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Pathways to meet critical success factors for local PPPs: The cases of urban transport infrastructure in Korean cities

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A B S T R A C T

Public–Private Partnerships (PPPs) have been utilized extensively in both developed and developing countries to provide various public services and infrastructure. The literature points to many common critical success factors, including a mature financial market, transparent regulatory framework, advanced technology, and people's acceptance of new forms, but those can vary from country to country. South Korea's mature market capitalist system and strong regulatory framework have led to somewhat successful infrastructure provision through PPPs at the national level, but as our two cases of urban transportation in the Seoul Metropolitan Area indicate, local-level PPPs have demonstrated mixed results. By elaborating on the factors that affect the outcomes of PPPs at the local level, we argue that under a relatively new local democracy, Korean cities are likely to be susceptible to producing unfair contracts mainly due to limited local fiscal authority and resources, opportunistic behavior of local politicians, an underdeveloped urban institutional framework for PPPs, and the rise of new conditions such as economic nationalism intermixed with speculative foreign investment.

Keywords:
Public–Private Partnerships
Local government
Urban infrastructure
Decentralization
South Korea

1. Introduction

Although the term Public–Private Partnerships (PPPs) has been used rather loosely, it is generally understood to be an arrangement whereby the private sector steps in to jointly share authority, responsibility, resources, risks, and benefits in the provision of public services and infrastructure (Hodge & Greve, 2007; Grimsey & Lewis, 2004). PPPs have been eagerly adopted by many local governments, especially with the prevailing neoliberal agendas and the decline of the welfare state in the West (Bloomfield, 2006; Williams, 2003; Sclar, 2015). It has also widely spread to the Third World, pushed by international donors, to address urban infrastructure deficits amid rapid urbanization and decentralization (Bennett, 1998; Miraftab, 2004). In short, local PPPs have become a global trend—a result that is surprising considering their controversial outcomes.

On the one hand, PPPs are expected to lead to greater efficiencies by increasing the role of the private sector in public service provision (Osborne, 2001). Hodge and Greve (2007, 550–2) have cited many examples of successful PPP projects, describing them as value-for-money propositions. On the other hand, concerns have been raised about several unintended outcomes—cost overruns, co-optation, poor feasibility studies, and corruption, to name a few—that are commonly observed in developing cities in Asia (Tam, 1999; ESCAP, 2012). A number of signs of PPP 'failures' have been noted, especially among public transportation PPPs, which are becoming increasingly popular in growing mega-cities across the globe. These failures include unachieved value-for-money, cancelled concessions, halted projects, nationalization of the projects, and suspended contracts (Soomro & Zhang, 2013). While PPPs appear ideal in their conception, they seem to easily succumb to malpractice.

Furthermore, when it comes to examining non-Western societies, the political and institutional environments in which local PPPs operate become critical, as one can no longer assume the existence of well-established local democracies and a functioning market economy. In such cases, the political and institutional frameworks in which the PPP contracts are designed and operated need to be more carefully examined. Studying PPPs in the developing world, Miraftab (2004), for example, identified the unequal playing field and distribution of power between the government and the private sector as an important factor undermining PPPs.

For South Korea (hereafter "Korea"), its advanced economic position in the international economy as a result of the 'developmental state' system provides a favourable and relatively reliable condition for financial and commercial activities at the national level. As a result, the country has become an attractive and profitable place for PPPs. Similar desirable conditions might not exist on the local level, however, amid Korea's relatively short history of local democracy and decentralization. In fact, despite some successful PPP cases at the national level, the outcome of subnational PPP-led infrastructure development has been questionable.

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As of 2013, the total debt of 244 local governments attributable to unsuccessful PPP infrastructure projects was 126 trillion Korean won (about 12 US billion dollars). What explains such outcomes of local PPPs in Korea? Why and how are long-term PPP contracts compromised at the local level?

While national-level PPPs and their successes and failures have been relatively well reported in the literature, local PPPs still remain underexplored in Korea. This study scrutinizes the factors and institutional conditions that impede the success of local PPPs in Korean cities. In general, Korean local governments are susceptible to the following three problems: lack of financial resources, increasing demands from citizens under local democracy, and structurally induced political interests of local politicians. To further scrutinize how some of these elements might affect local PPPs, the paper examines two highly controversial local PPP cases of public transportation infrastructure in the Seoul Metropolitan Area (SMA): Light Rail Transit and Metroline.

Despite taking place in the SMA—Korea's economic and political centre, with the strongest market potential—the two PPPs generated much criticism due to local governments' massive financial losses in the contracts. They also gained significant attention from the mass media and the public for involving international legal disputes between the local governments and global investors, and for failing to meet the original intentions of the PPP contracts. For the case studies, we carried out fieldwork in the cities of Yong-In and Seoul in July 2014 and February 2015, including interviews with political elites and relevant policymakers. We also conducted a comprehensive review of public documents issued by local and national governments, and of press releases. While there is the risk of making generalizations from the two cases, we believe that they are a good representation of the recent trend of local PPPs in Korea, where foreign and domestic investors are becoming increasingly involved in major urban infrastructure projects. In addition, because the cases have taken place amid relatively favourable conditions in SMA, they help to further illuminate why and how local PPPs in Korea often fail to meet expectations.

