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-- DRAFT --

From Lessons to Principles for the use of Public-Private Partnerships

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FROM LESSONS TO PRINCIPLES FOR THE USE OF PUBLIC-PRIVATE PARTNERSHIPS

1. Why OECD PPP Principles[1]

The OECD is in a unique position to assist member countries to respond to the challenges of using Public Private Partnerships (PPP) to deliver public services efficiently and effectively. Using lessons learnt by member countries, the OECD will develop principles for the institutional and procedural treatment of PPPs. These principles will enable both OECD members and other countries to harness the upside of PPPs without jeopardising fiscal sustainability.

Public-Private Partnerships are becoming an increasingly important tool for delivering public services both with regards to infrastructure assets (bridges, roads) and more complex assets (prisons, utilities). This presents the public sector with particular challenges that need to be met with prudent institutional answers. Public-Private Partnerships can be viewed in a broad way as covering most interactions between the private and the public sectors and in a more narrow way as focusing on particular sets of risk-sharing and financial relationships. Even when viewed in a narrow way the stock of PPPs in a number of countries is already substantial and in most countries the number of new PPPs is rising. If used correctly PPPs can deliver value for money, but they can also be dangerous for fiscal sustainability due to their complex nature in terms of risk sharing, costing, contract negotiation, affordability, budget and accounting treatment. For instance, OECD research has shown that the rules in a number of countries create incentives to prefer one form of procurement over another hindering countries from attaining the optimum value for money. The same research shows that for some countries the off budget nature of PPPs, rather than value for money, make them more attractive than traditional procurement of assets (OECD, 2011: 8, 21).

The PPP principles will aid decision makers facing the tradeoffs between three demands inherent in a PPP project process. First, the public sector must be a prudent fiscal actor. It falls on the decision maker to ensure that the PPP is affordable, that it represents adequate value for money, and that any fiscal risks, such as contingent liabilities, are limited. Second, the demands for investment from particular sectors

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1 This paper was drafted by Ian Hawkesworth of the Budgeting and Public Expenditures Division in collaboration with staff from the Regulatory Policy Division, Governance Reviews and Partnerships Division, Reform of the Public Sector Division, Regional Development Policy Division under the guidance of Mario Marcel, Deputy Director of the Public Governance and Territorial Development Directorate, OECD. The authors would like to express their gratitude for learned comments from the members of the OECD Network of Senior Public-Private Partnership officials, Prof. Philippe Burger, University of the Free State, Mr. Gordon McKechnie, Ms. Lisa von Trapp, Prof. Pedro Verga Matos, Universidade Técnica de Lisboa, Prof. Joaquim Miranda Sarmento, Universidade Técnica de Lisboa, Prof. David Heald, University of Aberdeen Business School, and TUAC.

such as transportation, health and education have to be assessed prudently against each other so that the projects that are pursued are those that yield the highest return on investment for society as a whole. Finally, decision makers must balance the risks taken by the private sector and those retained by the public sector. It also requires deciding what the appropriate price of such a transfer should be. There is not necessarily one right solution to these tradeoffs; much will depend on the concrete circumstances of each project. However, OECD countries all negotiate these issues and lessons from their experience form the basis for the principles.

This paper starts by considering the definition of Public Private Partnerships and particular challenges around them. It then shows how PPPs are a large and growing method of service delivery in OECD countries. It next examines some key questions related to the use of PPPs. A draft of possible PPP principles is included for discussion. Finally, the document sets out the process by which the principles will become an official OECD instrument and describes what other work exists in this and related fields.

2. Defining PPPs and the reasons for undertaking them

Public-Private Partnerships (PPPs) are way of delivering and funding public services using a capital asset where project risks are shared between the public and private sector. A PPP is here defined as a long term agreement between the government and a private partner where the service delivery objectives of the government are aligned with the profit objectives of the private partner. The effectiveness of the alignment depends on a sufficient and appropriate transfer of risk to the private partners. In the PPP, the government specifies the quality and quantity of the service it requires from the private partner. The private partner may be tasked with the design, construction, financing, operation and management of a capital asset and the delivery of a service to the government or to the public using that asset. A key element is the bundling of the construction and operation of the asset. The private partner will receive either a stream of payments from the government, user charges levied directly on the end users, or a combination of both.

This definition excludes a wider array of arrangements where non-governmental organizations such as non-profit civil society groups, trusts, church groups etc. are involved in the development and delivery of public or semi-public services.

If the government is responsible for a stream of payments to the private partner for services delivered, their actual payment will likely depend on the private partner's delivery of service and compliance with the contractually set quality and quantity specifications. Public-private partnerships are often undertaken by a special purpose vehicle acting as the government's private sector counterparty. A special purpose vehicle is typically (but not always) a consortium of companies responsible for the main activities of the public-private partnership[2].

