PPPs as a Growth Strategy

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Why Public-Private Partnerships (PPPs)?

- A large number of diverse countries, across all continents, have been calling international tenders in order to build public facilities and services, public housing, telecommunication networks, energy production, expressways, railway infrastructure, waste handling/treatment and protecting the environment,
- Done within a partnership framework between the public and the private sector
- PPPs allow governments to use private capital for building infrastructure, eliminating the usual public finance constraints
- When it works, it's the best of both worlds; public entities cannot present the same credible commitment on costs and schedules; allows rapid deployment of public infrastructure

Private Sector Intervention in Provision of Public Services

- The provision of public services is typically assumed by governments as their responsibility.
- Some examples: – Provision of infrastructure for public services (e.g. highways, bridges, tunnels, railways, ports, airports, hospitals, schools, prisons, etc.) – Provision of other long - life assets (e.g. trains, trams)
- But the actual production and delivery of some of those public services may be allocated to private entities so that the public may benefit from private sector cost efficiency, without releasing the responsibility for the provision of a public service
- These allocation may be done through: privatization, outsourcing, or public - private partnerships (PPPs)
    - <u>Outsourcing</u> : some components of public service are bought in the market; short - term contracts
    - <u>PPPs</u>: some components of public service (e.g. the infrastructure needed for service provision), or the whole public service, are contracted to a private provider through medium- or long -term contracts; public authorities monitor provision
    - <u>Privatization</u>: the responsibility for service provision is transferred to private partners, subjected to market discipline or a regulator

What is a PPP

- PPPs are long - term contractual relationships between a public sector entity and a private sector entity to provide public services
- Typically involves large amounts of upfront investment by the private sector, with performance incentives not based on financial metrics and penalties alone
- The private partner commits itself to providing a set of services according to some specified performance levels set by the public partner, usually output based benchmarks
- The public partner monitors the performance and pays the services or grants the private partner the right to collect fees from users
- Allows the public sector to refocus the role and resources of the public authority on its regulatory missions, and shifts most of the financial risks to the private party
- Relies upon a delegated management framework (such as a concession) as a means of improving the quality of public services
- Credibility brought by private capital being put at risk, where revenue depends on output volume and performance levels (KPIs are monitored by the public partner)
- Under PPP contracts, public authorities can rely on private sector expertise, and need not care for production expertise
- However, public authorities still need to build technical and managerial capacity in the public administration, especially the capacity for contract management, as they are ultimately responsible for service provision

Features of PPP

ssets:

the assets or services provided are specified in terms of outputs rather than inputs—that is, defining what is required, rather than how it is to be done

unctions:

it 'bundles' together multiple project phases or functions. Nonetheless, the functions for which the private party is responsible vary, and can depend on the type of asset and service involved.