2. Challenges of local PPPs

Perhaps the most frequently deployed argument in favour of PPPs is that the government gets value-for-money in delivering public infrastructure by bringing the advantages of competitive procurement processes, risk allocation between the public and private sectors, and advanced skills and management technology (Akintoye, Taylor, Beck, Chinyio, & Asenova, 2003; Osei-Kyei & Chan, 2015). The reputed inefficiency of the traditional public provision of infrastructure and services, especially in terms of time management and capital costs, has further boosted the adoption of PPPs (Flyvbjerg, Holm, & Buhl, 2002). In short, cash-strapped local governments are increasingly hoping to save costs, share risks, and improve public service quality by tapping into the private sector's expertise and strengths, making PPP a new instrumental and normative mechanism for public service provision.

However, the benefits of PPPs are hardly assured. The literature suggests quite a few critical factors for the success of PPPs in public infrastructure, including financial and commercial factors, technical factors, political and legal factors, and social factors (Ozdganm & Birgonul, 2000; Ng et al., 2012). Each of these factors is discussed in turn.

First, the financial and commercial factors refer to the financial feasibility of the project, including its profitability, overall stability of the economic environment, and the ability to attract foreign capital. Long-term PPP contracts for large-scale projects tend to have high risks associated with unpredictable and uncontrollable circumstances that the private sector is not willing to bear. Hence, to attract the private sector, local governments often end up with a disproportionate share of the risk (Johnson, McCormally, & Moore, 2002; Forrer, Kee, & Zhang, 2002). Furthermore, the private sector might be less confident of local economic conditions and the possibility of volatility, as compared to national conditions. Local governments are often forced to provide more incentives to private companies, given the former's apparent lack of scale and uncertainties in expected demand (Bel, Brown, & Marques, 2013). Only select big cities and projects would end up benefiting from the expansion of the global financial investment market; even then, it might result in undesirable consequences of financing and thus increase the risks for public infrastructure development (Palcic and Reeves, 2011).

Second are the technical factors, which are related to the possibility of stable management of sizable projects and the innovative skills and technology that private partners can contribute. Long-term contracts, especially for large infrastructure development, in effect eliminate market competition by producing a long-term monopoly for the selected private partner (van Ham & Koppenjan, 2001). There are a number of cases where the 'monopolization' of the private sector in PPPs has resulted in delayed procurement, higher costs for both consumers and governments, and renegotiation between the public and private sectors (Cruz & Marques, 2013).

Third, and most important, difficult problems might arise for PPPs from the political and legal environment, which is supposed to involve a stable and experienced government, a transparent and competitive tendering system, and an adequate regulatory and institutional framework for the PPP system to work well. For example, the local public sector is often considered to be no match for the private sector in drawing up complex and technical PPP contracts (Sclar, 2015; Dannin, 2011). There is a strong 'information asymmetry' (Siemiatycki, 2013; Sclar, 2000) and a gap in specialized expertise (Werkman and Westerling, 2000) between the two partners. In many cases, local governments lack the capacity to monitor and manage the private partners' pursuit of strategic goals under the PPP arrangements, and often fail to ensure the partners' contracted contribution to the public value. When it comes to transparency to the public, there is also the problem of governments themselves having a disincentive to disclose accurate information about the contracts (Bloomfield, 2006), as the PPPs allow them to obtain short-term benefits of public infrastructure and service delivery while spreading costs over the long term (Hodge & Greve, 2007). In fact, the PPP decisions are not merely technical solutions that are free from political influence; they can be highly political (Shaoul, 2005; Roberts, 2010). Particularly when it comes to local politicians considering their next elections, their political timetable is prone to being trapped in 'optimism bias,' omitting appropriate appraisals and overestimating expected revenue for the PPPs (Grimsey & Lewis, 2004). Short-term political decisions therefore frequently end up producing irresponsible long-term contracts, and in this context, there is now an argument for the need to acknowledge the political nature of PPPs, and to re-politicize them, by bringing debate over its policy alternatives into public forums (Higgins and Huque, 2014).

A final critical issue is to social factors, which include public acceptance of the project and the price of service, as illustrated in the case of serious public protests over the water concession in Cochabamba, Bolivia (Nickson and Vargas, 2002). The local PPPs in Korea provide an intriguing insight into economic nationalism amid globalization. Despite Korea's economic liberalization and globalization strategies, civil society and the media have increasingly been concerned with the growing presence of visible foreign capital in the Korean market (Lee, 2012). With the rising trend of local PPPs involving foreign investors, it might not be easy to achieve public acceptance once the details of the PPPs attract the public's attention.

