International Seminar on Strengthening Public Investment and Managing Fiscal Risks from Public-Private Partnerships

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Managing Fiscal Risk from PPPs: Main Issues for Governments

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Overview

- Background: Provision of Services—Public Provision, Private Provision, PPPs
- Fiscal Risks and PPPs
  - Main Issues
  - Factors for Success
  - Good Projects
  - Good Institutions
  - Good Accounting and Reporting

Background—Provision of Services

	Public Provision	Private Provision	PPPs
Essentials	Public sector: • Owns assets • Does planning • absorbs risks (construction, maintenance, demand)	Private sector: • Owns assets • Does planning • Receives user fees • absorbs risks (construction, maintenance, demand)	• Assets at most temporarily owned by private sector • Substantial public planning • Risk sharing (often ambiguously)
Non-Essentials	• User fees • Contracting out (e.g., maintenance)	• Regulated prices • Regulated quality	• Regulated prices • Creation of single purpose vehicle

Background--What's Wrong With Public Provision of Infrastructure Services?

- Nothing necessarily; but frequently:
  - poor overall planning processes;
  - costs underestimated: time and financial cost overruns are common;
  - overly optimistic demand forecasts.
- Institutional incentives sub-optimal:
  - Ministries have poor incentives for cost saving

Background—Are PPPs the Answer?

- Theoretical virtues of PPPs are similar to those offered for privatization:
  - private firms more efficient (e.g., benefit of private sector expertise; improvement in timely delivery of quality services);
  - distributive issues—those who benefit are those who pay;
  - Political economy considerations—e.g., easier to reject “pork barrel” projects.
- Have PPPs delivered on their promises?
  - With regard to efficiency?
  - With regard to reducing fiscal risks via risk sharing?

Fiscal risk & PPPs—Main issues

- Motivation for PPPs--Tempting for cash strapped governments trying to meet fiscal targets (e.g., SGP).
- Fiscal risks:
  - Move spending off budget and liabilities off balance sheet; can create contingent liabilities→example: minimum traffic guarantee.
  - Potentially threaten integrity of budget process and undermine efforts to safeguard macroeconomic sustainability.

Fiscal risk & PPPs—Main Issues

- Issues to be addressed by governments:
  - How to handle calls for more spending on infrastructure while safeguarding fiscal sustainability and the budget process?
  - How to ensure that top priority needs for infrastructure are addressed first? → Investment planning
  - To what extent should innovative financing mechanisms for infrastructure (e.g., PPPs, revenue earmarking) be pursued?
  - How to manage fiscal risks from PPPs?

Fiscal Risks & PPPs—Main Issues

- Is achieving fiscal discipline and good governance more difficult with PPPs?
- Perhaps—also because of potentially large contingent liabilities. Requires better institutional structures.
- Examples: Hungary’s M1—renationalized when operator ran into financial difficulties due to traffic shortfalls; Hungary’s M5—risk shifted back to budget through minimum revenue guarantee; other country examples.

Fiscal risk & PPPs—Factors for Success

- What determines success for PPPs → effective mitigation of fiscal risk & realization of efficiency gains.
- Governments can control these factors:
  - Good projects;
  - Good fiscal institutions (incl. legal & regulatory framework, supervisory institutions);
  - Good fiscal accounting and reporting.
- Keep in mind reputational risks: need to get it right from the outset →start small and build a reputation.....

Fiscal risk & PPPs—good projects

- Good projects:
  - Good investment prioritization procedures → investment planning (incl. use of project appraisal techniques)
  - Prioritize investment projects and build clear strategy.
  - Evaluate fiscal risks from concessions (VfM, PSCs).
  - Medium-term planning (MTFFs, MTBFs, MTEFs).

Fiscal risk & PPPs—good institutions

- Good legal & regulatory framework:
  - Governs overall PPP procurement process;
  - Integrates PPP proposals with budget cycle;
  - Clarifies institutional roles and responsibilities;
- Good supervisory institutions →management and oversight framework:
  - Establish due-diligence/multi-stage gateway processes with strong role of Finance Ministry. Finance Ministry actively has to manage the gateway process for PPPs.
  - Make sure PPPs are done for the right reasons.
- Clear separation of PPP promotion and PPP oversight functions.

Fiscal Risks & PPPs—good accounting and reporting

- Goal: Achieve full and transparent disclosure of all fiscal risks from PPPs.
- Issues to be addressed:
  - Limit public sector contingent liabilities from investments that are not on the public sector's books
  - Prevent creating budgetary rigidities from pre-committing spending for hidden liabilities
  - Create right incentives for risk sharing and for designing PPPs to achieve VfM
  - Develop common international PPP accounting standards
  - Take PPPs into account in medium-term fiscal scenarios

The End

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