Developing Public-Private Partnerships

Advanced Inter-American Program on Policy Innovation & Management
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Rui Monteiro
WB PPP Group

Objectives of the PPP CCSA

<table>
<thead>
<tr>
<th>Objective</th>
<th>Description</th>
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<tbody>
<tr>
<td><strong>Overall</strong></td>
<td>More and better PPP projects, especially in IDA countries</td>
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<tr>
<td></td>
<td>Reduce “cost of doing business” on PPPs with WBG</td>
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<tr>
<td><strong>Leadership &amp; Coordination</strong></td>
<td>Improve incentives and collaboration</td>
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<tr>
<td><strong>Country Engagement</strong></td>
<td>Provide expertise, tools to support CMUs, GPs, MIGA, and IFC</td>
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<td><strong>Global Leadership</strong></td>
<td>Develop global public goods and convene stakeholders to advance agenda</td>
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<tr>
<td><strong>Knowledge &amp; Innovation</strong></td>
<td>Create vibrant WBG hub for knowledge, innovation and learning</td>
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</table>
Knowledge creation and sharing

**PPP Reference Guide**
jointly developed by:
- World Bank Group
- Asian Development Bank
- Inter-American Development Bank

**PPP Knowledge Lab**
- Together with other MDBs
- Global knowledge platform for PPPs
- Launched last week

PPP Knowledge Lab
resources to help understand, prepare and implement public-private partnerships
https://www.pppknowledgelab.org/

PPPIRC
(www.pppirc.worldbank.org)

PPPIAF
(www.ppiaf.org)

PPP Laws and PPP contracts
PPP studies
Handshake thematic publications
PPI projects database

Private Participation in Infrastructure DATABASE
What are PPPs

Public-private partnerships are ...

... long-term contracts where the private sector supplies infrastructure assets and services that traditionally have been provided by the government

- Main characteristics:
  - Long term (25, 30, or more years, are common)
  - Private execution and financing of public investment
  - Joint contracting of design, construction and maintenance
  - Risk transfer to private sector (performance-based contract)
  - Sometimes, the full operation of the infrastructure

- Who pays for the contract?
  - Government-funded (e.g. availability payments), or
  - User-funded (e.g. user fees, tolls), or
  - Combination of both
What is a PPP?

PPPs are long-term contractual relationships between a public sector entity and a private sector entity

The private partner commits itself to providing a set of services according to some specified performance levels

The public partner monitors the performance and pays the services or grants the private partner the right to collect fees from users

Why PPPs
Rationale for PPPs

Main reasons presented by decision-makers for procuring PPPs:
- "creating fiscal space" ("bridging the gap")
- "transferring risk to private partners"
- "introducing efficiency"
- "accelerating infrastructure plans"
- "introducing innovation"

Bringing private finance, managing fiscal space

- $ potential collection → NPV
- $ fiscal space

market constraints & fiscal rules
fiscal surprises
Transferring (some) risks to private partners

What do we know about risk:
- Risk aversion
- Capacity for coping with risk
- Ability to pool risks
- "allocating risk to the parties best able to manage it"

What do we know about PPPs:
- SPVs
- Private finance, typically under project finance

Efficiency in the provision of infrastructure and services

- Incentive mechanisms
- Credible commitment

- Efficiency savings compensating for capital cost
- Risk transfer for incentive, not as a goal
- Fiscal space coming from efficiency
- Lack of efficiency reducing fiscal space
PPP, one among several procurement modes

Initial PPP experience: 1990s

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WORLD BANK GROUP
Initial PPP experience: 2000s

Current PPP experience: 2015
Global PPI Data

Private Investment in Infrastructure in Low and Middle Income Countries (by region)

FIGURE 1: TOTAL INVESTMENT IN ENERGY, TRANSPORT, AND WATER BY REGION

- Number of Projects
- 2014 US$ Billion

Source: World Bank and IFC, PPI Project Database

Global PPI Data

Private Investment in Infrastructure in Low and Middle Income Countries (main countries)

FIGURE 2: TOTAL INVESTMENT IN PPI IN COUNTRIES WITH THE HIGHEST INVESTMENT

- US$ Billion
- 2013
- 2014

Source: World Bank and IFC, PPI Project Database
Global PPI Data

Private Investment in Infrastructure in Low and Middle Income Countries (by sector)

FIGURE 3: INVESTMENT COMMITMENTS IN ENERGY, TRANSPORT, AND WATER

Source: World Bank and PPIAF, PPI Project Database.
* Adjusted by US CDF

Ancient PPPs in Giza...
Paris bridges

Case: Canal du Midi / Garonne

"mettre en risque mon bien et mon honneur à défaut de réussite et, par contre-coup, acquérant un peu de l'un et un peu de l'autre, en cas que j'en sorte heureusement"

Riquet, a local tax collector, presented to Louis XIV this unsolicited proposal: building a canal connecting the Atlantic Ocean to the Mediterranean at no cost to the taxpayer or royal purse.
Case: Canal du Midi / Garonne

Riquet was awarded a perpetual concession in 1666, with the right to collect a special purpose new tax.

