Private Public Partnerships for Managing the Risks and Opportunities

OECD Regulatory Reform Review of Indonesia
Working Group Meeting
Jakarta, 9 February 2011
Ian Hawkesworth, Budgeting and Public Expenditures Division, OECD
1. OECD Network of PPP Officials
2. Defining a PPP
3. Current usage of PPPs
4. Why do a PPP
5. Necessary conditions for a successful PPP
6. Building institutional capacity to ensure value for money
7. Institutional bias – one form of procurement preferred *vis a vis* another?
8. Questions
1. OECD Network of PPP Officials
OECD PPP Network

• To provide a forum for PPP officials for sharing experiences and mutual learning
• To provide analysis and knowledge sought by practitioners
• To involve the private sector to the extent it is helpful for the PPP practitioners

**Attendance:**
– 2008, 20 Countries,
– 2009: 24 Countries
– 2010: 24 Countries
Operating Principles

• Practitioner based
  – Forum for PPP professionals to share experiences openly and candidly with each other

• Delegate run
  – Chairman and topics selected by delegates
  – Meeting content (presentations and papers) frequently prepared by delegates

• Discussions, no lectures, no selling

• Confidential
Some agenda topics

- Overview of PPP units
- Ensuring value for money when choosing between PPPs and traditional public procurement
- The financial crisis and the use of PPPs
- The use of PPPs for infrastructure investments in urban areas
- Key issues in PPP project phases
- Accounting for PPPs: value for money and transparency
2. Defining a PPP
A number of definitions

A form of procurement of public assets with private involvement. Specific characteristics:

<table>
<thead>
<tr>
<th>Public-Private Cooperation</th>
<th>Private Role</th>
<th>Risk Sharing / Transfer</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Financing</td>
<td>Investing in Infrast. Assets</td>
</tr>
<tr>
<td>IMF</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>OECD</td>
<td>✓</td>
<td>(✓)</td>
</tr>
<tr>
<td>EIB</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>UK</td>
<td>✓</td>
<td>✓</td>
</tr>
</tbody>
</table>

Non essential: SPV, user fees, price regulation.

Source: C. Catorelli, IMF and OECD
Common denominators:

- Provision by private sector of a **public service** through a **contract** that backloads the **cash flow** payment for the government arising from the provision of the service; and

- **Sharing of risk** between public and private sector that is **innovative** with respect to traditional forms of risk sharing

- Meant to deliver a service that **provides value for money** compared to traditional procurement
Types of PPP arrangements vary depending on degree of involvement (and risk sharing) of private sector.

<table>
<thead>
<tr>
<th>Public Procurement</th>
<th>PPP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Design &amp; construction</td>
<td>Design &amp; construction</td>
</tr>
<tr>
<td>Service provision</td>
<td>Service provision</td>
</tr>
<tr>
<td>Maintenance &amp; renewal</td>
<td>Maintenance &amp; renewal</td>
</tr>
<tr>
<td>Quality of service</td>
<td>Quality of service</td>
</tr>
<tr>
<td>Volume</td>
<td>Volume</td>
</tr>
<tr>
<td>Force majeure</td>
<td>Force majeure</td>
</tr>
<tr>
<td>Obsolescence</td>
<td>Obsolescence</td>
</tr>
<tr>
<td>Residual value</td>
<td>Residual value</td>
</tr>
<tr>
<td>Regulation/policy</td>
<td>Regulation/policy</td>
</tr>
</tbody>
</table>

Source: E. Farquharson, PartnershipsUK
Public and private participation classified according to risk and mode of delivery
3. Current usage of PPPs
What percentage of public sector infrastructure investment takes place through PPPs? (2010)

<table>
<thead>
<tr>
<th>Range</th>
<th>N</th>
<th>Country</th>
</tr>
</thead>
<tbody>
<tr>
<td>0% - 5%</td>
<td>10</td>
<td>Austria, Germany, Canada, Denmark, France, Lithuania, Netherlands, Hungary, Norway, Spain</td>
</tr>
<tr>
<td>&gt;5% - 10%</td>
<td>7</td>
<td>United Kingdom, Czech Republic, Slovak Republic, Greece, Italy, South Africa, Ireland</td>
</tr>
<tr>
<td>&gt;10% - 15%</td>
<td>2</td>
<td>Korea, New South Wales</td>
</tr>
<tr>
<td>&gt;15% - 20%</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>&gt;20%</td>
<td>2</td>
<td>Mexico, Chile</td>
</tr>
<tr>
<td>Total</td>
<td>21</td>
<td></td>
</tr>
</tbody>
</table>
PPPs around the World

