

How To Mitigate Fiscal Risks for PPPs: Engaging PIM and PPP As Aligned and Integrated

Jay-Hyung Kim (World Bank, jkim5@worldbank.org)

Tokyo Fiscal Forum 2018: Strengthened Fiscal Management in Asia

Tokyo, Japan on June 4-5, 2018

Outline of Presentation

- Why the Need for Engaging PIM and PPP as Aligned and Integrated?
- Benefits from a Unified Approach to PIM and PPP
- Challenges to Having a Unified Framework in Practice
 - ❑ Challenge 1: Building the Legal and Institutional Frameworks for PIM-PPP Integration
 - ❑ Challenge 2: Integration of Upstream Project Appraisal/Selection for PIM and PPP
 - ❑ Challenge 3: Integrated Fiscal Management of PIM and PPP
 - ❑ Challenge 4: Integration of Downstream Project Implementation/Adjustment for PIM and PPP
- PIM-PPP Integration Efforts in Selected Countries
- Takeaway Questions and Discussions

Why the Need for Engaging PIM and PPP as Aligned and Integrated?

- Many countries have been managing public private partnership (PPP) projects separately from traditional public investment management (PIM) projects.
 - PPPs have been mostly prepared, appraised, selected, budgeted, and monitored separately from traditionally implemented projects (TIPs).
- This disparity has undermined adequate public financial management and created undue fiscal risks and unclear transparency, causing fiscal concerns with respect to appropriate forms of accounting, reporting, budgeting, and other processes.
- From a fiscal point of view, a key to initiating a PPP project is to engage government maintain the same level of fiscal efficiency and sustainability through PPP as through TIP.
 - Given there exists no such a thing as ‘PPP project’ intrinsically, PPP is a modality of implementing a public investment project.
- A unified approach for integrating PIM and PPP is critical for effectively mitigating fiscal risks for PPP projects.

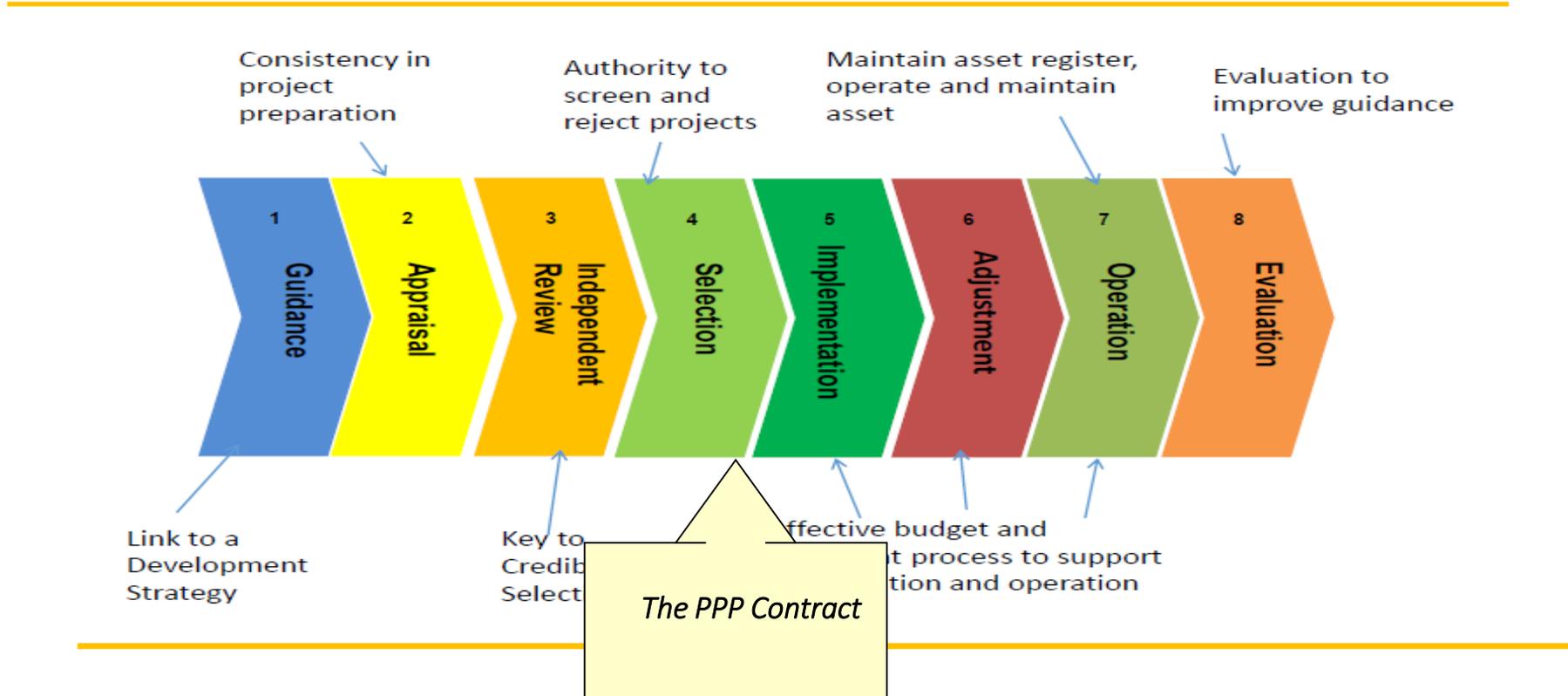
Benefits from a Unified Approach to PIM and PPP

