How governments can harness private investment for public good

Public investment in the private sector needs to focus on fostering societal benefits

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1 Public investment in "boring but important" infrastructure and public goods can set the foundation for economic success.

2 With resources limited, some governments have foregone these enabling investments in search of a guaranteed return on public investments that risks crowding out the private sector.

3 Designing public investments to prompt and enable private sector innovation or sustainability in areas that may not immediately, or ever, be profitable is crucial for societal resilience.

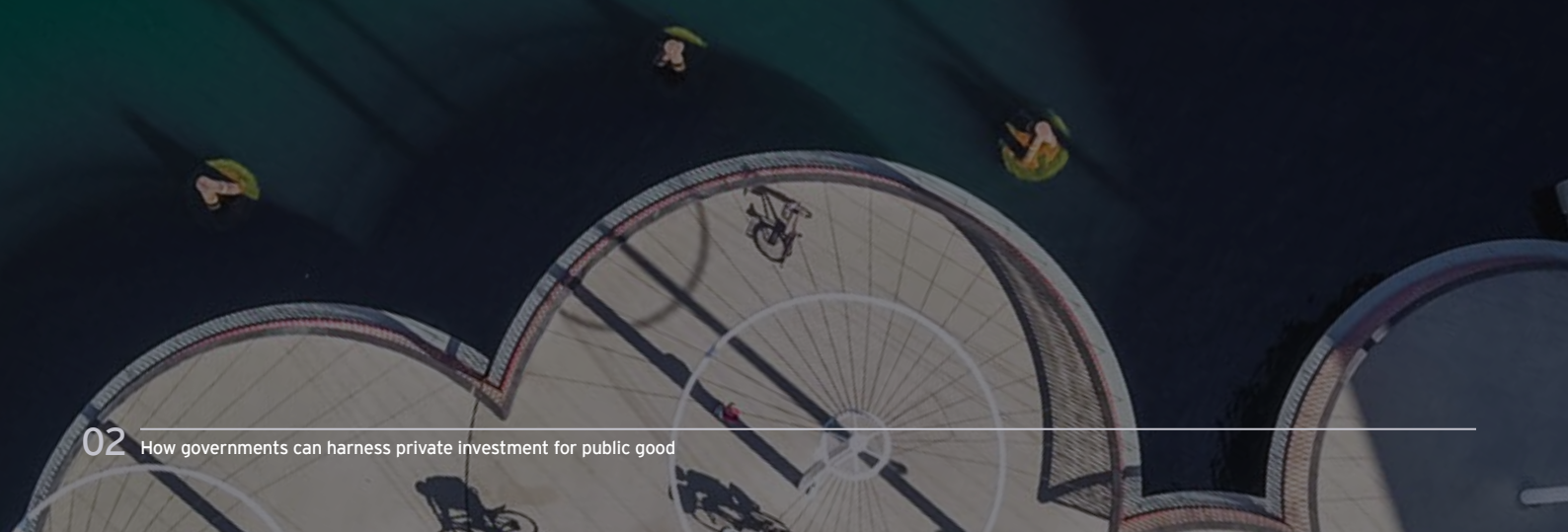
The decisions governments make today regarding the deployment of capital will have long-lasting implications for the communities they serve. With increasingly high levels of public debt and servicing costs, the situation is clear: Public resources are finite, and the need to invest wisely has never been more critical.