- PPPs are becoming popular with many low and middle income countries
4. Why do a PPP?
Argument for PPPs VfM (efficiency)

• Private sector has **greater incentive and ability** to deliver cost effective capital assets

• **Tying service** delivery with **payment mechanisms** may encourage **faster construction** and **better continued maintenance** over the contract life of the assets
The weaker argument

• The **fiscal constraint** argument: pressures for governments to reduce public spending to meet political, legislated or other targets coupled with

• a **perceived infrastructure** deficit inhibiting growth

• however, government should **not bypass value-for-money and affordability** (and can borrow)

• Beware of risk that is not accounted for

• **Institutional responses:** Strengthening measurement and reporting in budget annexes, establishing fiscal rules (caps on PPP flows/stocks, stock of contingent liabilities), PPP Units, role of Ministry of Finance
5. Necessary conditions for a successful PPP
Checklist – towards principles

• Effectively identify priority projects from a whole of government perspective.
• Make sure the project is affordable, regardless of procurement method, by using the regular budget process.
• Transfer the risks to those that manage them best.
• Price the risks transferred to the private operators.
• All levels of government need to have the capacity to
  – assess value for money using a PSC
  – conduct negotiations,
  – write comprehensive contracts,
  – monitor delivery,
  – take action if things go wrong.
• Consider the interaction between the PPP and other government policy tools (such as spatial planning, regulation of traffic, utilities and development plans).
Checklist

• Limit any institutional bias by integrating traditional infrastructure procurement with PPP procurement.
• Ensure transparency in budget, reports and accounts about all relevant information – payments, guarantees and contingent liabilities.
• Competitive markets are necessary to ensure risk transfer.
• Set up a clear, transparent and predictable legal framework for PPPs.
• Regulators of sectors serviced by PPPs should operate under an appropriate mandate, with prudent independence from political influence, and be appropriately resourced and equipped with necessary skills.
• Red tape costs money – create a clear and quick procurement process.
• Empower Anti-corruption and integrity rules.
• The Ministry of Finance should retain a general government overview of PPP stock.
Assessing value-for-money

- a complete cost-benefit analysis of all alternative provisions methods available to both the government and the private sector (most complex)
- calculation of a public sector comparator before the bidding process to assess whether or not public-private partnerships in general offer better value-for-money (e.g. South Africa)
- calculation of a public sector comparator after the bidding process to assess whether or not a particular public-private partnership bid offers better value-for-money
- the use of competitive bidding process alone without a comparison between public and private provision methods (e.g. France).
Good accounting: ESA95 Manual on deficit and debt chapter on PPPs

- Asset on the private sector balance sheet if majority of risks and rewards have been transferred to the private partner
- Three risks considered for practical reasons:
  - The construction risk
  - The availability risk
  - Demand risk
- For off government balance sheet private partner must bear the majority of:
  - The construction risk
  - Any of other two risks
- Some further considerations might be necessary:
  - To whom final allocation of the asset after the PPP?
  - Government provides financing or guarantees?
6. Building institutional capacity to ensure value for money
Dedicated PPP Unit

- organisation set up with full or partial aid of the government to ensure necessary capacity to create, support and evaluate multiple public-private partnership agreements by government.

Table 0.1. Is there a dedicated public-private partnership unit at the national level?

<table>
<thead>
<tr>
<th></th>
<th>Number of countries</th>
<th>Countries</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>17</td>
<td>Australia, Belgium, Canada, Czech Republic, Denmark, France, Germany, Greece, Hungary, Ireland, Italy, Japan, Korea, Netherlands, Poland, Portugal, United Kingdom</td>
</tr>
<tr>
<td>No</td>
<td>12</td>
<td>Austria, Finland, Iceland, Luxembourg, Mexico, New Zealand, Norway, Spain, Sweden, Switzerland, Slovak Republic, United States</td>
</tr>
</tbody>
</table>

Note: No data for Turkey.
Arguments for setting up a unit

- pooling expertise and experience within government,
- appropriate budgetary consideration of projects
- standardisation of procurement procedures
- the separation of policy formulation and project implementation
- demonstrating political commitment and trust.
Functions (1)

- **Policy guidance** including advising on the content of national legislation; defining eligible sectors and public-private partnership methods/schemes; project procurement and implementation processes; as well as procedures for conflict resolution/termination.

