WORLD BANK GROUP

Assessing and Managing Fiscal Risks from PPPs
Implications for Surveillance

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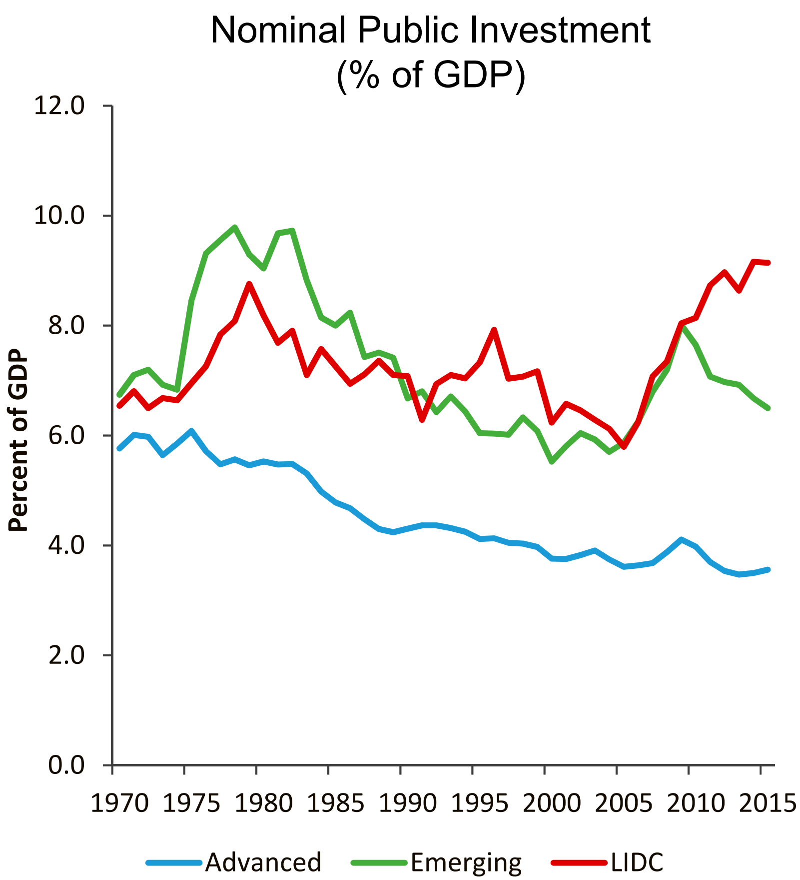
Rising infrastructure needs

Fiscal policy options

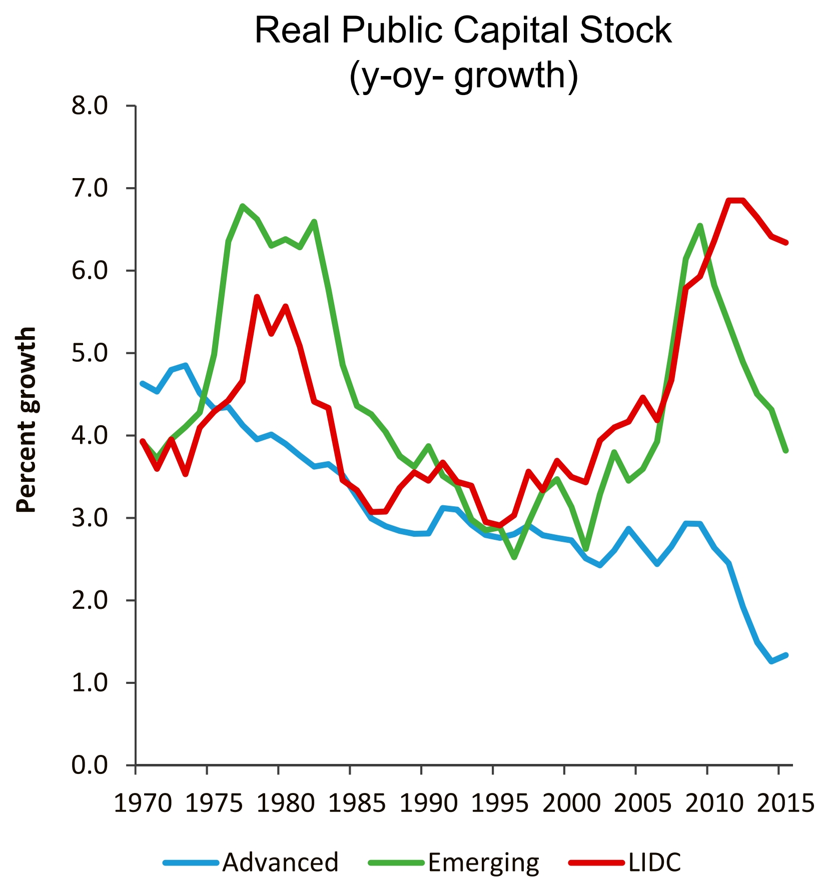
Traditional public investment	More efficient public investment	More reliance on private sector participation
• Fiscal sustainability concerns • Fiscal rules	• Better public investment management (PIM) framework • Requires long maturing period	• Public-Private Partnerships (PPPs) • “Perception” of fiscal space

