PPP arrangements in a post financial crisis era: learned lessons and still remaining challenges for MENA countries

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Outline

1. Why to implement PPP arrangements in MENA?
2. Political framework and institutional preconditions
3. PPP as a polymorphic concept
4. Some economics of PPPs
5. PPPs before, during and after (?) the financial turmoil
6. New funding conditions and new challenges for an efficient use
7. Some data about PPP contracts in MENA (if enough time left)
Private participation in public investments: interests for MENA countries

- If macroeconomic stability was maintained before the Arab Spring, fiscal deficits were high for oil importer MENA countries.
- Over the three last decades, economic growth was significant (3%) but lower than the average of developing countries (4.5%).
- It appears necessary to foster per-capita growth and to lower unemployment rates.
- How improving public services offer in order to respond to social needs, to develop infrastructure assets for enhancing economic growth and to attract more foreign direct investments?
A fiscal stress and a social pressure

- A higher growth rate requires additional investments and a fostering of productivity.
- In the same time the economic growth has to benefit to the largest part of the population who requires to access to enhanced public services.
- Nevertheless, funding such investments is particularly difficult for oil importer MENA countries.
How to fund public investments?

- Strained fiscal situations are made worse by political uncertainties, which induce increased sovereign borrowing costs.
- Private involvement in public projects
  - Could conciliate investment needs and fiscal difficulties
  - Could help to preserve macroeconomic stability while meeting the investment challenge and building social consensus
  - Should be based on
    - A long term sustainable fiscal framework
    - An enhancement of public accountability: making choices and trade-offs more transparent.
A political support to construct

- Building the consensus through transparency
- Taking care about social acceptance of deals in very sensitive sectors (as water distribution)
- Underlining that a PPP is not a privatisation
  - The control of tariffs and service definition remains to the public contractor
The requirements for PPPs

- Long-term economic viable projects
- Value for money and affordability criteria have to be met
- Government bodies have to dispose from the necessary skills
  - to run the competitive process,
  - to negotiate contractual terms,
  - to monitor the contract performance
  - and to manage the unavoidable renegotiations in such long-term arrangements
How to define a PPP?

- A very wide array of contractual relationships between public bodies and private firms
- A contractual agreement between the government and a private operator according to which the second one delivers a service to the first one or to final users in ex ante defined terms, upon which its payments are based according to incentive schemes.
- The service could be offered through an infrastructure asset conceived, built, operated, maintained and funded by the private contractor
- At the end of the contract, the asset could be transferred to the public contractor
A polymorphic concept

- Two different canonical models
  - PPP / concessions:
    - The service is paid by final users
    - The risk of demand is borne by the private contractor
    - Ex. in Lebanon, Société des tramways et de l’électricité de Beyrouth (1907)
  - PPP / PFI
    - The services are sold to Government
    - The contractor cash flows are mainly availability payments
- A continuum of long term and risk sharing public-private arrangements
- A very broad definition for the PPPI Database (World Bank): privatisations, lease and management contracts, concessions, Greenfield projects
Some economics of PPPs

- A macroeconomic foundation: to make up for the fiscal gap
- Some microeconomics basis
  - Contractual bundling: optimisation of the service whole life cost
  - Optimal risk sharing and incentive clauses (no delays)
  - Fixed price structure (theoretically no cost overruns)
- Do these characteristics remain unaltered after the crisis?
  → The question of the additional cost of private finance
PPP financial schemes before the crisis

- A project finance structure
- A French example: The partnership contract relative to prisons

The public contractor enters into agreement with a SPE – special purpose entity – which is especially set up by the sponsors for the project.
A typical PPP deal

- **SPE**
- **sponsors**
- **advisors**
- **Sub-SPE Construction/ performance risks etc...**
PPPs before the financial turmoil

- The SPE funding is a mix of equity, provided by the sponsors and third-party debt, which is provided by bank-loans or bond issuance.
- As debt is less costly than equity (because of a lower level of risk), the more debt percentage, the less overall funding cost
- So high leveraged schemes lead to limit the additional cost of private funding
PPPs before the financial turmoil

- The cash-flow of the project is the sole source of debt repayment (limited-recourse finance).
- The lower the risk borne by the SPE, the higher the gear level between equity and debt.
- Before the crisis, in due diligence procedures, lenders had to take into account:
  - The realism of risk allocation between contractors
  - The financial strength of the SPE
  - The credibility (and the rating) of the public counterpart
PPPs before the financial turmoil

• How the credit worthiness of SPE was increased?

