KHAZANAH RESEARCH INSTITUTE

VIEWS 62/24 | 30 DECEMBER 2024

Private Finance Initiatives: Opportunities and Risks

Shereen Hazirah Hishamudin

Views are short opinion pieces by the author(s) to encourage the exchange of ideas on current issues. They may not necessarily represent the official views of KRI. All errors remain the authors' own.

This view was prepared by Shereen Hazirah Hishamudin from the Khazanah Research Institute (KRI).

Author's email address: **shereen.hishamudin@krinstitute.org**

Information on Khazanah Research Institute publications and digital products can be found at www.KRInstitute.org.

Cover photo by freepik.

Introduction: Understanding Private Finance Initiatives (PFIs)

First popularised in the United Kingdom during the 1990s, a Private Finance Initiative (PFI) is a long-term contractual agreement between a private party and a government entity where the private party designs, builds, finances, and operates public assets and related services[1]. In return, the government pays the private party through fixed payments, often over decades, contingent on the asset's performance. Often referred to as Public-Private Partnership (PPP), PFIs transfer delivery, cost, and performance risk to the private sector, which safeguards the public sector from delays, cost overruns, and poor performance.

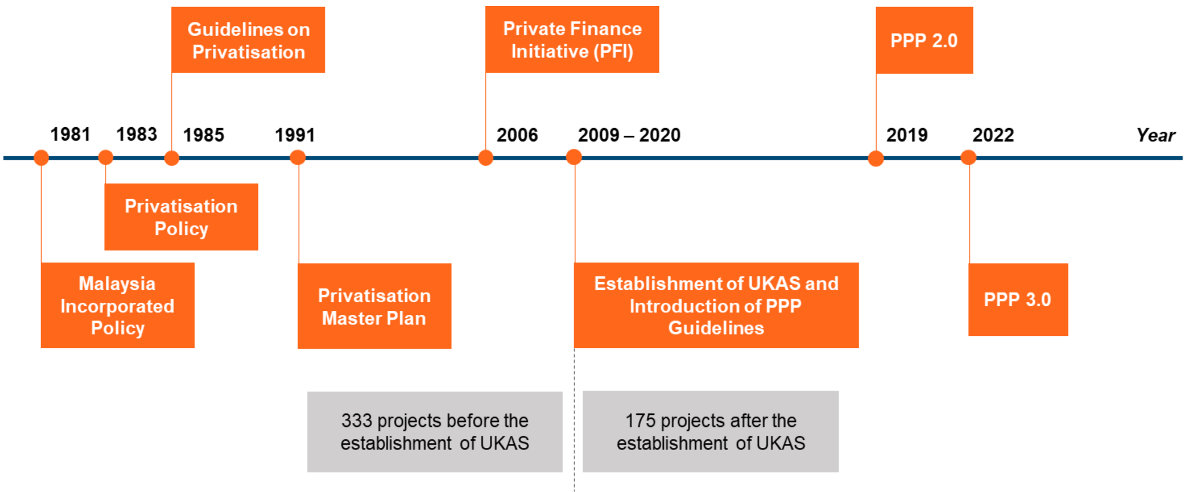
In the UK, PFIs have delivered around GBP56 billion of private sector capital investment in over 700 infrastructure projects including new schools, hospitals, roads, housing, prisons, and military equipment and accommodation[2].

[1] Infrastructure and Projects Authority (IPA) and HM Treasury (2017)
[2] Ibid

In Malaysia, PFIs gained traction in the early 2000s under the Ninth Malaysia Plan (9MP), aimed as a strategic tool to promote greater private sector involvement in the areas of management, operations, and maintenance to improve the delivery of infrastructure facilities and public services[3]. As outlined in the 9MP, the private sector creates the asset and delivers a service to the public sector and in return, the private sector will receive payment in the form of lease rental charges that commensurate with the levels, quality, and timeliness of the service provision throughout the concession period. Upon expiry of the concession period, the asset and facilities will be transferred to the public sector.

The evolution of PPP implementation in Malaysia's infrastructure development has undergone significant transformation over the past three decades, as illustrated in Figure 1. A pivotal development occurred in 2009 with the establishment of the Public-Private Partnership Unit (Unit Kerjasama Awam Swasta, UKAS) under the Prime Minister’s Department. UKAS was tasked with serving as the central coordinating body for PPP initiatives, streamlining both privatisation efforts and PFI under a unified PPP framework. Between 1983 and 2009, a total of 333 PPP projects were implemented. By the end of 2023, the cumulative number of completed PPP projects reached 175, amounting to a total project cost of RM185.5 billion[4]. This trajectory indicates a growing emphasis on leveraging PPPs to support infrastructure development and economic growth in Malaysia while adapting to evolving governance frameworks and institutional requirements.

Figure 1: Evolution of PPP in Malaysia, 1981 to 2023



Source: UKAS (2023)

Despite the potential role PFIs can play in encouraging economic growth, however, its implementation raises critical questions related to its long-term fiscal sustainability, the transparency of project selection, as well as broader social and economic implications.

[3] Ninth Malaysia Plan (2006)
[4] Public-Private Partnership Master Plan 2030 (2024)

PFIs as a catalyst for growth

Accelerated infrastructure development

One of the most significant benefits of PFIs is their ability to accelerate the development of critical infrastructure. PFIs have enabled governments to initiate and complete infrastructure projects that might otherwise be delayed due to budgetary constraints. For instance, projects like highways under PFIs have contributed to improving connectivity and urban development. By leveraging private sector capital, governments can implement multiple projects simultaneously, fostering economic growth and improving public services.

