

Public Investment Management for Public Private Partnerships

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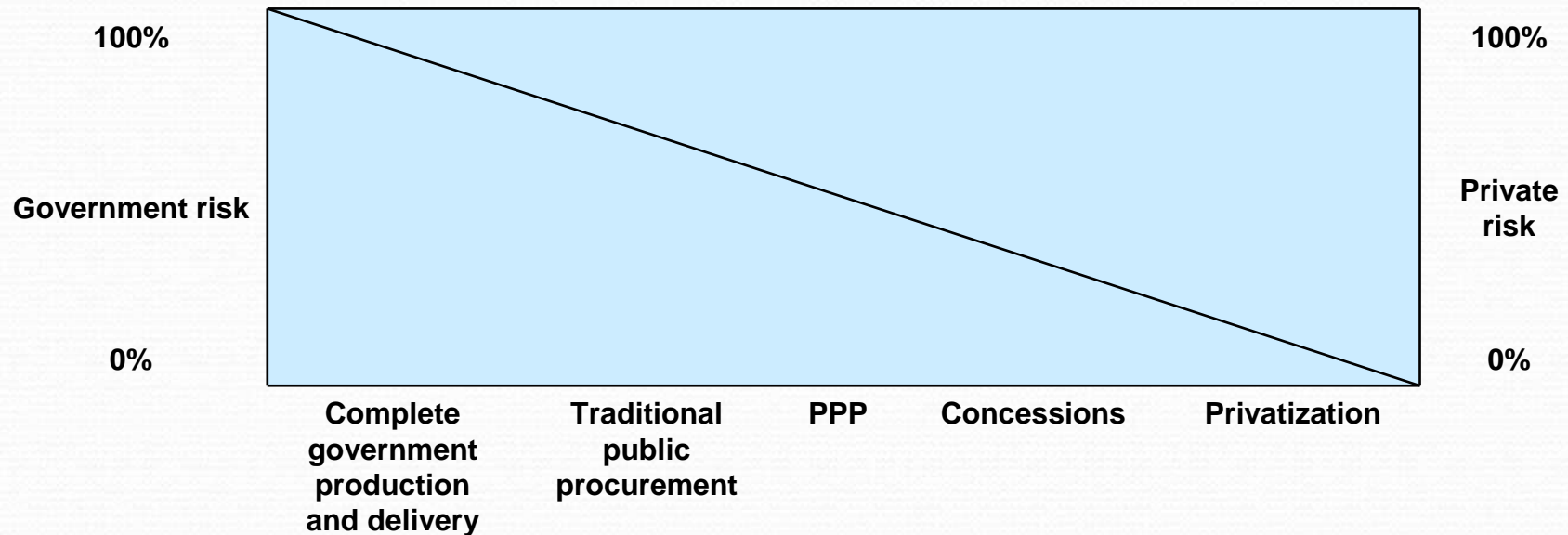
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Motivation: Aligning PPPs with Traditional Public Investment

- As an attractive modality for public infrastructure provision, PPP programs have been widely discussed and developed since the 1990.
 - The United Kingdom outstrips the rest of the world in the number of PPP projects, although Australia, Brazil, Germany, India, Korea, and South Africa as well as other developed and developing countries have also implemented many PPPs.
- Unfortunately, most countries have been managing PPP projects separately from traditional government-financed and procured projects.
 - PPP projects have been mostly appraised, selected, budgeted, and monitored separately from traditional projects.
- This disparity has undermined adequate public financial management and created undue fiscal risks, causing fiscal concerns with respect to appropriate forms of accounting, reporting, budgeting, and other processes.
- A project implemented through PPP should require the same level of social and economic justification in PIM.

(Spectrum of Public and Private Participation)

The Spectrum of combination of public and private participation, classified according to risk and mode of delivery



Source: OECD, *Public-Private Partnerships: In Pursuit of Risk Sharing and Value for Money*, 2008.

Why the Need for a Unified Framework?