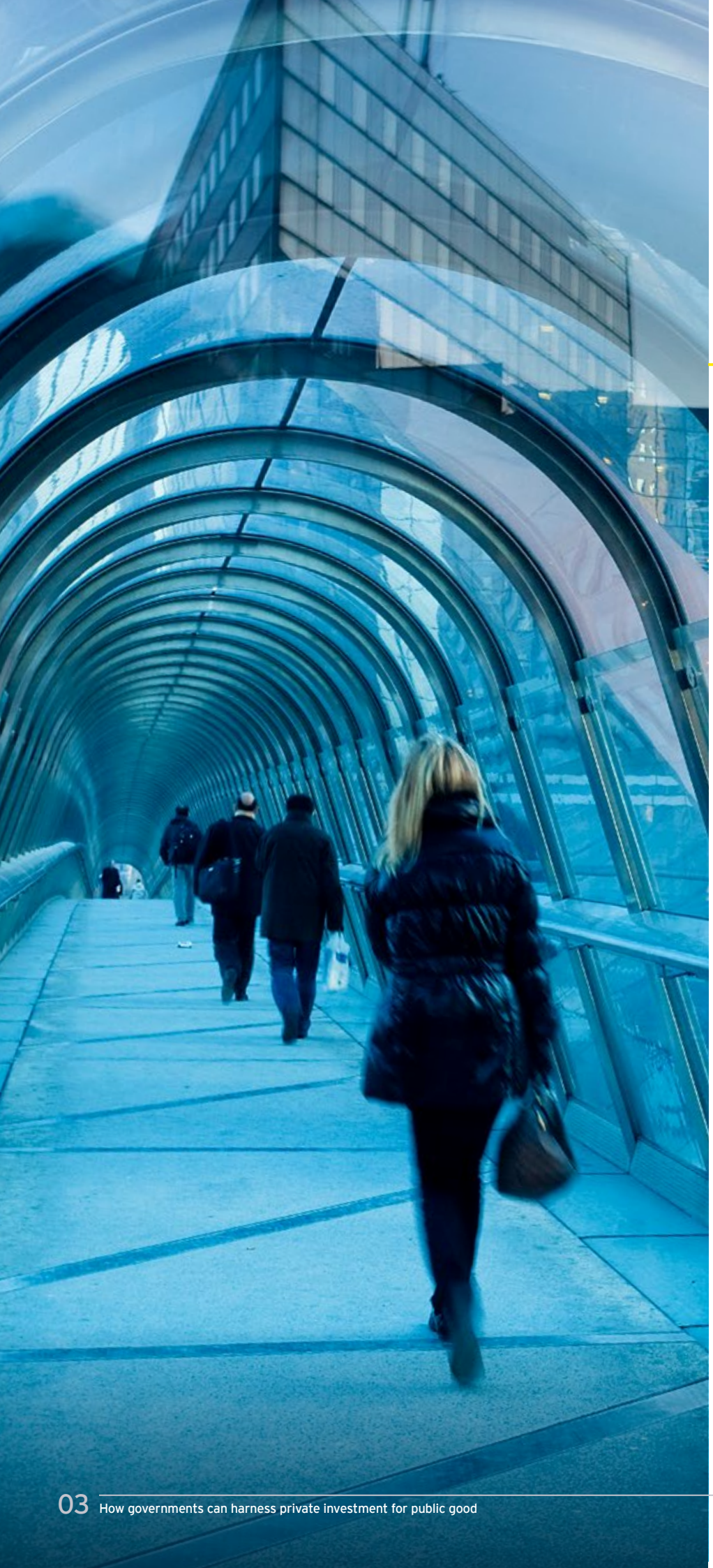
Public investment strategies must strike a delicate balance between fostering public benefits and not crowding out private sector innovation. With resources limited, government leaders are under increasing pressure to show results from public investments, which, in some cases, has caused government investors to forego the “boring but important" infrastructure investments in search of a guaranteed return.

This approach defeats the purpose of public investments in the private sector, which is to invest where no commercial incentives exist but should. When public capital addresses market failures, seeds publicly beneficial but otherwise unprofitable early-stage ventures and provides the public goods needed for private innovation, it provides a stable foundation for diverse economic activities to flourish.

As governments take a more active role in directing capital toward areas in the private sector, they should focus on developing a nuanced evaluation of success, looking beyond project completion to the wider economic and social benefits that these investments yield. Rather than a guaranteed financial return, public capital should prioritize projects with the most significant potential for broad societal impact, and those that can provide a bedrock upon which private enterprise and public services can flourish.

