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Strengthening Fiscal Governance in Public-Private Partnerships

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Public-Private Partnerships (PPPs) are powerful instruments for governments wishing to provide much-needed infrastructure services for their citizens. However, in order to have a sustainable PPP program, governments must pay close attention to managing the fiscal impacts of the PPP projects in their country.

1. Key Features of a PPP Project

PPPs are long-term contractual agreements between the public sector and the private sector, whereby the private sector provides infrastructure services. Often, those services include the activities of designing, building, operating and maintaining infrastructure facilities, before transferring the facilities back to the public sector at the end of the long-term contract – and these types of projects are known as DBOM arrangements. It is also very common to have the private sector provide the financing for these activities, under a DBFOM arrangement.

To compensate the private sector for undertaking these activities, PPP contracts typically use one of the following mechanisms:

- In an **Availability Payment PPP**, payments are made by the government's Contracting Authority (such as a Ministry of Transport) to the private sector Project Company on a periodic basis, as and when the facility is available for use (for example, the Ministry of Transport may make monthly payments to the Project Company for a new road, beginning when the road has been constructed, on the basis that the road is properly maintained and available for use by motorists);
- In an **End-User Payment PPP**, payments are made by the users of the facility (for example, if the project is a toll road, the Project Company would collect tolls from the motorists who use the highway after it has been built);
- In a **Hybrid PPP**, the payments to the Project Company come from a mix of availability payments and end-user payments.

2. The Critical Distinction between Financing and Funding

It is critically important to understand the difference between financing and funding.

Financing is the money required to pay for the upfront costs of an infrastructure project. In a DBFOM project, it comes from the Project Company's equity investors and from commercial banks and other lenders providing debt financing – plus, possibly, donors providing concessional financing.

Funding is the money which a Project Company receives, to allow it to repay the financing and to allow it to earn a profit. As indicated, the funding can come from taxpayers, in the case of an Availability Payment PPP, or from end-users, in the case of an End-User Payment PPP, or from a mix of the two sources, in the case of a Hybrid PPP. As was noted in a 2017 commentary published by the Brookings Institution:

It is important to note that there is no "free lunch" when it comes to PPPs: the cost of an infrastructure project must eventually be paid, either by the taxpayer or the consumer. When firms are offering to pay the upfront costs of infrastructure investments, it can be easy to lose sight of this reality (Schanzenbach, Nunn, Nantz, & Rotrosen, 2017).

3. What Are the Fiscal Impacts of PPPs?

In the context of a PPP project, the 'fiscal impact' of the project is the effect which the project may have on the government's fiscal balance sheet – in other words, the impact of the project on the government's budget balance and the sustainability of the government's financial position.

There are two different types of impacts which PPPs may have on a government's fiscal situation. One type arises from **direct liabilities**, while the other involves **contingent liabilities**.

Direct liabilities are the obligations which a government will have under a PPP Contract to make predictable payments to the private sector Project Company. For example, in the case of an Availability Payment PPP or a Hybrid PPP, these predictable payments will include the periodic payments that the government must make once the facility has been constructed and is available for use.

In addition, however, to these direct liabilities, attention must be paid to the contingent liabilities associated with PPPs. Virtually every PPP Contract – whether it is for an Availability Payment PPP, an End-User Payment PPP or a Hybrid PPP – will contain provisions that require the government to make substantial payments to the Project Company if certain contingent events happen. Such events may include, for example, a decision by the government to terminate the PPP Contract unilaterally and prematurely. Under such a scenario, the government may be liable under the PPP Contract for a very large contingent payment, so as to compensate the Project Company for its damages, including its future loss of profits.

Unfortunately, countries frequently pay insufficient attention to these contingent liabilities. Specifically, the Ministry of Finance in the country may not have considered the impact of such a large payment obligation on the fiscal situation of the government.

4. Managing the Fiscal Impacts of PPPs

In response to concerns over the failure of many governments to deal with the direct and contingent liabilities associated with PPP projects, international financial institutions have developed extremely useful knowledge products to help deal with this critically important governance issue.

One such knowledge product is the World Bank's 2019 *Guidance on PPP Contractual Provisions* (The World Bank, 2019). This document provides very detailed guidance on drafting the provisions in PPP Contracts that give rise to direct and contingent liabilities, with alternative approaches and explanatory annotations.

Another particularly useful tool, which has been jointly developed by the International Monetary Authority and the World Bank, is the 2019 Public Fiscal Risk Assessment Model (PFRAM 2.0) (Rial, et al., 2019), which is designed to allow a Ministry of Finance to manage the fiscal impacts of PPPs. This tool can be used to estimate the fiscal risks associated with an individual PPP project or with a portfolio of PPP projects. It generates a "fiscal risk matrix" for each PPP project in the country, identifying the main fiscal risks, their likelihood and potential impacts, and potential mitigation measures. Using this tool, a Ministry of Finance can estimate the potential macroeconomic shocks – caused, for example, by the premature termination of a PPP Contract – on the country's GDP growth, inflation and currency exchange rates. In emerging market and developing economy countries, the IMF and the World Bank offer training programs to Ministry of Finance officials on how to use the PFRAM 2.0 tool. These training programs are usually made available free of charge, as part of a Technical Assistance grant.

5. Conclusions

As indicated, Public-Private Partnerships are powerful instruments to help governments close the 'infrastructure gaps' in their countries. However, PPPs must be properly managed, particularly by the officials in the Ministry of Finance who are responsible for maintaining the fiscal health of the government. Fortunately, useful knowledge products are available from international financial institutions to help government officials undertake this task. By employing the available tools, proper governance arrangements can be put in place, in order to realise the full benefits of Public-Private Partnership programs.

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