- Although additional resources for PPPs can accelerate the establishment of new infrastructure, it is neither possible nor desirable to increase the amount of additional resources without limits.
 - It is not “free money”.
 - The government cannot increase the amount of future liability indefinitely.
- From a fiscal point of view, a principal key to initiating PPP projects is to establish whether a government can maintain the same level of fiscal efficiency and sustainability through PPPs as through conventional means of implementation.
 - Important to establish the fact that there should not be such a thing a ‘PPP project’ intrinsically.
 - PPP is only a form of implementing a public investment project.
- A unified framework for integrating both traditional government project implementation and PPP is in need.

Why the Need for a Unified Framework? (continued)

- **A unified framework in need for ensuring consistent assessment and decision making**
 - The value for money objective is often blurred in practice, and the choice between a PPP and traditional procurement is skewed by factors other than value for money.
 - Political preference for or against PPPs may also play a role in skewing choices and affecting outcomes.
 - A unified framework has the potential to minimize subjective decisions concerning traditional versus PPP implementation.
- **A unified framework in need for supporting optimal risk transfer**
 - Designing the optimal level of risk sharing (including the respective level of fees versus subsidies) involves complex trade-offs, and the optimal contract may depend on the specific circumstances of the project.
 - If each project, whether conventional or PPP, is separately managed, the concept of optimal transfer from one to the other may not be ensured.
- **A unified framework in need for avoiding unmanaged fiscal risks while improving transparency**
 - The framework may discourage parallel budgeting by reporting the known and potential future fiscal costs of PPPs in the traditional budget system.
 - By strengthening procedural controls on PPP commitments, the framework helps to improve overall transparency in the PFM system.

Challenges to Having a Unified Framework in Practice

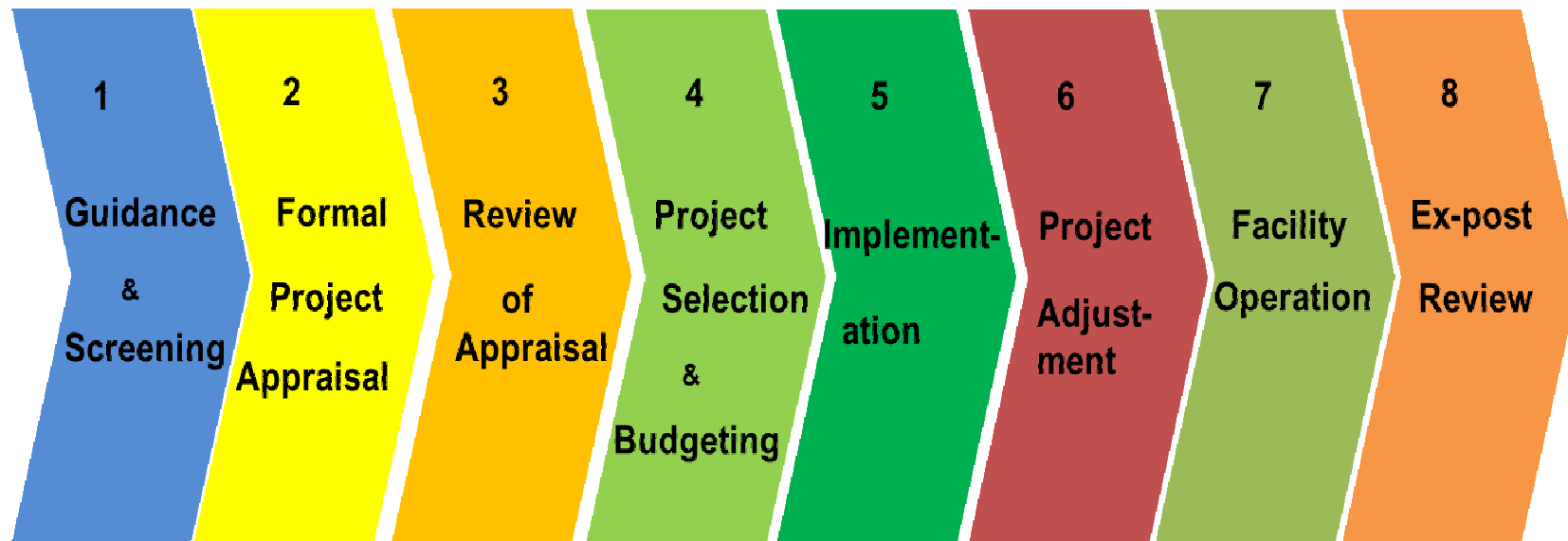
- Constraints and difficulties remain to swiftly apply such a unified framework.
 - In traditional schemes, based on solid information on the condition and cost of public services, the government specifies the quality and quantity of the services required. In a PPP scheme, however, the government explicitly specifies the quality and quantity of the service it requires from the private partner. Project risk is identified, priced, and allocated to the private company where appropriate through a payment mechanism and specific contract terms.
 - It is almost never the case that all risks in a project are transferred to the private company.
 - Difficult but important to identify commonalities and differences between traditional procurement and PPPs.
- It is important to identify the difficulties in applying a unified approach by running through the eight steps that correspond to the must-have PIM features for PPPs and to discuss several entry points to move toward such a framework → Develop a PIM diagnostic tool for PPPs (Eight PIM Features in PPPs).
 - Step 1: Strategic guidance for PPP screening and planning
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(Comparison of Traditional Procurement and PPP Procurement)