[2] Within the category of public-private partnerships a number of different models exist – which can also give rise to different definitions. These are influenced not only by the responsibilities of the private partner but also the ownership and conceptualisation of the asset. For example, the private partner may design, build, own, operate and manage an asset with no obligation to transfer ownership to the government (*e.g.* design-build-finance-operate). Alternatively, the private partner may buy/lease an existing asset from the government, modernise, and/or expand it before operating the asset but with no obligation to transfer ownership back to the government (*e.g.* buy-build-operate). Finally, the private partner may design, build and operate an asset before transferring it back to the government when the operating contract ends, or at some other pre-specified time (*e.g.* build-operate-transfer). There have emerged a large number of acronyms for public-private partnerships. This paper refers to public-private partnerships in general and does not go into specific types—which, indeed,

A key argument for PPPs is that through harnessing the private sector's expertise in combining the design and operation of an asset – applying a whole of life view – the service can be provided in a more efficient manner – i.e. providing more "value for money" compared to traditional forms of procurement and production. There are a number of conditions that need to be in place for a PPP to be successful. The most important generic issues are set out below.

Box.1. Different country definitions of public-private partnerships

There is no widely recognised definition of PPPs and related accounting framework. Eurostat, IASB, IMF, IFRS and others work with different definitions. As illustrated below there is variation between countries.

- **Korea** defines a public-private partnership project as a project to build and operate infrastructure such as road, port, railway, school and environmental facilities – which have traditionally been constructed and run by government funding – with private capital, thus tapping the creativity and efficiency of private sector.
- **South Africa** defines a public-private partnership as a commercial transaction between a government institution and a private partner in which the private party either performs an institutional function on behalf of the institution for a specified or indefinite period, or acquires the use of state property for its own commercial purposes for a specified or indefinite period. The private party receives a benefit for performing the function or by utilizing state property, either by way of compensation from a revenue fund, charges or fees collected by the private party from users or customers of a service provided to them, or a combination of such compensation and such charges or fees.
- The **United Kingdom** defines a public-private partnership as "…arrangements typified by joint working between the public and private sectors. In their broadest sense they can cover all types of collaboration across the private-public sector interface involving collaborative working together and risk sharing to deliver policies, services and infrastructure." (HMT, *Infrastructure Procurement: Delivering Long-Term Value*, March 2008). The most common type of PPP in the UK is the Private Finance Initiative. A Private Finance Initiative is an arrangement whereby the public sector contracts to purchase services, usually derived from an investment in assets, from the private sector on a long-term basis, often between 15 to 30 years. This includes concessions and franchises, where a private sector partner takes on the responsibility for providing a public service, including maintaining, enhancing or constructing the necessary infrastructure.
- The **State of Victoria (Australia)** defines a public-private partnership as relating to the provision of infrastructure and any related ancillary service which involve private investment or financing, with a present value of payments for a service to be made by the government (and/or by consumers) of more than AUD 10 mil. during the period of a partnership that do not relate to the general procurement of services.

3. Particular challenges around PPPs

PPPs are complex instruments which require a number of capacities to be present in government. These involve setting up a robust system of assessing value for money using a prudent public sector comparator and transparent and consistent guidelines regarding non-quantifiable elements in the value for money judgement. It also involves being able to classify, measure and allocate risk to the party best able to manage it and it requires sound accounting and budgeting practises.

Governments need to be able to assess whether or not a project represents value for money. Value for money is a relative measure or concept. The starting point for such a calculation is the public sector comparator. A public sector comparator compares the net present cost of bids for the public-private partnership project against the most efficient form of delivery according to a traditionally procured public-sector reference project. The comparator takes into account the risks that are transferable to a

vary significantly between countries. There exist a number of variations on design-build-finance-operate (DBFO), buy-build-operate (BBO) and build-operate-transfer (BOT) schemes.

probable private party, and those risks that will be retained by the government. Thus, the public sector comparator serves as a hypothetical risk-adjusted cost of public delivery of the output specification of the project. Some contest the robustness of a public sector comparator citing that it is open to manipulation in favour of public-private partnerships (e.g. much depends on the discount rate chosen or on the value attributed to a risk transferred).

In addition to the quantitative aspects typically included in a hard public sector comparator, value for money includes qualitative aspects and typically involves an element of judgement on the part of government. Value for money can be defined as what government judges to be an optimal combination of quantity, quality, features and price (i.e. cost), expected (sometimes, but not always, calculated) over the whole of the project's lifetime. What makes value for money hard to assess at the beginning of a project is that it ultimately depends on a combination of factors working together such as risk transfer, output-based specifications, performance measurement and incentives, competition in and for the market, private sector management expertise and the benefits for end users and society as a whole.

To ensure that the private partner operates efficiently and delivers value for money, a sufficient, but also appropriate, amount of risk needs to be transferred. In principle risk should be carried by the party best able to manage it. In this context best means the party who can manage the risk at least cost. This may mean the party best able to prevent a risk from realising (*ex ante* risk management) or the party best able to deal with the results of realised risk (*ex post* risk management). Some risks can be managed, and are hence called endogenous risks. However, not all risks can be managed and cases may exist where one or more parties to a contract are unable to manage a risk. To those parties such unmanageable risks are exogenous risks (an example is uninsurable force majeure risk that affects all parties, while political and taxation risk is exogenous to the private party and endogenous to government).[3] The ability to write and negotiate PPP contracts are an important public sector capacity requirement. Especially given the long term nature and the large transaction costs associated with PPPs.

