

Private Participation in Infrastructure: Lessons Learned

*Mobilizing Private Capital and Management into
Infrastructure Development*

**Enhancing the Investment Climate: The Case for Infrastructure
OECD Global Forum for International Investment
Istanbul, November 6th-7th, 2006**

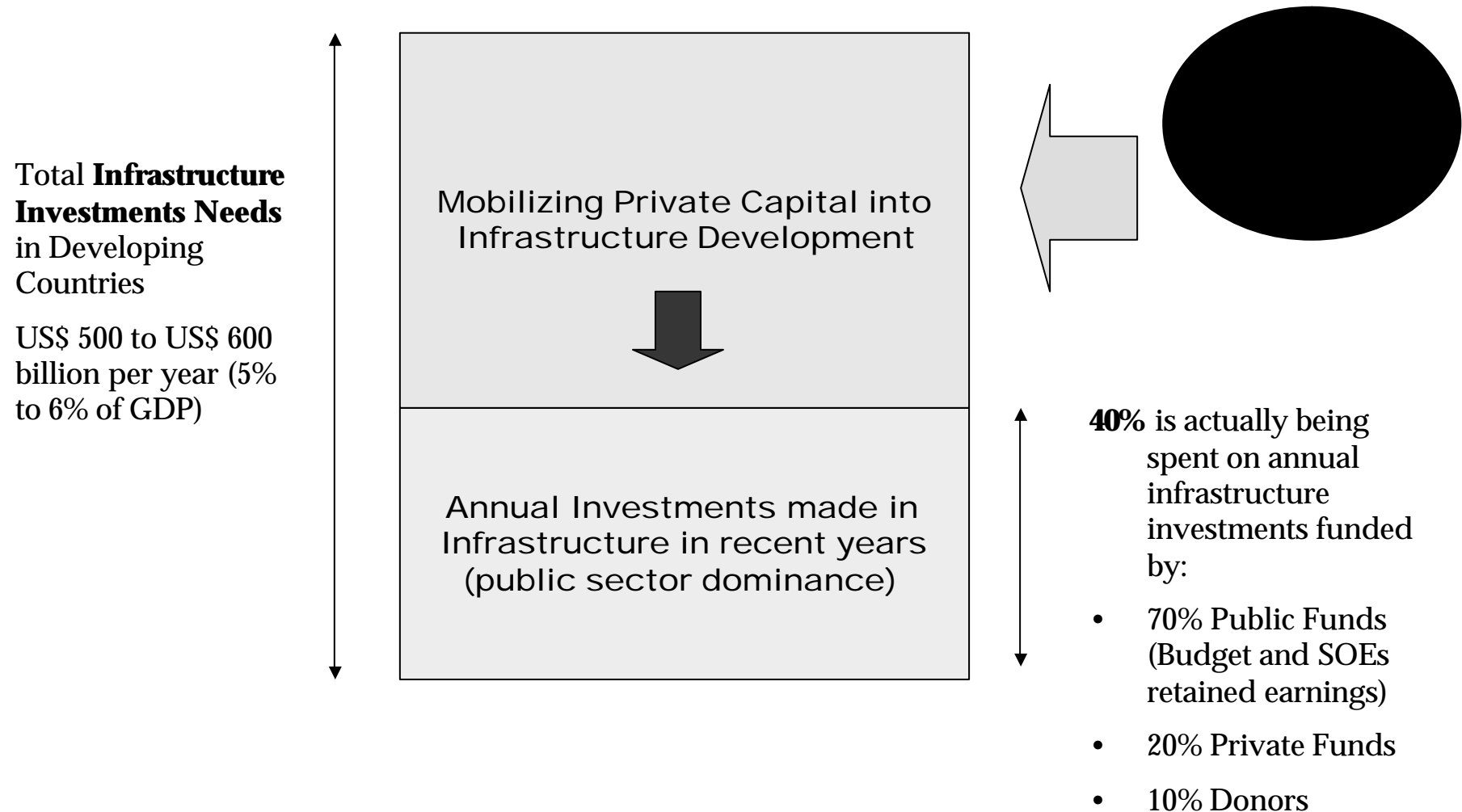
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Infrastructure Development, Growth and Poverty