	Traditional Procurement	PPP Procurement
Government purchase	Government purchases an infrastructure asset	Government purchases infrastructure services
Contract	Short-term design and construction contracts	One long-term contract integrating design, build, finance and maintenance
Specifications	Input-based specifications	Output-based specifications
Asset risk	Government retains whole-of-life asset risk	Private sector retains whole-of-life asset risk
Mode of payment	Payment profile has a spike at the start to pay for capital costs, with low ongoing costs	Payments begin once the asset is commissioned. The payment profile is relatively even, reflecting the level of service provision over the longer term of the contract
Construction time and cost overruns	Government is usually liable for construction time and cost overruns	Private contractor is responsible for construction time and cost overruns
Operation	Government operates the facility	Government may or may not operate the facility
Management of contract	Government manages multiple contracts over the life of the facility	Government manages one contract over the life of the facility
Performance standards	Often no ongoing performance standards	Performance standards are in place. Payments may be abated if services are not delivered to contractual requirement
Handover quality	Handover quality less defined	End-of-term handover quality defined

Source: adapted from Commonwealth of Australia, *National PPP Guidelines Overview*, 2008.

Eight PIM Features in PPPs



Eight PIM Features in PPPs: Strategic Guidance for Screening and Planning PPPs (Step 1)

- PPP projects are *not* formally included in the national development strategy or other medium- and long-term government investment planning.
 - PPPs are chosen without any integrated strategic guidance and coordination between conventional and PPP implementation methods. They are mostly managed as stand-alone projects or initiatives.
- Establishing strategic screening and planning guidance for potential PPPs should therefore be the starting point because it offers the following fundamental advantages:
 - By listing eligible asset types in the PPP law or regulation, some governments can more directly signal where and in which sectors private capital is required to benefit the public.
 - A certain level of restriction for a narrowly defined sector or candidate PPPs is useful: it facilitates the assessment based on a public sector comparator or a private finance initiative.
- One might well argue that such restrictions limit the flexible and innovative nature of PPPs. However, lack of guidance may open doors for politically driven projects. An explicit legal and regulatory framework, along with planning and proper guidance, facilitates the initiation of PPP projects as it concedes to the private sector the right for initiation or participation.
- A unified guidance for identification, appraisal, and selection of both PPP and conventional projects is arguably complex. It represents an ideal solution, but it is also clear that institutional arrangements in some countries, along with political conditions, might rule out a more comprehensive approach. In such a case, a more realistic and "second best" solution may be to develop a separate and basic guidance for qualifying PPPs along the following minimum criteria:
 - The project should be in accordance with the medium- to long-term national strategic plan for public investment in the country.
 - The project should meet eligibility criteria and appraisal standards relative to other candidate PPP projects.