Another key issue is affordability. A project is affordable if government expenditure associated with a project, be it a PPP or other mode of delivery, can be accommodated within the intertemporal budget constraint of the government. A public-private partnership can make a project affordable if it improves the value for money compared to that realised through traditional public procurement, and then only if the increased VFM causes a project that did not fit into an intertemporal budget constraint of the government under public procurement to do so with a PPP. Some countries are tempted to ignore the affordability issue due to the fact that PPPs may be off budget as discussed below.

Using PPPs reduces spending flexibility, and thus potentially allocative efficiency, as spending is locked in for a number of years. Given that capital expenditures in national budgets are often accounted for as an

[3] The Statistics Office of the European Union (Eurostat) considers that the main issue in classifying a public-private partnership depends on who bears the most risk. The recommendation in Eurostat's decision is that assets involved in a public-private partnership should be classified outside the government sector if both of the following conditions are met: (i) the private partner bears the construction risk; and (ii) the private partner bears either the availability risk or the demand risk. The bearer of risk is not always easy to define, and contract design varies. In cases where it is not possible to classify a public-private partnership as on or off the government books, other contract features can be considered, such as if the asset is supposed to be transferred from the private partner to the government at the end of the contract period and at what price. This event is also an important part of the risk sharing. Eurostat (2004), —New Decision of Eurostat on Deficit and Debt: Treatment of Public-private Partnerships, *News Release No. 18*, 11 February, The Statistical Office of the European Communities, Luxembourg.

expenditure when the investment outlay actually occurs, taking the PPP route allows a government to initiate the same amount of investments in one year while recording less expenditure for that same year. On the other hand, the obligation to pay an annual fee will increase expenditures in the future, reducing the scope for new investment in coming years. Government spending might also be affected if the government provides stated or implicit guarantees to the PPP project and thus incurs contingent liabilities. The system of government budgeting and accounting should provide a clear, transparent and true record of all PPP activities in a manner that will ensure that the accounting treatment itself does not create an incentive to take the PPP route. Critics find that in some cases systems make it possible to avoid normal spending controls and use public-private partnerships to circumvent spending ceilings and fiscal rules.

PPPs should only be undertaken if they represent value for money and are affordable. However, there are those that argue that PPPs should be used to invest in times of fiscal restraint. The fiscal constraint argument for public-private partnerships is driven by pressures for governments to reduce public spending to meet political, legislated and/or treaty-mandated fiscal targets. In parallel with this, many governments face an infrastructure deficit stemming from a variety of factors including a perceived bias against budgeting for capital expenditures in cash-based budgetary systems. However, when responding to fiscal constraints, governments should not bypass value-for-money and affordability. PPPs may also create future fiscal consequences if they violate the budgetary principle of unity, *i.e.* that all revenues and expenditures should be included in the budget at the same time. Potential projects should be compared against other competing projects and not considered in isolation to avoid giving priority to the consideration and approval of lower value projects. The case for preferring PPPs to other kinds of investment as a counter cyclical measure is also difficult to sustain as PPPs will often take longer to execute than traditional forms of investment.

4. The usage of PPPs in OECD countries today

Since the early 1990s, and even more so since the early 2000s there has been a significant increase in the use of PPPs by OECD countries. Countries such as the UK, Korea, France, Australia, Portugal and Germany increasingly use PPPs to deliver services that they previously delivered through traditional public procurement. For most of the last decade PPPs in the UK constituted approximately 12% of total annual capital expenditure (*cf*. EIB, 2004:5; KPMG, 2007: 4), with other countries following suit. The drive to use PPPs is increasingly premised on the pursuit of value for money (cf. OECD 2008). Although governments increasingly use PPPs, they still constitute a relatively small component of total public sector investment. The UK figure of 12%, mentioned above, is one of the largest. Some countries also informally state that they do not foresee PPPs to exceed 15% of total public investment, one reason being the rather cumbersome process to create a PPP (OECD 2008). However, notwithstanding difficulties, countries such as Korea, Australia, Germany, South Africa, as well as France, Spain and Portugal increasingly use PPPs. As noted above, there is a divergence in definitions regarding what constitutes a PPP. This also leads to different figures regarding the number of PPPs in the world. As such, not all the figures are comparable, but they do give an indication of the wide extent to which countries use PPPs. According to Deloitte Ireland (2009), infrastructure projects constitute the largest sector by number of deals internationally, followed by healthcare and education, while the UK is by far the leading country implementing projects, followed by the rest of Europe in second place. Furthermore, PPP activity reached a peak during the period 2003-7, before slowing down due to the onset of the international financial crisis and recession.