Public investment has not fully recovered from decades of steady decline, except in LICs

Public investment in % GDP still falling in advanced economies, but rising in low income countries

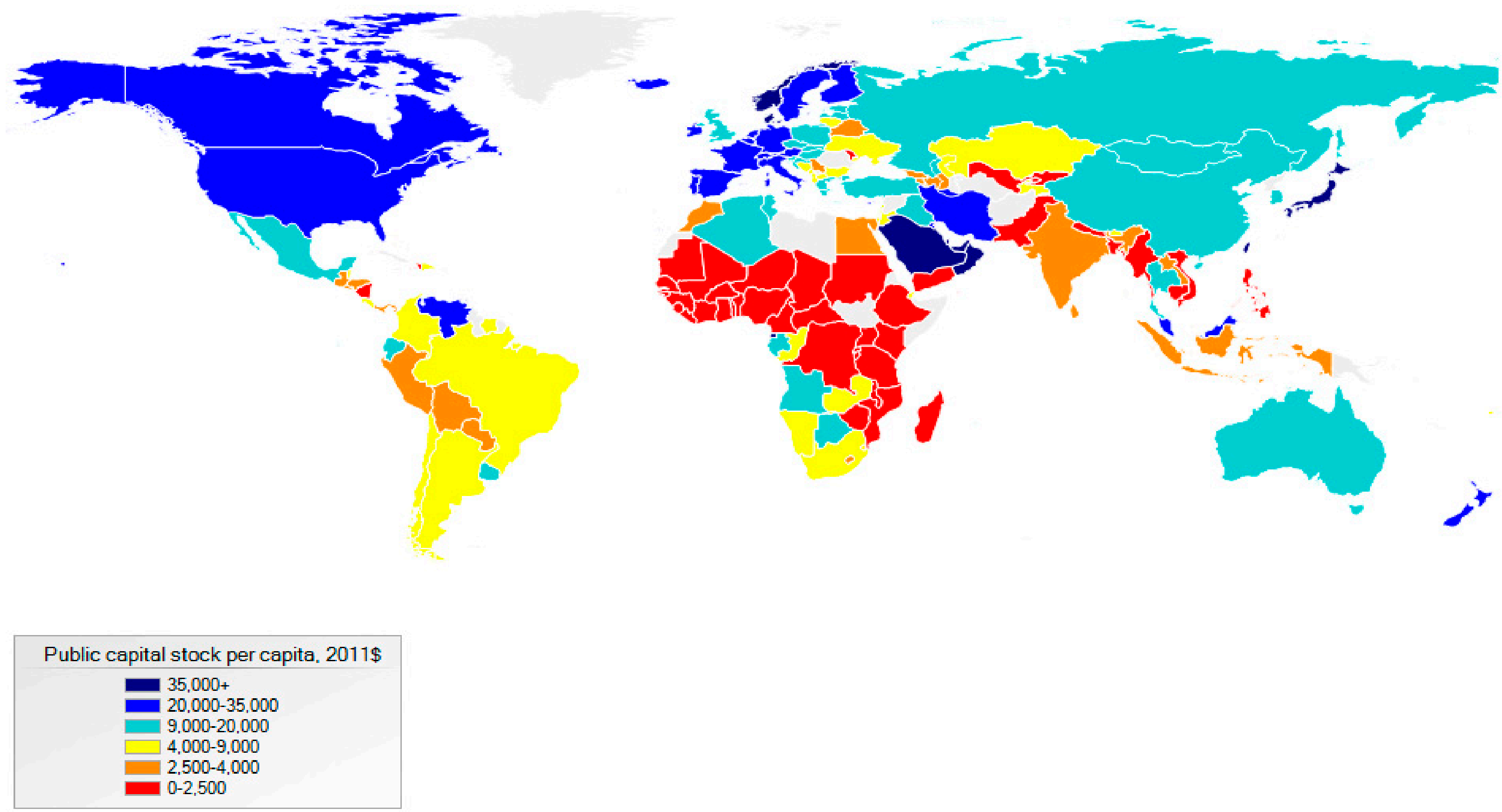


Public capital stock real growth rate has fallen in all country groups



Globally, real public capital stock growth outpaced population growth, but remains highly unequal

Public Capital Stock, 2011
(per capita, $2011)