This advantage is particularly critical in a rapidly developing country like Malaysia, where robust infrastructure is essential for attracting foreign investment, supporting industrialisation, and reducing regional disparities. PFIs also allow the government to shift the financial risk associated with project delays or cost overruns to the private sector, incentivising efficient project delivery.

Access to private sector expertise

PFIs capitalise on the private sector's technical and managerial expertise, often resulting in innovative solutions and operational efficiencies. Many PFI projects have benefited from the specialised knowledge and advanced technologies of private firms, particularly in sectors like transportation and energy. For example, private companies often implement advanced project management practices and technological innovations that reduce costs and improve service quality. This transfer of expertise not only enhances the quality of infrastructure but also promotes capacity-building within the public sector through collaboration and knowledge sharing. By fostering a partnership-based approach, PFIs can contribute to improving Malaysia's overall governance and project execution capabilities.

Budgetary flexibility and off-balance-sheet financing

A key rationale for PFIs is their ability to provide off-balance-sheet financing, allowing governments to undertake significant investments without immediately increasing public debt levels. For Malaysia, this has been particularly appealing, as PFIs reduce the fiscal burden in the short-term by deferring payments to future periods. This flexibility enables the government to allocate resources to other pressing priorities, such as healthcare, education, and poverty alleviation.

Risks of PFIs

Long-term fiscal risks and contingent liabilities

Despite their short-term appeal, PFIs often impose significant long-term fiscal obligations on governments. The deferred nature of payments under PFI contracts creates substantial contingent liabilities, which may strain future budgets. Unlike traditional public debt, these liabilities are often less transparent and can grow unsustainably if not properly managed. There are also concerns on the lack of accountability and monitoring in PFI projects leading to inflated costs and inefficiencies. When PFI contracts include overly generous terms for private firms, the government may face excessive financial burdens over the contract's lifecycle, crowding out spending on other essential services.

Risk of inefficiencies and cost escalations

While PFIs are designed to transfer risks to the private sector, the reality often diverges from this ideal. In some cases, the government ends up bearing the financial consequences of poorly structured contracts or unforeseen events, such as economic downturns. In Malaysia, several PFI projects have experienced significant cost escalations due to inadequate planning, weak regulatory oversight, and the absence of competitive bidding processes. Furthermore, PFIs may prioritise profit over public interest, leading to compromises in project quality or affordability.

Transparency and governance challenges

The implementation of PFIs have faced criticism for its lack of transparency and accountability. Many PFI contracts are awarded through direct negotiations rather than open tenders, raising concerns about cronyism and corruption. This opaque approach often results in suboptimal outcomes, as projects may be awarded to politically connected firms rather than the most qualified bidders.

Moreover, the complexity of PFI arrangements makes it challenging for policymakers and the public to evaluate their true costs and benefits. Without robust mechanisms for monitoring and evaluation, there is a risk that PFI projects will fail to deliver value for money, exacerbating fiscal pressures and social inequalities.

Social and economic implications

The reliance on PFIs can have broader socio-economic implications, particularly in terms of equity and access. In Malaysia, PFI-financed infrastructure, such as selected hospitals and universities, often rely on user fees to recover costs. While this approach reduces the government's financial burden, it can create affordability challenges for low-income households, limiting their access to essential services.

Additionally, PFIs may exacerbate regional disparities if private firms prioritise projects in high-income or urban areas, where profitability is higher. This uneven distribution of infrastructure development risks leaving rural and underserved communities further behind, undermining Malaysia's efforts to promote inclusive growth.

Final thoughts

While PFIs present a valuable opportunity for Malaysia to enhance infrastructure development and drive economic growth, their success hinges on the establishment of a robust governance framework. Maximising public benefits while minimising fiscal risks requires a comprehensive approach grounded in transparency, accountability, and strategic project selection. Central to this is the need to strengthen the regulatory framework by institutionalising competitive bidding processes, conducting rigorous cost-benefit and value-for-money analyses, and ensuring robust mechanisms for project monitoring and evaluation.

Furthermore, Malaysia can address its reliance on PFIs by diversifying its infrastructure financing strategies. Exploring alternative models, such as public-public partnerships (PuPs), blended financing mechanisms, or sovereign wealth fund participation, can mitigate fiscal vulnerabilities while maintaining momentum in infrastructure development. By integrating these reforms, Malaysia can harness the potential of PFIs as a tool for sustainable economic growth while safeguarding fiscal integrity and ensuring equitable access to public services. Ultimately, balancing innovation with prudence is crucial to achieving long-term development goals.

References

Government of Malaysia. 2006. *Ninth Malaysia Plan, 2006-2010*. Economic Planning Unit, Prime Minister's Department. Retrieved from https://www.ekonomi.gov.my/sites/default/files/2021-05/Ninth%20Malaysia%20Plan%20Document.pdf

Government of Malaysia. 2024. *Public-Private Partnership Master Plan, 2030*. Public-Private Partnership Unit, Prime Minister's Department. Retrieved from https://www.ukas.gov.my/en/component/edocman/public-private-partnership-master-plan-2030-pikas-2030/viewdocument/1016?Itemid=

Government of the United Kingdom. (n.d.). *Public-private partnerships*. Retrieved from https://www.gov.uk/government/collections/public-private-partnerships