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Public-Private Partnerships as rent-seeking opportunities: A case study on an unsolicited proposal in Lima, Peru

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ABSTRACT

Public-Private Partnerships (PPPs) are often seen as a panacea for a more efficient provision of public services and infrastructure. However, they may have adverse effects especially in weak institutional environments. This paper focuses on how the design and performance of PPP enabling mechanisms such as 'unsolicited proposals' (USP) permit and incentivize rent-seeking behavior in subnational contexts. It aims to elucidate the hazards of USP mechanisms by the incorporation of a perspective on incentives, which is important since it helps to map the environment where corruption and opportunism unfold. It also confronts the design of PPP policies with the specificities of certain political environments. The case-study on a large-scale road infrastructure project shows that the expected reliance on technical expertise and competitive procurement for guaranteeing public interest was outweighed by a number of design flaws. These problems were related to asymmetric, non-transparent and discretionary decision-making that led to a reallocation of unearned rents.

1. Introduction

Infrastructure is considered as a crucial factor for securing competitiveness and economic growth, and has reached record investment volumes as a share of global output (The Economist, 2008). Despite the current efforts to increase infrastructure endowments, governments have struggled to keep pace with changing growth patterns such as rapid urbanization (World Bank, 1994; Koppenjan and Enserink, 2009). According to the World Economic Forum, annual investments should increase by another 37% in order to overcome the global gap to year 2030 (The Economist, 2014).

The growing demand and constant resource constraints in a context of declining Statism have ignited a shift on the state's role to provide public services and infrastructure. In this regard, Public-Private Partnerships (PPP) have become a widespread mode of provision due to their capacity to unite the public sector's capital and expertise requirements and the private sector's low risk investment needs (Cruz and Marques, 2013).

This article deals with specific PPP enabling mechanisms called 'unsolicited proposals' (USP). USPs allow private agents to design and propose projects from scratch, differently from regular PPP schemes that are normally initiated by public agencies. USPs have become very popular in several developed and developing countries since they aim to take advantage of market incentives for greater efficiency and innovation, especially when government capacities and powers are constrained (PPIAF, 2014). Nevertheless, these same constraints can have an undermining effect on USPs original aims, driving to undesirable outcomes such as the capture of the monopolistic gains from public service and infrastructure operation (Hodges and Dellacha, 2007; PPIAF, 2014).

The study focuses on the design and performance of subnational USPs in relation to rent-seeking. In that sense, two main research questions are addressed: (1) In which way the design of the Peruvian USP framework permits and incentivizes rent-seeking behavior at the subnational level? (2) Do the new incentives generated in USP markets undermine existing mechanisms for more efficient PPP procurement such as technically based decision-making, transparency, accountability and competition?

The discussion is based on evidence from the Peruvian PPP and USP markets at the aggregate level supported by an in-depth case study. The 'Vía Expresa Línea Amarilla' (LA) is the biggest USP contract in the country granted by the PPP unit of the Metropolitan Municipality of Lima (MML) where one third of the country population lives. While only a few of the more than 1800 Peruvian subnational governments count with in-house PPP units, the MML has the biggest and oldest office after the national PPP agency, and

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holds the largest portfolio of granted USPs in the country.

The case is useful for anticipating the possible outcomes of a universe of approximately 72 procured projects in Peru from the moment it is understood as an 'extreme case' (Patton, 1990: 169). This assumption is supported by the size of the project, its level of relatively high public exposure in comparison to smaller projects and the alleged greater technical-bureaucratic endowments of the MML in comparison to the vast heterogeneity of subnational governments in Peru (Contraloría General de la República, 2014). Thus, it permits to observe the deploying of a highly problematic set of relations between institutional design and actors' performance occurred in the allegedly most suitable subnational governance environment in the country.

The analysis aims to make two primary contributions to literature. First, it elucidates the hazards of USP mechanisms by the incorporation of a perspective on incentives. This perspective is important since it helps to map the environment where corruption and opportunism unfold. Second, it confronts the design of PPP policies with the specificities of the political spaces where they perform in a moment when the implementation of USP policy frameworks is rapidly increasing at different government levels (PPIAF, 2014).

The text is structured as follows: Section 1 discusses some methodological concerns, Section 2 presents an overview of the main strands of related literature, Section 3 develops a short description of the Peruvian USP market and regulatory framework, Section 4 documents the case study while Section 5 discusses the case-study findings in relation to the literature. Finally, Section 6 provides some concluding remarks and policy suggestions.