- **Green lighting projects**, *i.e.* deciding on whether or not a project should move forward. Some PPP units do this at various stages, ranging from the inception, budgeting, business case stage to final approval of the contract to be signed by the partners.
Functions (2)

- **Technical support** to government organisations during the various stages of project identification, evaluation, procurement, contract management.
- **Capacity building** including training to public sector officials interested or engaged in PPPs.
- **PPP promotion** among the public and/or private sector (but a good idea?)
South Africa

- Treasury PPP Unit established in 2000 to filter fiscally irresponsible projects while maintaining investor confidence in the government’s public-private partnership programme.
- The creation of the PPP Unit followed Treasury’s concerns over a specific project, a 30-year build-operate-transfer contract for two prisons proposed by the Ministry of Public Works.
- In considering intervening and establishing a precedent of arbitrary intervention in public-private partnerships by the National Treasury, the government decided to create a dedicated unit.
The location of PPP units

Three models of dedicated PPP units:

1. locate a dedicated unit within the regular departmental structure of the **Ministry of Finance** (*e.g.* the United Kingdom, Victoria [Australia] and South Africa).

2. locate a dedicated unit as an independent **government agency** that collaborates with a secretariat in the finance ministry (or equivalent).

3. A third model is to locate a dedicated unit in an individual **line ministry** that is predisposed in its functions to use public-private partnerships, such as an infrastructure ministry.
<table>
<thead>
<tr>
<th>Country</th>
<th>Location</th>
<th>Year est.</th>
<th>Policy guidance</th>
<th>Technical support</th>
<th>Capacity building</th>
<th>Promotion</th>
</tr>
</thead>
<tbody>
<tr>
<td>Germany (federal)</td>
<td>Independent</td>
<td>2009</td>
<td>●</td>
<td>●</td>
<td>○</td>
<td>○</td>
</tr>
<tr>
<td>Korea</td>
<td>Independent</td>
<td>1999</td>
<td>●</td>
<td>●</td>
<td>●</td>
<td>●</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>Finance ministry</td>
<td>1997</td>
<td>●</td>
<td>●</td>
<td>●</td>
<td>●</td>
</tr>
<tr>
<td>Victoria, Australia</td>
<td>Finance ministry</td>
<td>2000</td>
<td>●</td>
<td>●</td>
<td>●</td>
<td>●</td>
</tr>
<tr>
<td>South Africa</td>
<td>Finance ministry</td>
<td>2000</td>
<td>●</td>
<td>●</td>
<td>●</td>
<td>○</td>
</tr>
<tr>
<td>Belgium (Flanders)</td>
<td>Finance ministry</td>
<td>2002</td>
<td>●</td>
<td>●</td>
<td>●</td>
<td>●</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>Independent</td>
<td>2004</td>
<td>●</td>
<td>●</td>
<td>●</td>
<td>●</td>
</tr>
<tr>
<td>Denmark</td>
<td>Line ministry</td>
<td>2006</td>
<td>●</td>
<td>●</td>
<td>○</td>
<td>●</td>
</tr>
<tr>
<td>France</td>
<td>Finance ministry</td>
<td>2005</td>
<td>●</td>
<td>●</td>
<td>○</td>
<td>●</td>
</tr>
<tr>
<td>Greece</td>
<td>Finance ministry</td>
<td>2006</td>
<td>●</td>
<td>●</td>
<td>○</td>
<td>●</td>
</tr>
<tr>
<td>Hungary</td>
<td>Finance ministry</td>
<td>2003</td>
<td>●</td>
<td>●</td>
<td>○</td>
<td>○</td>
</tr>
<tr>
<td>Ireland</td>
<td>Finance ministry</td>
<td>2003</td>
<td>●</td>
<td>●</td>
<td>●</td>
<td>●</td>
</tr>
<tr>
<td>Italy</td>
<td>Finance ministry</td>
<td>1999</td>
<td>○</td>
<td>●</td>
<td>●</td>
<td>●</td>
</tr>
<tr>
<td>Japan</td>
<td>Finance ministry</td>
<td>2000</td>
<td>●</td>
<td>●</td>
<td>○</td>
<td>○</td>
</tr>
<tr>
<td>Netherlands</td>
<td>Finance ministry</td>
<td>1999</td>
<td>●</td>
<td>●</td>
<td>○</td>
<td>○</td>
</tr>
<tr>
<td>New South Wales</td>
<td>Finance ministry</td>
<td>2000</td>
<td>●</td>
<td>●</td>
<td>○</td>
<td>●</td>
</tr>
<tr>
<td>Poland</td>
<td>Line ministry</td>
<td>2001</td>
<td>●</td>
<td>●</td>
<td>○</td>
<td>○</td>
</tr>
<tr>
<td>Portugal</td>
<td>Independent</td>
<td>2003</td>
<td>●</td>
<td>●</td>
<td>○</td>
<td>○</td>
</tr>
<tr>
<td>Total</td>
<td>n/a</td>
<td>16</td>
<td>17</td>
<td>8</td>
<td>10</td>
<td></td>
</tr>
</tbody>
</table>