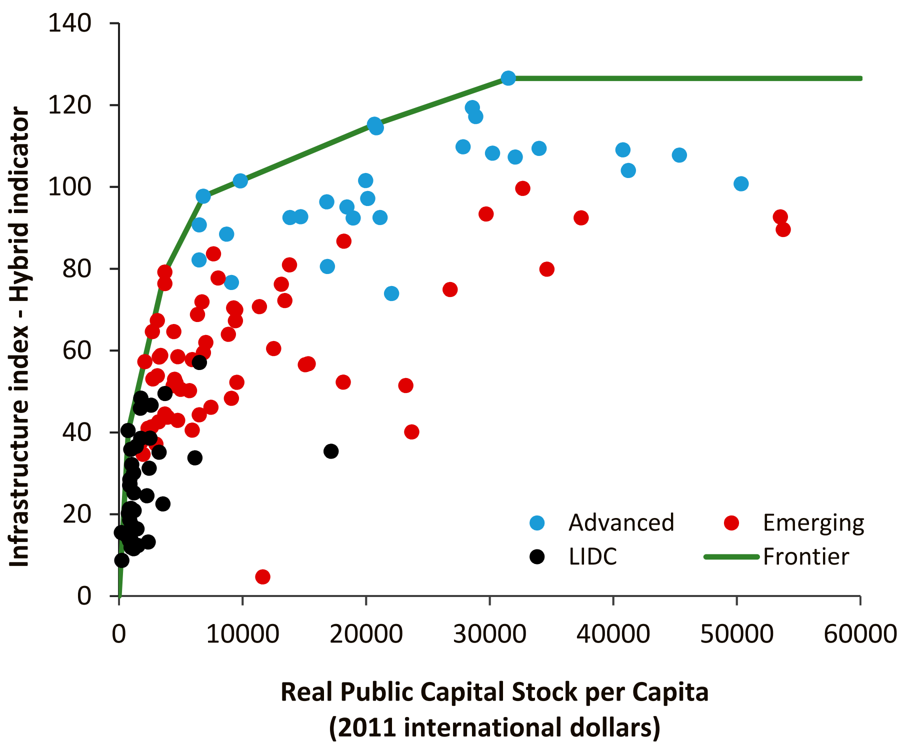


There are sizeable gaps in public investment efficiency, but improving efficiency takes time

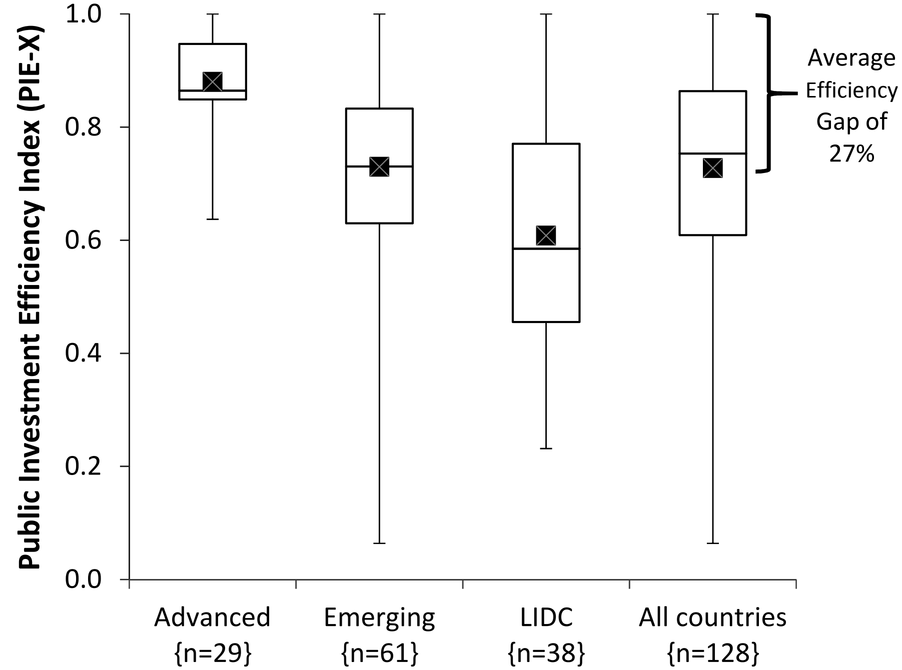
Large public investment efficiency gaps both across and within different income groups

Average country is 27% below efficiency frontier with largest efficiency gaps among low-income countries.