As examined in this section, local PPPs face a number of critical challenges to arrive at successful outcomes. It is thus not surprising to find rather discouraging empirical evidence of local PPP contracts (Bloomfield, 2006; Hodge & Greve, 2007), despite a strong conceptual idea and globally active promotion of PPPs by international agencies (Miraftab, 2004). Because local PPPs have spread globally, becoming part of many local governments' strategies to deliver public infrastructure and services to keep up with urban expansion, it is worthwhile examining these PPPs with careful attention to the aforementioned factors discussed here.

3. Case analysis: urban transportation PPPs in Korean cities

Korea is known for its economic development in the 1960s to 1980s under a strong, centralized, developmental state. The public sector had been the principal provider of infrastructure and service for most of the post-war period. After democratization in 1987 and the decline of the developmental state, Korea sought to increase its global competitiveness and embraced neoliberalism. To promote efficient provision of public infrastructure by attracting the private sector, it enacted the Private Capital Investment Promotion Act (1994). During the first phase, some road, railway, and port projects were initiated under the build–transfer–operate (BTO) mode where the private concessionaire is granted the right to operate infrastructure. Due to the immature capital market and inexperienced Korean government, however, PPPs did not take off at the time (Ahn, 2012).

Two subsequent events set the stage for the boom of PPPs in the 2000s. First was the Asian economic crisis of 1997, which led to government budget cuts. The government turned to the private sector for the delivery of public services and infrastructure development, and set up a few inducement strategies such as cheaper rent, national and local tax exemptions, infrastructure credit guarantees, and employment and construction subsidies. The Korean government also attempted to stimulate the domestic economy and repair Korea's reputation, which had been hit by the crisis, by attracting more private investment. In 1998, the government passed the Act on Private Participation in Infrastructure, which provided for preferential treatment to concessionaires; since then, the number of private sector-initiated PPP projects (unsolicited projects) has been particularly bolstered, with private investors eagerly snatching the opportunity to make more profit (Fig. 1).

The most influential strategy was the government's guarantee of base revenue for the private partners through the Minimum Revenue Guarantee scheme (MRG).[1] Under this scheme, the government promised to pay the concessionaires the difference between the actual operating revenue and the projected revenue of the project. From 1995 to 2003, the Korean government on average guaranteed 90% of the projected revenue to the private investor for 20 years (Ministry of Land, Transport and Maritime Affairs, 2011).

The MRG set the stage for providing excessive support to private investors, further increasing their already strong power in the partnership. As Table 1 shows, expressway construction and operation PPPs had accurately estimated traffic volume only 59.6% of the time as of 2009, resulting in the government having to pay private partners large sums every year. Other forms of financial support, such as construction subsidies, infrastructure credit guarantees and tax incentives, have also become burdensome for the government.

Secondly, the decentralization reform and local democracy that began in the mid-1990s led to the rise of local infrastructure PPPs. It was expected that decentralization would empower local governments to align public expenditures with the varying preferences of citizens in different localities, and help local governments to pursue their own priorities and economic strategies (Bolton & Roland, 1997). However, the reality has been different. In particular, local governments often find themselves under fiscal constraints (Prud'homme, 1995). In these circumstances, PPPs offer an easier way to raise money for public use as compared to raising taxes or issuing local bonds that are associated with up-front costs and public resistance (Vining, Boardman, & Poschmann, 2005, 201).

Korea, which had been a highly centralized state, began a process of decentralization in 1995. The massive transfer of political and administrative power to subnational governments under decentralization included the institution of direct popular elections of local executives

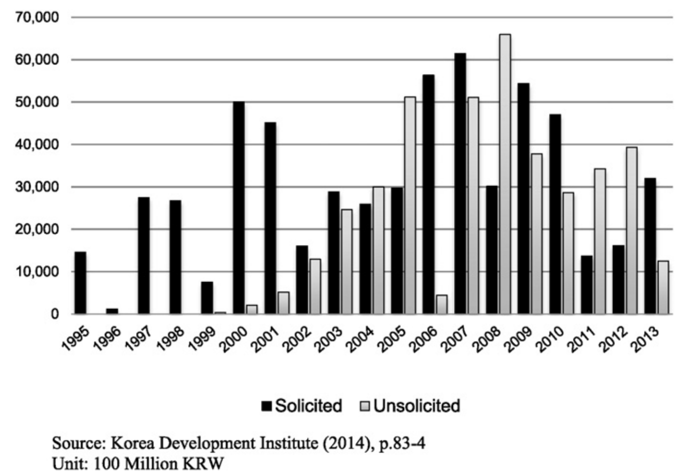

Fig. 1. Project investment by private proposals (unsolicited). Source: Korea Development Institute (2014), p. 83–4. Unit: 100 Million KRW.

