Managing Fiscal Risks from Public-Private Partnerships (PPPs)

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Yaoundé, March 2014

Outline

- What PPPs are and why do them?
- PPPs and fiscal policy: why to worry?
- How to manage fiscal risks from PPP operations?

1- What are they?

PPPs 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
  - Investment and service provision by the private sector
  - Risk transfer to private sector (performance-based contract)
  - Government-funded, or user-funded (e.g., user fees, tolls), or both

1- Why do PPPs ?

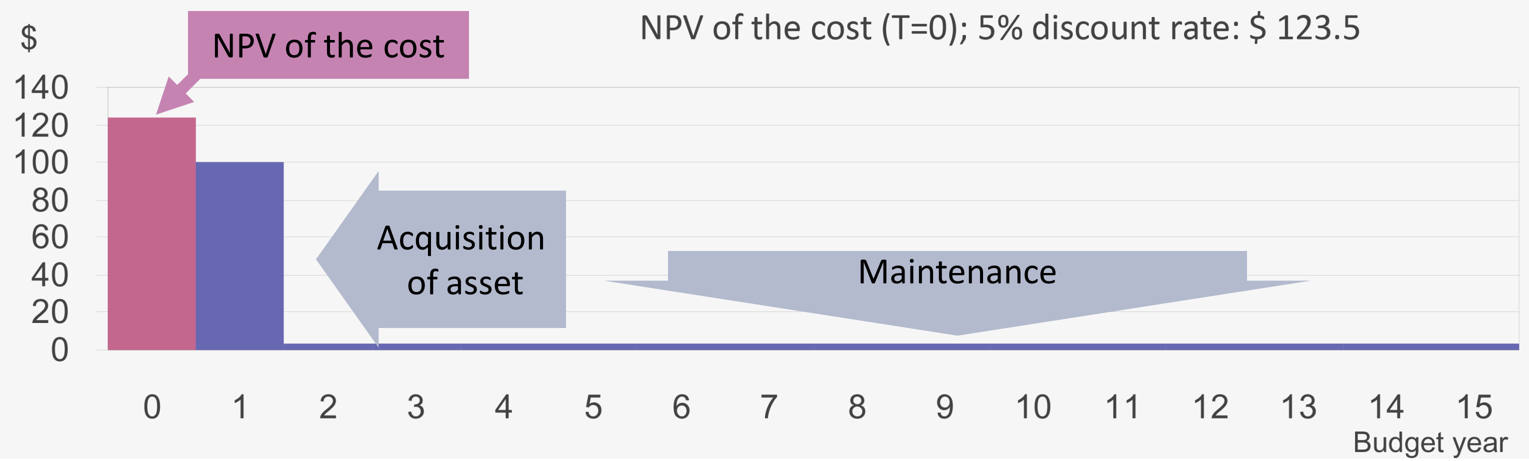
- PPPs cannot solve all those issues, but they can increase efficiency and provide value for money:
  - Containing cost overruns and delays
  - Improving project design and quality of service
  - Guaranteeing proper and timely maintenance
- Governments can abstract from detailed management, and focus on expected outputs and results

2-PPPs and fiscal policy: why to worry?