Eight PIM Features in PPPs:

Strategic Guidance for Screening and Planning PPPs (Step 1 continued)

- Dealing with Unsolicited Proposals:
 - An unsolicited proposal is one initiated by a private partner to undertake a PPP project rather than one in response to a request from the government.
 - However, unsolicited proposals create challenges that may increase the risk of mismatch in funding or prioritizing a government's strategic planning for infrastructure projects.
 - Accepting unsolicited projects, particularly if they are given preference and prevalence over already existing high-priority government projects, may cause distortion within the public investment portfolio.
 - To minimize these risks, specific eligibility criteria for unsolicited proposals should be developed and announced. The rules would assure that
 - The unsolicited proposal is consistent or comparable with the existing national planning so that it may not distort planned priorities;
 - It is creative and efficient enough to deliver “extra value” to the sector to compensate for possible costs of distortion; and
 - If the project fails to meet the above two clearing rules, it should be rejected.

Eight PIM Features in PPPs: A Unified Framework for Project Appraisal (Step 2)

- Most countries still have not developed clear criteria to identify whether projects are either PPP or conventional candidates.
 - Although PPP projects are often not numerous, they usually involve large sums of resources; as such, they are considered as special cases that create incentives for exceptions to established screening and eligibility criteria.
 - It is important to provide fiscal regulation for PPP project assessments with the same care applied to conventional implementation.
- Considering the experiences and lessons from Australia and the United Kingdom, a standardized example for project appraisal in a unified framework could be composed of two phases: (a) decision to proceed and (b) decision to implement.

Eight PIM Features in PPPs: A Unified Framework for Project Appraisal (Step 2)

- ***Decision to proceed (preliminary feasibility study):***
 - A preliminary feasibility study should be conducted to prepare for the decision to proceed and a full preparation in a later stage.
 - Cost-benefit analysis enables a feasibility assessment of the project from a national economy perspective and gives an early indication of whether a conventional or PPP approach might be feasible.
 - The preliminary feasibility study not only assesses whether to proceed with the full project preparation but also pushes the government to invest in more detailed project preparation in advance.