- Unified approach helps ensuring consistent project appraisal and decision making
 - The choice between a PPP and TIP is often skewed by factors other than value for money. Political preference for or against PPPs may play a role in skewing choices and affecting outcomes.
 - A unified approach has the potential to minimize subjective decisions concerning TIP versus PPP project selection and implementation.
- Unified approach helps supporting optimal risk transfer
 - If each project, whether TIP or PPP, is separately managed, the concept of optimal transfer from one to the other may not be ensured.
- Unified approach helps avoiding unmanaged fiscal risks while improving transparency
 - The unified approach may discourage parallel budgeting by reporting the known and potential future fiscal costs of PPPs in traditional budget system.
 - By strengthening procedural controls on PPP commitments, the approach helps to improve overall transparency in the PFM system.

Challenges to Having a Unified Framework in Practice

- Given commonalities and differences between PIM and PPP, constraints and difficulties remain to swiftly apply such a unified approach.
- Challenges moving toward a unified framework for PIM and PPP
 - Challenge 1: *Building the legal/regulatory and institutional frameworks for PIM-PPP integration.*
 - Challenge 2: *Integration of Upstream Project Appraisal/Selection for PIM and PPP.* Running through PIM/PPP upstream stages which correspond to must-have dimensions for project strategy and planning, pre-appraisal, appraisal, selection and budgeting.
 - Challenge 3: *Integrated Fiscal Management of PIM and PPP.* Clear rules for PPP accounting, budgeting, reporting to disclose all information regarding the costs and liabilities, and a safeguard ceiling for aggregate PPP expenditure.
 - Challenge 4: *Integration of Downstream Project Implementation and adjustment for PIM and PPP.* Running through PIM/PPP downstream stages which correspond to must-have dimensions for project implementation, monitoring and adjustment, operation and maintenance, ex post evaluation.
- PIM Diagnostic Tool is useful to learn how traditional investment projects and PPPs can move toward a unified framework → A PIM4PPP Diagnostic Tool.

[A PIM4PPP Diagnostic Tool of the World Bank to Check Out a Unified Framework]



Source: *The Power of Public Investment Management: Transforming Resources into Assets for Growth* (World Bank, 2014) and *PIM4PPP Analytical Framework and Assessment Tool* (World Bank, 2016).

The PPP Contract will define the means by which the assets underlying the contract are designed, built, financed and operated for a substantial number of years.

Challenge 1-1: For Support Relevant Legal Framework for PIM-PPP Integration

- **Common Law versus Civil Law system:** Clear differences between Common Law system and Civil Law system. Common Law countries, such as the United Kingdom, do not necessarily need a PPP Law, whereas Civil Law countries find it nearly impossible to take any action unless there is a specific law allowing them to do so. PIM-PPP integration will need to take account of the key differences between the different legal systems.