Table 2 below comprises data collected by Public Works Financing —International Major Projects Survey (PWF 2009: 2). It includes projects that represent various combinations of public and private sector risk-taking and represents cumulative data since 1985. According to Public Works Financing (PWF) Road PPPs represent almost half of all PPPs in value (USD 307 billion out of USD 645 billion) and a third in number (567 out of 1 747). Second is Rail and third is Water. The PWF database also confirms that Europe represents about half of all PPPs in value (USD 303 billion) and a third in number (642).

Table 1 – Global public-private partnership deals by sector and region 1985-2009

		Roads		Rail		Water		Buildings		Total	
		Number of projects	Cost US$m	Number of projects	Cost US$m	Number of projects	Cost US$m	Number of projects	Cost US$m	Number of projects	Cost US$m
United States	Total planned and funded since 1985	77	61 844	41	58 334	187	20 001	164	10 986	469	151 926
	Funded by 10/09	35	16 913	27	10 950	136	15 024	158	9 421	356	52 308
Canada	Total planned and funded since 1985	31	18 103	7	9 780	29	3 029	91	12 529	158	43 531
	Funded by 10/09	20	11 058	1	2 000	14	457	49	9 572	84	23 114
Latin America	Total planned and funded since 1985	272	101 236	69	51 184	153	17 163	19	1 729	513	171 222
	Funded by 10/09	140	61 652	26	10 355	79	9 865	8	521	253	82 393
Europe	Total planned and funded since 1985	339	320 375	102	157 293	218	34 178	306	90 369	965	602 215
	Funded by 10/09	193	156 692	55	54 579	171	24 657	223	66 975	642	302 903
Africa and Middle East	Total planned and funded since 1985	21	10 886	16	12 479	101	28 166	10	1 186	148	52 717
	Funded by 10/09	13	5 691	4	4 668	45	17 835	4	957	66	29 151
Asia and Far East	Total planned and funded since 1985	295	92 662	93	101 826	180	50 745	37	11 358	605	256 591
	Funded by 10/09	166	54 640	40	55 676	119	37 452	21	7 201	346	154 969
World	Total planned and funded since 1985	1 023	605 106	328	390 896	868	153 282	627	128 157	2 858	1 278 202
	Funded by 10/09	567	306 673	153	138 228	564	105 290	463	94 647	1 747	644 838

Notes:

Latin America includes Mexico, Latin America and the Caribbean.

Cost US$m refers to Nominal dollars, converted to USD at time of financial close.

This database comprises data collected by PWF's International Major Projects Survey. It includes all projects that are being planned, built or are operated in 131 countries. According to PWF (2009, pg. 3): "PWF's survey aims to describe projects where governments are seeking to franchise the delivery of public works infrastructure services to private, for-profit companies outside of a regulated, public-utility structure. That delegation of control can take the form of long-term service contracts, concession arrangements involving finance, construction and long-term operations of facilities under term-limited contracts; private development and ownership of facilities; and divestiture of infrastructure assets."

Source: Public Works Financing (2009), Public Works Financing Newsletter, Vol. 242, October, www.PWFinance.net.

Table 2 – What percentage of public sector infrastructure investment takes place through PPPs (2010)?

Range	N	Country
0% - 5%	9	Austria, Germany, Canada, Denmark, France, Netherlands, Hungary, Norway, Spain
>5% - 10%	7	United Kingdom, Czech Republic, Slovak Republic, Greece, Italy, South Africa, Ireland
>10% - 15%	2	Korea, New South Wales
>15% - 20%	0	
>20%	2	Mexico, Chile
Total	20	

OECD surveyed member countries in 2010 concerning what percentage of public sector infrastructure investment takes place through PPPs (OECD, 2011). Table 3 indicates the percentage of public sector investment that takes place through PPPs and the number of countries to which each range applies. For instance, in 9 of the 20 countries PPPs constitute between 0% and 5% of public sector investment in infrastructure. Furthermore, in 9 countries PPPs constitute between 5% and 15% of total public sector infrastructure expenditure. The stock of PPPs in countries varies significantly. It ranges from one at the federal level in Canada, three each in Norway, Denmark and Austria, to 670 in the UK[4] In between is France with 330,[5] Korea with 252, Mexico with 200, Germany with 144, Chile with 60, New South Wales with 35, the Netherlands and Hungary each with 9 and Ireland with 8.

5. Key questions for PPP Principles

Overall the preceding discussions give rise to a number of key questions regarding possible principles for PPPs. These include

1. What are the key lessons for policy makers when deciding whether or not to undertake a PPP?
2. What decisions at the political level need to be resolved for the PPP governance framework to be successful?
3. What procedures and processes are necessary for the PPP governance framework to produce projects representing value for money?
4. What institutional capacity must be present in the public sector to manage PPPs?
5. What conditions must be present in the business environment for the market for PPPs to work?
6. Is there sufficient reason to draft and endorse OECD Principles for PPPs?

[4] The UK count includes only PFIs, and not PPPs falling under a wider definition. Italy reported a much higher number, approximately 2000, but this number includes all concessions.

[5] Excludes concessions, and includes only those PPPs falling under the authority of the PPP unit.