1. Contractual engineering: allocating all types of risk to different sub-contracting SPE
   1. which bears one class of specific risk.
   2. which would compensate the SPE in case of difficulties (back-to-back contracts)

2. Financial devices
   1. Monoline insurers (credit enhancers)
   2. Bonds underpinning or underwriting...
   3. syndication
Financial crisis and PPP financial schemes: a new era?

- A favourable context before the financial crisis of 2008
  - High level of market liquidity
  - Relative low (and deceasing) levels of risk premiums
  - Availability of financial tools or agents, which were able to reduce the risks for lenders, as monoline insurers.

- A model threatened by the lack of liquidities and by the increasing of risk premiums
A financial crisis which would compromise a model

- Higher spreads on sovereign debts
- Mini-perms issues: banks are sometimes unable to offer a long-term financing, which matches with contract duration
- Lack of available funding to reach the financial closes
New risks for the public contractor during and after the financial crisis?

- Stabilising the financial gear for PPP deals could compromise the microeconomic foundations of these contracts by favouring sub-optimal risk sharing or by creating additional risk for public authorities.

- Two examples
  - Minimum revenue guarantee clauses
  - Mini-perms and contract refinancing
New risks for the public contractor?

- Minimum levels of revenue
  - Especially for PPP-concessions, the contractor could benefit from a minimum revenue guaranteed
  - It secures the SPE for the repayment of its debt
  - It requires that the SPE is always exposed – even partially to demand risk -, unless the incentive contract would be an illusion
  - It also requires that the potential fiscal consequences of such guarantees are very carefully assessed ex ante and well recognised in public body accounts
New risks for the public contractor?

- Refinancing
  - Banks (or financial markets) could not offer funds for the whole contract duration.
  - The maturity of the financial loans could be inferior to the contract one.
  - Refinancing the contract will be unavoidable whatever market conditions will be
    - A risk of illiquidity
    - A risk of a higher spread
  - In numerous deals, Government bears such risk
  - The PPP is no longer a fixed price contract
Other risks or difficulties induced by the new financial situation

- Allowing partial-credit guarantee (in order to enhance the borrower access to credit markets) could reduce the accuracy of due diligence procedures led by the potential lenders (and depriving the public contractor of a very pertinent information about the contract financial robustness)
Other risks or difficulties induced by the new financial situation

- The lack of market liquidity could blunt the intensity of the competition funding
- The risk is all the more important than in such long term contracts, there is just a competition for the contract
- At the microeconomic point of view such competition could be also biased by the recourse to bank club-deals (ex. M25 Highway in England)
A last but not the least risk: shifting from a microeconomic motive to a fiscal one

- Both economic crisis and increased social pressure could induce an excessive recourse to PPPs (even if they not meet value for money or affordability criteria), which could jeopardise fiscal sustainability
- PPP could appears as a counter cyclical investment device...
- PPP could be considered as the only game in town to finance public investments
A last but not the least risk: shifting from a microeconomic motive to a fiscal one

- Three risks must be underlined
  1. A bias in project selection: choosing not the best in terms of socio-economic utility but the one for which a PPP is suitable
  2. A sub-optimal use of public funds on an inter-temporal perspective
  3. From the SPE financial model robustness to public body credit worthiness?
     1. PPP commitments reduce fiscal flexibility
     2. PPP guarantees induce additional fiscal risks
A regulatory framework to improve

- Fiscal transparency and accountability are more important than ever
  - To testify from the optimality of the public choice
  - To identify and to assess the potential consequences of the guarantees given
  - To attract new lenders with a guarantee of transparent and sincere public accounts
- The financial cost of a PPP now depends not only on the expected capacity of the SPE to honour its debt service but also on the public contractor credit worthiness
- As a consequence, the quality of the regulatory framework is pivotal both for foreign investors and the social body
A more comprehensive accounting treatment for taking up current challenges?