2. Literature review

In contrast to full public provision schemes, PPPs have often been praised as a more efficient financial and management alternative for the delivery of public services and infrastructure, being even considered as a 'magic solution' and a panacea (Fobil et al., 2008: 267; Miraftab, 2004; Ke, 2014). Nevertheless, several criticisms to PPPs have been raised such as those related to the low public interest behind project decisions or the windfall rents obtained by private operators (PPIAF, 2014; Hodge, 2004). These controversies have been associated to information asymmetries and low levels of transparency, public participation and accountability that have boosted corruption, opportunism and rent-seeking behavior (Iossa and Martimort, 2013, 2015; Hoppe and Schmitz, 2013).

2.1. Rent-seeking and market competition

Rent-seeking is referred to the efforts made by economic agents for reaching some special market position or acquiring monopoly power (Tullock, 1980). Rent-seekers take advantage of the state for maximizing economic gains by biasing the redistribution of existing wealth instead of creating new value, which translates into an inefficient resource allocation and a loss of social welfare (Iossa and Martimort, 2013; Congleton, 2015). Rents are provided through different channels such as subsidies, natural resource exploitation rights, land transfers, trade restrictions, price controls, foreign exchange regulations and public procurement, among others.

Studies on rent-seeking such as Tullock's (1967) and Krueger's (1974) have been generally contextualized in interventionist or highly regulated regimes and called out for less government and a more open economy (Buchanan, 1980; Rose-Ackerman, 1996). Nonetheless, rent-seeking can also be pervasive in liberalizing/privatizing contexts since mechanisms designed to dismantle rent allocation can create new forms of rent (Schamis, 2002). This can reach the point in which decisions to privatize depend on the rent-seeking preferences of specific interest groups (Albalate et al., 2015).

In relation to public service and infrastructure markets, both full privatization and PPPs constitute important sources of rent-dispute because they usually imply the granting of monopoly rights due to their natural monopoly features. Given this situation, it has been argued that the transfer of rents to a sole firm can be prevented through the introduction of competitive bidding, in such a way that the possible adverse effects of monopolies in both tariff price and service quality are avoided or significantly reduced (Demsetz, 1968). The literature has recognized the introduction of competition and institutional development as two crucial factors for achieving efficiency and diminishing opportunism and corruption (Estache and Iimi, 2009; Bel et al., 2014).

The referred natural monopoly condition together with the use of long term regulatory contracts in PPP procurement (Marques, 2017), imply that competitive bidding is a once and for all opportunity to curtail inherent market failures. However, studies have shown the complex relationship between rent-seeking and competitive procurement while it has been 'blindly assumed that market competition will prevent exploitative economic rents from emerging on more than a temporary basis' (Hudson, 2011: 892). It lies on the misuse of mechanisms such as unclear and restrictive tendering procedures and time constraints, discriminatory release of information, strategic selection of award criteria or the forcement of contract renegotiation through predatory clauses (Auriol et al., 2016; Iossa and Martimort, 2013). These issues can be very common in contexts of non-mature markets, weak institutions or intrinsically less transparent and less competitive procurement processes such as PPPs under USP schemes (Hodges and Dellacha, 2007; PPIAF, 2014).

2.2. Rent seeking in USP markets

Differently from publicly initiated PPPs through which the government proposes projects, USPs delegate that task to private agents who are assumed to count with greater capacities and incentives to recognize investment opportunities and translate them into profitable enterprises. While in the first case, there is a constant fear of public agencies to have unreal expectations, USPs tend to avoid this problem given that private firms normally propose projects that are already profitable, saving resources and bearing certain failure risks. However, further risks may rise, related to their Value for Money (VfM), their social relevance compared to other alternatives or the uncertainty about their rent margins. The problem is that private agents would naturally select projects expecting the highest returns to their investments (private interest) instead of maximizing social welfare (public interest) (Sclar, 2014; Ortiz and Buxbaum, 2008).

This means that given that USPs are not necessarily aligned with existing public service or infrastructure plans or priorities, public and private interests do not match very often. This match is expected to be achieved through the reliance on technical knowledge, transparency and accountability for making decisions as open and unbiased as possible, and on market competition for reaching economic efficiency and further VfM targets (Bloomfield, 2006). Nonetheless, the structure of incentives that support USPs incorporates mechanisms that can be detrimental (PPIAF, 2014).

Two different types of incentives operate in USP markets: those for proponents (focused on maintaining and increasing the project pipeline) and those for challengers (focused on the maximization of efficiency and public interest). The equilibrium between both incentives is a crucial requisite for a USP market to reach maturity.

Among the incentives for proponents, there are bidding benefits