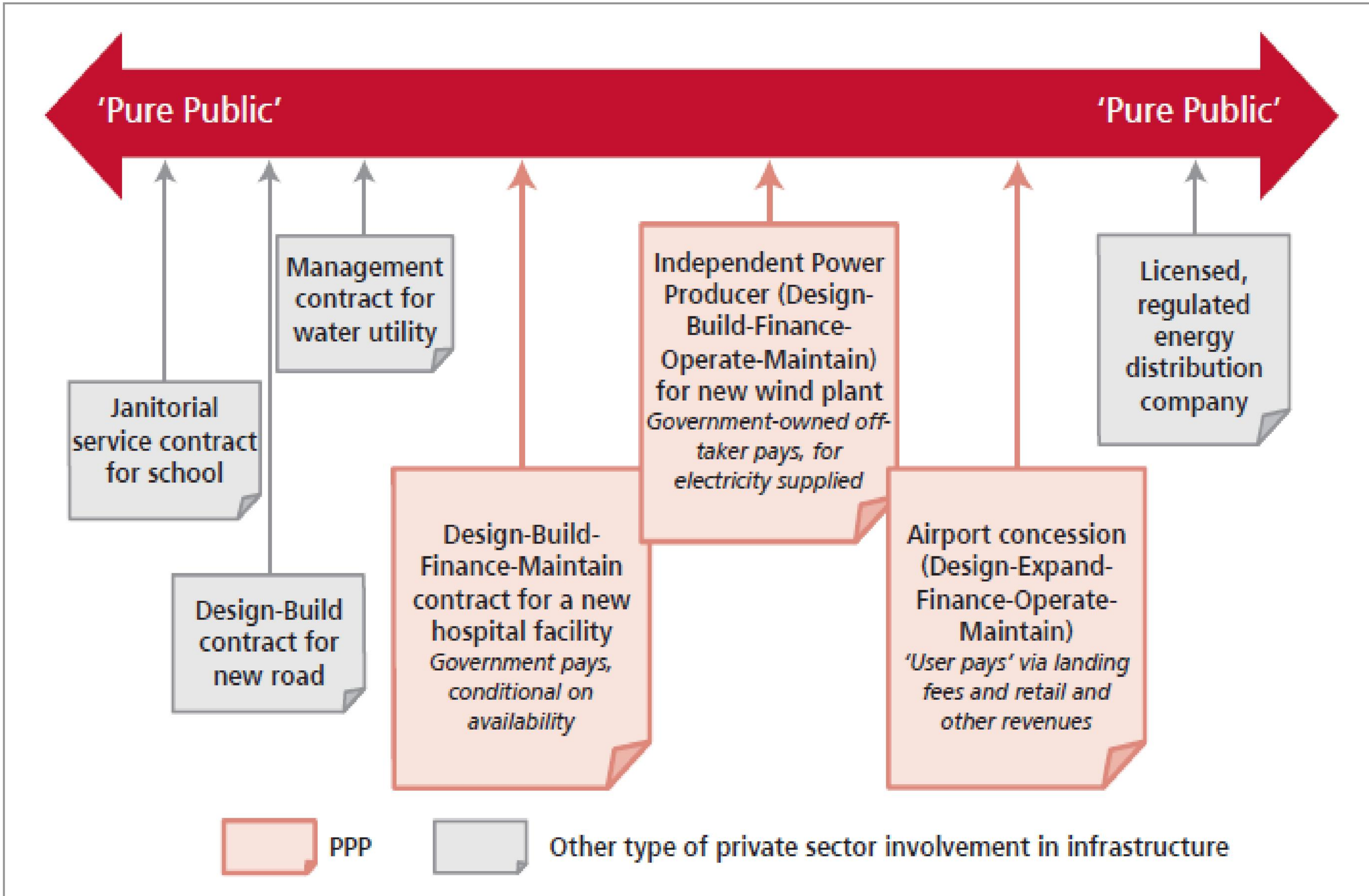
ayment Mechanism:

The private party can be paid by collecting fees from service users, by the government, or by a combination of the two—with the common, defining characteristic that payment is contingent on performance. The options for a payment mechanism can depend on the functions of the private party.

A successful PPP project needs an appropriate institutional environment

- institutions for steering and managing procurement (e.g. steering and appraisal committees)
- institutions for contract management and regulation (e.g. Tender Boards and Oversight Committees)
- institutions for project appraisal and selection (e.g. contract managers, regulators, auditors)

Examples of PPP Contract Types



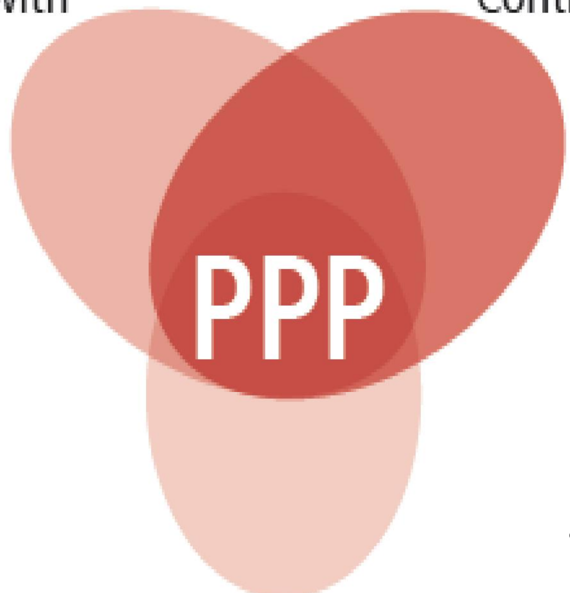
Examples of PPP Contract Types - cont

'Partnerships' with private sector

- Information sharing mechanisms
- Joint venture projects
- Government help to private sector not related to provision of public services