- Avoiding off-balance sheet treatments of contract
- Recognising the potential cost of contingent liabilities (ex. Government guarantees)

→ IPSASB project on Service concession agreements (SCA) based on a mirroring norm with IFRIC 12
PPPs in MENA: current trends

- In 2010, investors continue to be highly selective and new activity is concentrated in greenfield projects (72%) and mainly in India (43% of the 2010 investments)

- In the MENA, investments were stable (US$ 6.9 billions)
  - Less new projects
  - Telecommunications (85%) and water and sewerage (8%)
# PPPs in MENA countries

<table>
<thead>
<tr>
<th></th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
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<th>2008</th>
<th>2009</th>
<th>2010</th>
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<tbody>
<tr>
<td>MENA</td>
<td>5.4</td>
<td>4.2</td>
<td>1.7</td>
<td>2.3</td>
<td>8.8</td>
<td>7.0</td>
<td>13.2</td>
<td>12.5</td>
<td>6.3</td>
<td>6.9</td>
<td>6.9</td>
</tr>
<tr>
<td>Developing countries</td>
<td>104.4</td>
<td>83.3</td>
<td>61.2</td>
<td>66.9</td>
<td>77.2</td>
<td>109.2</td>
<td>135</td>
<td>165.3</td>
<td>166.2</td>
<td>158.3</td>
<td>170</td>
</tr>
<tr>
<td>%</td>
<td>5.2</td>
<td>5.0</td>
<td>2.8</td>
<td>3.4</td>
<td>11.4</td>
<td>6.4</td>
<td>9.8</td>
<td>7.6</td>
<td>3.4</td>
<td>4.4</td>
<td>4.1</td>
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Source World Bank, PPI data base
PPPs in MENA countries

2000-2010

- 12 countries out of the 13 implemented PPPs
- 102 contracts / US$ 75.1 billions
- 3 countries (Egypt, Algeria and Morocco) count for 61% of the investments
- The 2008-10 private commitment level is just the half of the 2006-2007 one
Some data on the PPPs implementation in MENA countries

New infrastructure projects (1990-2008) – source PPI Project Database
Breaking down of private commitments by contractual forms

PPI Database
## PPPs distribution in MENA

<table>
<thead>
<tr>
<th>2000-2010 (PPI database)</th>
<th>Number of contracts</th>
<th>Cumulated investments</th>
</tr>
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<tbody>
<tr>
<td>Telecom</td>
<td>30 contracts (11 countries)</td>
<td>54.5 (73%)</td>
</tr>
<tr>
<td>Energy</td>
<td>23 contracts (9 countries) 18 greenfield, 3 divestiture and 2 concession contracts</td>
<td>9.2 (12%)</td>
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<tr>
<td>Transport</td>
<td>31 contracts (10 countries) 12 concession, 11 greenfield and 8 management and lease contracts</td>
<td>7.4 (10%)</td>
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<tr>
<td>Water</td>
<td>18 contracts (5 countries) Greenfields (15) Management contracts for water utilities (3)</td>
<td>4 (5%)</td>
</tr>
</tbody>
</table>
PPP contracts: a breaking down by number of deals

Source PPI database
PPP contracts: a breaking down by private investment commitments

Source: PPI database
**2010 PPPs in MENA: focus on water projects**

<table>
<thead>
<tr>
<th>EGYPT</th>
<th>TUNISIA</th>
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<tr>
<td>NEW CAIRO WASTE WATER TREATMENT PLANT Greenfield (BOT) US $ 475 billions (capital value) 250 000 m³/s</td>
<td>DJERBA DESALINISATION PLANT Greenfield (BOT) US $ 50 billions (capital value) 50 000 m³/s</td>
</tr>
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