6. DRAFT OF OECD PRINCIPLES FOR PPP GOVERNANCE

The following draft principles are meant to guide policy makers when using PPPs. They cover particular institutional and procedural features in the governance system that will further a focus on value for money, efficiency, effectiveness, and transparency.

Political framework and institutional preconditions

1. The political leadership should ensure public awareness of the relative costs, benefits and risks of PPPs and conventional procurement

PPPs need to be addressed at the highest level of policymaking. Only if the political level is aware of and accept the costs and benefits of using PPPs can the issues around PPPs be tackled balanced appropriately. The Ministry of Finance, line Ministries and executive agencies should ensure that a coherent approach to PPP is rolled out in the public sector and is joined up with other initiatives in adjacent fields. Given their complexity and long-term scope, consensus building, including with social partners, is a prerequisite for the successful use of PPPs, especially when PPPs provide key public services. Consultation with stakeholders should be an integral element of the process.

2. Set up a clear, predictable and well regulated legal framework for PPPs

In order to attract investors to foster competition the legal framework of every project needs to be clear, transparent and predictable. Access to information and the decision-making process needs to be open and equitable. A stable regulatory environment with strong integrity will reduce the costs to business and enhance the chances that a project represents value for money. During all stages of the PPP process, there must be a clear and transparent legal framework that all parties can trust and that does not create barriers to entry. Clarity in the legal framework will also help minimise the risk of conflicts of interest, regulatory capture, corruption, and unethical behaviour.

Government administration of regulations should facilitate investment through the removal of unnecessary red tape and reducing delays to approval processes. This may require the coordination of approval processes in specific circumstances to remove regulatory obstacles to the delivery of PPPs, such as coordinating and streamlining multiple layers of regulation that may affect projects – either across one level of government, or different levels of government (federal, state and local).

Sound regulatory policy promotes the efficient functioning of regulatory agencies (independent regulators) by ensuring that they operate under an appropriate mandate, with the necessary independence from ministerial influence, and that they are appropriately resourced and equipped. Where PPPs are employed in the delivery of infrastructure facilities with natural monopoly characteristics (post-bidding), the role, design and organisation of regulators is important in order to secure value for money for the public sector. The appropriate sector regulator should consequently be consulted in the project design and subsequently monitor compliance with regulated service standards. This role is important not only in shaping the markets, but also with concrete issues such as service quality, profitability, tariffs and prices. Of particular interest in monopoly like situations is the degree of profitability compared to the sector average using national and international benchmarks.

3. Ensure that the necessary institutional roles and capacities are present in the public sector

A number of institutional roles need to be competently pursued when procuring and maintaining a PPP: securing the overall fiscal policy goals; ensuring the project represents value for money; implementing the specific PPP; and auditing of the PPP. These roles can be maintained in a number of institutional set-ups, but it is important that they are kept separate in order not to confuse the key tasks of each actor and secure lines of accountability.

The Central Budget Authority, often anchored in the Ministry of Finance in central government, is the custodian of the country's fiscal solvency, both in the short and long term. It is responsible for the annual budget and making sure the country's fiscal situation and prospects are transparently shown. The Central Budget Authority should ensure that the overall investment envelope is sustainable and in line with the government's fiscal policy. It should balance the use of PPPs against the need for budget flexibility in later years. Prior to the closing of a contract it should monitor whether or not projects are affordable, conform to certain procedural steps (gateways) and are in line with political agreements. While the Central Budget Authority need not possess deep and specific knowledge of the PPP project's technical design, it needs sufficient capacity to evaluate the documentation presented to it as part of the affordability and value for money examinations.

The dedicated Public-Private Partnership unit should be able to create, manage and evaluate a PPP in depth. This role requires that the PPP unit has the requisite in depth financial, legal, economic and project management skills. This capacity should be used to assess the concrete PPP in comparison with public investment and/or operation and support the procuring authority in its endeavor to secure value for money both in procuring and in implementation phases. This unit should be also responsible to ensure that procedural steps (gateways) are followed through.

The authority that is procuring the PPP is ultimate responsible for the concrete project, subject to approval, monitoring and advice from the other actors at various stages. The authority should draw on expertise from the PPP unit where necessary, but is also responsible for building up sufficient independent capacity to procure and in particular manage the PPP project. This authority is, therefore, ultimately responsible for the preparation, negotiation and administration of the contracts upon a PPP relies.

The Supreme Audit Institution should audit and assess the PPP ex post. It should maintain sufficient capacity to give a clear verdict on whether the project ultimately represented value for money, suggest possible improvements to the regulatory PPP framework and the procurement processes and make available overall lessons regarding the use of PPPs and investments.

The above roles need also be institutionally maintained at sub-national level.

The approval and management process

4. The decision to invest should be based on a whole of government perspective and be separate from how to finance the project

It is important that the projects that go ahead have been prioritised at the political level. The basis for the decision should include an initial cost assessment and evaluation of the opportunity cost which should feed into the affordability decision. The decision to invest should include a holistic cost benefit analysis addressing the project's interaction with other government policy tools (such as spatial planning, regulation of traffic, utilities, and development plans) and objectives. Line ministries and other actors should not be allowed to develop their investment programs without aligning them with the government's overall political priorities.

