PPPs, Fiscal Risk, and the IMF’s PFRAM Tool

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PPPs the financing solution for public investment in Asia?

- Infrastructure spending expected to grow 7-8 percent in real terms over the next decade in Asia Pacific
- By 2025 annual spend on infrastructure in the region will equal 60 percent of world’s total
- Annual financing requirement at least 1.7 trillion US$ over the 2016-2030 period (in 2015 prices)

>>> Traditional public investment constrained by limits to revenue mobilization and (appropriate!) fiscal rules
>>> SOEs can have legacy costs, considerable inefficiencies, and need government guarantees

>>> Are PPPs the solution?
Public investment not only hampered by lack of financing....

Public investment is critical for economic growth and for the quality of life, but.....

- cost overruns
- poor design
- corruption concerns
- poor project selection
- poor maintenance
- completion delays

but often affected by
PPPs can address some of these issues....

PPPs can be an efficient way of procuring public investment, if they help:

- Contain cost overruns and delays in construction phase
- Improve project design and quality of service
- Guarantee proper, timely and cost effective operation and maintenance
- Allow government to refrain from detailed project management, and focus on outputs and results

PPPs may be able to mobilize additional capital and user fees for project finance

PPPs can also transfer substantial project risk (financial, technical, operational) to the private party
But only to a limited extent.....

PPPs have higher financing costs, require a profit margin for the private entity, and have high transaction costs.

Also, while (official) public debt may remain low, (off-budget) expenditure obligations and contingent liabilities are likely to increase.

>>> PPPs generate fiscal risk and costs!
Use of PPPs in Emerging Asia and Advanced Countries is still quite modest

Public-Private Partnerships Investment (Nominal, % of Total Investment)

Note: Total investment = public investment + PPP investment
PPPs part of the Fiscal Iceberg!

- **Budgetary risks are related to:**
  - **direct costs**, and
  - **contingent liabilities** (explicit or implicit)

- **PPPs fiscal risks:**
  - Reduce budget flexibility by committing public funds through long-term contracts
  - May move spending and liabilities off budget
  - Bypass spending controls/fiscal discipline

- **PPPs – if not managed well - may undermine macroeconomic stability**
PPPs are not easy to manage

- PPPs are complex to design and implement:
  - Appropriate incentive/reward mechanism
  - Risk sharing (full transfer unrealistic)
  - Financing arrangements
  - Support measures (subsidies, guarantees, minimum revenue, equity injection, tax amnesty)
  - Contracting
  - Renegotiation/Termination

>>>Will require developing substantial public sector expertise
>>>Presents high transaction costs
>>>Which limits overall volume
Typical issues at the macro level…

- Inadequate legal framework

- Weak role of the Ministry of Finance as the gate-keeper of public finances

- Lack of integration of PPP projects within the budgetary process
  - Separate investment appraisal and selection process
  - Budgeting procedures bias decision-making in favor of PPPs
  - Annual appropriation mechanism not appropriate for PPPs
  - Inadequate long-term fiscal sustainability assessment

- Noncompetitive procurement

- Poor monitoring/lack of fiscal transparency
  - Inadequate accounting and reporting standards
  - Poor information on medium-term commitments and contingent liabilities
  - Use of State-owned enterprises, parastatals, etc. to hide government involvement
Managing Fiscal Risk of PPPs

• **Micro approach – reducing the risk of the PPP process**
  – Legal and Policy Framework
  – Integration into normal project appraisal/selection
  – Value for Money assessment and fiscal impact analysis
  – Risk sharing policy
  – Gatekeeper role MOF
  – Standard approaches and contracts
  – Monitoring Framework – individual
  – Capacity building

• **Macro Approach – limiting overall exposure of PPPs**
  – Monitoring Framework – macro
  – Improved accounting and reporting standards
  – Include PPPs in sustainability framework
  – Limits on *for example* (i) contingent liabilities (separate, or part of debt ceiling), (ii) direct expenditure of PPPs, or their NPV, (iii) total value of PPP program (stock and/or flow)
PFRAM estimates the macro-fiscal impacts of a PPP project recorded in line with international standards IPSAS 32 and GFSM 2014

- Fiscal commitments are recognized when the contract is signed (as the assets are built)
- Asset and liabilities of the PPP are accounted on the government balance sheet if government retains control of the asset
- It also generates results on cash basis and compares these with accrual results

How does PFRAM measure fiscal impact?
What P-FRAM doesn’t do?