***Ten 'Must-have' Elements of a PPP Legal Framework** can include amongst others:

- Principles upon which PPP contracts are to be awarded;
- Clear unambiguous authority to award PPP Contracts – who can award, what types, for how long?;
- How projects are assessed and appraised for value for money;
- How fiscal risks are assessed, monitored, and reported;
- Handling unsolicited proposals;
- Direct agreements;
- Forms of permitted government support;
- Appropriate procurement procedures;
- Dispute resolution procedures – including international arbitration; and
- Termination provisions – specifically compensation on termination.

- **Dedicated Legislation versus Adapting the Existing Legislation (or in combinations of the two)**
 - PPP Dedicated Legislation model has been widely adopted in many countries. Whether a dedicated PPP law or regulation is needed or beneficial typically depends on a country's legal and administrative systems. A PPP-specific law or regulation can help raise the profile and demonstrate political commitment to the PPP program—although care is needed to avoid conflict with any other existing relevant laws.
 - Adapting the Existing Legislation model has been adopted in some countries. The existing laws may define processes and institutional roles relevant to PIM and PPP, such as in those for sector laws, procurement law, contract law, and/or Budget/PFM law.
 - Country efforts to treat both TIP and PPP projects subject to the same provisions: Cyprus, Germany, Jamaica, Korea, Portugal, UK, Zimbabwe, etc. (see slides 13-15)

Challenge 1-2: For Support Relevant Institutional Framework for PIM-PPP Integration

- Two key roles in the existing institutional responsibilities for PPP are usually described as:
 - A promoter role: doing the day-to-day work to drive forward the PPP process through managing the various steps from identification to contract implementation - identifying potential projects, appraising, structuring, drafting the contract, bidding it out, and managing the contract after it is signed.
 - A gatekeeper role: overseeing the PPP process, typically through review and approvals at key stages, to ensure that the project represents a good investment decision for the government.
- Finance ministries play a central gatekeeping role in the overall PIM system in most countries. The avoidance of parallel systems for TIP and PPP implementation is essential.
 - Finance ministries (through their role in coordinating other actors) should therefore be at the heart of the PPP institutional arrangements.
 - It is generally the case that sector ministries and agencies play the role of promoter in day-to-day implementation of the steps involved in bringing a PPP project to fruition.
 - Among MoF, PIM/PPP Units, LMs, need to establish clearly differentiated roles and responsibilities for being a project proposal, a project reviewer, a project appraiser, and/or a decision-maker in each PIM stage.
- The roles and responsibilities of dedicated PPP Units need to be carefully examined because of the potential to create distortions in the overall PIM system (e.g., PIM Unit versus PPP Unit, and PPP Unit versus LMs).
 - Inherent conflicts of interest should be avoided, such as having the role of 'promoter' for PPP forms of implementation, whilst at the same time having the role of 'gatekeeper', overseeing the suitability and quality of project proposals under the umbrella of public investment projects in general.
 - It is important to highlight, in particular, the changing roles of PPP Units in recent years as they become more 'mainstream' and centralized within traditional PIM institutional arrangements.

Challenge 2-1: For Support Upstream Engagement of A Unified Project Appraisal and Selection

PPPs are a form of implementing a public investment project

And..

- ✓ All investment project proposals should be screened for compatibility and consistency with national policies
- ✓ All investment projects must have common economic assessment
- ✓ All investment projects need to be technically and legally feasible, environmentally compliant, socially sustainable, and economically viable
- ✓ All investment projects cost must be known and in line with fiscal priorities
- ✓ All investment projects should be appraised on their ability to address a need and for their potential value against the cost of the required investment

Establish a 'unified gateway' process integrating traditional and PPP public investment project appraisal and selection to qualify for inclusion in national budget.