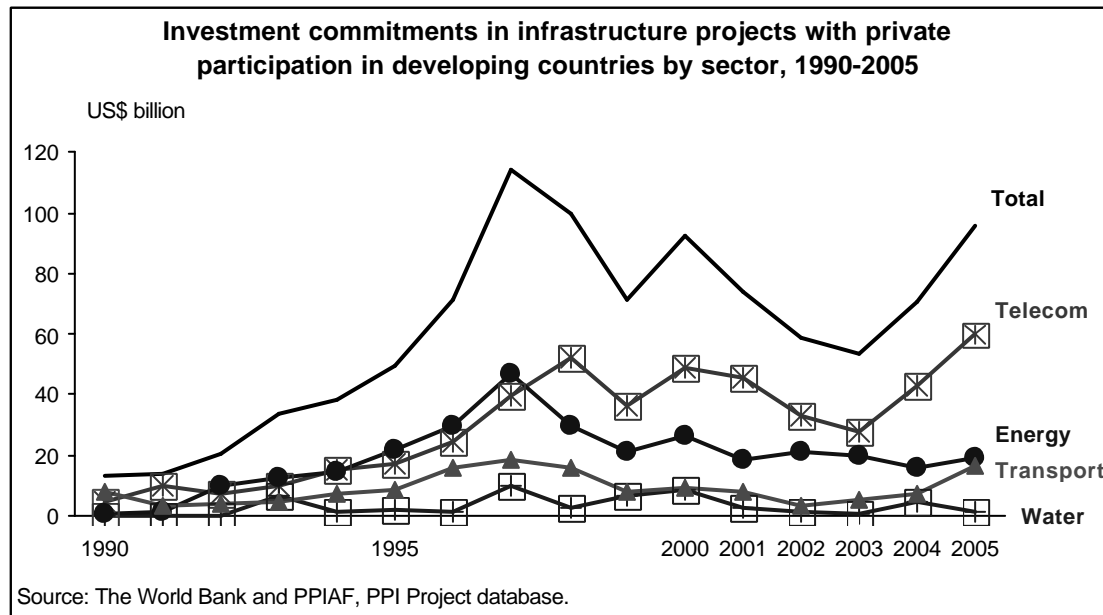
- The efficient delivery of quality public services is at the core of the poverty reduction agenda. The sustainable development needed to make progress in such agenda is not possible without strong economic growth. This growth **is not possible without substantial improvements in the delivery of infrastructure services.**
 - Access to electricity for the poor alone will require **US\$ 34 billion per year** between now and 2030.
 - Urbanization trends will also demand increasing amount of investments resources to keep up the provision of public services. In East Asia alone the urban population is expected to increase by **half a billion persons by 2025**. The impact of this type of population growth in services such as water and sanitation or public transportation is immense.
 - Infrastructure investment needs to sustain a 4% growth rate in the developing world are equivalent to US\$ 500 billion per year. **Only 40% of this amount is currently being spend.**
 - Donors US\$ 20 to 25 billion per year
 - Private sector US\$ 50 to 60 billion per year
 - Internal Public Sources (budget and cash flows from SOEs) US\$ 100 to US\$ 120

Global Infrastructure Finance (Developing Countries) ^{/1}



^{/1} Source: World Bank Staff estimates (Estache-2005, Fay-Yepez, 2003, Dailami, 2003, PPI data base-2005, etc.)

