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Municipal and other subnational PPPs

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Subnational governments including states, provinces, and municipalities provide many essential and basic infrastructure services, especially in water and sanitation and urban transport. Some subnational governments, for instance, Australian and Brazilian states and Canadian provinces, have put solid PPP programs together—their fiscal self-sufficiency, credit ratings, and execution capabilities are not far from those of central governments. The same cannot be said about municipalities. Municipal governments are closer to the populations they serve, and therefore better able to identify projects that satisfy local needs. However, they face additional challenges and raise particular issues:

- Municipal governments often have limited project development and procurement capacity. This lack of capacity may be exacerbated by frequent changes of personnel triggered by electoral outcomes. However, there are examples of municipalities that succeeded in building such capacity. There are other cases where central government worked with subnational governments to build capacity and provide knowledge and technical support.
- Most municipal governments do not benefit from the same credit ratings as central governments. They need to build their credit ratings gradually over time. However, in the short term, most will need central government support in the form of payment guarantees or public finance—but moral hazard concerns are leading central governments to move away from guaranteeing subnational governments fiscal decisions, as described by Canuto and Liu in the **World Bank book on subnational debt** ([Canuto and Liu 2013](#)). Moral hazard arises from subnational borrowers having an incentive not to repay their creditors, or to engage in too risky or poorly-structured projects, if they perceive that defaulting debtors could be bailed out by the central government. **Charbil and Gamper's article on**

coordination of infrastructure investment ([Frank and Martinez-Vazquez 2015](#)) notes that in a sample of OECD countries hardly any subnational infrastructure investment is carried out in isolation of central government—partial funding often flows from national or supra-national authorities as in many developing countries. In other developing countries, state governments can fund infrastructure on their own, but municipalities often need state government support.

- Municipal governments often do not have an efficient legal framework for procuring PPPs, reducing investors' appetite for their projects.
- Decentralization, when not accompanied by increased subnational accountability and transparency, may sometimes bolster corrupt practices, as noted by **Shah** ([Frank and Martinez-Vazquez 2015](#)). However, by bringing the decision-making process closer to the people directly affected by the project, decentralization may instead combat corruption. Often the natural geographical segmentation of construction in which local projects are only bid upon by local contractors, as identified by the **Charbonneau Commission in Québec** ([Charbonneau and Lachance 2015](#)), creates additional challenges in setting up an effective competitive framework. It also makes it more difficult to maintain integrity in PPP procurement at the local level.
- Many cities and subnational governments have fragmented and overlapping jurisdictions. For example, some public services may be managed by the regional government whereas others are administered by the municipality. This can generate problems of coordination in policy formulation and implementation. In addition, PPPs are sometimes selected without an efficient fiscal responsibility framework in place. Clear fiscal rules allow decentralization of decision-making without jeopardizing local and national fiscal sustainability. Lack of clarity on these rules either discourages subnational governments from using PPPs or encourages free-riding with no regard to fiscal sustainability.

This section addresses these five issues one-by-one with references and examples.

Despite the challenges, PPPs are now fairly common at the state level in advanced and developing economies in countries such as Brazil, Mexico, and Australia; and at the provincial and municipal level in South Africa and Canada. Large municipalities in Brazil and China have increasingly been using PPPs. Small municipalities have also experimented with PPPs for the procurement of their infrastructure projects; in India, PPPs have been used by local executive bodies like the Gram Panchayats for the provision of urban amenities in rural areas. **The World Economic Forum report on Accelerating Infrastructure Delivery** ([Maier and Jordan-Tank 2014](#)) refers to a portfolio of €6.1 billion with more than 300 municipal projects financed by EBRD between 1994 and 2014—of this amount, 20 percent was debt or equity in privately-financed infrastructure.

Capacity challenges at subnational level

While decentralization is theoretically a sound principle of good governance, it cannot function efficiently unless central and subnational governments develop new institutional arrangements and regulations, and build capacity. Subnational governments usually face capacity constraints of scale and governance. Traditionally, subnational governments, particularly municipalities, have been less involved in infrastructure policy and procurement than central governments. Exceptions are seen in federal countries where state/provincial governments have been responsible for infrastructure, such as **Brazil, Canada, and Australia**—examples are the Minas Gerais PPP Unit, Sao Paulo's Companhia Paulista de Parcerias, British Columbia's Partnerships BC, and Partnerships Victoria. These state/provincial units developed significant PPP knowledge and experience, even before the national PPP teams of their respective countries were established.

However, decentralization, in terms of devolution of responsibilities, seems to be spreading globally. Some countries, such as **Kenya, Turkey, and Kazakhstan** are shifting their legal regime toward decentralization; even without legislative changes, the responsibility for infrastructure procurement is increasingly transferred from central to subnational governments. Thus, a growing number of subnational governments are actively

procuring PPPs. This trend increases the need for capacity building in procurement and project management.