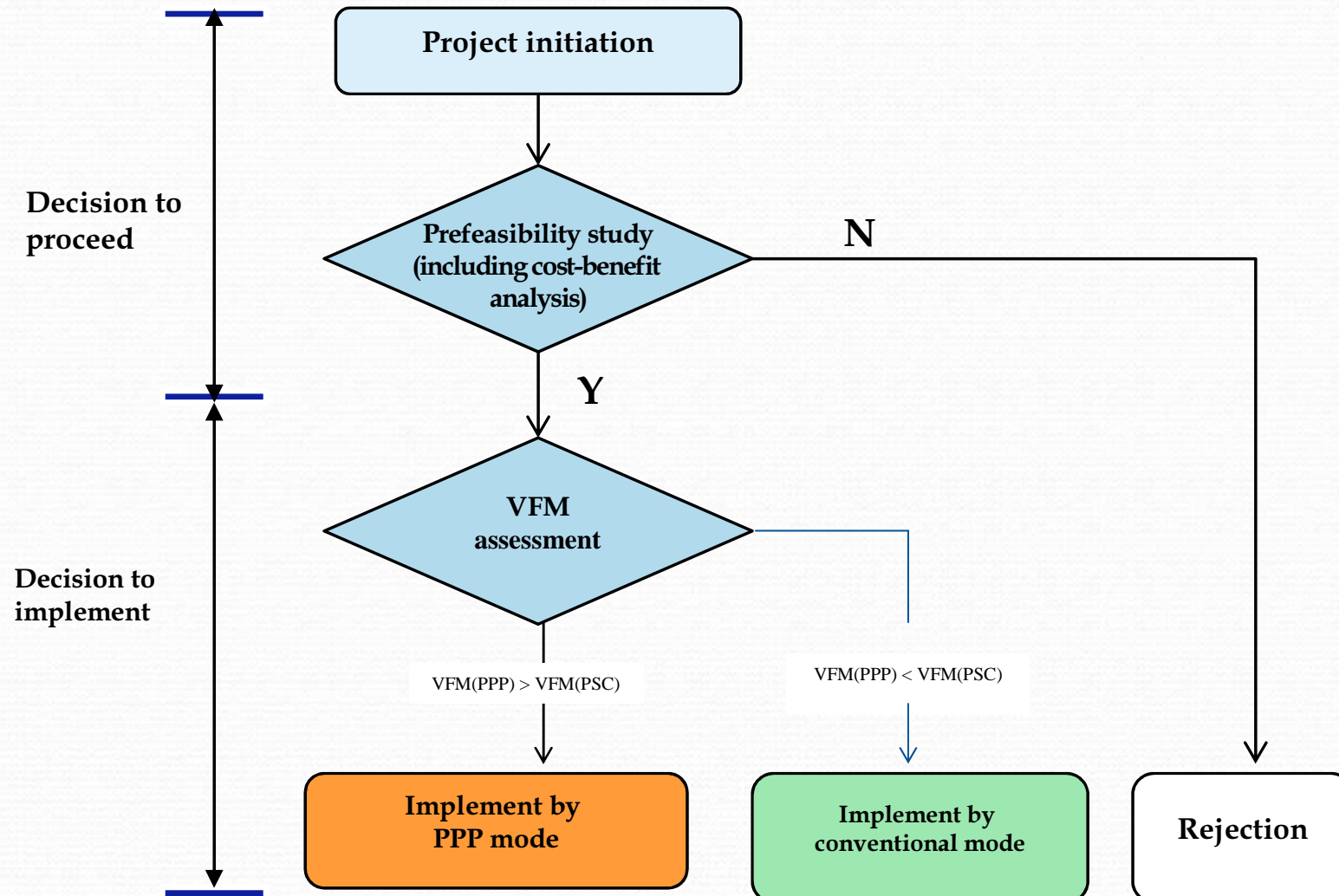
Eight PIM Features in PPPs:

A Unified Framework for Project Appraisal (Step 2 continued)

- ***Decision to implement (value for money [VFM] assessment):***
 - If the proposed project appears to be feasible, a VFM assessment would assess the implementation options—conventional versus PPP.
 - Basically, government costs and project inputs of an often-known *public sector comparator* are compared against those of the projected risk-adjusted costs of a PPP alternative to assess whether the PPP might achieve better VFM.
 - If the PPP option cannot demonstrate best value, the project is implemented by the conventional method, provided it fulfills all appraisal standards.

Eight PIM Features in PPPs:

A Unified Framework for Project Appraisal (Step 2 continued)



Note: Note: VFM = value for money. PSC = public sector comparator. PPP = public-private partnership.

Eight PIM Features in PPPs: Independent Review of the Appraisal (Step 3)

- In the case of PPPs, the role of independent peer reviews may be especially important given the role of dedicated PPP units.
 - The more the evaluating entity is independent from a particular delivery method or agency, the more its judgment is likely to be unbiased, which favors and facilitates an *optimal* partnership between two parties.
- Three Emerging Models
 - *A new agency*: Australia (Partnership Victoria), Portugal (Parpublica SA), and the United Kingdom (former Partnership UK)
 - *A government think tank*: Korea (PIMAC at KDI) and the Netherlands (Dutch Kenniscentrum PPS)
 - *A regulatory body within a ministry such as the finance ministry*: South Africa (National Treasury's PPP unit) and the United Kingdom (Infrastructure UK)
- PPP Unit as a PPP Promoter or a Gate-Keeper?
 - The models are not without the risk of conflict of interest: they are mandated to promote and improve PPP policy and projects for the direct interest of spending ministries and agencies, and, at the same time, they are supposed to be independent from the spending ministries and agencies.
 - However, the two roles of the unit—as a PPP promoter or an independent appraiser—may actually be in conflict with each other.
 - In light of these risks and possible conflicts of interest, the key recommendation is that there be strict independence from the direct interests of spending ministries and agencies.