(both mayors and governors as well as district heads) and local councillors. The new central–local relationship has important implications for the proliferation of PPPs at the local level. First, despite substantial progress in political and administrative decentralization, local fiscal autonomy is still limited, and the majority of tax decisions remain in the hands of the central government. It is also difficult for local governments to respond to rapidly changing local demands and the external environment in a timely manner because the local tax structure is heavily dependent upon property-related taxes (Jeong & Jung, 2011). Moreover, since the 1997 economic crisis, local income has become more dependent on central subsidies and grants, which are usually ring-fenced for nationally delegated affairs. The outcome has been declining local fiscal autonomy throughout the 1990s and 2000s (Fig. 2). Administrative decentralization without appropriate fiscal transfers, combined with growing demands for local welfare and basic social security services, has imposed an additional financial burden on local governments.[2]

Second, as elected local executives have been given power over the budget, personnel and policy decisions of local governments through political decentralization (Cho, Hong, Heo, & Oh, 2013), fiscal constraints and increased popular demands on local governments under local democracy have led local politicians to eagerly prescribe PPPs. This inclination has been further boosted by the central government's push for PPP, for example through the MRG system. Because fiscal affairs remain centralized, local governments can supplement the private investment with central and provincial government funding for important local infrastructure and developmental projects—mega infrastructure and landmarks that can increase a local executives' chances in elections. However, the central government, despite its partial financial support, is reluctant to intervene in local fiscal spending, as empowered local politicians criticize the central supervision as a violation of the constitutional principle of local autonomy or a jurisdictional dispute (Ahn, 2009).[3] As such, implicit central–local tensions can exist over local PPPs that provide short or mid-term financial resources to subnational governments and relieve central financial pressure that would otherwise have come from directly assisting local infrastructural needs.

To understand the multifaceted and multi-layered relationships in local PPPs, we examine two local PPP cases: the construction of Light Rail Transit (LRT) in Yong-In and the construction of the Seoul Metro Line Nine (SNML) in Seoul.

[1] In some other countries, like India, the scheme is known as the VGF (viability gap fund).

[2] Interview with a bureaucrat at Gyeong-gi Province, February 24, 2015.

[3] Interview with an assistant director of Audit and Inspection Institute on 7 December, 2015.

Table 1
MRG and redemption of excess revenue in expressway projects.
Source: Kim, Kim, Shin, and Lee (2011).

Expressways	Total investment	2009 projected traffic (A)	2009 actual traffic (B)	Accuracy (B/A)	MRG subsidy paid
Incheon Exp.	17,440	146,282	62,165	42.5%	7333
Cheonan–Nonsan Exp.	17,297	60,034	34,437	57.4%	2958
Daegu–Busan Exp.	27,477	62,127	34,361	55.3%	1723
Seoul Ring Exp.	22,792	78,084	72,865	93.3%	Δ27
Busan–Ulsan Exp.	14,777	35,609	15,599	52.2%	317
Yongin–Seoul Exp.	15,256	153,250	80,082	52.3%	24
Seoul–Choonchun Exp.	21,833	44,923	29,118	64.8%	36
Sum	136,872	–	–	Ave. 59.6%	12,364

Unit: 100 million KRW, as of 2009.

3.1. Yong-In LRT: the case of light rail transit

As one of the fastest-growing cities in SMA, the city of Yong-In has exhibited strong development potential and relatively healthy local finances. From 2000 to 2012, its population grew nearly 2.5 times, and is now nearly one million. Due to the rapid population growth, the city has spent a substantial portion of its budget on transportation infrastructure, especially to connect to Seoul. However, the city became notorious for abusing its local budget and misusing PPP in its large-scale urban infrastructure projects.

The most egregious misuse of PPP has been the light rail transit (LRT) project. The LRT was viewed as a reasonably priced mass transit option and was expected to reduce traffic congestion and improve air quality. In addition, because the LRT was to be linked to major subway systems through interconnecting stations, it was expected to allow easier access to other parts of the city—in particular, tourist sites such as Yong-In Everland (a theme park)—and of course to Seoul. The Ministry of Construction and Transportation (MOCT, now Ministry of Land, Infrastructure and Transport) undertook a feasibility study for the new transportation system and concluded that LRT would be a good option in terms of effective land use and environmental sustainability in smaller or medium-sized cities (Ryoo & Lee, 2013). Based on this research, the Gyeong-gi provincial government recommended that Yong-In consider this option in August 1995.