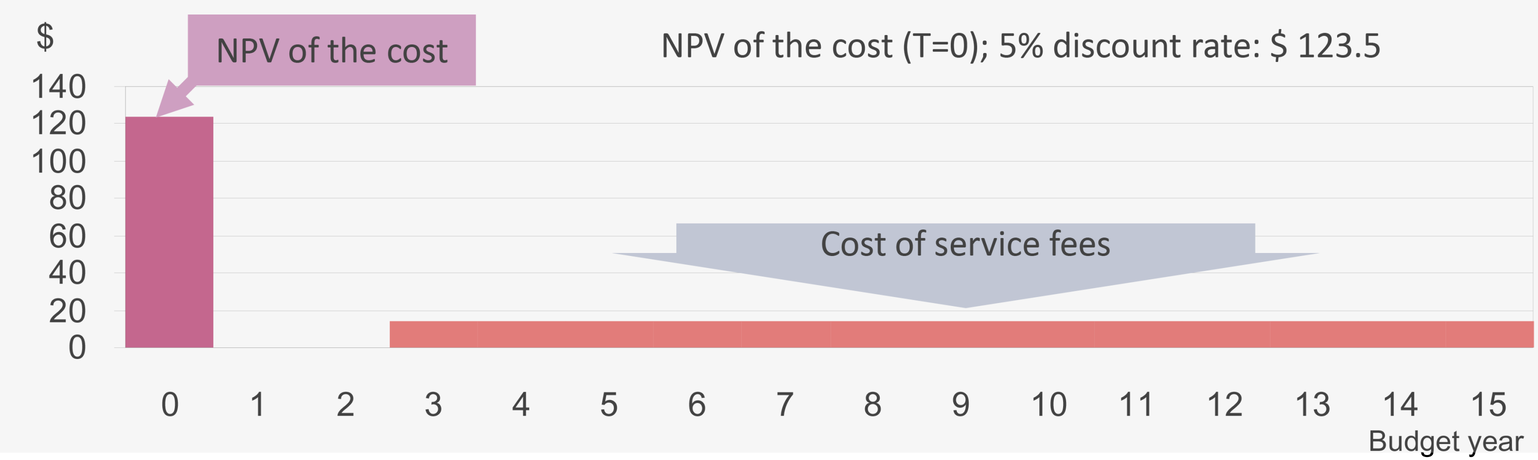
- Infrastructure for free?
  - Expectations of public service have risen steadily and governments are struggling to satisfy them
  - Allow governments to defer spending on infrastructure without deferring its benefit
  - Increase investment without immediately adding to government borrowing
  - Tempting, particularly for cash strapped governments trying to meet fiscal targets

Cash flow vs. Net Present Value (NPV)

Government traditional procurement

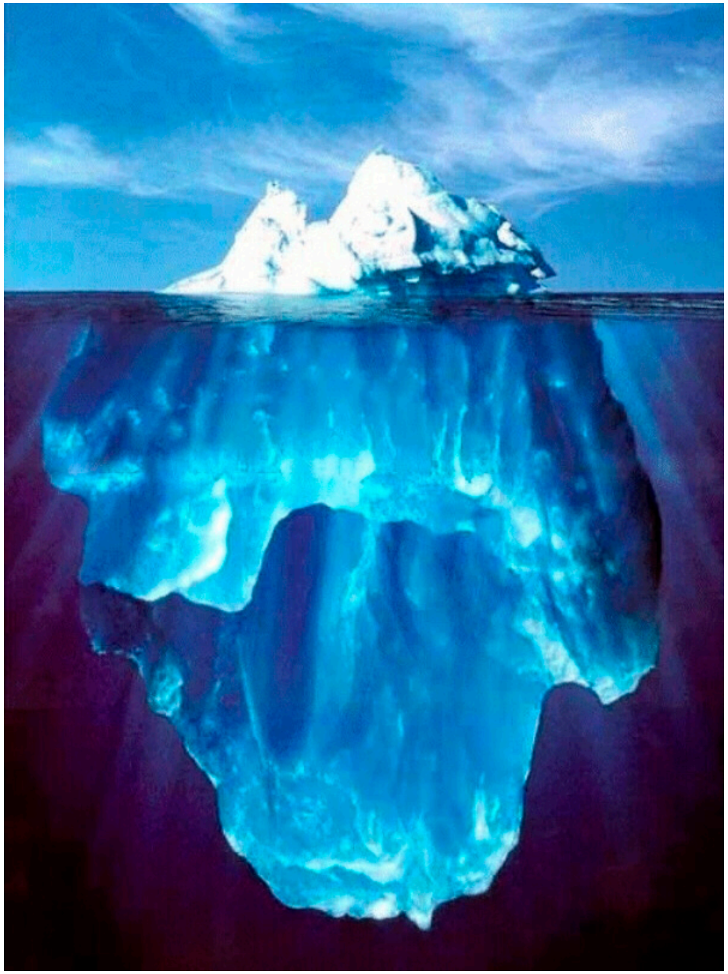


PPP



Fiscal Icebergs

- PPPs fiscal risks are potentially large:
  - Move spending off budget and bypass spending controls
  - Move debt off balance sheet and create contingent and future liabilities
  - PPPs reduce budget flexibility in the long term, and
  - can threaten macro sustainability
- Budgetary risks are related to:
  - direct costs, and
  - contingent liabilities (explicit or implicit)