Contracts for providing public assets and services

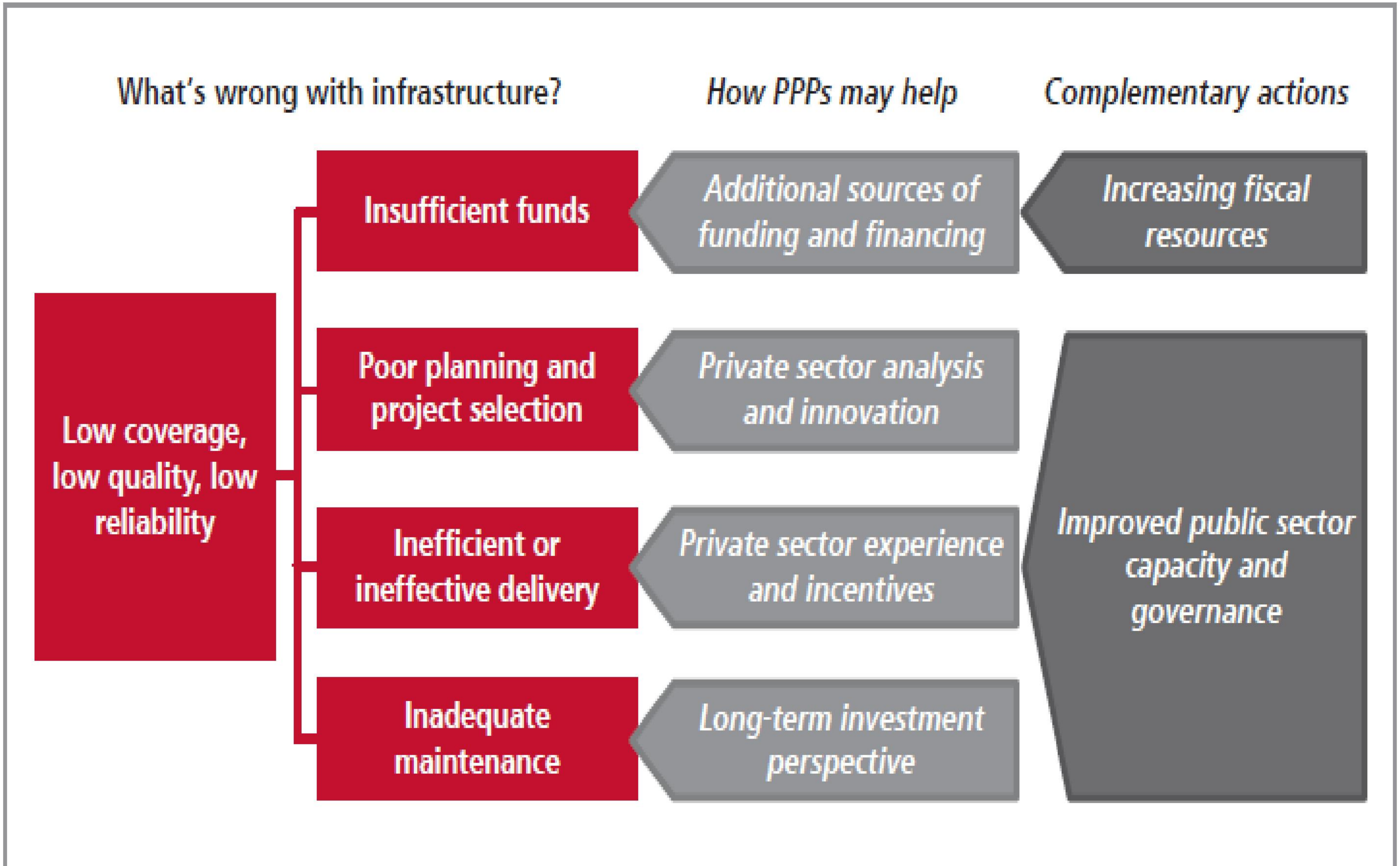
- Management contracts
- Design-build, or 'turnkey' contracts
- Financial lease contracts