Public Capital Stock and Infrastructure Performance

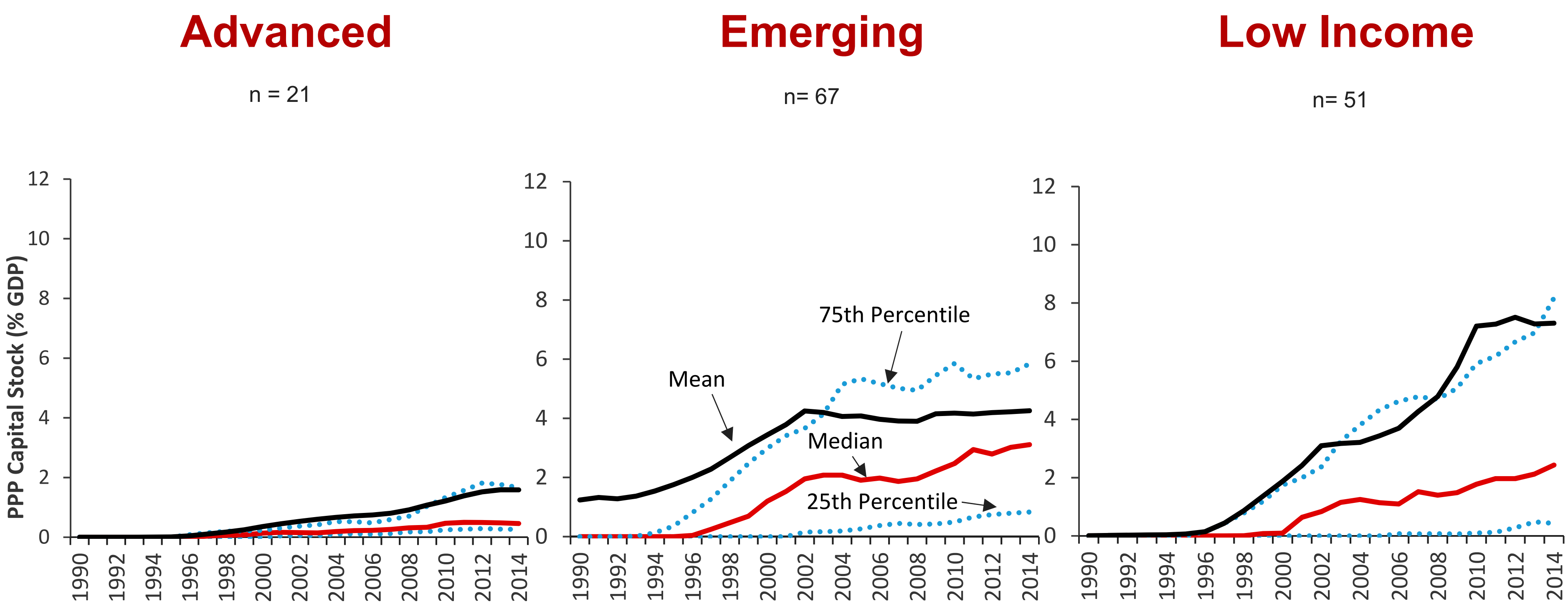


Public Investment Efficiency Index (PIE-X)