The canal, built in 1666-1683, was a success, but the public partner paid two thirds of its cost.

Rail in Continental Europe

demand based
Roads in Continental Europe

Railways in the United Kingdom

The Extension of the Railway System in England and Wales, 1845-1914
What do we know about those PPPs?

Over the long term, ancient PPPs were effective procurement modes, providing efficient delivery, but with some fiscal issues

- rapid implementation
- often innovation
- long term: "privatizing benefits, socializing losses"
- seldom no service to poorest users (e.g. water)
Why do we expect current PPP to perform better?

Current PPPs are expected to perform better than ancient PPPs because of:

- larger and less concentrated financial markets
- more competitive procurement
- better risk allocation (from project finance)

But we still need to improve:

- project selection and prioritization
- procurement and contract management
- PPP fiscal management

Efficiency, sustainability

Experience has demonstrated PPP effectiveness for

- the rapid development of infrastructure
- the reaching of productive efficiency
- the improvement of service to end-users

Efficiency (from the viewpoint of public finance) and affordability will probably require institutional improvements in most countries
Why are PPPs expected to deliver efficiency?

Specificity of infrastructure projects

Infrastructure projects are just a subset of public projects, but a special one due to their
- sunk costs
- size
- complexity
- long life
Public infrastructure

but often affected by

basic for economic growth and for the quality of life

cost overruns

corruption concerns

completion delays

poor design

poor maintenance

Two core PPP drivers

performance contract

private financing

life-cycle costing

low optimism bias

cost-efficiency

optimised design

innovation

fast delivery

guaranteed maintenance
Rationale for PPPs

In each case, services provided according to public sector rules

PPPs vs. privatizations

Outsourcing:
- components of public service bought in the market
- short-term contracts

PPPs:
- public service contracted to a private provider
- medium- or long-term contracts
- public authorities monitor provision

Privatization:
- responsibility for provision transferred to private partners
- subject to market discipline or a regulator
Range of PPP schemes

- Performance-based road maintenance contract
- Government pays, conditional on road quality
- Janitorial service contract for school
- Design-Build contract for new road
- Operations and Maintenance (O&M) contract for an existing hydroelectric plant
- Government-owned off-taker pays, for electricity supplied
- Design-Build-Finance-Maintain contract for a new school building
- Government pays, conditional on availability
- Licensed, regulated energy distribution company
- Design-Rehabilitate-Finance-Operate-Maintain contract to upgrade road and convert to toll road
- User pays through tolls

Other type of private sector involvement in infrastructure

Whole-life costing

PPP capital and maintenance expenditures (at constant prices) for a single stretch

The life cycle of an infrastructure project
The life cycle of a non-PPP project (1)

The life cycle of a non-PPP infrastructure project with poor design

The life cycle of a non-PPP project (2)

The most probable life cycle of a non-PPP infrastructure project
The life cycle of a non-PPP project (3)

Can you imagine what is the expected performance of an infrastructure with this level of maintenance?

the most probable life cycle of a non-PPP infrastructure project

Usual alternatives

- design-build contracts
  - fast delivery
  - poor design
  - cost overruns

- improved traditional procurement
  - better design
  - slow delivery
  - poor maintenance

- PPP procurement
  - fast delivery
  - good design
  - higher financing cost
  - long-term contract
Focussing on outputs, not inputs or processes

The **private partner** will care for design, implementation & maintenance/operation

The **public authority** needs to focus on

- Defining the project:
  - goals
  - performance indicators
- Drafting the PPP contract:
  - risk allocation
  - incentive scheme: rewards, bonus and penalties
- Creating institutions and capacity for:
  - procuring the contract under effective competition
  - monitoring project performance

Contract management, a new challenge

Complexity of contract management

- Interface with third parties
- Change management

Contract management capacity:

- Hiring and training
- Motivating and retaining
- Disclosure and transparency

Main sources of inefficiency:

- Contract renegotiation mismanagement
- Fast technological change and obsolescence
- Policy changes
PPPs as credible commitment

PPPs present a credible commitment for implementing a transport project

- project revenue is dependent on reaching the operational phase, creating a strong incentive for completion
- the private partner starts the project with a full financing scheme, avoiding the usual public finance troubles

The PPP scheme
Or is this the PPP scheme?

