Chapter 7

Public Investment Management for Public-Private Partnerships

Motivation: Aligning Public-Private Partnerships with Traditional Public Investment

There are a variety of modalities for provision of public infrastructure. A wide range of parties and agencies participate in this process. Investment requirements should consider the full range of available public and private modalities and provisions. This is the case not only for central government but also for state-owned enterprises, subnational governments, and the private sector, particularly in the form of public-private partnership (PPP) programs.

As an attractive modality for public infrastructure provision, PPP programs have been widely discussed and developed since the 1990s. The United Kingdom outstrips the rest of the world in the number of PPP projects, although Australia, Brazil, Germany, India, the Republic of Korea, and South Africa as well as other developed and developing countries have also implemented many PPPs.

Definitions diverge regarding what constitutes a PPP, which leads to different figures regarding the number of PPPs.1 As such, not all the figures are comparable, but those such as the following do give an indication of the wide extent to which countries use PPPs:

- Infrastructure projects constitute the largest sector by number of deals internationally, and PPP activity reached a peak during the 2003–07 period before slowing down because of the onset of the global financial crisis and recession (OECD 2010a). Public Works Financing Newsletter’s (PWF’s)
“International Major Projects Survey” collected data about projects that represent various combinations of public and private sector risk taking with cumulative data since 1985 (PWF 2009, 2; reprinted from OECD 2010a). As of 2009, road PPPs represented almost half of all PPPs in value ($307 billion out of $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 ($303 billion) and a third in number (642) (OECD 2010a).

The Private Participation in Infrastructure (PPI) Project Database developed by the World Bank and the Public-Private Infrastructure Advisory Facility (PPIAF) represents the same trend of PPP project numbers and investments. By number of projects and by investment commitments of the private sector in the transport, energy, and water and sewage sectors, PPI has been significantly increasing in the past decade although it has experienced a contraction since 2008 in the wake of the global financial crisis.

One key challenge for many governments is how to best justify PPP projects against the variety of other modalities. Unfortunately, most countries have been managing PPP projects separately from traditional government-financed and procured projects. Even if a government moves ahead with large-scale PPP projects, those projects have been mostly appraised, selected, and monitored separately from traditional projects. Governments have paid less attention to the careful appraisal and economic analysis of PPPs than to those of traditional projects, or, at most, considered them as a supplementary approach without any recognition that PPPs are inherently public investment projects that should be selected based on their capacity to produce an acceptable social and economic outcome. This disparity has undermined adequate public financial management (PFM) and created undue fiscal risks, causing fiscal concerns with respect to appropriate forms of accounting, reporting, budgeting, and other processes.

A project implemented through PPP should require the same level of public investment management (PIM) social and economic justification. To these ends, this chapter argues the necessity for a “unified framework” for integrating both traditional government project implementation and PPPs. The objective is to increase awareness of the need to integrate PPPs into the traditional PIM framework, identifying opportunities for strengthening the integration of PPPs into national PIM systems. The chapter characterizes PPP schemes through the lens of the eight “must-have” features of PIM as presented in figure 2.1, comparing PPP management with conventional PIM. It recognizes the challenge in adopting a unified framework in practice but also suggests starting points to handle PPPs under the umbrella of a unified framework.

The next section presents the rationale for employing PPP as an implementation method for public investment projects. Following that, the section titled “Why the Need for a Unified Framework?” describes the advantages of developing
such a framework. In the section titled “Challenges to Having a Unified Framework in Practice,” the eight must-have PIM features in PPPs are explicitly characterized one by one. Some features are similar to those addressed in conventional government PIM, while others need to be adapted to the specific requirements of the PPP methodology. The section presents challenges to having a unified framework in practice by running through the eight must-have PIM features in PPPs. The section titled “Future Work for the Unified Approach” contains the concluding remarks.

The Rationale for Public-Private Partnerships

Countries tend to promote PPP projects because (a) they anticipate attaining better value for money by taking advantage of the creativity and efficiency of the private sector, and (b) they lack the financial or human resources to carry out the projects themselves. These two rationales for PPPs are usually stated as enhancing efficiency (or better value for money) and easing fiscal constraints (or resource additionality).

The principal rationale should center on efficiency in general. However, the efficiency rationale is usually based on a number of assumptions that may or may not exist in a given country: competitive markets, effective identification and implementation, optimal transfer or share of risks, and the ability to prepare good projects and develop and agree on good contracts. The fiscal constraint rationale is also important because the lack of government financial resources, particularly in developing countries, can lead to inadequate investment in essential infrastructure, leading to low levels of public sector investment against gross domestic product (GDP) and constraining GDP growth. This low public investment may in turn impair the government’s ability to pay off debt. Given the effect of additional infrastructure investment on the national economy, many countries have promoted PPP projects instead of cutting investment amounts when they face a lack of financial resources.

Although additional resources for PPPs can accelerate the establishment of new infrastructure, it is neither possible nor desirable to increase the amount of additional resources without limits. Building infrastructure facilities through additional resources for PPPs means that the government borrows from the private partner to fund its investment needs; in effect, the additional resources still need to be paid off in the medium and long term. It is not “free money.” The government cannot increase the amount of future liability indefinitely. Insofar as the efficiency enhancement is not achieved, the additionality rationale cannot be sustainably increased and maintained.

From a fiscal point of view, therefore, a principal key to initiating PPP projects is to establish whether a government can maintain the same level of fiscal efficiency and sustainability through PPPs as through conventional means of implementation. Unfortunately, countries with limited experience in PPP projects, and even those with PPP experience, find it hard to calculate how much private involvement or government liability will be efficient and sustainable.

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Why the Need for a Unified Framework?

Across the whole investment cycle for PPP and conventional public investment, there are different modalities for identifying investment procedure and achieving value for money. In conventional schemes, based on solid information on the condition and cost of public services, the government specifies the quality and quantity of the services required. In a PPP scheme, however, the government explicitly specifies the quality and quantity of the service it requires from the private partner.