? So how can governments design public investments in the private sector to foster public benefits without stifling innovation?





Four components of a strategic public investment strategy

With public debt at historic highs, governments and public sector institutions need private partners to maximize the impact of public investments and limited resources. While investment vehicle choices depend on local circumstances, our research highlights four components of public investment strategies for driving public benefits from private sector investment:

1 Designing a purpose-led investment strategy

A critical role of public investments is filling economic gaps that foster social and community development while mobilizing rather than crowding out private investments that help generate further economic growth and development. Here are two ways (among many) that governments can design their public investment strategy to focus on creating social and economic impact:

- **Integrate climate and socioeconomic ambitions into investment decisions.** While all public investments have defined policy goals and outcomes tied to funding streams, the long-term impacts or short-term costs of investments are not always as identifiable. Performing impact assessments of both the potential and actual social, environmental and economic impacts of investments can help inform better decision-making and avoid backlash at the implementation stage. The Department of Transport in Ireland, for example, incorporates the results of environmental impact assessments (EIAs) into the project appraisal balance sheet (PABS) during the economic appraisal process for potential infrastructure projects. This enables government leaders to proactively identify potential adverse environmental impacts and design ways to mitigate them.[1]
- **Identify scale-up opportunities that can improve public service delivery and free up resources for other investments.** In an environment of strained public finances and evolving public needs, government leaders can use public investments to scale up private sector solutions to enhance efficiency and service delivery, improving citizen satisfaction and financial sustainability. Sometimes, these solutions — whether technology or capability — can create savings that free up resources for other priorities. For example, Singapore's social enterprise investment body, raiSE, offers a VentureForGood grant[2] that offers early and seed-stage startup funding for businesses that creates solutions that solve community issues but need financial assistance to launch or expand services.[3]

2 Making vital infrastructure the cornerstone

Public investments in infrastructure — ranging from sustainable transportation networks to digital connectivity — may not be glamorous, but they are vital to the functioning of a healthy economy. In fact, the economic multiplier effect of public investment (including infrastructure) is 1.5 times greater than the initial investment within two to five years.[4] Here are two ways (among many) that government leaders can make vital infrastructure a cornerstone of their investment strategy:

