Public Investment Management for Public Private Partnerships: A “PIM-for-PPP” Diagnostic Framework

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Why the Need for a Unified Framework Integrating PIM and PPP?

- Most countries have been managing public private partnership (PPP) projects separately from traditionally implemented projects (TIPs).
  - PPPs have been mostly appraised, selected, budgeted, and monitored separately from TIPs.
- This disparity has undermined adequate public financial management and created undue fiscal risks, causing fiscal concerns with respect to appropriate forms of accounting, reporting, budgeting, and other processes.
- From a fiscal point of view, a principal key to initiating PPP projects is to establish whether a government can maintain the same level of fiscal efficiency and sustainability through PPP as through TIP.
  - Important to establish the fact that there should not be such a thing a ‘PPP project’ intrinsically → PPP is a form of implementing a public investment project.
- A unified framework for integrating both TIP and PPP is in need.
Benefits from a Unified Framework

- Help ensuring consistent assessment 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 framework has the potential to minimize subjective decisions concerning TIP versus PPP implementation.

- Help 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.

- Help avoiding unmanaged fiscal risks while improving transparency
  - The framework 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 framework helps to improve overall transparency in the PFM system.
Challenges to Having a Unified Framework in Practice

- Constraints and difficulties remain to swiftly apply such a unified framework.
- It is important therefore to identify commonalities and differences between TIP and PPP by running through the PIM stages which correspond to eight must-have features for PPP and to discuss entry points to move toward such a unified framework.
- Need to develop a PIM diagnostic tool for PPP: “PIM-for-PPP”
  - Stage 1: Strategic guidance and policy for PPP
  - Stage 2: A unified framework for project appraisal
  - Stage 3: Independent review of the appraisal
  - Stage 4: Project selection and budgeting for PPP
  - Stage 5: PPP project implementation
  - Stage 6: PPP project adjustment by renegotiation/refinancing
  - Stage 7: PPP operation and maintenance
  - Stage 8: PPP project completion and ex post evaluation
Understanding the Differences: The PPP Contract

Key issues that the PIM-for-PPP will need to address are those that differentiate the two forms of implementation.

- PPPs are different from TIPs in that they need to attract the attention and resources of private investors, lenders and operators by the contract.
- In a PPP implementation, the contract ‘The Project Agreement’ takes on even more significance than in a TIP implementation as it frames the entire relationship between the responsible government entity and the private entity.

The PPP Contract should be subject to special attention in PIM-for-PPP assessment.

- There is one important exception to the consistency of the PIM ‘eight must-have’ features: the PPP Contract.
- 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.
PIM-for-PPP Diagnostic Framework: Eight plus the Contract Features

1. Guidance & Screening
2. Formal Project Appraisal
3. Appraisal Review
4. Project Selection & Budgeting
5. Implementation
6. Project Changes
7. Service Delivery
8. Project Evaluation

The PPP Contract
• PPPs are often chosen without any integrated strategic guidance and coordination between TIP and PPP implementation methods. They are mostly managed as stand-alone projects or initiatives.

• Establishing strategic screening and planning guidance for potential PPPs should therefore be the starting point because it offers the following fundamental advantages:
  
  ➢ By listing PPP legal and institutional arrangements, some governments can more directly signal where and in which sectors private capital is required to benefit the public.

  ➢ One might argue that such restrictions limit the flexible and innovative nature of PPPs. However, an explicit legal and regulatory framework facilitates the initiation of PPP projects as it concedes to the private sector the right for initiation or participation.

• The government should also issue guidelines on good practice that reflects the important differences between stakeholder management in TIP and PPP.
PIM-for-PPP Diagnostic Framework: A Unified Framework for Project Appraisal (Stage 2)

- It is important to provide fiscal regulation for PPP project assessments with the same care applied to TIP implementation.

- A standardized example for project appraisal in a unified framework could be composed of two phases: (a) decision to proceed and (b) decision to implement.

- (a) Decision to proceed (preliminary feasibility study)
  - A preliminary feasibility study could be conducted to prepare for the decision to proceed and a full preparation in a later stage. The preliminary feasibility study not only assesses whether to proceed with the full project preparation but also pushes the government to invest in more detailed project preparation in advance.