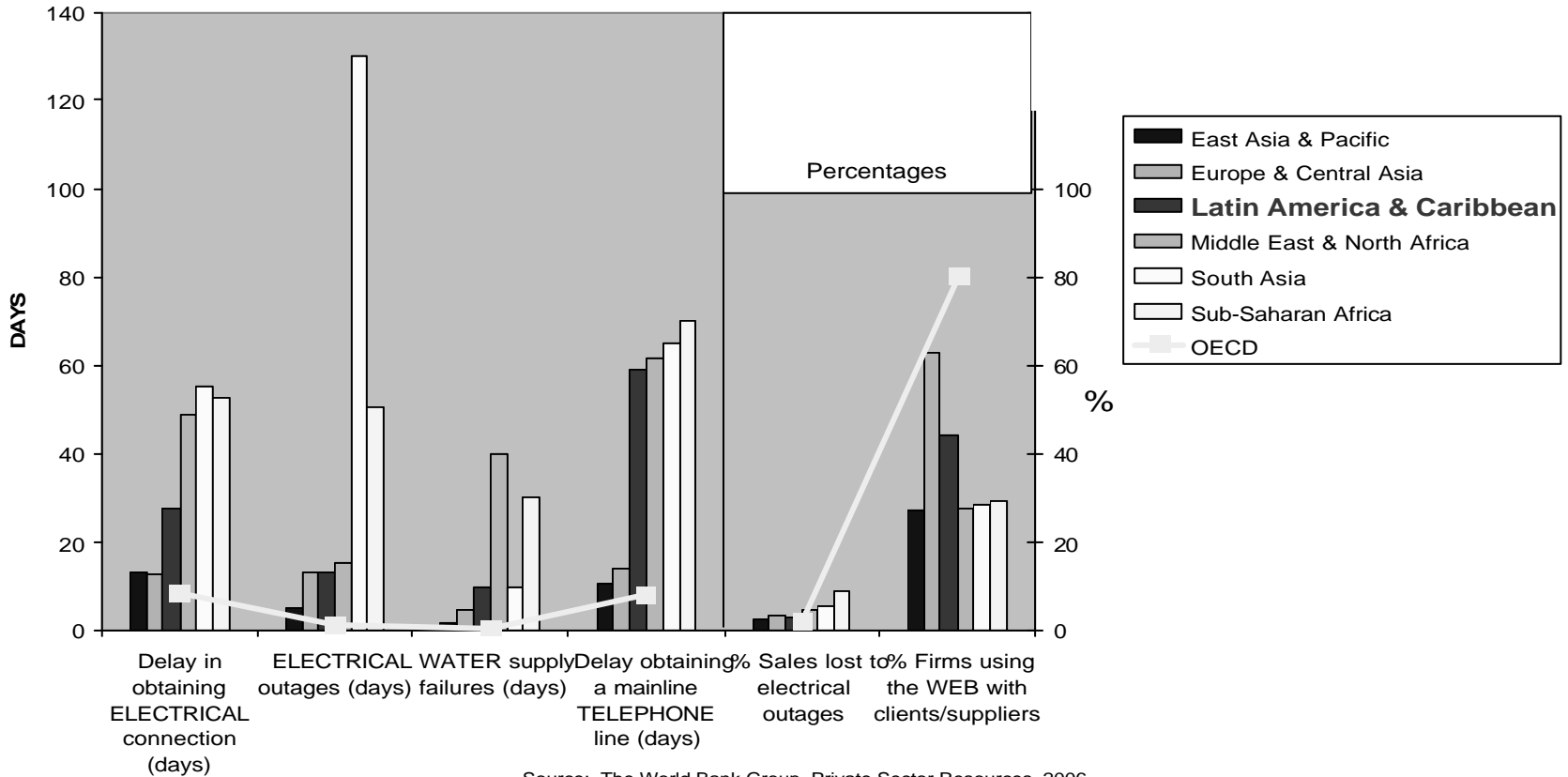
Evolution in the Roles of Public and Private Sector



- ✓ **Prior to 1990**: Public sector led the provision of infrastructure services (public utilities in distress, poor quality service, reduce access of poor segments, etc..)
- ✓ **Mid-1990s**: Private sector could eventually replaced the public sector as the main financier and provider (some believe). With the exemption of the telecom sector, evidence points in another direction.
- ✓ **Mid-2000s**: Private participation in infrastructure is not easy. Governments remain central to the delivery of infrastructure services, either as **providers or enablers**. No actor can replace government weakness in **policy formulation, regulation and risk management**.