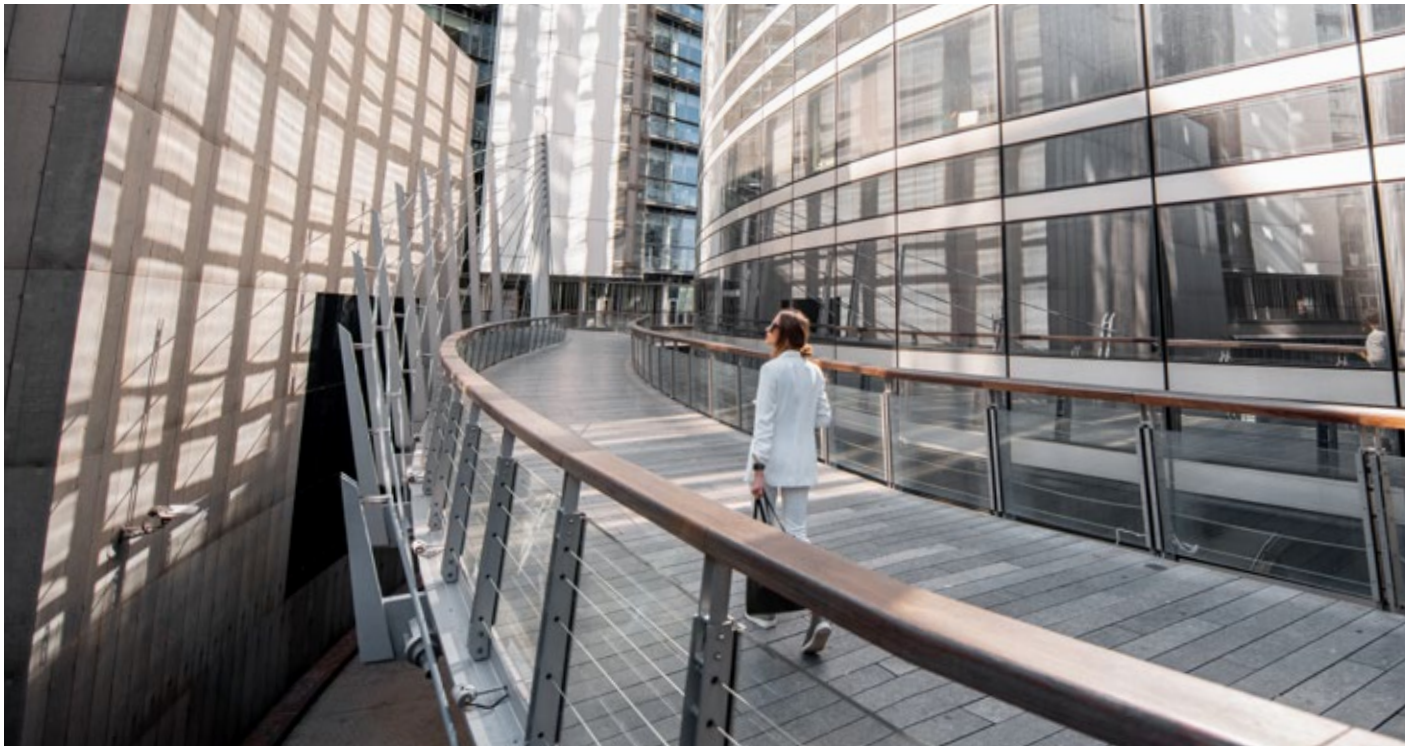
- **Prioritize foundational projects that prompt and enable further private sector development.** Public investments can have a significant economic and social impact when applied to challenges that will not drive immediate profit margins but enable and prompt private sector development and innovation that can. For example, a decades-long project in Japan to establish regional high-speed rail had significantly increased innovation in the regional knowledge economy. Research found this impact was larger in small, rural areas than in cities, revealing the importance of transportation and national resources to local economic development.[5]
- **Use public funds to attract private investment in infrastructure.** One of the most critical roles that public investments can play in economic development is de-risking private sector investment in initiatives that will not create a guaranteed financial return. Governments have a host of tools available to incentivize sustainable investments, such as by providing guarantees or innovative financing mechanisms. Saint Lucia, for example, issued blue bonds to attract investment in carbon sink preservation and climate adaptation infrastructure projects on the island.[6]

3 Fostering the ecosystem needed to maximize impact

The availability of public resources for investment is only part of the puzzle. Just as a homeowner seeking to install a swimming pool can't make progress without local contractors and artisans available to design and build it, public investments won't succeed without a viable ecosystem of partners to turn intent into strategic impact. Using governments' unique convening role can bring different parts of the local ecosystem together to create coordinated change and encourage market investment in any capability gaps. Here are two ways (among many) that government leaders can nurture the ecosystem needed to translate public investment into real-world impact:

- **Convene trifecta partnerships to enable community-led (re)development.** Business and public engagement in infrastructure and redevelopment initiatives is often kept separate. Doing so, however, can be a missed opportunity to build a broader-based coalition or "trifecta partnerships" between government, business and community leaders that can not only help drive more public support for initiatives but also enhance resource attraction and the solutions implemented. The City of Milwaukee, Wisconsin, for example, worked with local business and community leaders to establish a nonprofit public-private partnership to remediate unusable brownfields into useful public assets. More than 20 years on from that initial partnership, the Menomonee Valley Partners collaboration has yielded new access to recreation and green space for local communities bordering the area, and helped attract and establish a vibrant business community that continues to be a driver of growth and development for the area.[7]