Deciding on Public Investment Modality in a Unified Framework



Source: World Bank, 2014, *The Power of Public Investment Management: Transforming Resources into Assets for Growth*

Challenge 2-2: For Support Systematic Approach to Economic, Financial, Viability Gap, and VFM Analyses in Upstream Decision

- **Economic CBA**

- Analyze economic benefits of the project (e.g. reduction of travel time, fuel, and accidents) are large enough to justify the investment



- **Financial CBA → Viability Gap Analysis**

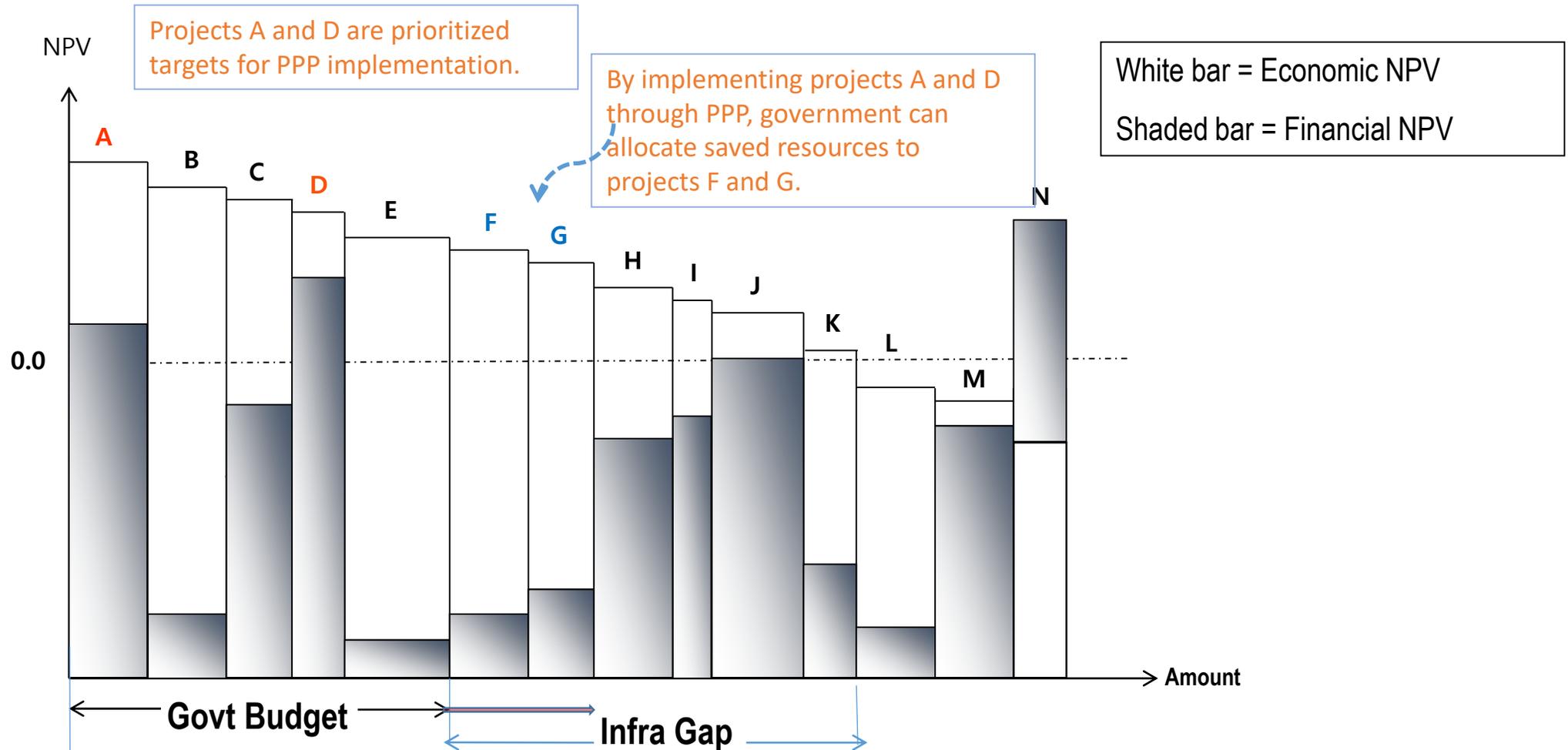
- Analyze financial return of the project *and* the affordability of public contributions (if needed)
- Test 1: Are toll and other revenues sufficient for full cost recovery?
- Test 2: What public financial contributions (e.g. availability payments, shadow tolls, guarantees) are needed?: Assuming the project is *economically viable* (from CBA) but not *financially viable* (e.g. due to low cost recovery, or high risk)
- Test 3: Are public contributions affordable?