The project eventually got off the ground with the 1999 by-election, in which the mayoral candidate Ye Kang-Whan highlighted the project as one of his key campaign promises. After Ye's successful election, he formulated a scheme to attract private capital for the LRT project. In the 2002 local election, both mayoral candidates (Mayor Ye and the challenger Lee Jung-Moon) promised to push forward the LRT project in their campaigns. Under Mayor Lee (who won the election), bids for the Yong-In LRT ('Yong-In Ever Line') were solicited in 2002, with a hasty feasibility test, and the 'Yong-In LRT Consortium' was selected through a competitive bidding process. The main contractor for the consortium was the Canadian aerospace and transport company, Bombardier (60%).[4] In July 2004, an agreement was finalized between the consortium and the local government, awarding the thirty-year concession by way of a BTO agreement. The total construction cost was estimated to be 727.8 billion KRW (US$654 million), of which private investment comprised 58.8%.[5] Construction began in 2005.

Despite the project having a strong potential for profit in the rapidly growing Yong-In, the local government was unable to strike a favourable deal with the private consortium. In fact, the project's positive development prospects—which were necessary to boost its legitimacy—seemed only to have led to a serious over-estimation of the number of passengers by both Bombardier and the Korea Transport Institute. For example, the Korea Transport Institute conducted a feasibility study in 2001 and estimated 183,000 daily passengers by 2011 and 197,000 passengers by 2016, which were even higher than the Bombardier's estimates.[6] When the Board of Auditing and Inspection later re-estimated the expected demand, it found it to be only 10,000 passengers a day in 2013 and 50,000 passengers a day in 2014 (*Yong-In Today* April 30, 2013). Under the rationale of risk-sharing, the local government had guaranteed 90% of the expected base fare (MRG), which implied that the city had to compensate Yong-In LRT Co. about 2.5 trillion KRW (US$ 2.2 billion) over 30 years.

In fact, there had been an opportunity to correct the unfair relationship with the private investors. In 2004, city councillors and a number of civic organizations pointed out the infeasibility of the project by highlighting the overestimation of riders and possible losses of one trillion KRW (US$ 898 million).[7] The central government (MOSF) also warned that the MRG rate was too high and recommended a steady reduction, but this warning was disregarded by the city government.[8] Facing much criticism, however, in 2009 Mayor Seo Jeong-Seok renegotiated with the consortium to reduce the MRG from 90% to 79.8%. The following mayor, Kim Hak-Gyu, cancelled the contract in 2011, after the mass media revealed possible fraud and abuse of local government power. The consortium quickly filed a claim for damages against the city through the International Court of Arbitration, and won the lawsuit after a fierce

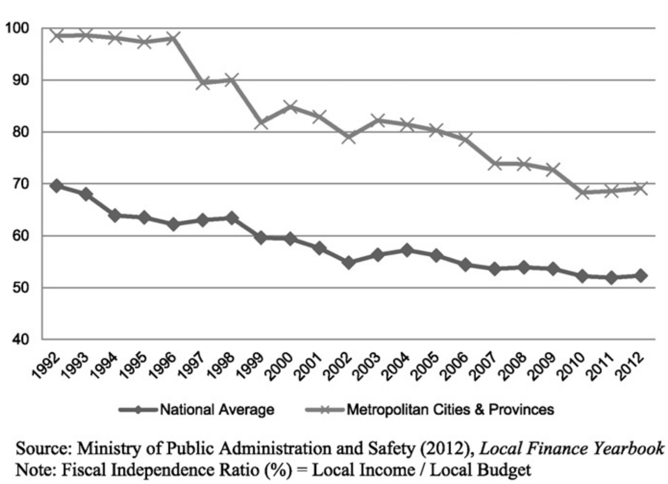

Fig. 2. Fiscal Independence Ratio (%) in local governments. Source: Ministry of Public Administration and Safety (2012), *Local Finance Yearbook*. Note: Fiscal Independence Ratio (%) = local income / local budget.

[4] *SBS news*, 'Yong-In LRT, the 'disaster' has not yet even begun.' April 29, 2013, accessed at http://news.sbs.co.kr/news/endPage.do?news_id=N1001760833 on March 19, 2015.

[5] City of Yong-In internal document, 'A Report on the Status of Private Investment Projects' (February 5, 2013).

[6] *Naeil Newspaper* and Citizens' Coalition for Economic Justice, 'Bad Mega-sized National Projects 1, Yong-In/Euijeongbu LRT,' October 24, 2013, accessed at http://www.naeil.com/news_view/?id_art=86791 on December 12, 2015.

[7] *JoongAng Daily*, 'Yong-In LRT, Not Outraged City Council and Citizens…Disaster already expected,' February 18, 2011, accessed at http://article.joins.com/news/article/article.asp?ctg=12&total_id=5073240 on January 15, 2014.

[8] Interview with an assistant director of Audit and Inspection Research Institute on 7 December 2015.

two-year legal battle. The court ordered the city to compensate the consortium by about 800 billion KRW (US$ 719 million).