- (b) Decision to implement (value for money [VFM] assessment)
  - If the proposed project appears to be feasible, a VFM assessment would then assess the implementation options—TIP versus PPP.
  - Basically, government costs and project inputs of an often-known public sector comparator are compared against those of the projected risk-adjusted costs of a PPP alternative to assess whether the PPP might achieve better VFM.
PIM-for-PPP Diagnostic Framework: A Unified Framework for Project Appraisal (Stage 2 continued)

Decision to proceed

Project initiation

Prefeasibility study (including cost-benefit analysis)

N

Y

VFM assessment

VFM(PPP) > VFM(PSC)
Implement by PPP mode

VFM(PPP) < VFM(PSC)
Implement by conventional mode

Rejection

Decision to implement

Note: VFM = value for money. PSC = public sector comparator. PPP = public-private partnership.
PIM-for-PPP Diagnostic Framework:
Independent Review of the Appraisal (Stage 3)

- In the case of PPPs, the role of independent peer reviews may be especially important given the role of dedicated PPP units.
  - The more the evaluating entity is independent from a particular delivery method or agency, the more its judgment is likely to be unbiased, which favors and facilitates an optimal partnership between two parties.

- PPP Unit as a PPP Promoter or a Gate-Keeper?
  - The two roles of the unit—as a PPP promoter or an independent appraiser—may actually be in conflict with each other.
  - In light of these risks and possible conflicts of interest, the key recommendation is that there be strict independence from the direct interests of spending ministries and agencies.

- The system of independent review should be formalized or/and supervised by the Ministry of Finance, and the reviewers are fully independent and have no vested interest in the outcome.
• 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 IFRS and the 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 PPPs:
  ➢ 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, Hungary, Korea, etc.)
PIM-for-PPP Diagnostic Framework: The PPP Contract (An Extra Feature)

- An extra assessment of the PPP Contract, which links the project selection process (in stages of 1-4) with the project implementation process (in stages of 5-8),’ is important to ensure consistent decision-making.
  - Check quality and comprehensiveness of the Contract, and compare with international good practices.
- The Contract sets out the way in which the risks are apportioned between the parties to the agreement. It profoundly affects the entire effectiveness and efficiency of the project and determines the outcomes.
  - Whilst it could be argued that the quality of the contract itself is only a reflection of the overall framework, it can nonetheless point specifically to weaknesses in that framework and in particular in the knowledge and negotiating skills of public officials and their advisers.
  - TIP projects have contracts too, mainly construction or engineering contracts. Whilst these are important in themselves, they do not encompass a working relationship between public and private sector entities for periods of up to 25 or 30 years.
During implementation of a PPP project, VFM outcomes are contingent on effective management over contract terms.

- Poor contract management with the private partner can result in higher costs, wasted resources, and impaired performance.

- A competitive bidding process (while not the only possible way of selection) is essential to ensure VFM and optimal allocation of risk between the public and the private sector.

- It is useful to develop and announce standard implementation guidelines for deciding procurement strategy, managing bid processes, developing model project agreement and standard clauses.
PIM-for-PPP Diagnostic Framework:
PPP Project Adjustment by Renegotiation and Refinancing (Stage 6)

- As projects enter into the implementation phase, it is essential to clearly understand the process of PPP project adjustment, particularly regarding the two distinct cases of renegotiation and refinancing.

- Before major adjustments, reassessment of economic viability and VFM is requested; this would enable the government to recheck 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.
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 agreement, 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.

- Each public authority manages projects by following the protocols stipulated in the project agreements and receiving project progress reports.

- Performance checks are conducted as specified in the standard maintenance quality requirement.
  
  - 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.
The evaluation of PPP projects is extremely difficult because of both the conceptual slipperiness and the large number of disciplines involved—economics, accounting, law, political science, engineering, and so on.

Difficult in practice to prove better value for money: Traditional versus PPP

- In theory and wishful thinking: check better VFM through project appraisal → In practice: two separate tracks for traditional public investment and PPPs → Difficult to check and compare.

One way to evaluate PPPs, nonetheless, is to trace out evidence of cost savings and efficiency gain as well as evidence of PPP contribution to the national economy:

- From a project point of view: whether gradual improvements, compared with the cases of conventionally implemented projects, have been made in the efficiency of costs, toll rates, and economic rates of return.

- From a wider point of view: PPP contribution to the national economy, whether they have ripple effects on the national economy through several channels: economic growth resulting from the inflow of private capital; increased social welfare resulting from the timely delivery of social services; and the early realization of social benefits.
## Annex: A PIM-for-PPP Indicator Assessment Tool

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Thank You