Complexity of PPPs
PPP as an incentive mechanism (1)

PPP as an incentive mechanism (2)
Why do we need to care for PPP fiscal management?

Fiscal icebergs
Transport in Portugal: the fiscal iceberg

Translating:
- Transport expenditure (Min. Public Works) €449m
- Transport expenditure (Min. Finance) €251m

Total reported expenditure 2008: €700m

Net change in assets in transport sector SOE:
- €2,500m to €3,000m

Net change in (out-of-budget) PPP commitments:
- €3,000m
Portugal: highway PPP development

Highway network developed 100% under PPP schemes

Source: Institute for Mobility and Transports (IMT), quoted by UTAP

Portugal: The situation in 2011

2011 debt crisis – strong fiscal sustainability concerns about PPP

- PPP sector “do nothing” scenario unsustainable from a contract lifecycle perspective → need to renegotiate contracts

2015 gross financial commitment

€ 2,100 million ≈ 1.5% of GDP

Total outstanding gross payments ≈ € 37,000 million

Source: OE2012, Ministry of Finance
Fiscal Transparency: Lessons from the Crisis
Example: General Government Debt in Portugal

![Graph showing changes in government debt](image_url)

*Only includes Central Government SOE debt pre 2007*

Johannes Mueller & Richard Hughes

World Bank BBL, April 2, 2013

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Fiscal Transparency: Lessons from the Crisis
Lack of Transparency Exacerbated Problems

<table>
<thead>
<tr>
<th>Sources of Unexpected Increase in General Government Debt</th>
<th>Issues Revealed by the Crisis</th>
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<tr>
<td>(percent of GDP, 2007-2010)</td>
<td>Unreported Deficits</td>
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<td></td>
<td>SOEs &amp; PPPs</td>
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<tr>
<td></td>
<td>Arrears</td>
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<td></td>
<td>Macroeconomic Risks</td>
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<tr>
<td></td>
<td>Contingent Liabilities</td>
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<tr>
<td></td>
<td>Stimulus / Consolidation</td>
</tr>
<tr>
<td>Underlying fiscal position</td>
<td>1.7</td>
</tr>
<tr>
<td>Revisions to 2007 deficit &amp; debt</td>
<td>1.8</td>
</tr>
<tr>
<td>Changes to government boundary</td>
<td>-0.7</td>
</tr>
<tr>
<td>Cash-accrual adjustments</td>
<td>0.7</td>
</tr>
<tr>
<td>Exogenous shocks</td>
<td>8.4</td>
</tr>
<tr>
<td>Macroeconomic shocks</td>
<td>4.7</td>
</tr>
<tr>
<td>Financial sector interventions</td>
<td>0.0</td>
</tr>
<tr>
<td>Policy changes</td>
<td>2.3</td>
</tr>
<tr>
<td>Other factors</td>
<td>2.1</td>
</tr>
<tr>
<td>Total Unforecast Increase in Debt</td>
<td>14.4</td>
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</tbody>
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*GDP-weighted average*
### Fiscal Transparency: Lessons from the Crisis
Addressing Weaknesses in Reporting Standards

<table>
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<tr>
<th>Problem</th>
<th>Weakness in Previous Standards</th>
<th>Recommendation</th>
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<tbody>
<tr>
<td>Revisions to Deficits</td>
<td>Infrequent fiscal reporting</td>
<td>Monthly operational fiscal reports</td>
</tr>
<tr>
<td>Quasi-fiscal Activity by SoEs</td>
<td>Exclusive focus on general government</td>
<td>Publication of fiscal data for public sector</td>
</tr>
<tr>
<td>Unreported Flows</td>
<td>Losses on asset &amp; liability holdings not recognized</td>
<td>Recognition of doubtful debts in summary aggregates</td>
</tr>
<tr>
<td>Macroeconomic Shocks</td>
<td>Bias in macroeconomic forecasting</td>
<td>Alternative macro-fiscal scenario analysis</td>
</tr>
<tr>
<td>Exposure to Financial Sector</td>
<td>No recognition of contingent liabilities</td>
<td>Recognition of quantifiable contingent liabilities</td>
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### Traditional budget process

- Cash-based
- Annual appropriation mechanism
- “Competition” for the budgetary endowment
- MoF project filtering, or decentralization
- Scarce checking for long-term sustainability

(this is not appropriate for the case of PPP)
Government payments in traditional procurement