Sector regulation

- Control of monopolies through tariffs, licensing and service standards

How PPPs can help with Infrastructure Provision



PPP Value Drivers

- Full integration, under the responsibility of one party, of up-front design and construction with on-going service delivery, operation, maintenance and refurbishment, can reduce total project costs.
- Full integration (under the responsibility of one party) incentivizes the single party to complete each project function (design, build, operate, maintain) in a way that minimizes total costs
- Risk transfer - Allocating some of the risk in owning and operating infrastructure to a private party can reduce the project's overall cost to government
- Budgetary predictability over the life of the infrastructure reduces the risks of funds not being made available for maintenance after the project is constructed
- Innovation—specifying outputs in a contract, rather than prescribing inputs, provides wider opportunity for innovation
- Mobilization of additional funding—charging users for services can bring in more revenue, and is usually done better with private operation than in the public sector
- Accountability—government payments are conditional on the private party providing the specified outputs at the agreed quality, quantity, and timeframe. If performance requirements are not met, service payments to the private sector party may be abated.
- PPPs can increase the 'fiscal space' available for infrastructure,

Types of PPPs

- Governments may use PPPs for delivering infrastructure, guaranteeing its maintenance for the whole life of the assets: government pays the availability of infrastructure
- Or contract the PPP private partner to deliver public services using a public infrastructure: users may pay user - charges, or the government pays service provision, or the government supplements user - charges collected by the private partner
- A typical PPP contract prescribes at least the provision of infrastructural services according to some performance levels (implying that the private partner will build or upgrade an infrastructure and be responsible for its maintenance)
- But in many contracts the private partner will be also responsible for the provision of intermediate services or services to end – users
- E.g. PFI – Privately Financed Initiative

Differences between PPPs and Privatization

- In the case of privatization, public authorities rely on the market (e.g. for food supply) or on regulators (e.g. telecom) for service delivery
- In the case of PPPs, public authorities perceive service provision as their responsibility, for constitutional reasons (justice, national defense, basic health, public education, etc) or for natural monopoly reasons (roads, water distribution, sanitation, etc); PPP contracts must define performance levels, and they must be monitored

Typical PPP functions can include the following

- **Design** (also called 'engineering' work)

means developing the project from initial concept and output requirements to construction-ready design specifications

- **Build**, or Rehabilitate

when PPPs are used for new infrastructure assets, they typically require the private party to construct the asset and install all equipment. Where PPPs involve existing assets, the private party may be responsible for rehabilitating or extending the asset

- **Finance**

When a PPP includes building or rehabilitating the asset, the private party is typically also required to finance all or part of the necessary capital expenditure.