Notes: ● = yes, ○ = no, n/a = not applicable
<table>
<thead>
<tr>
<th>Country</th>
<th>Number of staff</th>
<th>Approximate annual budget</th>
<th>Funding source</th>
</tr>
</thead>
<tbody>
<tr>
<td>Partnerships Germany</td>
<td>21</td>
<td>n/a</td>
<td>User charges</td>
</tr>
<tr>
<td>PIMAC, Korea</td>
<td>77</td>
<td>KRW 17,065 million (EUR 9.56 million)</td>
<td>Government budget &amp; user charges</td>
</tr>
<tr>
<td>PPP Policy Team, United Kingdom</td>
<td>13</td>
<td>No discrete budget</td>
<td>Government budget</td>
</tr>
<tr>
<td>Partnerships Victoria</td>
<td>12</td>
<td>No discrete budget</td>
<td>Government budget</td>
</tr>
<tr>
<td>National Treasury PPP Unit, South Africa</td>
<td>20</td>
<td>ZAR 35 million (EUR 3.1 million)</td>
<td>Government budget</td>
</tr>
</tbody>
</table>
Case: Korea

- Established Private Infrastructure Investment Centre of Korea (PICKO), later PIMAC, in 1999, as part of the government’s response to:
  - a perceived lack of expertise within government to develop and evaluate public-private partnerships.
  - a lack of transparency, excessively complicated procedures, unattractive risk-sharing arrangements and insufficient incentives – all of which detracted from the interest of private partners.
  - concern about the impact of the 1997 East Asian Financial Crisis on public investment.
Green lighting of projects

- Most PPP units **do not** green light projects.
- Of the five case studies carried out by OECD, three (the United Kingdom, Victoria [Australia] and South Africa) fulfil such a gate-keeping role. In the cases of Germany and Korea, the Ministry of Finance fulfils this role.
- The difference between these countries coincides with the location of the units; in the United Kingdom, Victoria and South Africa, the PPP units reside within the MoF, while in the case of Germany and Korea they are independent agencies.
- **Ministry of Finance should green light** (affordability is king)
Case: New South Wales

- Privately Financed Projects is a section within the Treasury since 2000
- Does policy guidance, technical support and promotion but little capacity building.
- Investment decision made before procurement decision based on line ministry submissions.
- Gateway review – 6 decision points (strategic, business case, procurement strategy, tender review, pre-commissioning, post implementation).
- It has proven difficult to retain skilled staff.
7. Institutional bias – one form of procurement preferred vis a vis another?
Do you think that the rules in place impede attaining the maximum value for money by creating incentives to prefer:

<table>
<thead>
<tr>
<th>Response</th>
<th>TIP over PPPs?</th>
<th>PPPs over TIP?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes, to a large extent</td>
<td>2</td>
<td>0</td>
</tr>
<tr>
<td>Yes, to some extent</td>
<td>5</td>
<td>1</td>
</tr>
<tr>
<td>No</td>
<td>9</td>
<td>15</td>
</tr>
<tr>
<td>Not enough data to make assessment</td>
<td>5</td>
<td>5</td>
</tr>
<tr>
<td>Total</td>
<td>21</td>
<td>21</td>
</tr>
</tbody>
</table>

Beware of bias

• Korea unit vs. other four case studies: Korean unit is not just a PPP unit. It considers all government investment projects, including PPP projects.

• In unifying the assessment and approval of all government investment projects makes it more likely that the value-for-money and investment criteria applied to PPP and traditionally procured projects are aligned.

• It might also eliminate a perception that a PPP unit is biased towards the creation of PPPs.
8. Questions

- What are the main challenges for Indonesia in project selection, controlling costs and ensuring standards for service delivery?
- Is the framework for procuring and managing PPPs relatively clear to relevant actors?
- When is it appropriate to use public sector financing to fund the development of public infrastructure assets in Indonesia? (and when is it not)?
- What capacity and systems are necessary for sub-national governments to run their own public-private partnerships?