The private partner may be responsible for the project design, construction, financing, operation, and management of a capital asset as well as the delivery of a service to the government or the public using that asset. Project risk is identified, priced, and allocated to the private company where appropriate through a payment mechanism and specific contract terms. Risk transfer to the private partner may improve value for the money, but only up to the point where it creates the incentive for the private partner to improve efficiency. It is almost never the case that all risks in a project are transferred to the private company. This point must be kept in mind when comparing PPPs and conventional implementing options.

Under these different modalities, a unified framework would provide several advantages:

- Ensuring consistent assessment and decision making
- Supporting optimal risk transfer
- Avoiding unmanaged fiscal risks while improving transparency

Ensuring Consistent Assessment and Decision Making

First of all, a unified framework helps to ensure that decisions on public investment projects are consistent in keeping value for money objective throughout the project cycle, even though objective decisions cannot be guaranteed. According to an OECD (2010b) survey, the value-for-money (VFM) objective is often blurred in practice, and the choice between a PPP and traditional procurement is skewed by factors other than value for money; government officials in many countries feel that the rules in place impede attaining the maximum value for money by creating incentives to prefer traditional procurement to PPPs. Various factors that may skew this choice and thereby undermine the pursuit of value for money include the following:

- The legal and institutional setup
- The range and complexity of the VFM tests to which PPPs and traditionally implemented infrastructure projects are subjected
- The roles in the procurement process of the parliament, the ministry of finance, the PPP unit, and the implementing entities
- The accounting standards applied to both PPPs and traditionally implemented infrastructure projects
Political preference for or against PPPs may also play a role in skewing choices and affecting outcomes. A unified framework has the potential to minimize subjective decisions concerning traditional versus PPP implementation.

**Supporting Optimal Risk Transfer**
Second, a unified framework helps to accomplish optimal risk transfer. It is important to note that all service delivery mechanisms—whether they are public, private, or partnership models—are exposed to risks. The key difference with PPPs is that a large part of their efficiency or value for money is derived from the effective identification, pricing, and transfer of risk from the public to the private sector. Failure by the government to mitigate these risks may not only have fiscal consequences for the government but also affect service delivery. Good risk management allocates risk to the party best able to manage it.

Designing the optimal level of risk sharing (including the respective level of fees versus subsidies) involves complex trade-offs, and the optimal contract may depend on the specific circumstances of the project (Engel, Fischer, and Galetovic 2007). With the addition of each activity to the responsibilities of the private partner, the question is whether the private partner is the best party to manage the specific risk involved with the additional activity.

If each project (whether conventional or PPP) is separately managed, the concept of optimal transfer from one to the other may not be ensured; it opens doors to inadequate risk shifting in different steps in the project cycle. A unified framework, therefore, might be considered one of the conditions for achieving optimal risk transfer in both conventional and PPP options.

**Avoiding Unmanaged Fiscal Risks and Improving Transparency**
Third, a unified framework may help to avoid unmanaged fiscal risks and to improve transparency in the PFM system. It could lead to the incorporation of all PPP fiscal commitments and risks into the government’s routine fiscal screening and monitoring process. As such, it enables the government to effectively assess the real burden of PPP commitments and risks within a medium- and longer-term fiscal framework. The government, for example, is able to forecast the present value of the PPP commitments as a fraction of current GDP or current government revenue to get a sense of its future fiscal flexibility and vulnerability to shocks that affect the payments.

A unified scheme is useful for the public reporting of PPP commitments as well. There have been numerous debates in the past decade about whether to attempt to classify PPPs as either government or private assets.² There is a concern that such a binary approach to accounting and reporting—where PPP assets are recorded either on or off the government balance sheet—will inevitably tempt governments to tailor PPPs to meet the requirements for off-balance-sheet recording (Hemming 2008, 239)² and is likely to present parallel budgeting for PPPs. A unified framework may discourage parallel budgeting by reporting the known and potential future fiscal costs of PPPs in the traditional budget system.
By strengthening procedural controls on PPP commitments, the framework helps to improve overall transparency in the PFM system.

**Challenges to Having a Unified Framework in Practice: Eight PIM Features in PPPs**

This section will apply the eight must-have PIM features presented in chapter 2 to the modality of PPPs with a view toward applying a unified framework. The preceding section provided arguments on the usefulness for a unified framework, but one must recognize a series of incentive problems and practical implementation constraints that limit the possibility to swiftly apply such a framework in practice. This section therefore highlights the difficulties in applying a unified approach by running through the eight steps that correspond to the must-have PIM features for PPPs and discussing several entry points to move toward such a framework.

**Step 1: Strategic Guidance for Screening and Planning PPPs**

In conventional public investment, strategic guidance is critical to anchor government- and sector-level decision making. Such guidance is described in a national plan or medium- to long-term strategic document that establishes economywide development priorities at the highest decision-making levels.\(^5\)

In contrast, in many countries, PPP projects are not formally included in the national development strategy or other medium- and long-term government investment planning. They are chosen without any integrated strategic guidance and coordination between conventional and PPP implementation methods. Instead they are mostly managed as stand-alone projects or initiatives. In most cases, planning instruments do not explicitly (a) provide any strategic guidance for PPP project identification or selection; (b) highlight the role of PPPs for economywide development priorities; or (c) describe why and how these projects might benefit a nation’s social and economic development. Under such nonunified proceedings, PPPs can be more easily affected by politically driven decision making. Although most governments declare that PPPs should be selected only when this approach promises better value for money compared with conventional public investment, in practice there is often insufficient scrutiny to properly screen and plan all candidate PPPs.

Establishing strategic screening and planning guidance for potential PPPs should therefore be the starting point because it offers the following fundamental advantages:

- By listing eligible asset types in the PPP law or regulation, some governments can more directly signal where and in which sectors private capital is required to benefit the public.
- A certain level of restriction for a narrowly defined sector of candidate PPPs is useful: it facilitates the assessment based on a public sector comparator or a private finance initiative.
On the downside, one might well argue that such restrictions limit the flexible and innovative nature of PPPs. However, lack of guidance may open doors for politically driven projects. An explicit legal and regulatory framework, along with planning and proper guidance, facilitates the initiation of PPP projects because it concedes to the private sector the right for initiation or participation. Clearly, the enabling legislation also needs to allow for some flexibility to cover most circumstances.