A project that largely began as the political tool of local politicians ultimately produced unfair contracts and left the residents and subsequent mayors to cope with the damage. In order to compensate the consortium for MRG payments, the city had to issue 500 billion KRW (US$ 450 million) of local bonds, and total local debt reached 694 billion KRW (US$ 624 million) as of 2012. Yong-In is also suffering financial losses from a number of other BTO projects, including sewage treatment facilities and expressway construction. The favourable development conditions of this mid-sized city provided a stage on which local politicians took opportunities to promise and execute various projects via PPP, allowing them to build short-term political assets but leaving behind a huge financial burden for the city.

3.2. Seoul metro line nine: the case of a subway line

The city of Seoul surpasses any other city in Korea in terms of its political and economic significance. It is the only city given the title of 'Special City', and has a fiscal independence rate of 100%. With its population of 10 million, Seoul receives significantly more attention than the rest of the country from the media and the national government, as well as from NGOs and civil society organizations.

The prospects for the Seoul Metro Line Nine (SMLN), the first private metro in the city, were strong. Seoul, which had begun constructing its subway system since 1974, already had an extensive network of 327 km of tracks, and carried about seven million passengers daily. Integrating into this network, the SMLN (originally planned in the early 1990s) was to traverse the southern part of Seoul (Kangnam) as a 25.5-kilometre-long artery line. The project was expected to fare well as it would provide extended services in the heavily developed Kangnam area.

Following its approval by the MOCT in 2002, the local government decided to invite private investors in order to adopt the private sector's innovative management, with the hope of overcoming the chronic operating deficits that had characterized public sector operation. Under Mayor Lee Myung-Bak (who later became president of Korea), the SMLN Consortium was selected in 2003, and the 30-year BTO concession was finalized in 2005. The consortium comprised Hyundai-Rotem (25%), an Australian investment firm — Macquarie Infrastructure (MKIF, 24.5%), Shinhan Bank (14.9%), and other private investors.

Mayor Lee had a strong belief in the private sector (he had been CEO at Hyundai Construction Company prior to becoming a politician) and sought to burnish his mayoral accomplishments by improving Seoul's public transportation system. As a result, the local government sought to swiftly execute PPP, granting undue favours to private investors in the process. First of all, as with the Yong-In LRT project, an excessive MRG was granted: the contract promised an MRG of 90% for the first five years of operations, 80% for the next five years, and 70% for the rest of the concession period. In return for the declining ratio, the local government allowed a 43% higher base fare in the contract than the one suggested by the consortium. Many Korean citizens and congressmen complained that the consortium's guaranteed profits were unjustified, considering the amount of the investment contributed by the consortium. In fact, national and city government subsidies covered more than 80% of the 3.4 trillion KRW of total construction costs (Park & Kim, 2013:63). This meant that despite bearing at most 20% of total construction costs, the consortium was permitted to operate the subway for 30 years with favourable MRG (Park & Kim, 2013).

Another problem raised by a civic organization (Citizen's Coalition for Economic Justice) was the fact that MKIF, the Australian investment firm, was making substantial loans to the consortium at an interest rate of 15%.[9] Consequently, the consortium was paying a significant amount to MKIF as interest (on top of the loan itself), and this was problematic, because the city government had guaranteed the consortium minimum revenue equivalent to the 8.9% internal rate of return. After the completion of SMLN in 2009, the local government paid the consortium 14.2 billion KRW (US$ 12.7 million) in 2009, 32.4 billion KRW (US$ 29 million) in 2010, and 24.6 billion (US$ 22 million) in 2011, even though operations revenues were increasing.[10]

Against this backdrop, in 2012 the consortium also attempted to increase the base subway fare by 50% without warning. This triggered extensive discontent among citizens and was strongly opposed by the Seoul government, which charged that increasing the fare without prior consultation was in violation of the contract. After wrangling over fares, the consortium in the end withdrew the fare increase plan, but a few weeks later filed a complaint against the city government. A year later, the Seoul Administrative Court ruled that the city government's rejection of the SMLN's increase of fare was legitimate.

What became known to the public during this controversy was the fact that MKIF was making huge profits in the Korean PPP market in general. Since 2002, it has invested 1.77 trillion KRW (US$ 1.6 billion) in fourteen major infrastructure development projects, with more than 60% of the investment in the form of subordinated loans at high interest rates. As Fig. 3 shows, MKIF has consistently raised significant income through interest earnings of more than 100 billion KRW (US$ 89.8 million) since the mid-2000s. When this information was exposed during the legal dispute between the city and the consortium over the metro fare, the Korean public reacted angrily to the drainage of national and city wealth to a foreign investment firm.

Civic associations demanded that the SMLN contract be restructured,[11] and the local government negotiated a deep cut in the rate of return guaranteed to the private consortium. Following this decision, MKIF decided to pull out of the SMLN project in August 2013. Although the local government of Seoul demonstrated a stronger hand in handling the situation in the end, as compared to Yong-In, the problem was the same: the lopsided design of the PPP contract favoured private investors to benefit at the expense of local governments.