Frank and Martinez-Vazquez, in their **book on decentralization and infrastructure** ([Frank and Martinez-Vazquez 2015](#)), insist on the need to create **intergovernmental** capacities for public investment—institutional capacities, whether in financial management, human resources or procurement, can benefit from shared approaches which go beyond individual levels of government, particularly in the design of procurement systems, monitoring arrangements, and ex-post reviews. Training provided by commercial and academic entities may be complemented by the **APMG Certification Program** sponsored by MDBs ([APMG 2016](#)). [PPP Training](#) describes several Massive Open Online Courses (MOOCs) developed by the World Bank and the Inter-American Development Bank, which may also be helpful.

Knowledge interchange inside a national or multi-national practitioners' network has been used, not only by national governments, but also by subnational governments. **Rede PPP** ([Rede PPP 2017](#)), a network created to promote PPP collaboration in Brazil, has fostered cooperation between states and municipalities. **EPEC**, the **European PPP Expertise Centre** ([EPEC](#))—based in Luxembourg and funded by the European Investment Bank and EBRD's Infrastructure Project Preparation Facility (IPPF)—has many subnational governments among its members and beneficiaries, and several of them participated in secondment programs at EPEC, allowing staff members to spend time at EPEC, working with other European governments. In line with the National PPP Capacity Building program for civil servants organized by the Government of India, PPP cells have been created within various state governments—those PPP cells offer assistance to line departments in the development of projects through PPP arrangements.

For complex projects, capacity constraints may induce subnational governments to hire private companies to manage complex project preparation and implementation—they can provide expert advice in the elaboration of PPP contracts, joint ventures, management contracts, or operations and maintenance (O&M) contracts. However, procuring private investment will still require capacity building within the subnational government for managing external consultants and advisors during project preparation and tendering, and for contract management.

Subnational creditworthiness and access to finance

The financial challenges of subnational governments are discussed in an **Inter-American Development Bank concept note on financing sustainable urban infrastructure** ([UN-Habitat/IDB 2016](#)). The note highlights the link between municipal PPP opportunities and cities' creditworthiness. Creditworthy local governments can generally attract private sector investment; those that are not creditworthy will require central government guarantees for their financial commitments. Sound financial management is often critical to the creditworthiness of subnational entities. Failure on the side of central governments to honor commitments towards subnational entities jeopardizes chances of attracting quality investors for subnational PPP projects.

Multilateral organizations provide technical assistance programs to strengthen the capacity of local governments to design and plan infrastructure projects, including PPPs. For example, **PPIAF's subnational technical assistance (SNTA) program** ([PPIAF-Work](#)) helps subnational entities improve their investment planning and project preparation skills, strengthen their financial management practices and processes, ensure fiscal responsibility, and ultimately improve their creditworthiness.

Creditworthiness depends on a credible, capital investment program. Investment programs provide a framework for PPPs to be identified, prioritized, and eventually approved and budgeted. A **World Bank toolkit on city creditworthiness** ([WB 2017a](#)) can be used to assess cities' preparedness for commercial-based transactions, allowing users to: (1) get a quick sense of their city's overall financial performance without burdening them with complicated studies; (2) verify their city's commitment to various financing schemes; (3) get a quick sense of its portfolio and pipeline of projects, including financing needs; (4) agree

on action-plans that can help identify and prepare projects. A **World Bank book on subnational finances** ([Canuto and Liu 2013](#)) discusses fiscal incentives and insolvency risk in municipal and state governments, analyzing cases and experiences in many subnational governments.

Legislative and regulatory framework

The absence of a clear and efficient legislative and regulatory framework, including a procurement code and fiscal management guidelines, may restrict the ability of subnational governments to implement PPPs and create uncertainty for private investors. Several countries have taken some initiatives to share information on good practices across subnational entities. Other countries have endowed each state with their own PPP legislation—such as **Brazil, India, Australia, and Mexico**. In other instances, procurement at the municipal level is governed by national legislation. And in some countries, the central government provides uniform regulations for all government institutions—hence, in **South Africa**, the government provides one PPP manual for national and provincial institutions and a separate manual for municipalities. This is also true in almost all EBRD countries.

Brazil introduced hard-budget constraint legislation—the Fiscal Responsibility Law—in 2000. This law applies to all levels of government, and is reinforced by the PPP Law, which puts a cap on the volume of PPPs that each level (federal, state, municipal) can procure based on its expected revenue. **Frank and Martinez-Vazquez’s book on decentralization and infrastructure** ([Frank and Martinez-Vazquez 2015](#)) highlights that national governments often pay insufficient attention to developing appropriate local authority procurement systems and capacity. Standard legal provisions and guidelines often reproduce the central procurement standards at the local level. For example, thresholds for project approval at the national level will apply at the local level.