- **Develop a policy environment and deal frameworks for public-private collaboration that articulate and price in risks.** Transparency and clarity on roles, scope, goals and potential risks are necessary for the success of public-private collaboration. Government leaders can develop governance standards based on consultation with partners and the public before the bidding process begins. These could include creating standards for transparency, public sector project involvement, risk-sharing, lifecycle and performance management, and value for money and efficacy. In Australia, the Partnerships Victoria framework helps design and guide long-term contracting between the governments and the private sector to deliver full-cycle infrastructure development and management.[8] This procurement governance prices in risk through mechanisms such as performance-based payments and output-based specifications and has helped deliver projects worth more than US$19.7 billion[9] as diverse as desalination plants, hospitals and courthouses.[10]



4 Embedding accountability and evaluation

With public trust in institutions low globally,[11] it's important to design strategic investments in the private sector with public oversight, evaluation and iteration in mind. Beyond defining policy outcomes, determining and developing the access and capacity to track and evaluate progress toward these goals can help limit project cost and time overruns. While potential financial upsides can be accounted for in design, setting a requirement for a particular rate of financial return on investment can inadvertently restrain decision-making and prevent possibly game-changing public investment in critical opportunities that may be smaller in scale or unprofitable. Here are two ways (among many) that government leaders can embed accountability and evaluation into public investment strategies:

- **Institute contractual requirements and metrics for performance management, monitoring, evaluation and iteration.** Assessing the value added by investments after implementation can be a source of important lessons and data points that can help mitigate challenges in future projects or speak to the need for iteration of existing investments. Often, the complexity of internal hierarchies, stakeholders and systems, along with a lack of capacity or infrastructure, complicates government leaders' ability to measure and track outcomes transparently. To address this, India instituted model contractual agreements (MCAs),[12] and has continued to iterate on contractual performance and evaluation metrics for different concessional partnership models. These instruments outline government and private partner obligations and damages for nonperformance or delays to infrastructure projects.[13] Standardizing public-private partnership performance and risk provisions has helped increase investment, particularly in transport and energy.[14]
- **Include upside sharing terms and clawback provisions in public contracts.** Governments can foster a more results-oriented approach from stakeholders by including accountability and transparency provisions in partnership governance and public contracts. Upside sharing terms, which define profit sharing in case of venture profitability, and clawback provisions, which allow governments to recover funds in case of fraud and non-performance, help align the interests of private contractors with public goals. In doing so, such provisions can incentivize better performance and ethical behavior. For example, the US CHIPS Program Office, which is administering billions in private sector investment for advancing computing and semiconductor manufacturing, requires recipients of more than US$150 million in direct funding to share with the US government a portion of any cash flows or returns that exceed the applicant's projections above an agreed threshold.[15]

Building a sustainable future through strategic public investment

In an environment of increased economic precarity, government leaders are being challenged to become more creative in how they use strategic public investments and increase uptake across services. Public investments in assets and development that the private sector avoids can offer opportunities for inclusive growth and broad-based benefits, but only if institutions increase the socialization of risk and increase executive and civil service learning and development in this investment capability.

There are three ways that government leaders can begin to operationalize these strategies:

- **Socialize risk among executive and civil service leaders.** Too much risk aversion in public investment decisions among public sector leaders can lead to an unwillingness to take the calculated risks needed to achieve greater social, economic and environmental benefits.
- **Adopt an investment mindset.** Going beyond immediate needs and short-term goals, and focusing on long-term planning, value creation, continuous learning, adaptation and collaboration, can help to drive sustainable progress and benefits for communities.
- **Evaluate existing investments and partnerships for accountability and transparent risk sharing.** Understanding the share of risk and accountability mechanisms in existing partnerships, and conducting thorough investigations of project progress and outcomes, can help assure the responsible use of resources, incentivize timely project delivery, and identify lessons learned and potential future savings.

Although it may not always be the tool that public sector leaders reach for, a strategic investment capacity should be a fundamental part of governments' capability mix. Moving these strategies from the fringes of government back into the mainstream policy toolkit can help public investments yield the greatest possible returns for society.