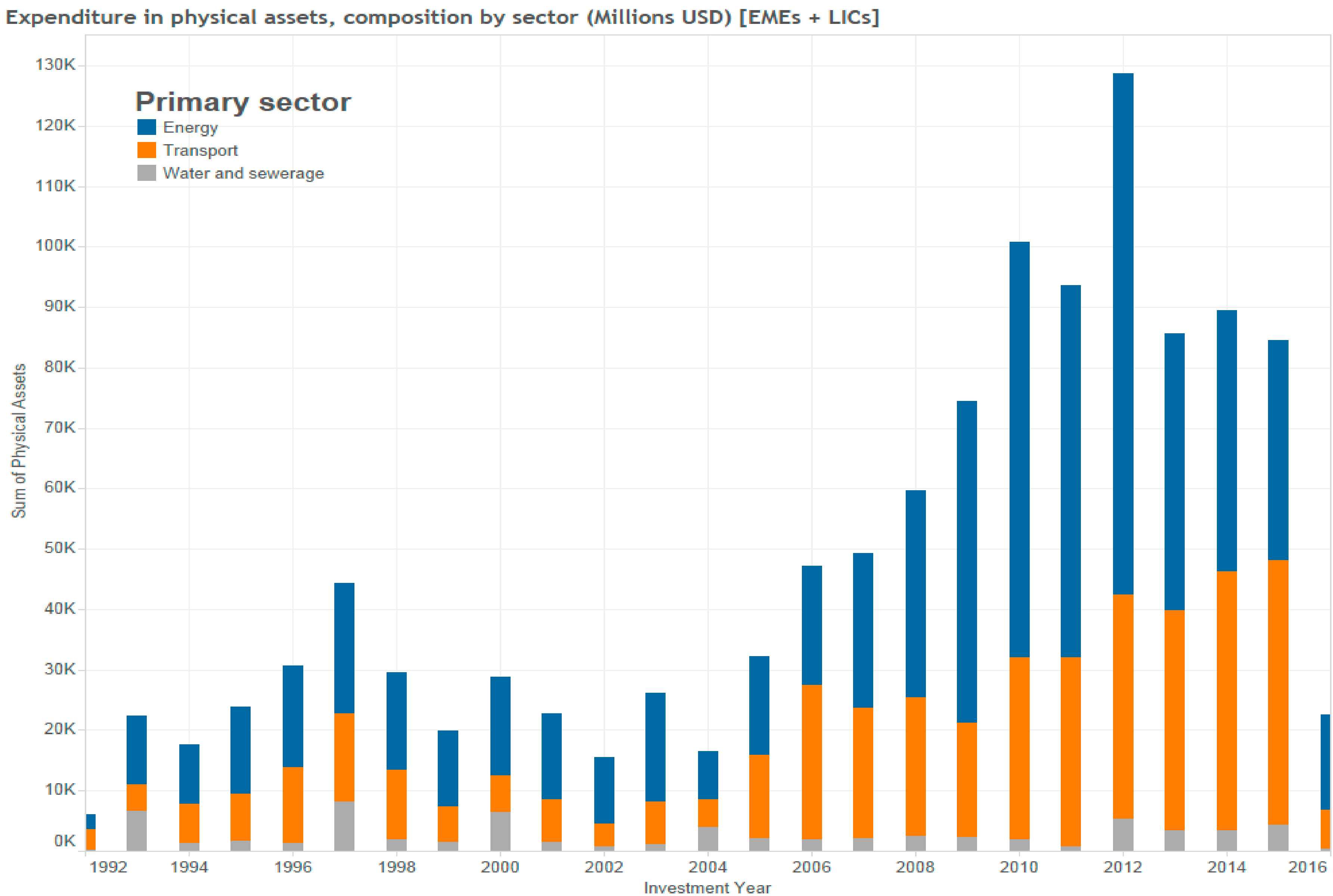
Rising use of PPPs, particularly in EMEs and LICs…

PPP Capital Stock (% of GDP)



Sources: European Investment Bank; World Bank; and IMF staff estimates.

…where PPPs are used extensively in the provision of energy, transport, and water



Why we do PPPs?

Potential benefits from PPPs

The private sector can offer better value for money—higher quality of services at lower cost—because:

- its drive, motivation, and creativity
- the combination of creating assets and delivering services
- efficiency gain mostly linked to internalization of maintenance strategy
- the possibility of introducing user fees

Yet, efficiency gains in PPPs should be high enough to offset:

- higher cost of private capital
- fixed costs associated with managing PPPs

Why we do PPPs?

"Illusion" of fiscal space

Only *"good"* PPP projects *"may"* create space *"if"* efficiency gains are achieved and are larger than higher financial and transaction costs compared to traditional public procurement

The PPP bias

- Perception of **"infrastructure for free"** due to
- **Lack of integration of PPPs in budget process (off-budget),** medium-term fiscal framework and debt sustainability analysis
- Focus on PPP **fiscal impact on cash basis** (deferral of government or users payments)

Understanding fiscal implications of PPPs

Difference between "financing" and "funding" of PPPs

Financing PPPs

It is expected that the private brings most of the financing of the project

3 main options:

- **Debt**
- **Equity**
- **Government support**
  - Guarantees
  - Subsidies
  - Equity injections
  - Tax amnesties
  - Others

Funding PPPs

The private never funds the project (it expects a profit margin)

3 possibilities:

- **Government-funded PPPs**
  - Government pays during operation (fixed or variable)
- **User-funded PPPs**
  - Users of services pay fees (fixed or variable)
- **Combination**