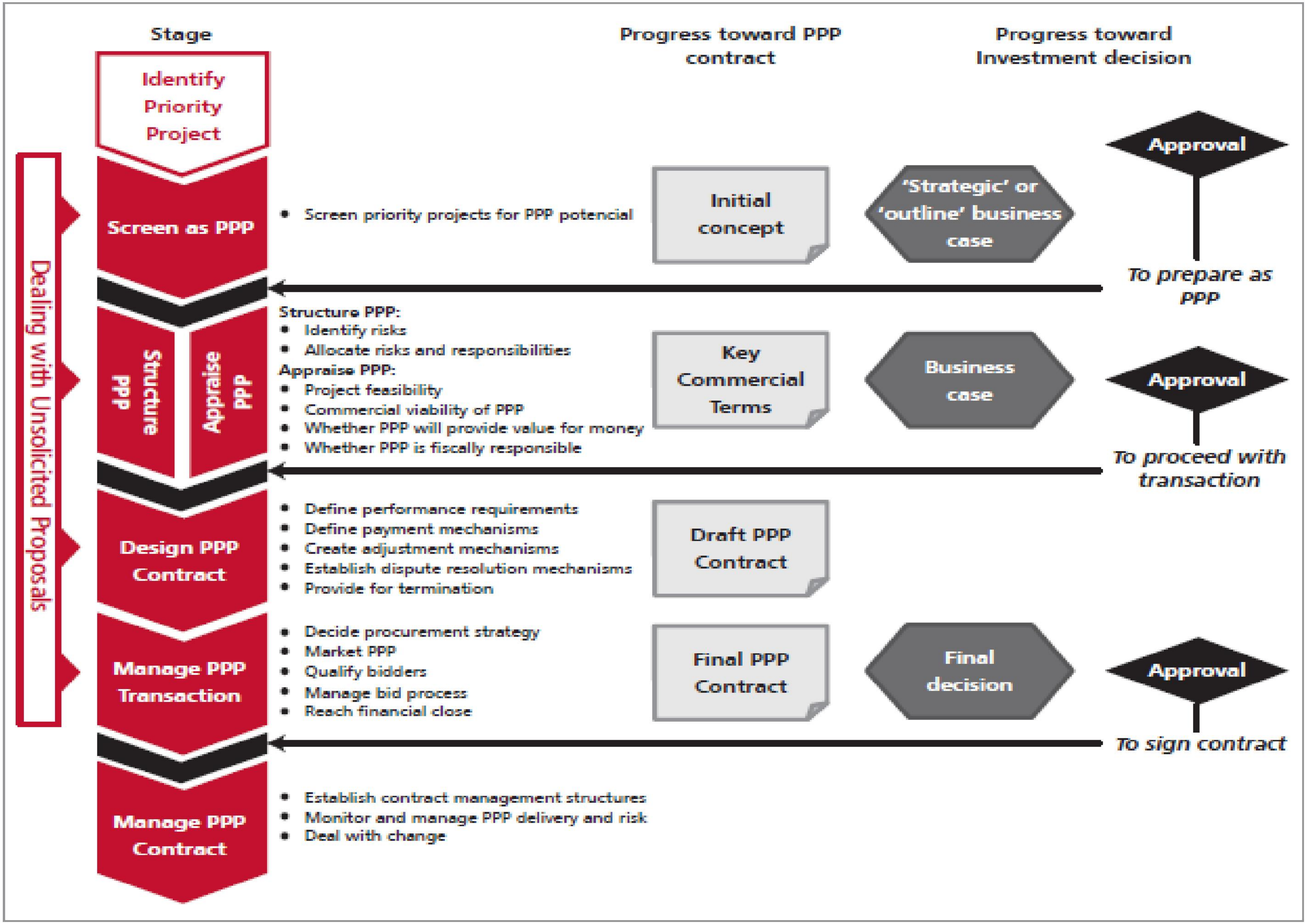
- **Maintain**

PPPs assign responsibility to the private party for maintaining an infrastructure asset to a specified standard over the life of the contract. This is typically considered a defining feature of PPP contracts.

- **Operate**

The operating responsibilities of the private party to a PPP can vary widely, depending on the nature of the underlying asset and associated service.