- **VFM Analysis**

- Analyze whether the project be implemented as a PPP or through a traditional Public Procurement?/What is the preferable PPP structure?
- Qualitative VFM and Quantitative VFM

[Example: How PPP can Help? Strategic PPP Selection with Expanded Fiscal Space]



Challenge 3: For Support Accounting and Capital Budgeting Engagement

- **Accounting PPPs**

- The absence of clear and operationally relevant accounting standards limits the enforcement of spending controls, and therefore PPP projects often circumvent spending ceilings and fiscal rules.
- However, 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.

- **Budgeting PPPs**

- 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.
- When governments provide up-front payments to PPPs, the payments required are similar to those for TIPs, and they can be built into annual budgets and the medium-term expenditure framework relatively easily.

- **Safeguard Ceiling for Aggregate PPPs Expenditure**

- Given the 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 (for examples: Brazil, Cyprus, Hungary, Korea, etc.)

- **IMF & World Bank develop P-FRAM** (PPP Fiscal Risk Assessment Method)

- P-FRAM is a tool to assess the fiscal impact of a PPP project and help national debt management (tested in some countries).

Challenge 4-1: For Support Downstream Engagement of Project Implementation/Adjustment by Renegotiation and Refinancing

- Before major project adjustments or changes by renegotiation and refinancing, reassessment of economic viability and VFM is requested; this would enable the government to re-check the impact of changes in project contents or the business case as well as to scrutinize the adequacy of the adjustment.
- **Renegotiation**
 - Renegotiation means an adjustment or change in the project agreement between two or more parties in a PPP.
 - Ex ante VFM should not be negatively affected whenever renegotiation is made. Any renegotiation process should be made transparently and subject to the law.
- **Refinancing**
 - Under the terms of PPP project agreements, the government may expect to share the refinancing benefits equally with the project company.
 - There should be clear rules in place for managing refinancing.
- **Clarify dispute resolution and early termination rules/procedures**

Challenge 4-2: For Support Downstream Engagement of 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.
 - To achieve the value for money envisaged at the signing of the Project Contract, 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.
- Performance checks are conducted as specified in the standard maintenance quality requirement in the Project Contract.
 - The purpose of the performance check is to 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.

PIM-PPP Integration Efforts in Selected Countries (1)

United Kingdom

- Institutional development to support PPP form of implementation constantly adapted to changing circumstances since mid-1990s → Partnership UK (2001)
- Infrastructure UK (IUK) in 2010 → Merge of Major Projects Authority (MPA) and IUK into Infrastructure and Projects Authority in 2016 → HM Treasury merged PPP with TIP to recognize the need to assess and appraise project proposals as objectively as possible regardless of means of implementation.
- PPP is only used for implementation when a VFM compared to TIP case can be demonstrated.

Germany/Portugal

- Germany: No PPP dedicated law. Budget Law establishes guiding principles and appraisal requirements for 'all' public procurements including PPP projects.
- Portugal: No PPP Law (only a PPP Decree-Law on the work of the PPP Unit). Permitting legal texts include a section on PPPs in the Public Procurement Law, and a section on PPPs in the Budgetary Framework Law.