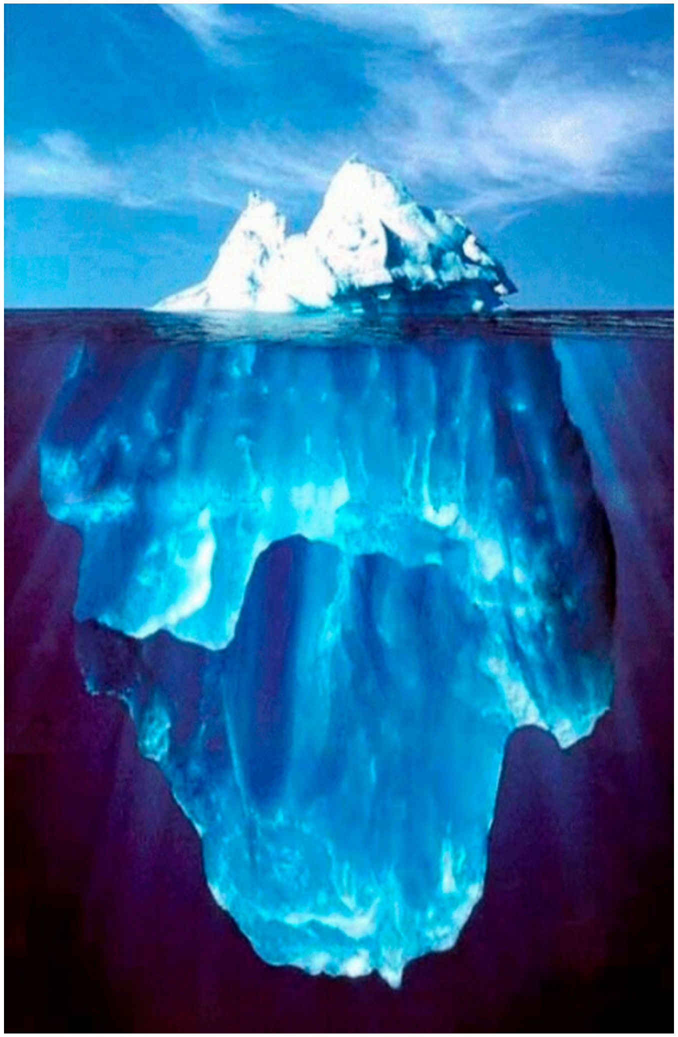
Recognition of government's fixed assets and related liabilities under certain conditions

Why worry about PPPs?

PPPs create firm and contingent liabilities for the government, even if treated on-budget

If not properly monitored and managed, PPPs

- Reduce budget flexibility by committing public funds in long-term contracts
- Threaten integrity of budget process if treated off-budget, obscuring efforts towards fiscal discipline
- Might undermine macroeconomic stability in the event of a shock if mitigation measures are not in place



Why worry about PPPs?

Even when properly managed, PPPs

- In the short-term
  - Create fixed assets for government, but these assets are not liquid… while PPP-related liabilities are payable
  - Limited data tends to underestimate liabilities
- In the medium-term
  - They might improve public net worth…but only if fixed assets are properly maintained by private operator, which requires government capacity to monitor and manage long-term contracts

What set of toolkits are available to the user?

To assist countries to proper procure, monitor, and manage fiscal risks from PPPs WB developed a set of toolkits in collaboration with other international organizations:

- **Framework for Disclosure in PPP Projects (WB)** provides systematic structure for proactively disclosing information pertaining to PPP Projects (2013)
- **Recommended PPP Contractual Provisions (WB)** The initiative aims to develop recommended language on certain key provisions found in virtually every PPP contract to make drafting PPP contracts faster and less expensive (2015)
- **PPP readiness tool (WB)** Assesses a country readiness to make inform decisions regarding private sector participation in the provision of infrastructure, identifying areas in need of improvement in line with global good practices (2016)

What set of toolkits are available to the user?

- **Infrastructure Prioritization Framework (WB)** This tool is an alternative approach to selecting and prioritizing PPP projects based on a multi-criteria methodology incorporating social, environmental, financial, and economic factors (2016)
- **Screening of PPP projects (WB/GIH/OECD)** Provide technical guidance and tool/s for early screening of projects for implementation as PPP, including both qualitative and quantitative variables (2017)
- **USP policy guidance (WB)** Provide guidance and recommendations for governments that are considering the development and operationalization of an unsolicited proposal policy in infrastructure projects (2017)

What set of toolkits are available to the user?

- **PFRAM (FAD/WB)** accounts for PPP-related assets and liabilities, and assists users in identifying and assessing fiscal risks from PPPs (2016)
- **Benchmarking PPP Procurement tool (WB)** Assessment of regulatory frameworks and institutional arrangements for PPPs in 82 countries (2017)

PPP Fiscal Risk Assessment Model—PFRAM

What is it?

- Tool to assess potential fiscal costs PPP project
- Provides a structured process for collecting project information
- Framework to identify the main fiscal risks arising from PPP contract

What is its scope?

- Project-by-project assessment tool
- Best suited to big projects
- Consistent with international standards
- Flexible accounting base (cash and accrual, flows and stock)

How does it work?

- Decision tree to identify project type
- Input project-specific data
- Input macro-data
- Input project risk information
- Automatically generates a series of outcomes

What does it produce?

- Cash flows of the project company
- Fiscal impacts and financial statements (IPSAS 32)
- Charts of fiscal balance and debt (GFSM 2014)
- A summary risk matrix of the project
- Sensitivity analysis to changes in paramaters

Accounting PPPs in PFRAM
Accrual vs. Cash

PFRAM is based on International Public Sector Accounting Standards (IPSAS 32) and International Statistical Standards (GFSM 2014)

- **P-FRAM is modelled based on accrual standards**
  - Fiscal commitments are recognized when the contract is signed (as the assets are built)
  - Government recognizes asset and liability if it retains control of the asset
- **But, also generates results on cash basis …**

  … and compares results on accrual and cash basis

PFRAM
How does it work?