Figure 3.1: PPP Development and Implementation Process



Issues with PPP

- Is the private sector able to deliver all public services better than the public sector , apple to apple?
- May lead to regulatory hijack; without transparency and proper contract enforcement, rent - seekers and corruption will flourish
- Due to the massive size of PPP contracts, may transfer to private entities the control of future public resources.
- PPPs should NOT be perceived by public authorities as zero- cost projects
- Although PPPs use private capital to finance capital investment, but many of them require long - term payments by public authorities and create budgetary risks that should be carefully evaluated and budgeted
- Malaysia's experience have shown that even some risks allocated to the private partner may, under some circumstances, be transferred back to government; so fiscal risks should be carefully identified
- The cost of the infrastructure in PPP projects is ultimately met from the public purse either way—in practice, the payment stream to repay a debt-financed public procurement may be very similar to a stream of availability payments under a PPP for the same project
- Absent real efficiency gains, this means the apparent fiscal advantages of PPP arise from accounting quirks— the limitations of cash budgeting, or the definition of public sector debt. At best, this can create budgeting issues; at worst, it can enable governments to use PPP to bypass their own prudent public borrowing and budget limits—creating a temptation to spend more now, in response to political and other pressures to deliver new and improved infrastructure.

Actual Examples of PPP Downside

- The United Kingdom's Private Finance Initiative (PFI—a large British PPP program) has also come under criticism for concealing the cost of the government's obligations. A House of Lords inquiry into PFI found many witnesses imputed the choice to use PFI to the fact that the government's commitments under these contracts were often not recognized as part of public debt
- Inadequate control of the PPP process meant the Government of Portugal took on significant fiscal exposure to its PPP contracts, contributing to its 2011 fiscal crisis. The PPP program created budget problems, was used by agencies simply to loosen budget constraints.
- In the 1990s, the Government of Colombia guaranteed revenue on toll roads and an airport, as well as payments by utilities that entered into long-term power-purchase agreements with independent power producers. Lower-than-expected demand and other problems required the government to make payments of US$2 billion by 2005
- In the 1990s, the South Korean government guaranteed 90 % of forecast revenue for 20 years on a privately financed road linking the capital, Seoul, to a new airport at Incheon. When the road opened, traffic revenue turned out to be less than half the forecast. The government has had to pay tens of millions of dollars every year

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- In most countries, at the time a PPP project is approved, the future payment commitments still may not be included in expenditure plans and budgets, which often do not look more than one to three years ahead.
- Even where a PPP is expected to generate additional resources—for example, by charging users for services—governments typically bear or share certain project risks. For example, governments may provide guarantees on particular risk factors such as demand, exchange rates, or certain costs; while PPP contracts often contain compensation clauses in case of termination of the agreement for a range of reasons.
- Doing so creates contingent liabilities for government—the cost of which can be harder to assess than the direct liabilities and upfront capital costs created by a traditional government investment project. As a result, governments often take on significantly more fiscal risk under PPP projects than they had expected, or than would be consistent with prudent fiscal management.
- In addition to the government's explicit liabilities such as profit guarantees, PPPs can give rise to implicit liabilities— that is, non-contractual liabilities that arise from moral obligation or public expectations for government intervention—that create further fiscal risk

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- Given the great importance of infrastructure and the tight constraints on their resources, governments have increasingly sought to tap private sources of finance. Although most investment in infrastructure is still public, the private sector has increased in importance as governments have gained experience in regulating it. These PPPs can help a government stretch its budget further. They also spare the public sector the burden of running projects.
- But if the partnerships are to work, governments must be prepared to establish autonomous regulatory agencies to oversee the activities of the private agents. The terms of the partnership must be written and monitored carefully, so that the private investor can earn an honest return but not a monopoly profit.
- It is also crucial for commercial risks to be borne by the private party. In too many cases, the division of labour has put profits in private hands, and risks in the public lap; especially default risks. The Government of course faces political risks too.
- There is now a great deal of accumulated, international experience with these partnerships. Some have been extremely successful in a wide variety of infrastructure areas, including telecommunications, roads, power generation, port management. But there have been equally numerous failures. Lessons should be drawn from both.

CONCLUSIONS

BENEFICIAL WHEN PROPERLY USED

Establishing the PPP Framework

- PPP Policy
- PPP Legal Framework
- PPP Processes and Institutions
- Public Financial Management Framework
- Broader PPP Program Governance

Implementing PPP Projects

- Identifying PPP Projects
- Appraising PPPs
- Structuring PPPs
- Designing PPP Contracts
- Managing PPP Transactions
- Dealing with Unsolicited Proposals
- Managing PPP Contracts