A unified guidance for identification, appraisal, and selection of both PPP and conventional projects is arguably complex. It represents an ideal solution, but it is also clear that institutional arrangements in some countries, along with political conditions, might rule out a more comprehensive approach. In such a case, a more realistic and “second-best” solution may be to develop a separate and basic guidance for qualifying PPPs along the following minimum criteria:

- The project should be in accordance with the medium- to long-term national strategic plan for public investment in the country.
- The project should meet eligibility criteria and appraisal standards relative to other candidate PPP projects.

The first requirement is expected to help minimize distortion in prioritizing PPPs relative to conventional investments, whereas the second should help in prioritizing among PPPs.

Dealing with Unsolicited Proposals

An unsolicited proposal is one initiated by a private partner to undertake a PPP project rather than one submitted in response to a government request. This is the opposite of conventional proposals, which are solely initiated by the government. Most countries reserve the right only to the public sector to initiate PPP projects. However, some countries also allow unsolicited proposals. They require a specific treatment because it can be expected that more countries are likely to allow unsolicited proposals in order to reap further efficiency gains and additionality of resources. Unsolicited proposals allow governments to benefit from the creative knowledge and ideas of the private partner.

However, unsolicited proposals also create challenges that may increase the risk of mismatch in funding or prioritizing a government’s strategic planning for infrastructure projects. Solicited PPP projects would be selected within the scope, sectors, and boundaries established by a national strategy and planning, but, by definition, unsolicited projects are not mainstreamed or included within such a national strategy. Accepting unsolicited projects, particularly if they are given preference and prevalence over already existing high-priority government projects, may cause distortion within the public investment portfolio.

To minimize these risks, specific eligibility criteria for unsolicited proposals should be developed and announced. The rules would assure that

- The unsolicited proposal is consistent or comparable with the existing national planning so that it may not distort planned priorities;
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- It is creative and efficient enough to deliver extra value to the sector to compensate for possible costs of distortion; and
- If the project fails to meet the above two clearing rules, it should be rejected.

**Step 2: A Unified Framework for Project Appraisal**

Achieving the objectives of the project at the optimum “value for money” should be the driving force behind any project appraisal. In many countries, the VFM objective in project appraisal is sacrificed for other goals or even simply ignored. Conventional methods are applied to PPP projects as default modes without any careful VFM comparisons (OECD 2010b).6

Unfortunately, most countries still have not developed clear criteria to identify whether projects are either PPP or conventional candidates. Although PPP projects are often not numerous, they usually involve large sums of resources; as such, they are considered as special cases that create incentives for exceptions to established screening and eligibility criteria. It is important, therefore, to provide fiscal regulation for PPP project assessments with the same care applied to conventional implementation. A unified framework in appraisal would ensure achievement of this goal.

Countries that have a long history of PPP implementation have made efforts to establish a unified framework for project appraisal (further discussed in box 7.1), such as the following:

- In Australia and the United Kingdom, most PPP projects have been service-contract types that generate long-term government commitments, and there is a need to establish the same scale and quality of project preparation, appraisal, and screening processes for all forms of projects.
- In the United Kingdom, the government’s guidance on appraisal and evaluation, known as The Green Book, provides a unified framework for the preparation and assessment of both conventional and PPP projects. It provides guidance for all central government agencies on how to conduct ex ante project appraisal and ex post project evaluation (HM Treasury 2011). The Green Book clearly states that public bodies need to carefully consider which implementation route is likely to be most efficient and effective, and it also contains principles to guide decision makers on how to undertake a project, including the degree of private sector involvement.
- In Australia, the state government of New South Wales delivers a unified scheme by first deciding whether the investment in a specific project is necessary (“decision to invest”) through analytical methods such as cost-benefit analysis, then considers the procurement option (“method of financing”) through VFM analysis. At that time, it compares VFM inherent in a conventional approach relative to making use of a PPP. This process can prevent the government from pursuing PPPs for motives other than VFM (NSW Government 2006).
- Korea is another case where a unified framework for project appraisal was established that required an option test using cost benefit and VFM analysis in considering a potential investment project.
Box 7.1 Project Appraisal Frameworks in the United Kingdom and Australia

The United Kingdom
The decision on the need for investment is made during the appraisal process, implemented by the proposing ministry. The economic study and the affordability study are thoroughly reviewed. When the project business case is approved, HM Treasury, through the Spending Review, makes the final decision on the project implementation.

The Green Book is the HM Treasury guidance that sets out a framework for the appraisal of all central government projects and programs (HM Treasury 2011). It clearly states that public bodies need to carefully consider which implementation method is likely to be most effective, and it also contains guidance to decision makers on how to undertake a project, including the degree of private sector involvement.

Among the stages of an assessment—broadly identified as justifying action, setting objectives, option appraisal, developing and implementing a solution, and evaluation—the option appraisal stage is often the most significant part of the analysis where values of the costs and benefits are identified and adjusted. In the ensuing solution development and implementation stage, implementation routes, including the role of the private sector, are considered. The outputs are presented in the form of business cases.

Business cases are the documents through which investment proposals are proposed, scrutinized, and, if approved, executed to ensure that the proposed project is affordable and offers value for money. A strategic outline case (essentially a prefeasibility study) establishes the need for investment, appraises the main options for service delivery, and issues a recommendation. The document entails preparation and appraisal of the wide range of options for achieving the project objectives, including service delivery options and funding options. The service delivery options range from in-house to outsourcing, from using the public sector to using the private sector, or a strategic combination of both (PPP). Regarding funding options, the choice of whether the required services may be provided on a PPP basis is carefully looked at.

To achieve better value for money for public spending, HM Treasury revised the project approval process, which has been effective since April 1, 2011. The Major Projects Authority, replacing the Major Projects Directorate in the Office of Government Commerce, has been established within the Cabinet Office’s Efficiency and Reform Group.8

Australia
The decision on a capital investment consists of government approval of both the investment and the preferred implementation method. The procuring agency initially identifies infrastructure needs and analyzes the expected benefits of the investment. Government departments and agencies analyze implementation methodologies to determine the most appropriate method.