A 5-step structured process to assess a PPP project

- **Step 1.** Who initiates the project?
- **Step 2.** Who controls the asset?
- **Step 3.** Who ultimately pays for the asset?
- **Step 4.** How is the payment done?
- **Step 5.** Does the public sector provide any additional support to the private partner?

Additional government support
What is it modeled?

1	No additional support	Government does not provided any support to the private partner.
2	Debt Guarantee	Government guarantees a percentage of private partner debt. Contingent liability for government.
3	Minimum Revenue Guarantee	Government provides a minimum revenue guarantee to the private partner. Contingent liability for government.
4	Other	E.g., lump-sums, equity injections, subsidies, tax amnesties and preferential treatment, etc. Not specifically modeled in the P-FRAM

PFRAM
5 Main Outcomes

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

PFRAM Outcomes

Fiscal Risk Matrix: Summary Heat Map

PROJECT RISK SHARING ARRANGEMENTS

	IDENTIFICATION OF RISKS		ALLOCATION	LIKELIHOOD	FISCAL IMPACT	RISK RATING Likelihood*Impact	MITIGATION STRATEGY	PRIORITY Rating*Mitigation
1	Governance risks	Details	Public	High	Medium	High	NO	High priority
2	Construction risks	Details	Shared	Medium	Medium	Medium	NO	High priority
3	Demand risks	Details	Private	High	High	*Critical*	NO	*Critical*
4	Operational and performance risks	Details	Shared	Low	Low	Irrelevant	NO	NO action required
5	Financial risks	Details	Private	Medium	Low	Low	YES	Low priority
6	Force majeure	Details	Shared	Low	High	Medium	NO	High priority
7	Material adverse government actions	Details	Public	Low	Low	Irrelevant	NO	NO action required
8	Changes in law	Details	Public	Low	Medium	Low	YES	Low priority
9	Rebalancing of financial equilibrium	Details	Private	Low	High	Medium	NO	High priority
10	Renegotiation	Details	Shared	Medium	High	High	YES	Medium priority
11	Contract termination	Details	Shared	Low	Medium	Low	NO	Medium priority

PFRAM Outcomes
Fiscal Risk Matrix: Identification of Risks

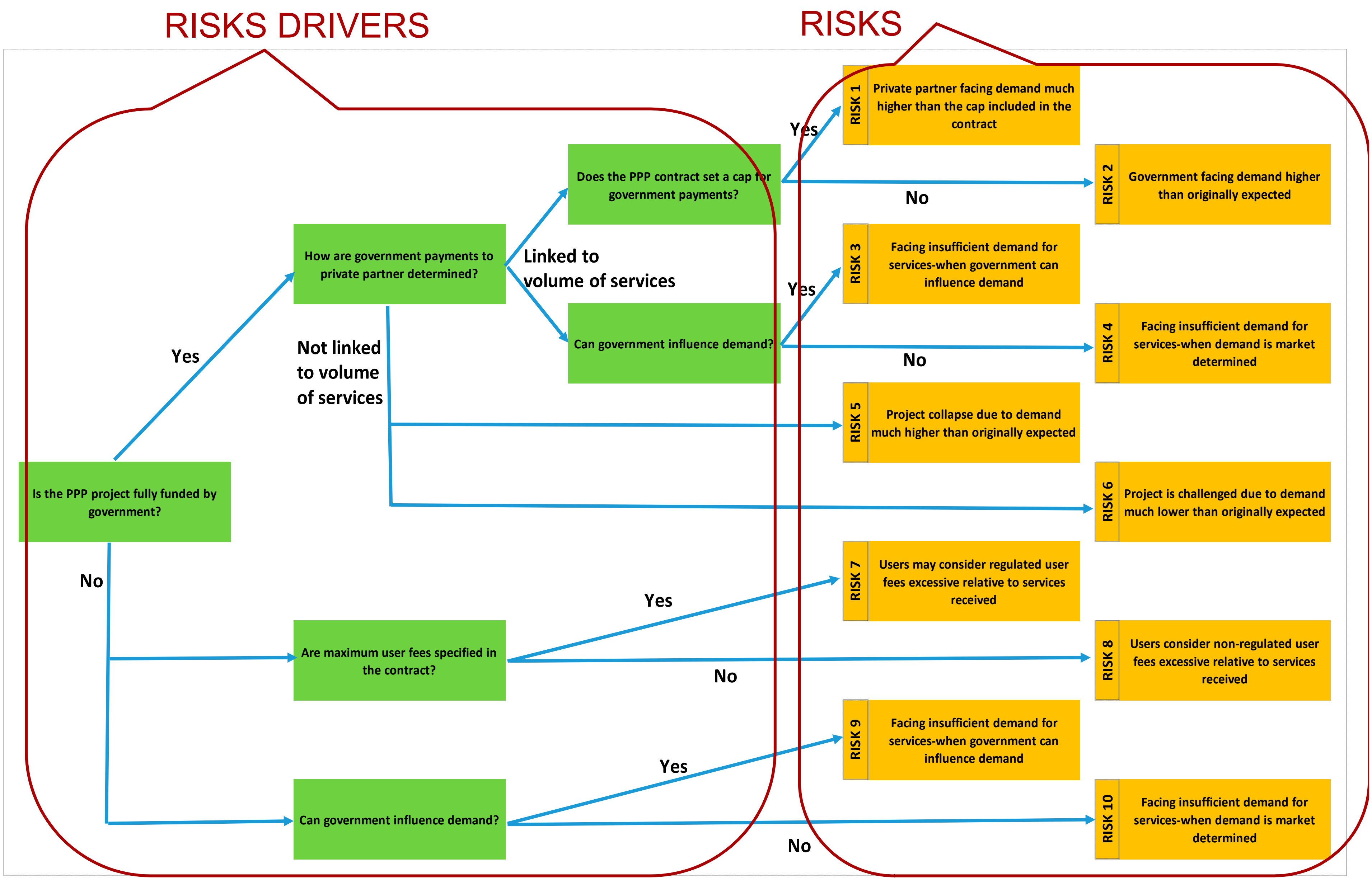
- **Trade-off between risks and costs**
- **Which risks are we interested in?**
  - **Contractual risks**
  - **Other risks not allocated by contract**
    - E.g., risks arising from the governance structure, legal framework, low institutional capacity

