

PPPs: Solution or Gimmick?

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What I'm Going to Talk About

- What are PPPs
- Characteristics of PPPs
- Pros and Cons of PPPs
- Requirements for a Good PPP
- Criteria for Scoring PPPs Off Budget
- To PPP or Not To PPP



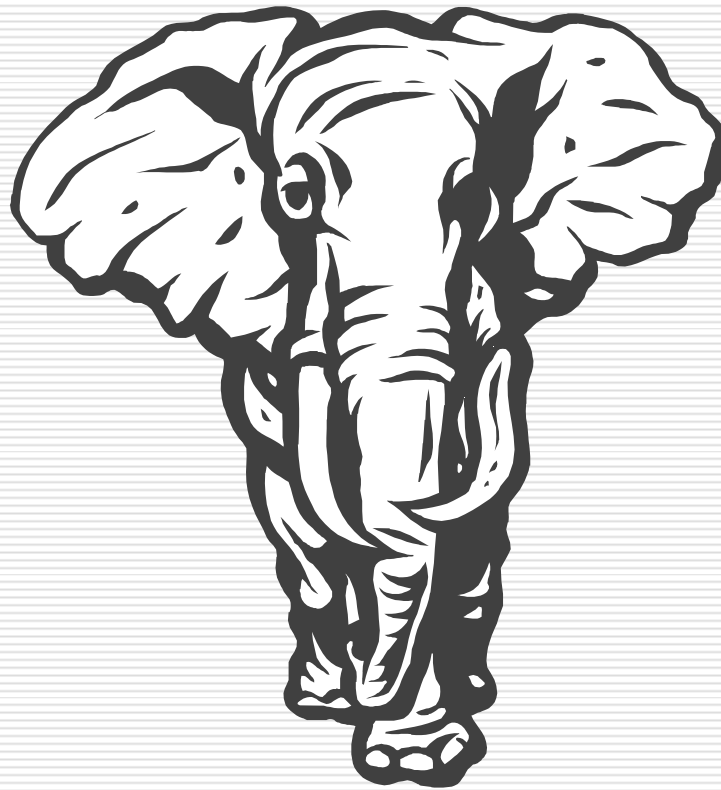
Why Am I Talking About PPPs?

- They're Everywhere! They're Everywhere!—not quite.
- They're Good!—maybe.
- They're Bad!—maybe.
- But they are clearly a growing factor in countries around the world.
- Today's Goal: Increase Your Awareness of PPPs.



What I'm *Not* Going to Talk About

- Public Investment and Fiscal Policy
- And,



What Are PPPs?

- “Public-private partnerships (PPPs) involve private sector supply of infrastructure assets and services that have traditionally been provided by the government.” (IMF)
- “The transfer to the private sector of investment projects that traditionally have been executed or financed by the public sector.” (European Commission)
- There is no clear agreement as to what is a PPP.

Characteristics of PPPs

- Private Execution & Financing of Public Investment
- Private Provisions of Services
- Private Risk
- Whole-of-Life Perspective
- Mainly used to build & operate hospitals, schools, prisons, water facilities, & especially roads, bridges & tunnels, & other transportation infrastructure



Alternatives to PPPs

- ❑ Privatization: sale of public assets where competition is both feasible & desirable
- ❑ Joint Ventures: exploit commercial potential of existing public assets
- ❑ Franchising: competition among private companies to be a monopoly supplier
- ❑ Contracting Out: outsourcing of supply to the government

Basic Features of PPPs-Forms

- Typically, PPPs have a design-build-finance-operate scheme, as opposed to design-build only which is common for traditional public investment, but there are many other variants
- Government frequently the main purchaser of services provided



Basic Features of PPPs-Financing

- Tolls
- Shadow tolls
- Operating contracts
- Government equity
- Government guarantees
- Special Purpose Vehicles (SPVs)



Pros and Cons of PPPs

Pros

- Private capital & management can:
 - Increase efficiency
 - Ease fiscal constraints on infrastructure investments

Cons

- PPPs are not necessarily more efficient
- PPPs can be used to:
 - Bypass spending controls
 - Move public investment off budget while government continues to bear most of the risks

Requirements for a Good PPP

- Service Quality is Contractible
- Adequate Risk Transfer to Private Sector
- Competition, or Incentive-Based Regulation, Must Be Present
- Good Value For Money (Efficiency gains offset higher private borrowing costs)

Risk Transfer & Financing Costs

- In theory, risk transfer should not affect financing costs
 - Cost of capital should depend only on project risks
- But, since governments can spread risks across taxpayers, private sector borrowing usually costs more than government borrowing
- “The key issue is whether PPPs result in efficiency gains that more than offset higher private sector borrowing costs.”
(IMF)

Transferable Risks

- Construction: design problems; costs overruns; project delays
- Financial: variability in interest rates & exchange rates
- Performance: availability of an asset & quality of service
- Demand: ongoing need for services
- Residual Value: future market price

Assessing Risk Transfer

Very Difficult

- Legal complexity of PPP contracts
- Implications of renegotiations
- Guarantees, explicit & implicit
- Ex Post risks for providers of essential services & those too big to fail

Very Important

- Basically determines whether PPPs are more efficient & effective

Pricing of Risk

- Governments tend to use a risk-free rate in pricing market risks (which affect all projects & are not diversifiable) where private bidders attach a risk premium.
 - This could bias choice against PPPs.
- In addition, risk allocation can be affected as private sector attempts to minimize risks assigned to it.
- These issues need to be considered when reviewing proposals versus a Public Sector Comparator.

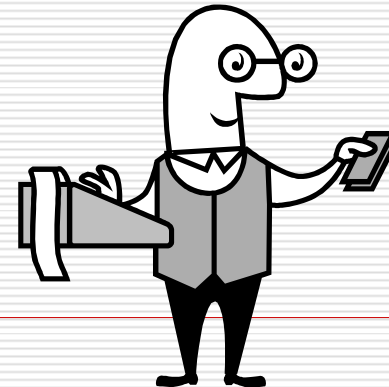
Criteria for Scoring PPPs Off Budget

□ UK

- Demand: service payments must be dependent on future need for services
- Residual Value: asset must be transferred at true economic value
- No guarantees of private liabilities

□ Eurostat: PPPs are non-government assets *if* private partner bears *both*:

- Construction risk *and*,
- Demand *or* Performance risk



Problems With Eurostat Rules

- Since the private sector usually assumes construction risk and performance risk, most PPPs will be classified as private sector assets even though governments can bear substantial demand risks.
- Example: Romania. “Heads we win; tails you lose.”



More on PPP Accounting



- ❑ No internationally accepted accounting standard has been developed to reflect varying degrees of risk transfer
- ❑ Country practices differ substantially
- ❑ Classifying PPPs as either public or private fails to recognize risk sharing
- ❑ A more appropriate treatment might be to reflect the range of fiscal costs & risks, but few, if any, accounting (let alone budget) systems can handle this treatment



To PPP or Not To PPP

- Service Quality is Contractible
 - Focus on end result, not means of delivery
 - Clearly specify outputs & performance standards
 - Public Sector Comparator
 - Value For Money
 - No presumed advantage to private or public sector
 - Refined project appraisal & prioritization process
 - Political Commitment/PPP Law
 - Fair, Accountable, Informed, Competitive, Transparent Process: Government Expertise (PPP Unit)
 - Fiscal Implications Properly Accounted & Reported
 - Pay For Performance
 - See www.partnerships.vic.gov.au
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PPPs: Solution or Gimmick?

- Comparator
- Transparency
- Efficiency first; scoring second

