi.re.kr/eng/mission/ppp_view.jsp accessed on 28 May, 2013]
3. For detailed list of eligible infrastructure facility types and sectors please see the Act on PPP in Infrastructure 2005 [available at: http://pimac.kdi.re.kr/eng/mission/ppp_view.jsp accessed on 28 May, 2013]

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