Risks that have fiscal implications

PFRAM Outcomes
Developing a Fiscal Risk Matrix

Identification	• 11 risk classes identified, 52 detailed risks
Allocation	• Risks mostly allocated to private, shared, or mostly allocated to government
Likelihood	• Low, Medium, High
Fiscal impact	• Low, Medium, High
Rating	• Equal to [Likelihood * Fiscal Impact] • Irrelevant, low, medium, high, critical
Mitigation measures	• Is mitigation in place? YES/NO
Priority actions	• Function of Rating and Mitigation • No action, low/medium/high priority, critical

PFRAM Outcomes
Identification of Risks Example: Demand Risks



PFRAM Outcomes
Identification of Risks Example: Demand Risks

RISK DRIVERS

- **PPP fully government funded**
  - Are government payments linked to volume of services?
    - Yes
      - Is a cap for government payments negotiated in the contract?
        - » Yes
          - » Is demand higher that negotiated in the contract?
            - » Yes
            - » **RISK 1:** private partner facing demand much higher than the cap negotiated in the contract
            - » **MITIGATION MEASURE:** the government manage demand by diverting it to other similar project

Example: hospital with government payments capped number of patients/services, facing higher demand, government rerouting patients/services to other hospitals with lower demand

Outcomes

Fiscal Risk Matrix: Risk Rating

Risk Rating = Likelihood x Fiscal Impact				
Fiscal Impact	HIGH	Medium	High	*Critical*
	MEDIUM	Low	Medium	High
	LOW	Irrelevant	Low	Medium
		LOW	MEDIUM	HIGH
		Likelihood		

Outcomes
Fiscal Risk Matrix: Priority Actions

Priority Actions = Risk rating x Mitigation measures						
Mitigation measures	NO	No action	Medium priority	High priority	High priority	*Critical*
	YES	No action	Low priority	Medium priority	Medium priority	High priority
		IRRELEVANT	LOW	MEDIUM	HIGH	CRITICAL
		Risk Rating				

Outcomes
Fiscal Risk Matrix: Summary Heat Map

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Governments can prepare to manage fiscal risks from PPPs!

- **Success in PPPs = realization of efficiency gains + effective mitigation of fiscal risks**
- **Governments can take actions to manage PPPs fiscal risks**
  - **Good projects**: investment portfolio and prioritization procedures
  - **Good institutions**: strong public investment management (PIM) frameworks to handle PPPs efficiently
  - **Good laws**: comprehensive legal framework provisions that govern overall processes of project selection, implementation, and management.
  - **Good management, accounting, and fiscal reporting**: strong decision making process to mitigate and/or phase fiscal risks and achieve full and transparent disclosure of these risks

References

- Public Investment Management Group www.imf.org/publicinvestment
- PPP Knowledge Lab www.pppknowledgelab.org