Infrastructure Indicators (Investment Climate Survey, World Bank)

INFRASTRUCTURE Developing Countries vs. OECD



Source: The World Bank Group, Private Sector Resources, 2006

Public-Private Partnerships (PPP) Effective

- The amounts of needed funding together with the required operational capacities to effectively manage the provision of quality public services are not possible **under the sole responsibility of the public sector.**
 - Available fiscal space and prudent macro-economic policies
 - Infrastructure competes for access to public funds with other pressing needs such as the social safety network and security.
 - PPPs have become one of the few public financial instruments to leverage available public money for infrastructure by mobilizing additional private capitaland there is private capital available!
 - Procurement tool of choice when allocating scarce public sector resources to infrastructure development.... **Anti-corruption instrument if well implemented!**
 - We need to find effective ways to build and develop partnerships across the public and private spectrum. It is only through these mechanisms that we will be able to channel the needed amount of resources to sustain growth and eradicate poverty in our developing countries

Lessons Learned: De-politicizing end-user charges

- **Provision of infrastructure services are funded by tax payers and end-users**

Tax payers

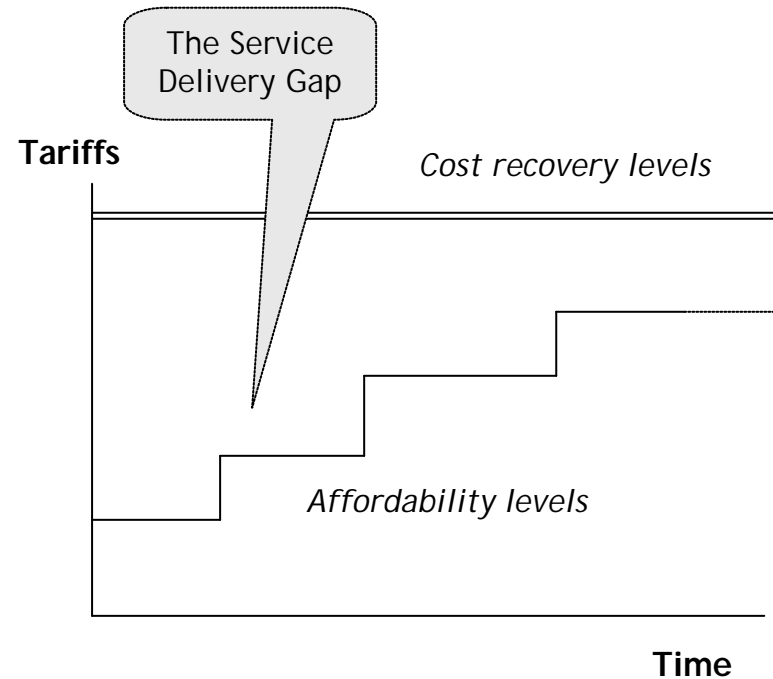
- Funded via ordinary revenues (tax payers)
- Funded via earmarked taxes (selected group of tax payers)
- Funded via public debt financing (future tax payers)

End-users

- End-user tariffs

- **PPP are funded by a combination of tax payers and end-users**

- **Successful PPPs are able to maintain a full cost recovery cash flow stream through time via a combination of end-user tariffs and subsidies.**
- **Balance Growth (efficient investments) with Access (reaching the poor) for better results.**



1. Limited affordability
2. Externalities of quality service provision
3. Limited full cost recovery
4. Room for “smart” subsidies

Lessons Learned: Smart Risk Allocation

- The most important “P” for successful PPPs is the last one **Partnership**
- The key is to efficiently share risks, liabilities and profits between government, PPP entity and end-users.
- Principle : Risk should be allocated to those best able to manage them
- Allocating PPP Risk Guidelines:
 - Allocate to the **party best able to influence the risk** factor (e.g., constructions cost to private sector – completion risk).
 - Allocate to the **party that can best anticipate or respond** to the risk factor -- influence impact or sensitivity of risk factor on project value (e.g., shifting inflation risk to users of the facility linking tariffs to CPI)
 - Allocate to the **party best able to absorb** the risk (e.g., tariff setting to public sector)