Departments and agencies undertake asset and infrastructure planning. It is generally advised that new infrastructure investments be planned only if the assets required for service delivery and resources are likely to be available. In the project assessment and procurement strategy stage, a business case is widely used, which addresses project objectives and scope, financial analysis, and risk analysis. The procurement strategy includes procurement...
Considering the experiences and lessons from Australia, Korea, and the United Kingdom, a standardized example for project appraisal in a unified framework could be composed of two phases: (a) decision to proceed and (b) decision to implement (see figure 7.1):

- **Decision to proceed (preliminary feasibility study):** A preliminary feasibility study should be conducted to prepare for the decision to proceed and a full preparation in a later stage. Justifying the need for an intervention and setting the objectives for a project are crucial first steps. Cost-benefit analysis enables a feasibility assessment of the project from a national economy perspective and gives an early indication of whether a conventional or PPP approach might be feasible. The preliminary feasibility study not only assesses whether to proceed with the full project preparation but also pushes the government to invest in more detailed project preparation in advance.

- **Decision to implement (value for money [VFM] assessment):** If the proposed project appears to be feasible, a VFM assessment would assess the implementation options—conventional versus PPP. Basically, government costs and project inputs of an often-known *public sector comparator* are compared against those of the projected risk-adjusted costs of a PPP alternative to assess whether the PPP might achieve better VFM. The VFM assessment provides a quantitative VFM comparison between the options and a justification for the decision on the implementation option. It also encourages project appraisers to consider risks early in the project life cycle and address risk transfer options in the bidding process.
If the PPP option cannot demonstrate best VFM, the project is implemented by the conventional method, provided it fulfills all appraisal standards.

**Step 3: Independent Review of the Appraisal**

As described previously in chapter 2, an independent review is useful particularly for projects that are large, whose benefits are uncertain, or whose fiscal risks are too high. The so-called optimism bias—underestimation of costs and overestimation of benefits—is a well-known incentive problem, and an independent peer review can provide additional constraints to limit any undesirable effects. The function can be performed by the ministry of finance, a planning ministry, other specialized agency, or technical specialists outside the government. Clarity of specific responsibilities is important: a multiplicity of players with unclear accountabilities in independent reviews can overburden the appraisal system and weaken it.

In the case of PPPs, the role of independent peer reviews may be especially important given the role of dedicated PPP units. Although OECD (2010a) and World Bank and PPIAF (2007) do not highlight the importance of the independent role, it is essential to clearly establish whether and from whom the dedicated unit should be independent. The best value for money should be achieved when optimal risks, but not the highest risks, are transferred and shared among the public and the private partners. This is because risk transfer can increase value for money, but only up to the point where it creates the incentive for the private partner to improve efficiency. The more the evaluating entity is independent...
from a particular delivery method or agency, the more its judgment is likely to be unbiased, which favors and facilitates an optimal partnership between two parties.

The cases of Australia (Partnership Victoria); Korea (Public and Private Infrastructure Investment Management Center [PIMAC] at Korea Development Institute [KDI]); the Netherlands (former Dutch Kenniscentrum PPS); Portugal (former Parpublica SA); South Africa (National Treasury’s PPP unit); and the United Kingdom (former Partnership UK or Infrastructure UK) deliver some different rationales of good practices. There are three emerging models for these units:

- **A new agency**: Australia (Partnership Victoria), Portugal (former Parpublica SA), and the United Kingdom (former Partnership UK)
- **A government think tank**: Korea (PIMAC at KDI) and the Netherlands (former Dutch Kenniscentrum PPS)
- **A body within a ministry such as the finance ministry**: South Africa (National Treasury’s PPP unit) and the United Kingdom (Infrastructure UK)

These units are mostly declared to contribute to managing PPP policy and strategy, project analysis, transaction and contract management, monitoring, and enforcement. The models are not without the risk of conflict of interest: they are mandated to promote and improve PPP policy and projects for the direct interest of spending ministries and agencies, and, at the same time, they are supposed to be independent from the spending ministries and agencies as gatekeepers. However, the two roles of the unit—as a PPP promoter or a gatekeeper—may actually be in conflict with each other. A body responsible for promoting PPPs cannot really be seen to be independent of interest in the subject matter.

In light of these risks and possible conflicts of interest, the key recommendation is that there be strict independence from the direct interests of spending ministries and agencies.

**Step 4: Transparent Accounting, Budgeting, and Safeguard Ceilings for Fiscal Commitment**

*Accounting and Reporting of PPPs*

There is still no comprehensive and universally binding or accepted accounting standard for the treatment of PPPs in national budgets and international comparable statistics. With the growing harmonization of accounting worldwide, steps have been steadily taken to offer guidance on the PPP accounting issue, but so far the guidance has been still too limited and its application in practice has been uneven.

The absence of clear and operationally relevant standards limits the enforcement of spending controls, and therefore PPP projects often circumvent spending ceilings and fiscal rules. Existing standards are also too lax, with no clear mechanism to prevent investment that would be considered public investment off the government’s balance sheets. These circumventions include moving expenditures to future budgets, increasing government liabilities, and entering into guarantees to receive private financing but with taxpayers bearing the risk of future high costs and failure of the contract.
It is not surprising then, that European Union (EU) countries, for example, have previously turned to PPPs as a way to avoid the limits on public debt and budget deficits set under the EU’s Stability and Growth Pact. Facing growing criticism of this loophole, governments of member states decided to set rules on accounting procedures for PPP projects (Eurostat 2004, 2012).¹³

Recent developments in international accounting and statistics standards, such as the International Financial Reporting Standards (IFRS) and the International Public Sector Accounting Standards (IPSAS), increasingly reduce the opportunities to use PPPs to distort fiscal realities, but these have not filtered through to actual practice and so do not as yet provide an effective response to the misuse of PPPs (see box 7.2).¹⁴

**Budgeting PPPs**

It is essential that the process of planning, appraising, and selecting public investment projects be linked appropriately to the budget cycle even though the project cycle may run along a different timetable. There is clearly a two-way relationship between the budget cycle and the project cycle. The keys to efficient investment are good decisions about the choice of investments; active management of the asset portfolio; and a budgetary process that ensures recurrent funding to operate and maintain existing assets.