Eight PIM Features in PPPs: Transparent Accounting, budgeting, and Safeguard Ceiling for PPP Commitment (Step 4)

- Accounting PPPs:
 - There is still no comprehensive and universally binding or accepted accounting standard for the treatment of PPPs in national budgets and international comparable statistics.
 - The absence of clear and operationally relevant standards limits the enforcement of spending controls, and therefore PPP projects often circumvent spending ceilings and fiscal rules.
 - Existing standards are also too lax, with no clear mechanism to prevent investment that would be considered public investment off the government's balance sheets.
 - Recent developments in international accounting and statistics standards, such as the International Financial Reporting Standards (IFRS) and the International Public Sector Accounting Standards (IPSAS), increasingly reduce the opportunities to use PPPs to distort fiscal realities: Risk and reward criteria → Control criteria.
- Budgeting PPPs:
 - IMF (2006) and OECD (2012) address the principle that budget documentation should transparently disclose all information possible regarding the costs (capital and recurrent), explicit liabilities, and contingent liabilities of PPPs.
 - The information should include what and when the government will pay as well as full details of guarantees and contingent liabilities.
 - When governments provide up-front payments to PPP projects, the payments required are similar to those for traditional government-financed projects, and they can be built into annual budgets and the medium-term expenditure framework relatively easily.

Eight PIM Features in PPPs: Transparent Accounting, budgeting, and Safeguard Ceiling for PPP Commitment (Step 4 continued)

- Safeguard Ceiling for PPP Commitments:
 - Given the difficulties in deciding whether a particular PPP commitment is affordable, limits or ceilings on aggregate PPP expenditure can be a helpful way to ensure that the government's total exposure to PPPs remains within manageable limits.
 - Cases:
 - Hungary: Public finance law limits the total nominal value of multiyear commitments in PPPs to 3 percent of government revenue.
 - Brazil: Following the financial crisis in 1998, the government set a safeguard ceiling—the upper limit of the local governments' financial commitment to PPP projects—of up to 1 percent of the government revenue.
 - Korea: a government payment ceiling for PPPs of 2 percent of the annual budget expenditure.
 - To practically implement a safeguard ceiling on government commitments to financing PPP projects, the following points should be carefully reviewed and answered in each country:
 - What is an optimal or acceptable level of PPP expenditure for a safeguard ceiling?
 - Is the ceiling mandatory or merely a guideline?
 - What is an appropriate annual reporting format?
 - How should the ceiling be reported to parliament, and should the ceiling be subject to parliament's approval?
 - Is there any responsibility for publishing?

Eight PIM Features in PPPs: Tightening PPP Project Implementation (Step 5)

- During implementation of a PPP project, VFM outcomes are contingent on effective management over contract terms.
 - Poor contract management with the private partner can result in higher costs, wasted resources, and impaired performance.
- A competitive bidding process (while not the only possible way of selection) is essential to ensure VFM and optimal allocation of risk between the public and the private sector.
- In the case of cost overrun, reassessment of feasibility and VFM is recommended at least for large projects; this would enable the government to recheck the impact of changes in project contents or the business case as well as to scrutinize the adequacy of the cost increase.
 - Korea: the reassessment study of feasibility (RSF) is mandatory on a project where a total project cost increase of more than 20 percent is proposed over the estimate at a previous phase of the project.
- It is useful to develop and announce standard implementation guidelines for deciding procurement strategy, managing bid processes, developing model project agreement and standard clauses.