2- PPPs and fiscal policy: why to worry?

- PPPs are complex to design and implement:
  - Complex and powerful incentive mechanism, translated into a complex contract
  - Require complex financing schemes
  - Require developing public sector capacity
  - Presents high transaction costs (structuring, procurement, contract management, possible renegotiations, termination management)

2- PPPs and fiscal policy: why to worry?

- Infrastructure projects can be far beyond what a country can afford
- Renegotiation is common and tend to favor private-sector operators
  - 55 percent of all PPPs get renegotiated, on average every 2 years
  - increase in tariffs (62 percent of all renegotiations)
  - automatic pass-through to tariffs of increases in cost (59 percent)
  - postponement and decrease in private sector obligations (69 percent);
  - decrease in concession fees paid to the government (31 percent)
- Concessionaire may go bankrupt and requests relief from the government

3- How to manage fiscal risks from PPP operations?

Governments can manage fiscal risks arising from PPPs while achieving efficiency gains by implementing:

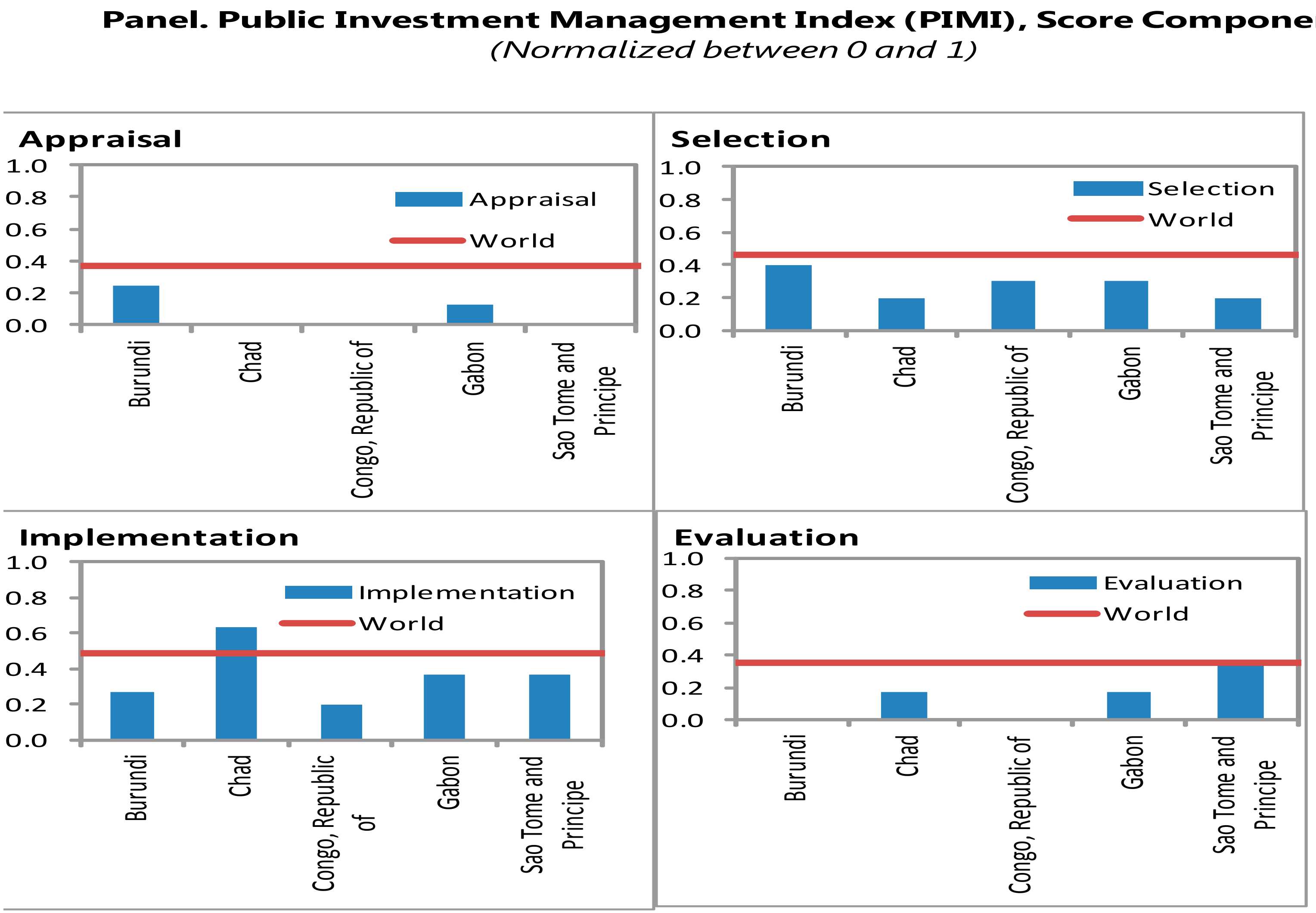
- Good projects
- Good institutions
- Good laws and regulations
- Good budgeting, accounting and reporting