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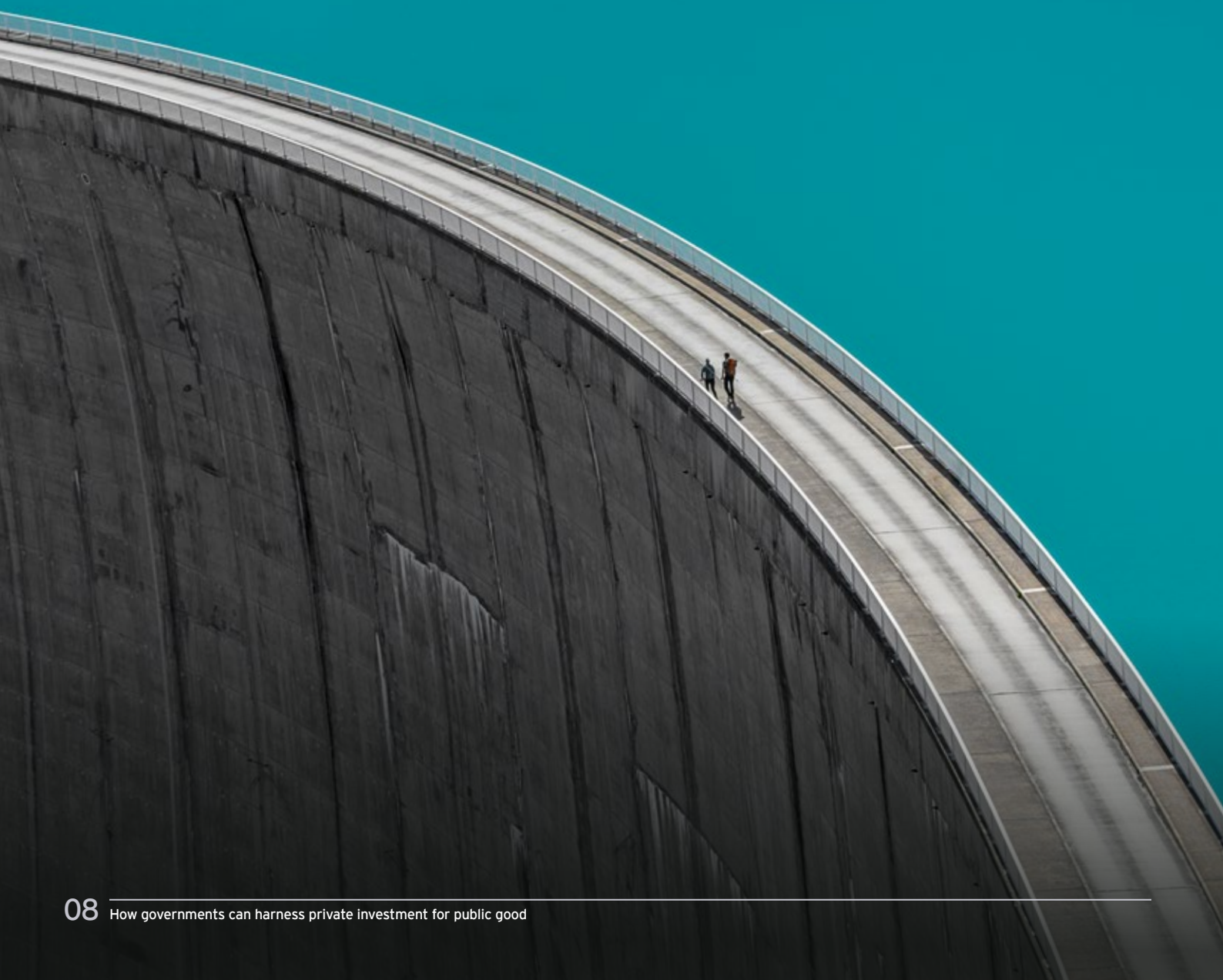

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