The growing interest in PPPs has increased the need for clear rules for budgeting. Transparency is a key element in budgeting and good governance, and, therefore, IMF (2006) and OECD (2012) address the principle that budget documentation should transparently disclose all information possible regarding the costs (capital and recurrent), explicit liabilities, and contingent liabilities of PPPs. In countries with significant PPP programs, disclosure could be in the form of a budget statement on PPPs (see box 7.3). The information should include what and when the government will pay as well as full details of guarantees and contingent liabilities. The payment stream from the government under the PPP contract should be highlighted, particularly if it is loaded toward the outbound years.

Because PPP costs may be contingent or occur in the future, annual budget cycles may be insufficient. So, at a minimum, there needs to be a credible and practical budgeting approach for good PFM.

When governments provide up-front payments to PPP projects, the payments required are similar to those for traditional government-financed projects, and they can be built into annual budgets and the medium-term expenditure framework relatively easily. In some countries, such as India, special PPP funds from which such payments will be made are introduced as well.¹⁵

**Safeguard Ceilings for PPP Fiscal Commitment**

IMF (2006) recommends giving high priority to the institutional framework for PPPs—including disclosure requirements and, when appropriate, ceilings on government payments. As Irwin (2008) describes, setting a safeguard ceiling can create incentives for agencies to choose conventional implementation over a PPP even when a PPP might provide better value for money. Nonetheless, given the
Box 7.2 Recent Development of International Accounting and Statistics Standards for PPPs

The International Financial Reporting Standards (IFRS) Interpretations Committee (IFRIC) issued the IFRIC 12 “Service Concession Arrangements” published on November 30, 2006, and effective for annual periods beginning on or after January 1, 2008—to decrease the diversity of existing accounting practice for service concession arrangements (IFRIC 2006). No specific IFRS recognition and measurement guidance previously existed for these types of arrangements.

IFRIC 12 applies to those service concession arrangements in which the public sector (the grantor) controls or regulates the services provided with the infrastructure and their prices, and controls any significant residual interest in the infrastructure. In these circumstances, the operator does not recognize the infrastructure as its property if the infrastructure is existing infrastructure of the grantor or is infrastructure constructed or purchased by the operator as part of the service concession arrangement. The operator recognizes either a financial asset or an intangible asset, or both, at fair value as compensation for any construction services that it provides.

The International Public Sector Accounting Standards (IPSAS) are the accounting standards for public sector entities developed by the International Public Sector Accounting Standards Board (IPSASB). The accrual IPSAS are based on the IFRS, issued by the International Accounting Standards Board.

On October 31, 2011, the IPSASB finalized IPSAS 32, “Service Concession Arrangements: Grantor,” effective for annual financial statements covering periods beginning on or after January 1, 2014. IPSAS 32 addresses the grantor’s accounting using an approach that is consistent with that used for the operator’s accounting in IFRIC 12. IPSAS 32 uses the principles in IFRIC 12 for determining which entity (the grantor or the operator) should recognize an asset in a service concession arrangement, to ensure that the grantor recognizes a service concession asset it controls. The aim of approval of the new standard is to enhance the transparency and accountability of public sector entities by ensuring that service concession arrangement assets and their related financing are reported. It is believed that this will close the gap on significant assets not being recognized by either the grantor or the operator.

Eurostat of the European Commission published on March 15, 2012, the revised Manual on Government Deficit and Debt, an application document complementary to the European System of Accounts (ESA95) (Eurostat 2012). The manual states that the core approach to be applied as a matter of principle in national accounts is the “risk and rewards” approach, which differs from the “control over the asset” approach adopted by the private sector accounting standard (IFRIC 12) and the international public sector accounting standard (IPSAS 32). According to the manual, it is not the role of statisticians to examine the economic and financial viability of projects or to provide detailed definition of PPPs because the expression applies to a wide range of arrangements. For the time being, therefore, the EU approach to accounting treatment of PPPs will use the method of examining existing risk and rewards.
difficulties in deciding whether a particular PPP commitment is affordable, limits or ceilings on aggregate PPP expenditure can be a helpful way to ensure that the government’s total exposure to PPPs remains within manageable limits. Box 7.4 highlights some different approaches.

To practically implement a safeguard ceiling on government commitments to finance PPP projects, the following points should be carefully reviewed and answered in each country:

- What is an optimal or acceptable level of PPP expenditure for a safeguard ceiling?
Box 7.4 Recent Country Experiences with Fiscal Limits on PPPs

Indeed, several countries are endeavoring to establish some limits and regulations. In Hungary, the public finance law limits the total nominal value of multiyear commitments in PPPs to 3 percent of government revenue.6 Following the financial crisis in 1998, the Brazilian government set a safeguard ceiling—the upper limit of the local governments’ financial commitment to PPP projects—of up to 1 percent of the government revenue. It adopted a series of strict fiscal rules, including central government authority to withdraw support for a PPP project if the local government fails to comply with the standard on public financing.

The Korean government also examined and adopted the idea of a ceiling on the total governmental disbursement for PPP projects in 2008. It was recommended that the government set a safeguard limit to effectively manage aggregate fiscal commitment to PPPs. Under the recommendation, it is assumed that if the government maintained either a government payment ceiling for PPPs of 2 percent of the national budget expenditure or PPP investment at 10–15 percent of total public investment and managed the commitment in the medium and long term, this would ease the fiscal pressure when it comes to public financing commitments of PPP projects.b,c

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b. No specific guidelines or upper limits for PPPs exist in the United Kingdom, which controls an aggregate amount of annual government payment related to PPP (or Public Finance Initiative [PFI]) projects. A series of government documents and data in early 2000, however, implied that annual government payments for PFI have been maintained at about 2 percent of the total annual government budget. The UK government also seemed to watch the total amount of PFI projects based on a standard, such as the capital budget. PFI accounts for 10–15 percent of total public investment. (HM Treasury 2004, 2006).
c. For more information, see chapter 6 of Kim (2007).