Transparency and governance

Maintaining transparency and good governance may be challenging in subnational PPPs, particularly when the stricter oversight of central governments is removed. As the responsibility of subnational governments for resource allocation and service provision increases, so does the importance of commitment, coordination, transparency, and accountability. This is highlighted by the **International Budget Partnership** ([Lawson and Alvarez 2013](#))—its pilot studies report a wide range of fiscal transparency levels, with many subnational governments exhibiting significant weaknesses. Where subnational governments are subject to strict balanced-budget rules, borrowing constraints, or restrictions on their power to increase spending or taxes, lack of fiscal transparency rules may invite decision-makers to opt for PPPs as a way to bypass fiscal rules. A report by the **Canadian Council for PPPs** ([CCPPP 2011](#)) provides guidelines for municipalities in this regard, including a critical path and a discussion on the specific challenges that may arise when implementing PPPs, depending on whether the municipality is large or small.

National central support to subnational governments

The **IADB report on Financing the New Urban Agenda** ([UN-Habitat/IDB 2016](#)) describes the experience of a Guatemalan municipality requiring central government support to upgrade its waste management facilities. In some countries with established PPP frameworks (e.g. South Africa and France), a major part of the activity of the central PPP Unit relates to supporting PPPs procured by subnational governments. In others (e.g. Brazil and Australia), several state governments already have more PPP experience than the central government. Often, the central PPP Unit acts as a knowledge center, leading the PPP processes at the central government level and helping subnational governments. **South Africa’s National Treasury** provides guidance and training for municipalities; **Croatia and Tanzania** conducted municipal-level PPP training; **Colombia’s Planning Department (DNP)** helps provinces and municipalities assess PPPs; **Peru’s Proinversion** is mandate to assist structure projects at the subnational level; and **Canada’s** central

government provides funding support to provincial and municipal PPP projects. Central public sector institutions provide other forms of support: The **Indonesia Infrastructure Guarantee Fund (IIGF)** supports subnational PPPs and **Brazil's BNDES** and **Mexico's Fonadin** help subnational government structure and finance projects.

Municipal Water PPPs in Benin

In 1999, Benin went through a reorganization of its public administration leading to the introduction of decentralized, financially autonomous municipalities or communes. The country's 77 municipalities own the water supply facilities and pipe networks and are responsible for the provision of water and sanitation services to their populations.

To support the Government's decentralization program and strengthen the quality of water services in small towns and rural areas, IFC, in close cooperation with the Water Sanitation Program (WSP), a multi-donor partnership administered by the World Bank, provided advisory services and technical assistance. The contribution of the WBG included advice on the structuring and implementation of a PPP pilot scheme for the delivery of improved and expanded water services to the households of three municipalities, through the participation of small domestic private operators.

The project required the private operators to design, engineer, rehabilitate, operate, and maintain systems, without increasing the price of water. This included rehabilitating equipment, extending the network, installing private water connections, and partially financing these activities. The concessions were structured with an output/result-based subsidy payable to private operators upon verification of delivery. The subsidy ensures the profitability of the operations and creates an incentive for delivery. The output-based subsidy also permitted private operators to raise financing from local commercial banks.

From 2007 to 2014, the number of piped water systems managed by private operators in Beninese municipalities increased from one to 269, providing water services to 28 percent of the population. As of February 2015, approximately 77 private operations were functioning all over Benin. Initially, the municipalities demonstrated a dearth of technical capabilities to prepare and financially close such PPP transactions. However, their effectiveness improved gradually through a combination of institutional reforms and provision of technical assistance by the World Bank. The piped water systems performance has improved significantly, leading to approximately 32 kilometers of additional network pipes and 1,071 new household water connection pipes installed. Given the success of the pilot projects, the Government of Benin decided to scale up this approach countrywide through a World Bank lending project involving more than 180 piped water systems.

Source: ([Adokpo Migan and Tremolet 2015](#))

Key References

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- [PPPIRC. 2016. "India: State Sub-National PPP Policies." Public-Private Partnership in Infrastructure Resource Center](#) Presents subnational PPP policies for select Indian states.
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- [PPIAF-Work. Accessed March 9, 2017. "Our Work." Public-Private Infrastructure Advisory Facility. URL.](#) Highlights the objectives of the SNTA program, as well as the type of activities supported by PPIAF.
- [WB. 2017a. "City Creditworthiness Self-Assessment & Planning Toolkit." World Bank. URL.](#) This toolkit helps municipal-level units/ cities identify where they stand vis-à-vis investment grade, and undertake a self-assessment to help develop an action plan.
- [Canuto, Otaviano, and Lili Liu, eds. 2013. *Until debt do us part: Subnational debt, insolvency, and markets*. Washington, DC: World Bank.](#) Addresses guidance on fiscal solidarity.

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