Eight PIM Features in PPPs: Project Adjustment by Renegotiation (Step 6)

- As projects enter into the implementation phase, it is essential to clearly understand the process of PPP project adjustment, particularly regarding the two distinct cases of refinancing and renegotiation.
- Refinancing:
 - Refinancing of a PPP project is the process of changing the project company's equity structure, investment share, or debt financing conditions. Under the terms of many PPP project agreements, the government may expect to share the refinancing benefits equally with the project company.
 - Several governments have already introduced rules for how refinancing benefits will be treated. The public authority and the concessionaire may split the benefit 50-50 or in other alternate ways.
- Renegotiation:
 - Renegotiation means an adjustment or change in the project agreement between two or more parties in a PPP.

Eight PIM Features in PPPs:

Project Adjustment by Renegotiation (Step 6 continued)

- Guidelines for Renegotiations:
 - Renegotiation requires agreement among the public and the private partners along with their financiers.
 - Renegotiation takes into account the original project agreement.
 - Ex ante value for money should not be negatively affected whenever renegotiation is made.
 - The government should consider compensating the private partner only when conditions change due to discretionary public policy actions.
 - Any renegotiation process should be made transparently and subject to the law.

Eight PIM Features in PPPs:

Better Service Delivery through PPP Operation and Maintenance (Step 7)

- By definition, a large portion of value for money in PPPs should be created by more efficient management of the delivery of the services and operation and maintenance of the assets.
 - To achieve the value for money envisaged at the signing of the project agreement, both the government and the private partner need to make sure that the planned allocation of responsibilities is clear and that risks are optimally shared and balanced.
- Each public authority manages projects by following the protocols stipulated in the project agreements and receiving project progress reports.
- Performance checks and evaluation are conducted as specified in the standard performance quality requirement.
 - The purpose of the performance evaluation is to check and assess whether service delivery outputs and outcomes are in accordance with the project agreement and output specification.
 - Deductions can be applied to the payments from government to private partner for poor performance to promote private sector accountability and incentivize better operational performance.
 - The facility operation performance is evaluated on a regular basis, and, if the agreed-upon service availability levels are not met, a deduction is applied to the government payments.

Eight PIM Features in PPPs:

PPP Project Ex Post Evaluation: Does PPP Provide Better Value for Money? (Step 8)

- The evaluation of PPP projects is extremely difficult because of both the conceptual slipperiness and the large number of disciplines involved—economics, accounting, law, political science, engineering, and so on.
- Difficult in practice to prove better value for money: Traditional versus PPP
 - In theory and wishful thinking: check better VFM through project appraisal → In practice: two separate tracks for traditional public investment and PPPs → Difficult to check and compare.
- One way to evaluate PPPs, nonetheless, is to trace out evidence of cost savings and efficiency gain as well as evidence of PPP contribution to the national economy:
 - *From a microeconomic point of view:* whether gradual improvements, compared with the cases of conventionally implemented projects, have been made in the efficiency of costs, toll rates, and economic rates of return.
 - *From a macroeconomic point of view:* PPP contribution to the national economy, whether they have ripple effects on the national economy through several channels: economic growth resulting from the inflow of private capital; increased social welfare resulting from the timely delivery of social services; and the early realization of social benefits.

Future Work for the Unified Approach

- Because the scale of PPP investment and related government commitments (both explicit and contingent) have rapidly increased in the world, the need for a unified framework is increasing as well.
- Future work is needed to help governments put in place the unified approach for public investment that enables them to select the public investment option that delivers the best value for money, whether by traditional budget financing or PPP.
- An immediate task to make the unified approach viable is to provide further diagnostic tools that would synthesize and deepen guidance on systematic assessments for PPPs in and jointly with PIM systems.
- Such tools, while aligned with the Public Expenditure and Financial Accountability (PEFA) assessment tool of the conventional PIM framework, would need to develop new indicators and means of verification to assess the performance of PPP systems, processes, and institutions.

Thank You