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- Is the ceiling mandatory or merely a guideline?
- What is an appropriate annual reporting format?
- How should the ceiling be reported to parliament, and should the ceiling be subject to parliament’s approval?
- Is there any responsibility for publishing?

Step 5: Tightening PPP Project Implementation

During implementation of a PPP project, modifications to the original project plan need to be anticipated. Therefore the government should make sure that the indicators laid out in the project feasibility study, the business case, and the VFM analysis are not weakened or impaired during the process. VFM outcomes are contingent on effective management over contract terms. Poor contract management with the private partner can result in higher costs, wasted resources, and impaired performance. Hence PPPs require careful oversight and regular audits.

After the ex ante project appraisal and selection stages, a competitive bidding process (while not the only possible way of selection) is essential to ensure VFM and optimal allocation of risk between the public and the private sector.16 Tender documents should be formulated based on the results of the project appraisal so that minimum requirements to achieve the project objectives and
VFM are satisfied. The final PPP contract terms and conditions resulting from negotiation with the private sector should reflect the ex ante VFM. This aspect needs regular checking throughout the preparation and tender stages of the project.

In practice, there are often changes to the project cost in the course of the procurement process. In the case of cost overrun, reassessment of feasibility and VFM is recommended at least for large projects; this would enable the government to recheck the impact of changes in project contents or the business case as well as to scrutinize the adequacy of the cost increase. In Korea, for instance, the reassessment study of feasibility (RSF) is mandatory and requested by the central budget authority on a project where a total project cost increase of more than 20 percent is proposed over the estimate at a previous phase of the project.17

It is useful to develop and announce standard implementation guidelines for deciding procurement strategy, managing bid processes, developing model project agreement, and standard clauses, issuing guidelines for output specification, managing contracts, and so forth. These guidelines provide both public procurers and private companies with a basic understanding and clarity on how individual PPP projects have been developed and procured under a unified framework, which reduces project risks and uncertainty. It is also important to provide public officers in charge of implementing and managing PPP projects with capacity-building and training programs on how to develop and procure PPP projects.18

**Step 6: Project Adjustment by Refinancing and Renegotiation**

The main focus of PPP project management has been on the ex ante stage, meaning “good” project appraisal and initiation. As projects enter into the implementation phase, efficiency of project management and renegotiation acquire importance. It is essential to clearly understand the process of PPP project adjustment, particularly regarding the two distinct cases of refinancing and renegotiation.19

**Refinancing a PPP Project**

Refinancing of a PPP project is the process of changing the project company’s equity structure, investment share, or debt financing conditions. Upon completion of construction, private construction companies generally want to exit the project by selling their shares. Also, shareholders want to convert a part of their equity into subordinated debt upon completion of construction. Because significantly less risk is present after the construction and commissioning stages have been completed, the premium paid for that risk (reflected in the margins on the finance) should also be less. This is one of the major reasons for refinancing maturing PPP projects.

Under the terms of many PPP project agreements, the competent authority may expect to share the refinancing benefits equally with the project company. The refinancing benefit is measured as the increase in investors’ expected internal rate of return in the postrefinancing financial model against the base case financial model. Several governments have already introduced rules for how refinancing benefits will be treated. The public authority and the concessionaire may split the benefit 50-50 or in other alternate ways.20
Renegotiating a PPP Project

Renegotiation means an adjustment or change in the project agreement between two or more parties in a PPP. Terms and conditions in the project agreement can be renegotiated when the project agreement allows it. This might be foreseen, for example, when policies related to the project or the project scope change. Renegotiation is possible when the government wants to rebalance the use of facilities among government facilities and PPP facilities. The government and public authorities are supposed to pursue renegotiation in the interest of the public and users. The request for renegotiation is not restricted to public authorities. The concessionaire can also request changes to the project agreement. Guasch (2004, 19) argues that renegotiation can be a positive instrument when it addresses the inherently incomplete nature of PPP contracts, while particularly opportunistic renegotiation can reduce or eliminate the expected benefits of competitive bidding.

Some guidelines for effective renegotiations include the following:

- Renegotiation requires agreement among the public and the private partners along with their financiers.
- Renegotiation takes into account the original project agreement.
- Many countries (the EU countries, in particular) have strict rules on adding to the original scope or scale of the project without changing the nature of the original tender process.
- Ex ante value for money should not be negatively affected whenever renegotiation is made.
- The government should consider compensating the private partner only when conditions change because of discretionary public policy actions.
- Careful consideration is needed regarding any shifts in the project risk profile. The financier of the project will equally want to be sure that its own rewards are not diluted through a renegotiation.
- Any renegotiation process should be made transparently and subject to the law.

Step 7: Better Service Delivery through Better Operation and Maintenance

By definition, a large portion of value for money in PPPs should be created by more efficient management of the delivery of the services and operation and maintenance of the assets. PPP project monitoring is managed by the relevant public authority, and the management structure is stipulated in each project agreement. To achieve the value for money envisaged at the signing of the project agreement, both the government and the private partner need to make sure that the planned allocation of responsibilities is clear and that risks are optimally shared and balanced.

Throughout the term of the contract, the following is assumed:

- The government is responsible for monitoring contract compliance and service performance by the private partner and for ensuring that all contracted payments are paid appropriately.
• The private partner is likely to monitor compliance by the government to ensure its responsibilities under the contract.
• Both parties are responsible for mitigating risks in operation and maintenance.

Each public authority manages projects by following the protocols stipulated in the project agreements and receiving project progress reports. Public authorities typically receive monthly reports from the private project company and may submit the results to the central PPP unit or the central budget authority. It is recommended that the authority input detailed information about PPP projects in a database. The main components of this database might include financial status, project progress, and fiscal support-related matters. The database can be used to develop better PPP policy and implementation at hand and in the future.

A good thing about PPPs is that PPP projects easily use a satisfaction survey and performance evaluation to assure service quality control. Performance checks and evaluation are conducted as specified in the standard performance quality requirement. The purpose of the performance evaluation is to check and assess whether service delivery outputs and outcomes are in accordance with the project agreement and output specification. Deductions can be applied to the payments from government to private partner for poor performance to promote private sector accountability and incentivize better operational performance. The facility operation performance is evaluated regularly, and if the agreed-upon service availability levels are not met, a deduction is applied to the government payments. If the level of service (content and quality) falls short of what the project agreement stipulates, a certain percentage can be deducted from the agreed-upon government payment.

