Public-Private Partnerships, Government Guarantees, and Fiscal Risk

Staff Team Led by Richard Hemming

International Monetary Fund

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Acronyms and Abbreviations

BBO	buy-build-operate
BDO	build-develop-operate
BLOT	build-lease-own-transfer
BOO	build-own-operate
BOOT	build-own-operate-transfer
BOT	build-operate-transfer
BROT	build-rent-own-transfer
BTO	build-transfer-operate
CAPM	capital asset pricing model
CBO	Congressional Budget Office (United States)
DBFO	design-build-finance-operate
DBFT	design-construct-manage-finance
ESA	European System of Accounts
EU	European Union
Eurostat	Statistical Office of the European Communities
FAD	Fiscal Affairs Department of the IMF
FCCEE	Contingent Liabilities Fund (Colombia)
FCRA	Federal Credit Reform Act (United States)
FSBR	Financial Statement and Budget Report (United Kingdom)
GDP	gross domestic product
GFSM	Government Finance Statistics Manual
IAS	International Accounting Standard
IASB	International Accounting Standards Board
IFAC	International Federation of Accountants
IFAC-PSC	International Federation of Accountants Public Sector Committee
IFRIC	International Financial Reporting Interpretations Committee
IFRS	International Financial Reporting Standards
IPSAS	International Public Sector Accounting Standards
IFSASB	International Public Sector Accounting Standards Board
ISWGNA	Inter-Secretariat Working Group on National Accounts, comprising Statistical Office of the European Communities (Eurostat), International Monetary Fund (IMF), Organization for Economic Cooperation and Development (OECD), United Nations (UN), and World Bank
LDO	lease-develop-operate
MIDEPLAN	Ministry of Planning and Cooperation (Chile)
MRG	minimum revenue guarantee (Chile)
NDP	National Development Plan (Ireland)
OECD	Organization for Economic Cooperation and Development

OMB	Office of Management and Budget (United States)
PIDIREGAS	(Spanish for) long-term productive infrastructure projects with deferred impact in the recording of expenditures
PFI	Private Finance Initiative (United Kingdom)
PPP	public-private partnership
RSA	revenue-sharing agreement (Chile)
SGP	Stability and Growth Pact (euro area)
SNA	System of National Accounts
SPV	special purpose vehicle
STPR	social time preference rate
UF	*Unidad de Fomento* (Chile)
VAR	value at risk
VFM	value for money
WAA	wrap-around addition

Preface

This IMF Special Issues paper is based on two papers—on public-private partnerships and on government guarantees and fiscal risk—discussed by the IMF Executive Board in April 2004 and May 2005 as part of a wider-ranging discussion of issues related to public investment and fiscal policy. The paper has been prepared by a staff team from the Fiscal Affairs Department of the IMF led by Richard Hemming and comprising Max Alier, Barry Anderson, Marco Cangiano, and Murray Petrie. Teresa Ter-Minassian, Director of the Fiscal Affairs Department, has been closely involved with the work of the team. The team is grateful to IMF and World Bank colleagues for their contributions and comments, and especially to Ana Corbacho, Tim Irwin, Gerd Schwartz, and Ethan Weisman. Linda Griffin Kean of the IMF's External Relations Department edited and coordinated the production of the publication.

Introduction

Public-private partnerships (PPPs) refer to arrangements under which the private sector supplies infrastructure assets and infrastructure-based services that traditionally have been provided by the government. PPPs are used for a wide range of economic and social infrastructure projects, but they are mainly used to build and operate roads, bridges and tunnels, light rail networks, airports and air traffic control systems, prisons, water and sanitation plants, hospitals, schools, and public buildings. PPPs can be attractive to both the government and the private sector. For the government, private financing can facilitate increased infrastructure investment without immediately adding to government borrowing and debt, and user charges can be a source of revenue for the government. At the same time, the private sector can be more efficient than the public sector because of its superior management capabilities and greater capacity to innovate, which in turn can translate into a combination of better-quality and lower-cost services. For the private sector, PPPs can open up business opportunities in new areas.