Only once government approves a project should the question arise as to the manner of financing and managing it. Thus, only once government decides that a project should receive priority and is affordable in terms of the budget, should government consider whether traditional procurement or a PPP constitutes the best way to secure the intended value for money of the project.

5. The project should be affordable and transparently treated in the budget process – regardless of which level of government it applies to

An investment project is affordable if the expenditure and contingent liabilities it entails for the government can be accommodated within current levels of government expenditure and revenue and if it can also be assumed that such levels will be and can be sustained into the future. PPPs, as well as long term borrowing for investment, are more difficult to integrate with the annual budget process than more ordinary variable expenditures that can be modified from year to year. Budget documentation must disclose all information regarding the present and future costs and liabilities of PPPs in a transparent way. The information should include what and when the government will pay, and full details of guarantees and contingent liabilities. Preferably the cost assessment should include an adjustment for probable cost and time overruns and revenue shortfalls based on evidence from similar projects. The payment stream from government under the PPP contract should be highlighted, particularly if they are back loaded. The information should preferably be disclosed at the same time as the results of the long-term fiscal analysis that shows the long-term effects of the stock and new flow of PPP contracts. The treatment of PPPs should adhere to The OECD Best Practices for Budget Transparency (OECD, 2002).

If constitutionally appropriate sub-national governments should be allowed to use PPPs prudently. These projects should adhere to all the principles discussed in this paper. PPP modalities can be tested at the sub-national level and if successful rolled out to a wider area. If there are implicit or explicit central government guarantees to sub-national government levels, PPP activity must be controlled through rules on PPP stocks and flows. The Ministry of Finance should retain an updated overview of all PPP liabilities relevant for central government.

6. Carefully investigate which investment method yields most value for money

If the government has decided to move forward with the investment, a project should be subjected to a procurement option pre-test. This should guide government in selecting which mode of procurement is likely to deliver the most value for money. It consists of the following elements:

- What are the comparative costs of (a) finance (b) construction (c) operation, in each alternative mode of procurement?
- Can the risks of the project be clearly defined, identified and measured? Can the right types of risk be transferred to the private partner to ensure value for money? Does the project involve any transfer of risks onto other stakeholders, including workers and local communities? Is the risk appetite of the private partner sufficiently robust to explore a PPP?
- What is the potential level of competition for the market and what is the potential level of competition in the market?
- How large are the benefits from combining the construction and the operating phases of a project in one contract?

- What is the risk of project failure associated with similar PPPs? What are the costs to the public authority associated with such failures?
- Can the risks, cost and quality trade-offs be managed by the public sector?
- Can the output be defined clearly ex ante?
- Is the asset subject to rapid change?

If relevant, further analysis regarding using a PPP should be based on input from a prudent Public Sector Comparator, especially when operation is an important component of the project. There are different methods used to assess the relative value for money of the different delivery models. In principle a public sector comparator compares the net present cost of bids for the PPP project against the most efficient form of delivery according to the output specification (a so-called reference project). Thus, the public sector comparator serves as a hypothetical risk-adjusted cost of public delivery of the output specification of a PPP project. The methodology for preparing the public sector comparator should be published. The value for money concept is broader in that it is the optimal combination of quality, features and price, calculated over the whole of the project's life.

7. Transfer the risks to those that manage them best

After the fundamental assessment of comparative costs, a key element in the decision to use PPPs is the transfer of risk from the government to the private partner. Risk is identified, priced and either retained by the public sector or transferred to the private partner through an appropriate payment mechanism and specific contract terms. Risk should be allocated where it can be best managed. By 'best' managed is meant the party for whom it cost the least to prevent the risk from realising, or the party for whom it cost the least to deal with the fallout of realised risk.

Risk should not be transferred to the private partner at any price for the sake of transferring risk alone or to achieve a desirable accounting treatment. Governments and public authorities cannot transfer to the private sector the risks associated with statutory responsibilities to maintain services.
The key question is whether the risks of the project can be clearly defined, identified and measured. If risk cannot be defined, identified or measured, there is room for conflict over the contract, particularly when the risk realises. In addition, potential private partners might also be unwilling, for an acceptable price, to take on risks that are not clearly defined, identified and measured. Risk definition needs to include financial/economic, environmental and social dimensions.

8. Involve the user in the design and monitoring of PPP to increase value for money

There is a risk of reducing value for money when the downward pressures on cost, introduced by competition, are neutralized by high transaction costs of procuring and managing long-term contracts and maintaining high quality of services. While clearly defining outputs in the contract is key, involving end-users in defining and monitoring service quality can be instrumental in achieving better alignment of service specification with user expectations and exert pressure on service providers to meet service standards. Public independent oversight of PPP implementation can also promote better outcomes for the society as a whole through greater accountability and social control.