Step 8: PPP Project Ex Post Evaluation: Does PPP Provide Better Value for Money?

Chapter 2 argues that a basic completion review should apply to all projects in a systematic way. That review comprises an examination by a responsible agency or line ministry to assess whether the project was completed within the original (and amended) budget and time frame; whether the outputs were delivered as specified; and whether the original objectives of the project have or are being achieved. As a supplement, the supreme audit institution should periodically conduct a compliance audit of a sample of investment projects. Good practice suggests that the project design should build in the evaluation criteria and that learning from such ex post evaluations should be used to improve future project design and implementation. OECD (2012) recommends that the supreme audit institution (a) maintain sufficient capacity to give a clear verdict on whether the project ultimately represented value for money; (b) suggest possible improvements to the regulatory PPP framework of the preparation and procurement processes; and (c) make available overall lessons regarding the use of PPPs and investments.

Unfortunately, the evaluation of PPP projects is extremely difficult because of both the conceptual slipperiness and the large number of disciplines involved—economics, accounting, law, political science, engineering, and
so on—that need to be brought together and reconciled (Allen 2012). Many important technical areas, such as developing an international accounting standard for PPPs and an appropriate legal framework, have not been fully resolved. Hodge (2010, 93) explains why different reviewers often see the same results differently. Evaluation has also proved difficult in practice because of the inherently political nature of the decision-making process, which acts as a distorting lens (see box 7.5).

One way to evaluate PPPs, nonetheless, is to explicitly trace out evidence of cost savings and efficiency gain as well as evidence of PPP contribution to the national economy, as follows:

- **From a microeconomic point of view,** the efficiency of PPP projects could be measured and analyzed to review whether gradual improvements, compared with the cases of conventionally implemented projects, have been made in the efficiency of costs, toll rates, and economic rates of return.

- **From a macroeconomic point of view,** the PPP contribution to the national economy could be analyzed. The impact of PPP projects could be diagnosed as to whether they have ripple effects on the national economy through several channels: economic growth resulting from the inflow of private capital; increased social welfare resulting from the timely delivery of social services; and the early realization of social benefits. Despite such expansion in private investment through PPPs, it is not easy to measure and present private investment’s contribution to economic growth.22

Despite these challenges, the ex post evaluation of PPPs should be more rigorously managed within a comprehensive framework of analysis, applying both micro- and macroeconomic points of view. Multidisciplinary approaches and
comparative studies, combining PPPs and conventional financing, are strongly recommended. Because it is not always clear whether the PPP is a good route, the cost and benefit of PPP initiation should be reviewed objectively within a unified PIM framework.

**Future Work for the Unified Approach**

Because the scale of PPP investment and related government commitments (both explicit and contingent) have rapidly increased in the world, the need for a unified framework is increasing as well. Too often, PPP investment has been treated separately from publicly financed investment and has not come under direct regulation as government expenditure. Because large parts of future government obligations on PPPs are long-term commitments such as government payments for service purchase-type projects and guarantee payments in some cases, it is important to examine whether a government can maintain the same level of fiscal soundness and sustainability for both conventional and PPP financing in a unified framework.

This chapter pointed out the importance of a unified framework for comparably and effectively appraising and analyzing both conventional and PPP forms of implementation. But to make this a win-win situation, an optimal partnership between both parties needs to be fostered. This is arguably challenging in practice because it requires reconciliation of the public interest with private interest. Such reconciliation is more likely found when the bias for one form of implementation or another is mitigated or eliminated.

Future work is needed to help governments put in place the unified approach for public investment that enables them to select the public investment option that delivers the best value for money, whether by traditional budget financing or PPP. An immediate task to make the unified approach viable is to provide further diagnostic tools that would synthesize and deepen guidance on systematic assessments for PPPs in and jointly with PIM systems. Such tools, while aligned with the Public Expenditure and Financial Accountability (PEFA) assessment tool of the conventional PIM framework, would need to develop new indicators and means of verification to assess the performance of PPP systems, processes, and institutions.

**Notes**

1. There exists no standard definition of what constitutes a public-private partnership (PPP). The World Bank and Public-Private Infrastructure Advisory Facility (PPIAF) (2012) define a PPP as "a long-term contract between a private party and a government agency, for providing a public asset or service, in which the private party bears significant risk and management responsibility." The Organisation for Economic Co-operation and Development (OECD) (2008) defines a PPP as "an agreement between the government and one or more private partners according to which the private partners deliver the service in such a manner that the service delivery objectives of the government are aligned with the profit objectives of the private partners."
and where the effectiveness of the alignment depends on a sufficient transfer of risk to the private partners.” HM Treasury (2008) of the United Kingdom defines a PPP 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.”

2. The World Bank and PPIAF database (http://www.ppiaf.org/) provides good information for PPP projects. The database includes data on a wide spectrum of private participation in infrastructure (PPI).

3. For further discussion on PPP reporting and accounting, see the next section under “Step 4.”

4. Hemming (2008) argues that a binary approach could result in governments accepting bids from private partners prepared to accept more risk, irrespective of the cost to government of having them do so, which would defeat the objective of using PPPs to achieve value for money. By the same token, projects that offer good value for money may be of little interest to the government given that they have to be recorded on the balance sheet. In other words, bad PPPs could end up driving out good ones.

5. This is the document that sets priorities for government investments in the national strategic guidance and planning. In practice, such documents are not always followed and are subject to political influence. Many countries at least provide national guidance and planning for prioritizing traditional government investments.

6. The OECD recommendation seems to highlight that the traditional procurement mode should not remain the default mode (OECD 2010b).

7. In managing PPPs, arguments exist both for and against the establishment of a dedicated PPP unit. OECD (2010a) points out that these arguments center on the separation of policy formulation and project implementation, the pooling of expertise and experience within the government, the standardization of procurement procedures, the appropriate budgetary consideration of projects, and the demonstration of political commitment and trust. World Bank and PPIAF (2012) also reviews establishment of a PPP unit.