Too little:
no Value
For Money

Too much:
project
failure

Risk Transfer to Private Sector

- **Understanding how much risks can the private party and end-user absorb is the best proxy for defining how much public money support (i.e., subsidies and guarantees) is required in that particular PPP project.**

Lessons Learned: Managing Contingent Liabilities

Types of Fiscal Obligations created by PPPs

1. PPPs selling to the government:

- **Unitary (or “capacity” or “availability”) Payments.** Long term obligation to pay for services provided by the private party. The government main fiscal obligation is not contingent to the occurrence of any unlikely event but to the performance of the PPP.
- **Contingent Obligations.** The government assumes a contingent fiscal obligation based on the occurrence of a particular event (risk allocated to the public sector, e.g., termination payment).

2. PPP selling to end-users:

- **Subsidies.** Similar to the unitary payment, the government has an obligation to make a payment to supplement end-users tariffs because the project is socially valuable but privately unprofitable (on the basis of existing tariffs).
- **Guarantees.** In projects where revenues are uncertain, government could guarantee a minimum revenue level to allow the project to service its debt or could assume debt service payment if tariffs are not increased as defined in the PPP contractual arrangements. These type of arrangements creates contingent obligations.

Public sector resources are limited. Allocation of public money support needs to be managed, monitored and made transparent and accountable. Successful PPP Programs include mechanisms for the government to provide multi-year commitments (beyond the budget cycle), creditworthy support and prudent management of the fiscal obligations (both cash and contingent) created by PPPs (i.e., the concept of a “Guarantee Fund”)

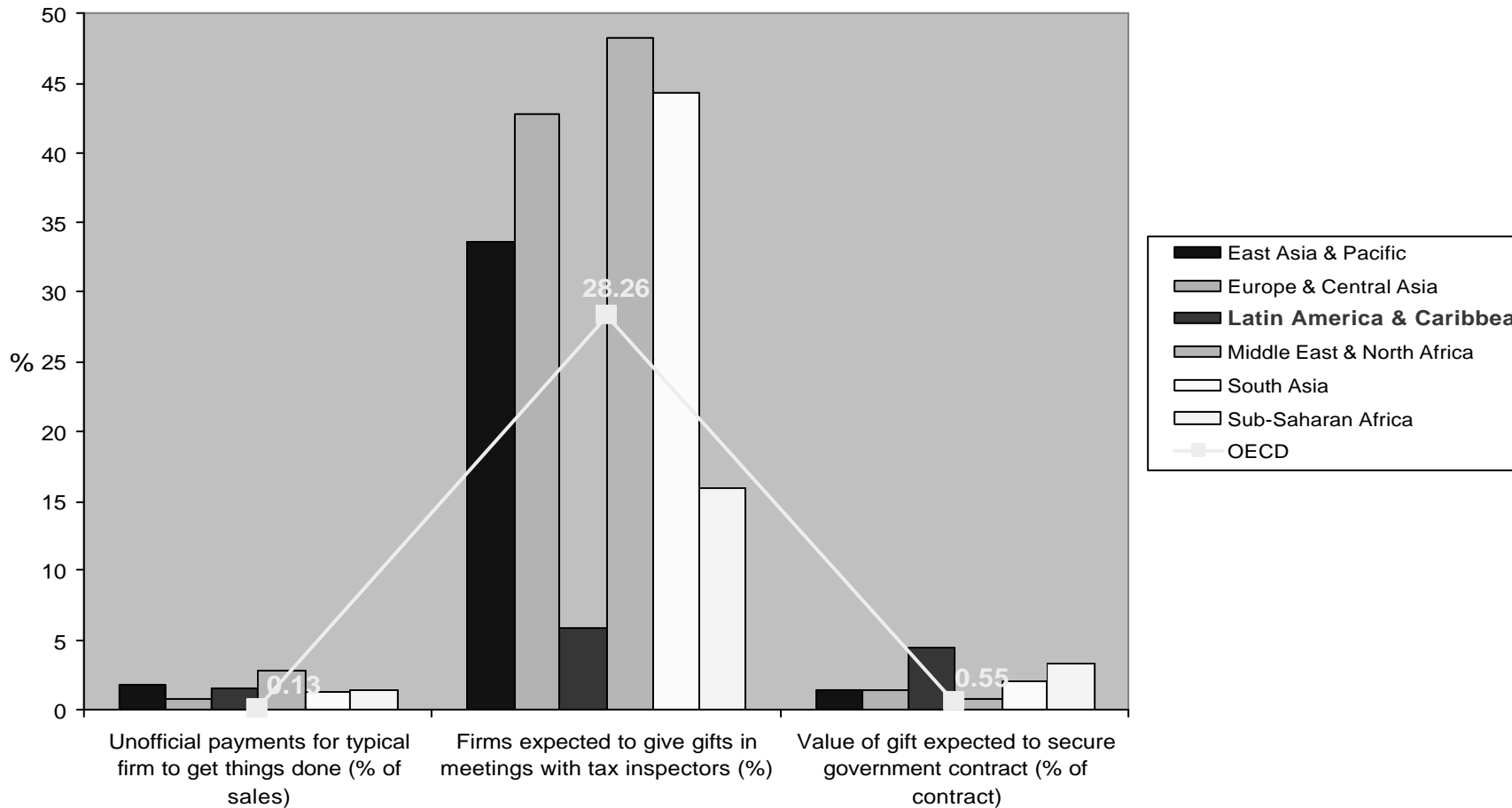
Lessons Learned: Building Institutional Capacities