9. Maintain value for money during operation, renegotiation and project failure

By monitoring and liaising with the private contractor, the public sector needs to maintain a project's value for money throughout its operation. The original risk transferral should consequently be maintained which requires that sufficient capacity and resources are made available to the public side.

Nonetheless, in some cases the assumptions for the project turn out to be wrong leading the project towards failure. As the public sector has an interest, sometimes a statutory responsibility, in making sure the asset remains smoothly in operation, a re-negotiation should take place to investigate possible solutions. However, even if the current project outcome for the private partner differs from what it expected, the outcome might just be a realisation of the risk that it carried. Both parties need to distinguish between the realisation of risk and a genuine unforeseen change in circumstances. Only in the latter case is re-negotiation with an eye on government assuming the risk justified. Furthermore, any re-negotiation that substantially alters the original agreement should be made public and be subjected to approval by the authority responsible for approving PPPs. Such an agreement should be as competitive as possible. Particular attention should be paid at contractual arrangements and monitoring capacity at later stages of a project, so as to ensure that incentives do not deteriorate as the cost of non-compliance lowers.

10. Ensure competition and integrity in the procurement process

Competition *for* the market and competition *in* the market are integral to PPP success. Thus, a competitive market is necessary when tendering for PPP bids, but also once the contract has been concluded and the PPP is operational. This is particularly important in cases where the PPP subsequently becomes a monopoly provider in a certain area. Competition helps ensure the effective transfer of risk, that optimal solutions are developed by the private sector and that keenest pricing is tendered. In its absence, the government effectively carries the risk, irrespective of the conditions set out in the PPP contract. A single potential private partner, who knows this, might take advantage of its monopolistic position, reducing the efficiency with which it delivers the service, and reducing or eliminating the benefit of a public-private partnership relative to traditional procurement. In markets where competition is absent after the award of the contract, the market should at least remain contestable – thus, the private partner should know that there is always the possibility of alternative private partners entering the market.

Enhancing integrity in public procurement is not simply about increasing transparency and limiting management autonomy in the decision making processes. Discretion in procurement decision making is needed to achieve value for money. Enhancing integrity necessitates recognising the risks inherent throughout the entire procurement cycle, developing appropriate management responses to these risks, and monitoring the impact of mitigating actions. PPP procurement should be a strategic profession, informed by an understanding of relevant commercial principles rather than a simple administrative process within a public organisation. This transformation necessitates developing knowledge and creating tools to support improved procurement management decision making. Enhancing integrity in public procurement must be placed within the broader management systems and reforms of the public administration. Good governance is essential throughout the entire public procurement cycle, from needs assessment to contract management and payment as discussed in the 2008 OECD Principles for Enhancing Integrity in Public Procurement.

APPENDIX 1: Next steps and previous work

Process for developing PPP Principles and their subsequent usage

No decision has been taken as to the appropriate status the PPP Principles should have. The purpose of presenting them to each of the groups listed in table 1 is to incorporate each forum's comments on both the content and the status of the principles. Examination of the PPP Principles will start at the network of senior PPP Officials, then be discussed at the Working Party of Senior Budget Officials, and finally be adopted by the Public Governance Committee. In addition the PPP Principles will be discussed at the Territorial Public Governance Committee, the Regulatory Reform Committee, the Investment Committee and possibly at other relevant committees. The process is listed in table 1. below.

The goal of the PPP Principles is not to create a rating system in terms of application, rather the principles will be a guide for action which countries will report back on as time progresses. This in turn will enable the principles to be refined over time.

In addition, it is envisioned that the PPP Principles would form the basis for the development of a number of case studies to inform a handbook and toolkit. The two sets of principles, the handbook, and the toolkit will provide a concrete guide on how to apply OECD good practices to the benefit of PPP-practitioners.

Table 3. Timeline 2010-2011

March	• **Draft principles circulated to delegates to PPP Network meeting, World Bank, IMF, EIB, TUAC, BIAC**
24-25 March	• **Annual PPP meeting endorses draft**
13-14 April	• **Discussion at RPC**
14-15 April	• **Briefing of PGC**
End of April	• **Deadline for receipt of country comments regarding PPP principles draft**
6-7 June	• **Draft principles endorsed by Annual meeting of Senior Budget Officials**
15-16 June	• **Discussion at TDPC**
Summer/Fall 2011	• **Draft principles presented to other relevant OECD Committees and bodies** • **Endorsement by PGC**
Spring 2012	• **Final draft principles presented to Council**

The Organisation's governing body, the Council, has the power to adopt legal instruments. These acts are the result of the substantive work carried out in the Organisation's Committees. They are based on in-depth analysis and reporting undertaken within the Secretariat and cover a wide range of topics from Anti-Corruption to the Environment. The end products include international norms and standards, best practices, and policy guidelines.

- *Decisions* are legally binding on all those Member countries which do not abstain at the time they are adopted. While they are not international treaties, they do entail the same kind of legal obligations as those subscribed to under international treaties. Members are obliged to implement them and to take the measures necessary for implementation.