Plus contingent liabilities coming from construction cost overruns and operations

Traditional procurement $m

Government payments under PPP procurement

PPP procurement $m

Plus medium- and long-term contingent liabilities from explicit or implicit guarantees
How PPPs (mis)fit into the traditional budget process

- Usually there is no formal appropriation for PPPs
- No competition for the budgetary endowment
- Typically poor (or absent) MoF project filtering
- Significant long-term liabilities (costs and risks)

The link to fiscal reporting

Poor fiscal management and reporting may:
- Bias decision-making in favour of PPPs
- Reduce the quality of project selection
- Distract contract-design from efficiency goals
- Reduce concerns for fiscal sustainability
- Reduce private sector confidence in government
Effectiveness and efficiency

- cost-efficient
  - efficient from the viewpoint of public purse
- effective
  - efficient from the viewpoint of society

Foundations of PPP efficiency

- Output-based long-term contracts:
  - Core: design + construction + maintenance
  - Performance-based payments
    → whole-life costing
- Private capital at stake → credible commitment
- Good project selection (CBA, VFM, affordability)
- Competitive procurement
- Adequate contract management
  - Partnering
  - Contract enforcement
  - Prevention of strategic moves
Applying the contract (enforcement)

- Performance should be monitored

- Poor performance should imply applying penalties

- Project performance should be disclosed and audited

Partnersing

- Implementation requires some public action

- Public sector should cooperate and not jeopardize efficiency

- Contract manager should link with other public stakeholders

- PPP contracts are long-term, complex, incomplete contracts

- PPP projects are related to services of general interest

- PPP projects are subject to political, commercial, technological change
Change management

- PPp contracts are long-term, complex, incomplete contracts
- PPP projects are related to services of general interest
- PPP projects are subject to political, commercial, technological change

change may affect and disturb public service

change should be managed by contract managers

contract management procedures should be in place

Private operator strategic behavior

- PPp contracts are long-term, complex, incomplete contracts
- PPP projects are related to services of general interest
- PPP projects are subject to political, commercial, technological change

Private operators may induce change

contract manager should prevent perverse moves

contract management should include some strategic reasoning
**Renegotiation**

PPP contracts may need to be renegotiated

- PPP contracts are long-term, complex, incomplete contracts
- PPP projects are related to services of general interest
- PPP projects are subject to political, commercial, technological change

PPP contract renegotiation may jeopardize PPP efficiency

PPP contract disclosure helps in safeguarding PPP efficiency

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**Poorly designed contracts**

- Contracts may lack proper incentives for efficiency
- PPP contracts are long-term, complex, incomplete contracts
- PPP projects are related to services of general interest
- PPP projects are subject to political, commercial, technological change

They should have been carefully reviewed and adjusted

Gateway processes should guarantee the review of PPP contracts
**Poorly selected projects**

- Projects may be poor projects or lack priority
- PPP contracts are long-term, complex, incomplete contracts
- PPP projects are related to services of general interest
- PPP projects are subject to political, commercial, technological change
- No proper contract management can save them
- Gateway processes should guarantee the review of PPP projects

**Unaffordable PPP programs**

- A PPP program may simply be unaffordable
- PPP contracts are long-term, complex, incomplete contracts
- PPP projects are related to services of general interest
- PPP projects are subject to political, commercial, technological change
- Long-term fiscal costs and risks should be well scrutinized
- Gateway processes should review PPP program affordability
Institutional Framework

Parliament

Court of Auditors

Government

assessing costs, benefits, and risks; selecting PPP projects
procurement; preparing PPP schemes and draft contracts; tendering contracts
managing PPP contracts: applying the contracts, partnering, and managing change and fiscal risks

Academia

Users

Private firms

Civil society

PPP and governance

Reviewing and strengthening the institutional framework for PPPs
Working with Parliaments on PPP efficiency and integrity
Working with Courts of Auditors on PPP efficiency and integrity
Networking and knowledge transfer between peers
Strengthening project assessment and project selection
Strengthening project preparation and procurement
Strengthening gov't accounting and fiscal sustainability
Promoting effectiveness and transparency in contract management
Promoting contract transparency and monitoring

Do PPPs bring innovation to the public sector?
**PPPs and innovation**

What kinds of innovations PPPs can bring to the public sector, even outside the scope of PPP projects:

- additional design focus on **outputs** and **results**, instead of inputs and production processes
- project cycle **whole-life costing** approach adopted in all project assessments
- additional **performance benchmarking** (PPP versus other projects, including non-PPP projects)
- improved **fiscal management** of infrastructure