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Strengthening Public Investment and Managing Fiscal Risks from Public-Private Partnerships

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As a discussant, I find myself in a difficult situation, because there is little I could add to these comprehensive and thoughtful analyses. On the other hand, these excellent materials provide an opportunity to place emphasis on the most important features of the issue. First, I will stress the importance of common features of PPPs and traditional public spending. Then, I will focus on the main weakness of PPPs. Finally, based on these two points, I will propose a practical solution.

As the presenters mentioned, both services and fixed assets involved in PPPs may have the same special characteristics as traditional public services and assets.

Actually, most of the services involved in PPPs are public services. Their fundamental characteristics, as Mr Monteiro stated, are that public authorities intend to keep public services running. Another feature is that such services would yield insufficient profits in the private sector. As a consequence, these services could not be operated by a private operator without explicit involvement of the public sector or an implicit guarantee.

The majority of fixed assets involved in PPPs also have a specialised nature of providing specific public services. In other words, they cannot be used for other purposes without making some major modifications. Gerd Schwartz also noted that PPP investments involve substantial government planning, which can be attributed to the specialised nature of those assets. As a consequence of insufficient profitability in the absence of government support, these fixed assets have no private sector markets. This is an important feature not only at the investment phase, but also in the event of bankruptcy. As a Hungarian example, Gerd Schwartz mentioned the case of two motorways, which ran into difficulties due to insufficient demand. These motorways were formally privately owned, but it became evident that their assets had no private sector market. As the public authorities intended to keep the motorway service running, this implicit guarantee was exercised, and the assets were renationalised.

After recalling these negative experiences we can follow the discussion with the weaknesses of PPPs. I will not address the problems related to the operational period of PPPs, as both presenters made several important points here. I would rather focus on the basic weakness of PPPs, which can be identified right at the investment stage. As the presenters stressed, many of the problems with PPP investments also occur in the case of traditional government fixed investment. Let me quote Mr Monteiro here: "the difference in the case of PPPs is that because PPP contracts delay and smooth the flow of payments from the government to private partners, the perceived impact of costs and risks is reduced, effectively allowing costs and risks to be shifted from present to future generations" "PPPs will thus tend to perceived by public policy-makers as zero-cost projects." As Mr Schwartz pointed out rightly, cash-strapped governments have a motivation for PPPs. The special purpose of many PPPs can be to circumvent fiscal rules which include public investment. Of course, this motivation does not exist in the case of the golden rule, which excludes public investment. In EU countries, however, both deficit and debt limits can be circumvented by outsourcing public investment into PPPs. Let me quote Mr Monteiro again: "the simple on/off balance sheet treatment developed by Eurostat provides strong incentives to design a project to pass the Eurostat test." The binary on/off balance sheet treatment means that PPPs can be classified as either operating or financial leases on the basis of risk sharing. In the case of operational leases, the private partner bears the major part of risks, while in the case of financial leases the major part of risks are left to the government. The Eurostat criteria focus on three risk categories, therefore a recent IMF paper argued that these criteria give considerable cause for concern. Since most PPPs involve a private partner who bears construction and availability risks, they can be treated as private investment, even though the government bears other risks, including demand risk. While a government initially has an incentive to design a project to pass the Eurostat test, later, when the stream of amortisation payments proves to be too costly, this incentive can be reversed. By changing the risk sharing, PPPs can be reclassified into the government sector shifting the costs from the present to the past.

Now, let me turn to the three possible solutions. As I mentioned, the first option could be to adopt a golden rule framework. The second option could be to replace the binary classification with a continuous approach, as Mr Irwin of the World Bank suggested. The uncertainties cannot be measured properly by operating binary classification, where the analysis of the degree of risk transfer aims to examine whether the obligation exceeds a threshold value for recognition. Under the alternative continuous approach, both partners may share economic ownership of the asset, recognising all relevant rights and obligations as assets and liabilities to the extent of those rights and obligations.

I suggest a third option by adopting a simple criterion, which is derived from international accounting standards and does not require detailed information. The International Federation of Accountants has adopted a PPP criterion to ascertain whether an asset is of a specialised nature, i.e. it cannot be used without making major modifications. It may reflect insufficient profitability and the probability of bankruptcy. A similar PPP criterion has been adopted in US budgetary rules regarding the private sector market for those assets. As I mentioned earlier, most PPP assets have a specialised nature of providing specific public services. Of course, some exceptions can be found; for example, the government may rent buildings which have a private sector market. If most PPP investment with a specialised nature were classified as public investment, the motivation of circumventing rules would diminish. These PPPs could be called as special purpose PPPs, SPPPPs or SP4s. If the statistical recording may not be changed, the structural deficit would be increased by SP4, because upfront spending can be reduced only temporarily at the cost of future instalments or a loss of tolls collected. This one-off improvement can be seen as a temporary measure or, according to the OECD definition, creative accounting, therefore, the structural deficit should be increased by the upfront costs of the investment.

As both presenters stressed, transparency, comprehensive accounting and reporting are essential. The reporting of detailed data is the precondition for adopting any alternative approach. Such data should cover all PPP investments and their recording in government statistics. The sum of PPP investments recorded in the private sector can also be very useful for analytical purposes. This can be particularly important, since PPP projects exert practically the same effects on external equilibrium, economic growth and inflation as traditional public fixed investment does: they boost domestic demand and deteriorate external equilibrium, irrespective of the extent of risk transfer.

Let me stop here for a few concluding remarks. We can all agree that PPPs may enhance efficiency, the gains of which may be shared by the private partner and general government, as well as the parties using the service, similarly to risks. Savings earned from a permanent rise in efficiency should, however, be able to cover certain additional costs, such as the higher burden of private financing. Both presenters recommended several approaches which would improve the efficiency of PPPs. Mr Monteiro stressed that those perverse incentives which arise from using long-term contracts in a short-term budgetary framework should be controlled. I do believe that this challenge should be addressed first.