3- How to manage fiscal risks from PPP operations?

- Good projects → Systematic three-step investment planning process

1. Choose the right projects
    - Have a clear investment strategy
    - Prioritize investment projects (CBA)
2. Evaluate if a project should be procured through traditional public procurement or PPPs
    - Choose only PPPs that provide value-for-money
    - Include PPPs in budget and medium-term budget framework
3. If the PPP procurement option is selected, then:
    - Establish a due-diligence/multi-stage gateway process

PIM is fairly weak in Central Africa



Source: Dabla-Norris et al. (2011).

3- How to manage fiscal risks from PPP operations?

- Good institutions→ Strengthen management and oversight framework
  - PPPs are particularly risky in a context of pervasive corruption and poor governance
  - Establishing a sound institutional framework requires:

  ... clear assignment of responsibilities

  ... capable, dedicated staff

  ... a step-by-step validation process for PPPs

3- How to manage fiscal risks from PPP operations?

- Good organization → The Ministry of Finance (MoF) has to establish a validation process to look into:

  ... poor value for money; "fiscal affordability"; any threat to macroeconomic stability

- Each step has to be validated by MoF
- Can help the government build a reputation as a good partner: lower political and regulatory risks, and risk premia
- Need of a specialized entity in the MoF (normally called PPP unit) to manage the validation process

3- How to manage fiscal risks from PPP operations?

- Good laws → For PPPs to be successful, there must be a sound legal framework which:

  … establishes a legal environment that is clear, fair, predictable, and easily accessible

  ... gives the private sector assurance that the public sector will honor its commitments, and

  … clarifies the roles and responsibilities of all relevant counterparts in a PPP transaction

- PPPs are less likely to get renegotiated when the regulatory framework is embedded in the law (17% of all renegotiated) than when it is embedded in the concession contract itself (40%) or in government decrees (28%).

3- How to manage fiscal risks from PPP operations?

- Good budgeting, accounting and reporting→ Achieve full and transparent disclosure of all fiscal risks from PPPs
  - Implementation of new international PPP accounting and reporting standards (IPSAS 32, GFSM 2001…) could be gradual

  - Include potential costs to the budget in DSA and MTBF
  - Emphasize full disclosure of budgetary costs of PPPs:
    - Future payment obligations
    - Main provisions in the projects that could impact the budget
    - Obligations borne by the government or public financial institutions/enterprises
  - Arrangements for transfer of assets at contract termination.

Thank you!