It does not substitute a complete financial and economic project evaluation

- Aim is to estimate the macro-fiscal impacts
- User-friendly design means it is based on a limited amount of information and assumptions
- So, it can only provide a broad idea of costs and risks

PFRAM v2.0 is in the works – Improvements + PPP portfolio approach
## 5 Main Outputs

<table>
<thead>
<tr>
<th><strong>Private partner cash flow</strong></th>
<th>Expected cash flow for private partner</th>
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<tr>
<td><strong>Public Financial Statements</strong></td>
<td>Government income statement, balance sheet, and cash statement (accrual and cash)</td>
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<td><strong>Project Macroeconomic impact</strong></td>
<td>Summary charts comparing fiscal balance and DSA with/without PPP project</td>
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<td><strong>Fiscal Risk Matrix</strong></td>
<td>Fiscal risks retained by government and mitigation measures</td>
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<td><strong>Sensitivity Analysis</strong></td>
<td>Macro variables: GDP, exchange rate, inflation Project parameters: contract termination</td>
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Outputs

Private cash flow

Project fiscal impact

Impact of PPP Project on Headline Fiscal Indicators

Cash Flows of the PPP Private Project Company

Government Liabilities

Government Nonfinancial Assets

Gov. Net Lending/Borrowing (Accrual balance)

Government Cash Balance
Outputs

Debt including PPP project

Fiscal / Cash balance including PPP project
## Outputs: Summary Project Risk matrix

<table>
<thead>
<tr>
<th>Identification of Risks</th>
<th>Allocation</th>
<th>Likelihood</th>
<th>Fiscal Impact</th>
<th>Risk Rating</th>
<th>Mitigation Strategy</th>
<th>Priority</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Governance risks</td>
<td>Public</td>
<td>High</td>
<td>Medium</td>
<td>High</td>
<td>NO</td>
<td>High priority</td>
</tr>
<tr>
<td>2 Construction risks</td>
<td>Shared</td>
<td>Medium</td>
<td>Medium</td>
<td>Medium</td>
<td>NO</td>
<td>High priority</td>
</tr>
<tr>
<td>3 Demand risks</td>
<td>Private</td>
<td>High</td>
<td>High</td>
<td>Critical</td>
<td>NO</td>
<td>Critical</td>
</tr>
<tr>
<td>4 Operational and performance risks</td>
<td>Shared</td>
<td>Low</td>
<td>Low</td>
<td>Irrelevant</td>
<td>NO</td>
<td>NO action required</td>
</tr>
<tr>
<td>5 Financial risks</td>
<td>Private</td>
<td>Medium</td>
<td>Low</td>
<td>Low</td>
<td>YES</td>
<td>Low priority</td>
</tr>
<tr>
<td>6 Force majeure</td>
<td>Shared</td>
<td>Low</td>
<td>High</td>
<td>Medium</td>
<td>NO</td>
<td>High priority</td>
</tr>
<tr>
<td>7 Material adverse government actions</td>
<td>Public</td>
<td>Low</td>
<td>Low</td>
<td>Irrelevant</td>
<td>NO</td>
<td>NO action required</td>
</tr>
<tr>
<td>8 Change in law</td>
<td>Public</td>
<td>Low</td>
<td>Medium</td>
<td>Low</td>
<td>YES</td>
<td>Low priority</td>
</tr>
<tr>
<td>9 Rebalancing of financial equilibrium</td>
<td>Private</td>
<td>Low</td>
<td>High</td>
<td>Medium</td>
<td>NO</td>
<td>High priority</td>
</tr>
<tr>
<td>10 Renegotiation</td>
<td>Shared</td>
<td>Medium</td>
<td>High</td>
<td>High</td>
<td>YES</td>
<td>Medium priority</td>
</tr>
<tr>
<td>11 Contract termination</td>
<td>Shared</td>
<td>Low</td>
<td>Medium</td>
<td>Low</td>
<td>NO</td>
<td>Medium priority</td>
</tr>
</tbody>
</table>
Questions?