4. Discussion

The two cases illustrated here suggest that the promise of PPPs in terms of value-for-money has been far from realized in Korea. Few benefits from the private sector were added into the projects, primarily because of lopsided contracts that guaranteed high returns with little risk to the private sector, in particular the MRG policy. While the criticisms of local PPPs in the West have chiefly related to the difficulties of enforcing private sector performance guarantees (Bloomfield, 2006), Korean local PPPs have in fact produced contracts that guaranteed profit for the private sector, while allocating all investment risks to the public sector. The public partner was not responsible for enforcing the private partner's performance, but was instead guaranteeing its profit, completely eliminating any motivation to perform well. It is not a surprise, then, that the Korean PPP market became a highly attractive playground, especially for international finance. What is surprising is why such unfair PPP contracts were possible in the first place.

One of the key explanations is that PPPs in the two cases were far from apolitical and technical solutions; on the contrary, they displayed a strong political dimension. Local politicians pride themselves on their ability to quickly find and attract a private partner for a major infrastructure project. In practice, this often required exceedingly biased contracts. As such, in both Yong-In and Seoul, the contracts were rashly signed in the first couple of years of the new mayor's term. In other words, PPPs became important political tools of the locally elected mayors, who were seeking short-term political gains. This was accentuated by limited local financial resources and an immature regulatory

[9] *Hankyoreh 21*, 'Redemption of Metro Nine: Being Constrained by Korea-US FTA Deal?' April 30, 2012.

[10] Ibid.

[11] Ibid.

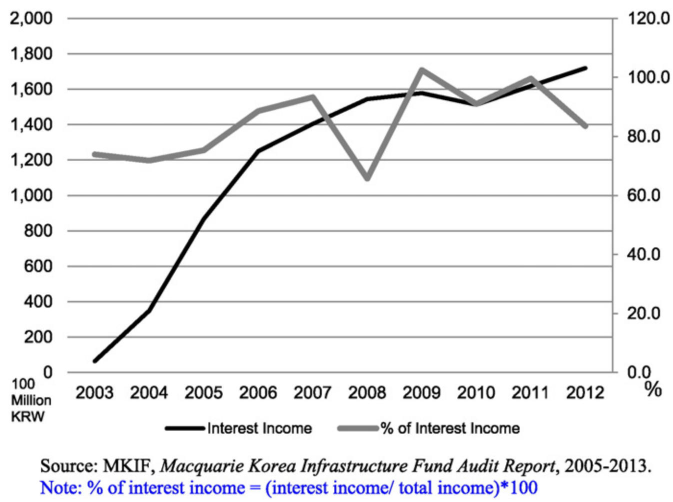

Fig. 3. Financial performance of MKIF in the Korean PPP Market. Source: MKIF, Macquarie Korea Infrastructure Fund Audit Report, 2005–2013. Note: % of interest income = (interest income / total income) ∗ 100.

framework at the subnational level under a relatively new local democracy.

Even when considering the subsequent elections, which take place every four years, the large infrastructure PPPs continue to act in the favour of the mayor who initiated the project. A study showed that from 1999 to 2010, candidates who had successfully launched a large-scale infrastructure development project in their previous term had much higher chances of re-election (Kim & Lee, 2012). The impact of signing the contract carried on positively to the second election, which usually occurred fairly soon after the start of the project, but the debt from such PPP projects became visible only much later. And because Korean mayors can run for a maximum of three terms (which itself rarely happens in the intensely competitive political system), by the time the problems surfaced and became openly controversial in the public arena, there was little chance they would influence the mayors' re-election fate. In fact, for both Seoul and Yong-In, it was only under the subsequent mayors that civil society demanded greater accountability and led local governments to try and renegotiate the poorly performing contracts.

In short, it is understandable why there was no careful prior evaluation of the projects, or even if there was, it was quickly ignored. An interview with a bureaucrat in the Ministry of Government Administration and Home Affairs illustrates the strong political motivation inherent in the local Korean PPPs:

> The reason for the failure of many of these local PPP projects (including the LRT) is that the popularly elected mayors tend to either ignore the evaluation of the project, or do not even carry one out properly. The underlying reason for this is their political motives. They are thinking about re-election and catering to the demands of their constituents.[12]

Additionally, under the 'strong mayor system' of local governments, local councils were not effective in checking local executives' growth-oriented expenditure. There was also limited opportunity for the central government to regulate local financial activities like PPPs, because any regulatory action by the central government was considered to be 'anti-decentralization' in the process of decentralization reform (Bae, in press). With the strong electoral political power over the bureaucracy in a politically decentralized Korea, it becomes clear why risky local PPPs, approved without careful evaluation and deliberation, became prominent.