PPPs offer benefits similar to those offered by privatization, which is the sale of government-owned enterprises or assets. Privatization became a fairly common tool for governments seeking to increase the use of markets to allocate resources, following its introduction in the early 1980s in the United Kingdom by Prime Minister Margaret Thatcher (Megginson and Netter, 2001). Privatization was taken furthest where the public sector was heavily involved in supplying goods and services to private individuals and firms, and where competition was both feasible and desirable. Thus, there was extensive privatization of trading establishments, local transportation, and small and medium enterprises during the 1980s and 1990s. The large sunk costs associated with providing economic infrastructure and the tendency of the private sector to undervalue social infrastructure have been obstacles to competition, and hence to privatization, in these areas. As a result, the privatization of large public enterprises engaged in key areas of infrastructure—electricity, gas, and water utilities; oil and airline companies—was, on a global scale, not as widespread, primarily because of the monopoly position and/or the strategic importance of many of the companies involved. The principal exception in this regard has been in the area of telecommunications (and to a lesser extent power), where technological progress significantly increased opportunities for competition across the world (e.g., to provide cellular phone services). Moreover, some countries—primarily the advanced member countries of the Organization for Economic Cooperation and Development (OECD), and in Central and

Eastern Europe and Latin America—have successfully privatized public enterprises across many sectors.

By the late 1990s privatization was losing much of its earlier momentum, yet concerns about infrastructure remained in many countries. It was at this time that PPPs began to be widely seen as a means of obtaining private sector capital and management expertise for infrastructure investment, both to carry on where privatization had left off and as an alternative where there had been obstacles to privatization. After a modest start, a wave of PPPs is now beginning to sweep the world. Yet, as in the early days of privatization, the driving force behind the expansion of PPPs may be a quest not only to increase economic and social efficiency, but also to bypass expenditure controls, to move public investment off budget, and to move public debt off the government balance sheet.

Chapter 1 provides an overview of some of the issues raised by PPPs, with a particular focus on their fiscal consequences. Following a description of the main characteristics of PPPs, there is a brief discussion of country experiences with PPPs. Chapter 1 then provides some economic analysis that is relevant to the major issues raised by PPPs and outlines the institutional framework that is needed for their success. One key to success is the transfer of risk to the private sector, and Chapter 1 discusses the challenges involved in assessing who bears PPP risks and the implications of limited risk transfer. The chapter concludes with coverage of the important topic of fiscal accounting and reporting, offering interim guidance while an internationally accepted accounting and reporting standard for PPPs remains under development. Three appendices augment the discussion in Chapter 1: Appendix 1 provides more information on country experiences with PPPs, Appendix 2 summarizes the statistical reporting framework used to discuss fiscal accounting and reporting, and Appendix 3 addresses in more detail accounting for risk transfer.

Chapter 2 looks more closely at government guarantees, which are used fairly widely to shield the private sector from risk and are a common feature of PPPs. Public disclosure of information about guarantees is a good fiscal transparency practice, but it is unclear how best to reflect in the fiscal accounts the financial impact of fiscal risk associated with guarantees. Chapter 2 looks beyond narrow accounting or statistical questions, however, to address a wider range of fiscal issues raised by guarantees. The discussion places guarantees and other contingent liabilities in the context of the government's broader obligations, addresses the public policy purpose and design of guarantees, and outlines the problems associated with guarantees. Following a discussion of fiscal accounting and reporting, the chapter turns to managing the fiscal risk posed by guarantees. Appendix 4 covers modeling and estimating the value of guarantees in Chile, and Appendix 5 summarizes international accounting and reporting standards for contingent liabilities.

Although Chapter 2 refers mainly to guarantees provided in connection with PPPs, much of the discussion is relevant to a wider range of guarantees and to other contingent liabilities, including government support of the financial sector and governments' response to natural disasters. For a discussion of some of these topics, and of guarantees and contingent liabilities more generally, see Brixi and Schick (2002).

Chapter 3 looks at the consequences of PPPs and guarantees for debt sustainability, focusing on the appropriate approach to debt sustainability analysis and addressing the uncertainty created by guarantees. Chapter 4 summarizes and concludes with a list of measures that can maximize the benefits and minimize the fiscal risks associated with the use of PPPs.