8. World Bank and PPIAF (2007) defines a dedicated PPP unit as any organization designed to promote or improve PPPs that has a lasting mandate to manage multiple PPPs’ transactions in response to government failures including poor procurement incentives, lack of coordination, lack of skills, high transaction costs, lack of information, and so on. OECD (2010a) defines a dedicated PPP unit as any organization set up with full or partial aid of the government to ensure that necessary capacity to create, support, and evaluate multiple PPP agreements is made available and clustered together within government. The reference to “multiple” PPPs is an important distinction to differentiate a dedicated government PPP unit from a dedicated PPP project unit, which may be located in government organizations to support the management of an individual project. The definition of OECD (2010a) seems more oriented toward supporting the role of independence.

9. The Portuguese government established a PPP Unit in Parpublica SA in 2003, but, with a concern that technical support was too dispersed within the public sector, Parpublica’s role as the main PPP unit was ceased and in 2012 the Ministry of Finance established UTAP under its direct authority. See EPEC (2014).

10. The former Partnership UK as a new agency was abolished, and the Infrastructure UK as a regulatory body within HM Treasury of the United Kingdom was formed separately with a different mandate since 2010.
11. OECD (2010a) presents a good survey of institutional and governance structures of dedicated PPP units.

12. However, there exists an example of government financial statistics as a form of PPP reporting. The Eurostat standards, widely accepted in European Commission countries under the European System of Integrated Economic Accounts (ESA95) standards, are reporting following the standards of the International Monetary Fund’s Government Finance Statistics Manual 2001 (IMF 2001). At present, the standards do not ensure useful reporting of PPP commitments in long-term purchase contracts.

13. According to the accounting rules announced by Eurostat in 2004 and restated in 2012, the assets (or debts) involved in a long-term PPP contract between a government unit and a nongovernment unit can be considered as nongovernment assets (or debts) only if there is strong evidence that the nongovernment partner is bearing most of the risks attached to the asset (or debts) all over the contract (Eurostat 2004, 2012). The rules state that in such cases where government revenues exceed 50 percent of government payments to the private partner in a PPP project, the project should remain on the balance sheet of the government and not be classified as a PPP.

14. Accounting treatment of PPPs has historically been based on “risk and reward” criteria, but recently IFRS and IPSAS argued for “control” criteria. The “risk and reward” criteria, adopted by Eurostat, highlight the responsibility of the party that bears the project risk and reward, while the “control” criteria claim the responsibility of the party that controls the decision. The assets (or debts), whose risks are mostly borne by the nongovernment unit, can be considered as government assets (or debts) only if the government controls the decision on who bears the risks. See IFRIC 12 “Service Concession Arrangements” (IFRIC 2006) and the IPSAS ED 43 (IPSAS 2010).

15. In July 2005, the Cabinet Committee on Economic Affairs established India’s Viability Gap Fund (VGF) program through its approval of the “Scheme for Financial Support to Public Private Partnerships in Infrastructure.” The primary objective of India’s VGF program is to attract more private investment in infrastructure by making PPP projects financially viable. The scheme is funded by the Government through its budgetary resources, with budget provisions made on an annual basis linked to likely demand for disbursements during the year. In the first year a budgetary provision of US$40 million was made. The scheme also provides for a revolving fund to be kept at the disposal of the Empowered Committee to ensure liquidity of the VGF, and replenished as needed. In any given year, the scheme provides for a cap on the value of projects approved equivalent to ten times the budget provisions for VGF in the annual plan—to ensure continuing liquidity and preventing bunching of disbursement requests as far as possible. This cap can be modified if the Ministry of Finance considers necessary. In practice, the cap has not been binding, and the total VGF support during any year has been based on the estimated requirement for disbursements during the coming year. Source: Ministry of Finance, Government of India (2013), Scheme for Support to Public Private Partnerships in Infrastructure. See World Bank and the PPIAF (forthcoming).

16. The relevant authority—either a central or a local government agency—forms a tender evaluation team, and, in general, the evaluation is conducted with prequalification and evaluation of technical and financial or price elements. One preferred bidder is selected for negotiation based on the result of the evaluation, and the second preferred bidder is invited to negotiate only if the negotiation with the first preferred bidder has failed. Under EU rules, a Competitive Dialogue procedure can be conducted where the procuring agency negotiates with more than one bidder simultaneously.
17. The mandatory reassessment study of feasibility (RSF) in the Republic of Korea, declared in the National Finance Law, has proven to be effective in discouraging unnecessary cost-increase requests by spending ministries and agencies. They are more likely to quit requesting higher cost increases (more than 20 percent) than to let the projects be reassessed at a zero-base.

18. Public officers in every country are well acquainted with traditional procurement policy and projects but not necessarily with their PPP counterparts. Therefore, PPP capacity-building and training programs are strongly recommended.

19. Among various issues of ex post monitoring, performance management, refinancing, and renegotiation, issues of refinancing and renegotiation are unique to the PPP route, whereas the remaining issues (of ex post monitoring and performance management) pertain to both PPP and traditional procurement projects. Traditional procurements, in general, hardly ever have refinancing and renegotiation issues.

20. The United Kingdom's HM Treasury introduced into its standard PFI contracts a 50-50 split of any refinancing gain (HM Treasury 2003), but this was subsequently revised up to a 70-30 split in favor of the government in the wake of the global financial crisis in the late 2000s.

21. OECD (2012) encourages the supreme audit institution to assume an important role in examining whether the risks involved in PPPs are managed effectively. The supreme audit institution's reports to the parliament can keep the public informed about the service that they receive and disseminate best practice.

22. According to a study by Rhee and Lee (2007) in Korea, the promotion of PPP projects results in a decline in fiscal investment by the government, implying a crowding-out effect of PPPs on public investment, and therefore PPP promotion does not have a significant effect on total investment.


24. To assess the performance of PPPs in a unified framework, a new “PIM for PPP” diagnostic framework with the PEFA-type indicators and means of verification was developed by the World Bank (World Bank forthcoming).

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