- *Recommendations* are not legally binding, but practice accords them great moral force as representing the political will of Member countries and there is an expectation that Member countries will do their utmost to fully implement a Recommendation.

- Other legal instruments are also developed within the framework of the Organisation:
  - *Declarations*: solemn texts setting out relatively precise policy commitments are subscribed to by the governments of Member countries. They are not formal Acts of the Organisation and are not intended to be legally binding, but they are noted by the OECD Council and their application is generally monitored by the responsible OECD body.
  - *Arrangements and Understandings*: are instruments, negotiated and adopted in the framework of the Organisation by some Member countries. They are not Acts of the Organisation and are not legally binding, but they are noted by the OECD Council and their implementation is monitored.
  - *International Agreements*: concluded in the framework of the Organisation, they are legally binding on the Parties.

Other relevant work

A key issue regarding the merit of doing PPP Principles is whether they can add value compared to OECD instruments that are already in place. A key instrument in this regard is **DAF's 'OECD principles for private sector participation in infrastructure'** (Infrastructure Principles). The infrastructure principles cover five set of challenges facing national authorities:

1. The decision to involve the private sector has to be guided by an assessment costs and benefits and availability of finance, the pricing of risks transferred to the private operators and prudent fiscal treatment of risks remaining in the public domain.
2. Authorities need to ensure an enabling policy framework for investment.
3. The success of private involvement in infrastructure depends on public acceptance and on the capacities at all levels of government to implement agreed projects.
4. A challenge for public authorities and the private sector is to establish a working relationship toward the joint fulfilment of the general public's infrastructure needs.
5. Governments' expectations regarding responsible business conduct need to be clearly communicated by governments to their private partners.

There are also other instruments and guidelines in place, the most relevant of which are:

- **OECD Best practises for Budget Transparency** focusing on how key processes and statements regarding the government's custodianship of the economy are made available to the public.
- **OECD Principles for Integrity in Public Procurement** aims to ensure that public's funds are spent efficiently, with a minimum of waste and corruption.
- **OECD Guiding Principles for Regulatory Quality and Performance** and the OECD Recommendation Concerning Structural Separation in Regulated Industries provide general guidance on good practices for regulation, as well as specific recommendations for the balance between competition and regulation in regulated sectors.
- **The Policy Framework for Investment** provides a checklist of issues for consideration by governments engaged in creating an environment that is attractive to domestic and foreign investors.

- **The OECD Guidelines on Corporate Governance of State-Owned Enterprises** provide recommendations to the state on how to exercise its ownership function vis-à-vis state-owned enterprises.

Why PPP principles add value

There are a number of reasons why the PPP Principles can add value despite the fact that some of these issues will also have been partly addressed in the above listed tools.

- First, the PPP Principles will **focus on PPPs**. While there are principles that cover various aspects of PPP procurement (investment, budget transparency, regulation, integrity) the PPP Principles will bring relevant lessons together and tailor them specifically to the circumstances to help authorities handle **a particular challenge that will only become larger in the coming years.**
- Second, there are key elements that are currently not fully addressed, for example those related to PPP budgeting, affordability, accounting and when to use PPPs vs. traditional procurement. These are key issues for PPPs and need to be highlighted.
- Third, the PPP Principles will focus on **public governance** of PPPs. Focus will be on how the public sector derives as much value from using (or not using) PPPs as possible by optimising how the public sector approaches PPPs via procedures, rules and systems. They will *not* focus on private corporate governance, competition policy, etc.
- Fourth, the PPP principles will be **concrete enough to be of value for senior officials** such as permanent secretaries in line ministries and budget directors in ministries of finance.

The principles will be aligned with OECD recommendations in adjacent fields and will contribute to an OECD-wide approach to developing the public sector.

Other relevant international tools

International instruments

- OECD Best Practices for Budget Transparency
- OECD Principles for Integrity in Public Procurement
- OECD Guiding Principles for Regulatory Quality and Performance
- OECD Principles for Private Sector Participation in Infrastructure
- OECD Declaration on International Investment and Multinational Enterprises
- OECD Guidelines for Multinational Enterprises
- OECD Code of Liberalisation of Capital Movements
- OECD Recommendation concerning Structural Separation in Regulated Industries
- OECD Principles of Corporate Governance
- Guidelines on Corporate Governance of State-Owned Assets
- OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions
- United Nations Convention against Corruption
- International Labour Organisation Declaration on Fundamental Principles and Rights at Work

Tools and guidance

- OECD Competition Assessment Toolkit
- The Public-Private Infrastructure Advisory Facility (PPIAF) Toolkits
- UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects
- International Finance Corporation’s Equator Principles
- OECD Policy Framework for Investment
- EU Commission Guidelines for Successful Public-Private Partnerships
- OECD Recommendation on Common Approaches to the Environment and Officially Supported Export Credits
- DAC Guiding Principles for Guidelines Guiding Principles on Using Infrastructure to Reduce Poverty (in Promoting Pro-Poor Growth: Infrastructure)