Korea

- PPP Law is special and precedes other laws and PPP fiscal management is explicitly legislated in PPP Law in line with TIP fiscal management under National Finance Law.
- Both National Finance Law and PPP Law regulate TIPs and PPPs respectively in a unified framework which makes TIP and PPP interchangeable if needed.
- According to PPP Law, PPP projects shall be strictly reviewed/approved as aligned to TIP in three legal stages of (i) project appraisal/selection, (ii) contract agreement, and (iii) renegotiation /refinancing, by the PPP Review Committee chaired by the Finance Minister.
- According to both laws, a dedicated PIM/PPP unit (PIMAC) provides both TIP and PPP appraisal and implementation supports.

PIM-PPP Integration Efforts in Selected Countries (2)

Cyprus

- According to the new Fiscal Responsibility and Budgetary System Law (FRBSL) in to effect in February 2014, a PIM chapter which integrates PPP regulations as well has been created.
- Under the primary legislation of FRBSL, the integrated PIM/PPP Guidelines and the Methodological Manual have been developed as a second and a third tiers of PIM regulation.
- A unified project appraisal/selection framework over PIM and PPP has been established.
- A PPP safeguard ceiling has been set under the overall PFM/PIM context.

Jamaica

- A PIM4PPP Diagnostic has been completed in 2015.
- Developed a coordinated and integrated system for covering 'all' projects funded by central state budget (Capital A), donor's fund (Capital B), public corporations fund, and /or PPPs.
- Established PIM Committee (PIMC) and the Secretariat (PIMSEC) to systematically screen, review, and prioritize all projects including TIPs and PPPs in a very early stage.
- Strengthened Public Investment Management System (PIMS) to support greater harmonization between TIPs and PPPs.

PIM-PPP Integration Efforts in Selected Countries (3)

Ukraine/Belarus/Jordan

- There remain parallel systems of PIM and PPP in Ukraine, Belarus, and Jordan.
- PIM4PPP Diagnostics have been carried out in 2015 (Ukraine), 2016 (Belarus), and 2018 (Jordan), respectively, to lead a comprehensive PIM and PPP reforms.
- In Ukraine: Both PIM and PPP Guidelines for project appraisal and selection have been separately established in 2015 and 2016. Efforts are made to systematically align these two for keeping consistency.
- In Belarus: Based upon the PIM and PPP Diagnostic, the government recently requested the World Bank a support on how to facilitate strategic allocation of funds between TIPs and PPPs.
- Jordan: The Ministry of Planning and International Cooperation recently requested the World Bank a work to develop the PIM-PPP governance framework which includes both PIM and PPP regulations harmonized.

Cambodia/Zimbabwe

- PPP is new in Cambodia and Zimbabwe.
- Cambodia: The Ministry of Economy and Finance recently requested the World Bank to support developing the PIM Decree as PIM Guideline which makes PIM and PPP decisions harmonized in project appraisal and selection.
- Zimbabwe's Ministry of Finance and Economic Development is recently strengthening efforts through reform actions to upgrade PIM and PPP systems in greater harmonization. In the PIM Guideline promulgated in 2017, 'all' public projects, including budget projects, PPP projects, SOE projects, and donor funded projects, are regulated in a unified appraisal and selection framework.

Takeaway Questions and Discussions

- How to identify different versus common areas between PIM and PPP in the country?
- How to develop an integrated system for PIM and PPP in the country?
 - How to build the legal and institutional framework for PIM-PPP integration: Establish a PPP-specific legislation versus a PPP under the routine PFM/PIM laws and regulations? Establish a dedicated PPP unit, separate from PIM unit, recommended and useful?
 - How to develop the PIM/PPP upstream project appraisal and selection institutions and guidelines: differentiated roles and responsibilities of key stakeholders (who will be a project proposer, an appraiser, a reviewer, and a decision-maker) in each stage?
 - How to establish the PIM/PPP capital budgeting rules? How to develop a safeguard ceiling? How to disclose/manage PPP liabilities and contingent liabilities?
 - How to develop the PIM/PPP downstream project implementation institutions and guidelines?
 - How to manage project adjustment through renegotiation and refinancing in PPP?
- How to use various tools of WB PIM/PPP Diagnostic, IMF PIMA, P-FRAM, etc?

Many Thanks

Jay-Hyung Kim (jkim5@worldbank.org)