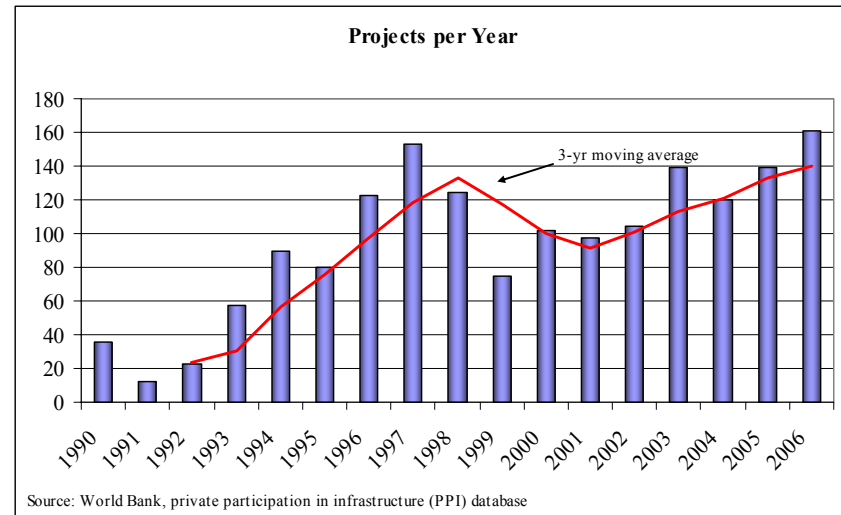


# Managing Fiscal Risks From PPPs

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# I. PPPs – Growing Around the World

- PPPs are becoming popular with many low and middle income countries
- A lot of talk about PPPs now, but they have been around for a while
- Still, they represent a low share of public investment flows. But trend is increasing



# PPPs – What Are They ?

- More prevalent in roads, but important in other areas. Electricity higher measured by investment
- Activity in social infrastructure less frequent but expanding
- Limited information on PPP activity
- Role for national registries

# PPPs – What are they ?

- PPPs refer to arrangements in which the private sector supplies infrastructure assets and services that traditionally have been provided by the government.
- No clear- cut definition but 3 characteristics are key:
  - i) private execution and financing of public investment;
  - ii) emphasis on both investment and service provision by private sector; and
  - iii) risk transfer from government to private sector e.g. Design-Build-Operate-Finance scheme.

# PPPs – What are they ?

- Key difference between PPPs and traditional public procurement is the structure of contracts involved.
- i) Debt incurred by government under traditional procurement and under a PPP its private sector;
- ii) Under PPP government has a long-term service contract with specific private sector partner – usually a “special purpose vehicle” (SPV) set up to run project;
- iii) Private partner recovers investment and financing costs by charging fees to consumers (e.g. tolls) or charging fees to government

# PPPs – Benefits

- Main argument in favor of PPPs relates to potential efficiency gains.
- i) By involving private sector management and innovation PPPs deliver increased efficiency, better quality, and lower cost services than traditional procurement
- ii) Whether PPPs have achieved efficiency gains in practice remains an open question. Evidence is positive in UK but recent study by EIB staff finds that PPP roads are on average 24% more expensive than traditionally procured roads.

# PPPs – Why Worry

- Despite efficiency benefits PPPs can also entail substantial fiscal risks and could turn out to be more costly than traditional procurement
- Risks are prevalent when PPPs are implemented:
  - i) inexperienced governments;
  - ii) without an adequate legal and institutional framework; or
  - iii) to bypass budgetary spending controls (i.e. to move public investment off budget and debt off the government balance sheet).

# PPPs – Why Worry

- Like all projects, PPPs entail different types of risks including:
  - i) *Construction risk*. Design problems as well as cost and schedule overruns.
  - ii) *Financial risk*. Project's cash flow falls short of level needed to repay project loans and capital invested
  - iii) *Demand risk*. Possibility that demand for the services provided declines. Reducing cash flow-generating potential of project
  - iv) *Residual value risk*. Uncertainty regarding the market price of infrastructure asset and end of contract period.

# PPPs – Why Worry

- Specific fiscal risks from PPPs, involve creation of government liabilities that can be direct or contingent, explicit or implicit, known or unexpected.
- i) Direct fiscal liabilities occur when government has a fiscal obligation in any event;
- ii) contingent liabilities are triggered by an event e.g. minimum income guarantees given to private partner, or government guarantees to banks that finance PPPs;
- iii) Explicit liabilities created by a law or contract
- iv) Implicit liabilities reflect public and interest-group pressures e.g. bail out of private partners
- v) Known fiscal consequences derive from contracts but there is a lot of room for unknown and may lead to contract renegotiation

# How To Manage Fiscal Risks

- Effective management of fiscal risks from PPPs requires governments to focus on:
  - i) Strengthening overall framework for public investment planning;
  - ii) developing legal and institutional framework to handle PPPs;
  - iii) implementing transparent accounting and reporting; and
  - iv) Political commitment and good governance are overarching conditions for successful PPPs.

# How to Manage Fiscal Risks

- *Framework for Public Investment Planning*
- i) PPPs should be integrated with government's investment strategy, its medium-term fiscal framework, and the budget cycle
- ii) PPPs part of investment strategy and pursued only when VfM compared to standard procurement
- iii) VfM determined by project appraisal – cost/benefit analysis and then decision is project is a PPP or direct government investment
- iv) PPP must be part of regular cycle of investment projects to ensure integration into medium-term fiscal framework. This ensures fiscal constraints are not reason for a PPP.

# How To Manage Fiscal Risks

- *Legal and Institutional Framework should cover:*
- i) Clear definition of PPPs and their scope;
- ii) assignment of roles and responsibilities for PPPs;
- iii) fair and transparent procurement rules;
- iv) basic elements for conclusion, renegotiation, and termination of PPP contracts, including dispute resolution mechanisms;
- v) financial management and audit procedures;
- vi) general accounting and reporting requirements; and
- vii) Contracts should be awarded on competitive bidding

# How To Manage Fiscal Risks

- *Institutional Framework*
- i) Institutional setup should have capacity to manage and assess risks from PPPs.
- ii) Clear allocation of responsibilities within government for dealing with PPPs
- iii) Ministry of Finance (MoF) should have strong role in managing fiscal risks from PPPs to protect finances
- iv) PPP process should be supported by safeguards. Gateway safeguards empowers MoF to stop or suspend a PPP project that does not satisfy VFM or affordability conditions.
- Gateways installed at specific stage of PPP project – preparation, negotiation (renegotiation) e.g. South Africa

# How To Manage Fiscal Risks

- *Capacity Requirements: Expertise needed to*
- i) conduct thorough project appraisals (including VfM assessments);
- ii) prioritize and manage projects;
- iii) assess and price risks involved in PPP projects;
- iv) negotiate effectively with private sector; and
- v) ensure PPPs consistent with broader fiscal and macro objectives.