In addition to politicians' rent-seeking behaviour, it is also important to consider that the fiscal constraints of the local governments after the decentralization helped set the stage for local politicians to legitimize and attract PPPs, amid increasing needs for public infrastructure and services. This structural condition pressures local politicians to seek supranational capital from firms such as Bombardier and MKIF with various revenue guarantees and support, eventually resulting in a 'systemic power imbalance' between local governments and private capital. In the age of globalization and Free Trade Agreements, local governments do not have adequate legal or regulatory frameworks to protect local stakeholders in PPPs that involve foreign capital. Other related public actors that should be acting as watchdogs—including the central government—might also perceive private investment in infrastructure as the only available option, hoping that the joint forces of eager local politicians and a competitive and capable private partner will solve their urban infrastructure problems.

So far, we have considered local fiscal constraints as one of the major reasons behind the unfair PPP contracts. However, the lack of financial independence at the local level could also suggest higher dependence on the central government, who then earns some of the blame for failing to prevent such outrageous contracts. As a matter of fact, the outcome we have studied in this paper was only possible because the central government set the stage with its MRG policy. In a way, we can close the loop here by highlighting the fact that as local PPP contracts began to manifest their problems over time, and after several legal disputes, the MRG was abolished in 2009. This helps explain the sharp drop in the number of local PPP contracts after 2009 (Fig. 4).

In short, under the combined circumstances of local fiscal constraints, pervasive political opportunism, and growing involvement of transnational investors, PPPs in Korean local governments have been politically designed and implemented without a proper institutional framework. The bias towards electoral politics in developing long-term local PPP contracts in the context of nascent decentralization and democracy will likely lead to failure rather than increasing local public benefit, accountability and public discourse.

5. Conclusion

Amid the increasing adoption of PPPs among rapidly and massively urbanizing Asian cities, it is high time to direct attention to examining the local contextual environment of PPPs. This paper illustrates how local PPPs in Korea have been strongly pushed by both local politicians and private partners to fulfil their own goals, amid fully-fledged political

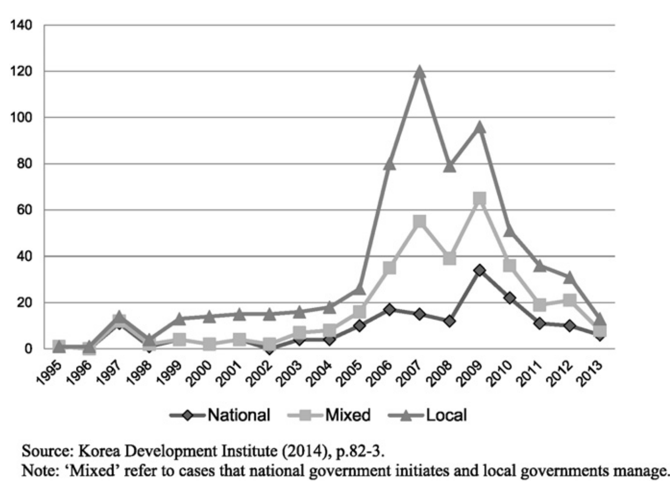

Fig. 4. Number of PPPs at different levels of government. Source: Korea Development Institute (2014), p. 82–3. Note: 'Mixed' refer to cases that national government initiates and local governments manage.

[12] Interview with a bureaucrat at Ministry of Government Administration and Home Affairs, February 25, 2015.

and administrative decentralization and local fiscal constraints. Eager to raise 'visibility' in the political marketplace and to attract private partners, elected local executives are keen to guarantee profit for the private sector, and structure PPP contracts so that a rigorous feasibility evaluation cannot be conducted. This, in effect, results in well-aligned motives between the two partners. In the prevailing circumstances— where both the public and the private partner gain much in the short term from the 'unfairly' designed contracts—the discussion of PPPs should move beyond the systemic power imbalance between the 'public' and 'private' partners.

Furthermore, for those localities deprived of developmental potential in the global economy, the argument that there is an inherent power imbalance between the public and the private partners—and in particular, experienced global investors—is a gross understatement. Devoid of their own local private sectors, such markets are powerless to attract a private partner, and thus do not even attempt to impose appropriate checking mechanisms to ensure that a private partner bears its share of the risks and brings competitiveness into the partnership.

Lastly, Korea's experience, as introduced in this paper, suggests that as PPPs are expanding globally, we need to pay more careful attention to the political and institutional environments in which PPP contracts are planned and executed. In a striking contrast to the local private sector, whose fate is tied to local economic growth, Korea's local PPPs are attracting international finance loans. In fact, unregulated international capital is avidly seeking new, speculative investment opportunities in urban development projects outside the West, in the rapidly growing and urbanizing countries, via private equities and debt-financing firms (Goldman, 2011). These foreign investment firms are extremely speculative in their urban project portfolios, yet demand a guaranteed rate of return for investing in so-called highly risky markets. The outcome of such 'partnerships' is a worsened fate for already questionable local PPPs, since the private partner's real interest lies not in maximizing its own profit from the development, but in pursuing a high rate of investment returns in a speculative and volatile manner.

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