- Mobilizing **greater private sector participation** in the provision of public services is challenging and requires solid and well steer government leadership. Public private partnerships are by no means a panacea and they require strong government institutional capacities to be able to be effectively implemented.
 - Experience has demonstrated that the best way to mobilize more private capital into infrastructure is to provide a **sustainable and credible policy and regulatory framework** governing investments in the provision of public services.
 - The provision of **risk mitigation financial products and the deepening of local capital markets** also play a contributing role in the mobilization of private capital (but second to the need for adequate policies and regulation).

- **Seldom are this institutional capacities present at the launch of a PPP program, results take longer to mature raising concerns regarding effectiveness of private investment. It is important to be patient and “invest” the time and resources to build such capacities.**

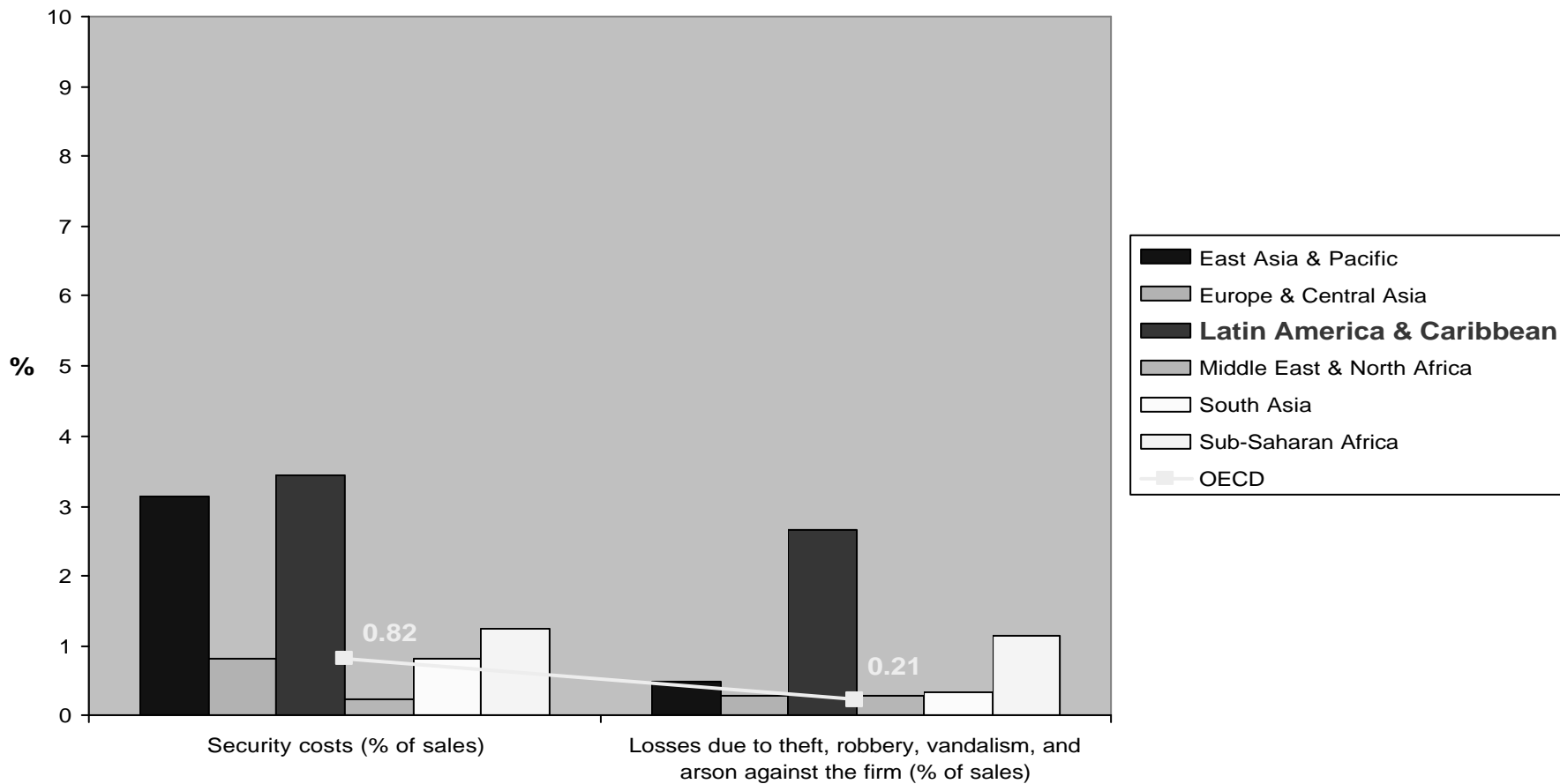
Corruption Indicators (Investment Climate Survey, World Bank)

CORRUPTION - Developing Countries vs OECD



Crime Indicators (Investment Climate Survey, World Bank)

CRIME - Developing Countries vs OECD



Lessons Learned: Governance & Corruption

- Infrastructure is particularly vulnerable to corruption, which degrades quality, increases costs, keeps honest investors away and undermines public trust and public support to PPPs. Strengthened financial management and procurement systems help prevent some abuses at project level. Improved governance and the rule of law raised the awareness of decision makers and the general public.
- **Corruption needs to be addressed within a PPP Program in an explicit manner. Competitive bidding, disclosure policies, transparent process and public reporting do not guarantee that corruption will be eradicated but limits substantially the events of occurrence. Under normal circumstances, direct negotiations and non-transparent unsolicited bids processes increases the risk of corruption (i.e., Extractive Industries Transparency Initiative)**

Way Forward

- Rebuild and adapt the **PPI Model** of the 90s on the basis of the lessons and experiences of the recent years and the immediate needs to reach MDGs by 2015.
 - ✓ **Public sector role** as enabler (policy maker and regulator) and in some cases provider cannot be substitute.
 - ✓ **Private sector** is still a key player to provide the large amounts of capital and management needed to sustain infrastructure development and economic growth.
 - ✓ **End-users** play a significant role in the “political economy” required to sustain a successful PPP Program.
- The Bank is committed to assist our client countries in the design and development of their PPP programs. We believe that only through effective partnering and increase mobilization of private resources will we be able to make a “dent” in the growth and poverty reduction agenda. Is not easy and certainly more demanding than a pure public or a pure private investment but as scale up the engagement in the provision of public services, in particular to the poor, PPPs need to be mainstream as an important policy tool to provide public services.