

Budgeting for Government Commitments to PPPs

[Download](#) [Chatbot](#)

Budgeting for PPPs involves making sure money is appropriated and available to pay for whatever cost the government has agreed to bear under its PPP projects. Because such cost may be contingent or occur in the future, PPP budgeting can be hard to manage in traditional annual budget cycles. Nevertheless, credible and practical budgeting approaches are needed for good public financial management, and to assure private partners that they will be paid. This section describes how some countries have introduced systems specifically to enable better budgeting for PPP payments, both direct and contingent.

Budgeting for Direct Commitments to PPPs

Direct commitments to PPP may include ongoing payments such as availability payments and shadow tolls, as well as capital subsidies during project construction.

When governments provide capital subsidies to PPPs, the payments required are similar to those for traditionally-procured government projects. Because these payments are typically made within the first few years of a project, they can be relatively easily built into annual budgets and medium-term expenditure frameworks. Nonetheless, some governments have introduced particular funds, called Viability Gap Funds, from which such payments will be made. One example of such a fund is in India, as described in The Viability Gap Fund Program in India.

The Viability Gap Fund Program in India

In July 2005, the Cabinet Committee on Economic Affairs established India's Viability Gap Fund (VGF) program through its approval of the *Scheme for Financial Support to Public Private Partnerships in Infrastructure*. During its first eleven years, 58 projects with a total project cost of approximately \$4.9 billion and VGF allocation of \$872 million received final approval thanks to the scheme.

The primary objective of India's VGF program is to attract private investment in infrastructure by making PPP projects financially viable, with three underlying objectives:

- Mobilizing additional finance to meet India's infrastructure needs more rapidly
- Prioritizing PPP projects to improve the efficiency of service delivery, control timing and cost, and attract private sector expertise
- Developing projects through an inclusive approach that does not neglect geographically or economically disadvantaged regions

Knowing that the funding is available encourages firms to bid on India's PPP projects. The resulting competition has meant that many projects that the government thought might need a subsidy have, in fact, been fully privately financed, without a VFG contribution being called on or in some cases with *negative grants*, or upfront payments by the private sector.

The scheme is funded by the Government through budgetary resources. Budget provisions are made on an annual basis based on the likely demand for disbursements during the year. In the first year, a budgetary provision of \$40 million was made. The scheme also provides for a revolving fund under the authority of the Empowered Committee to ensure liquidity of the VGF facility. The fund is replenished as needed.

In any given year, the value of projects approved is capped by a ceiling equivalent to ten times the budget provisions for VGF—to ensure continuing liquidity and prevent bunching of disbursement requests as far as possible. This cap can be modified at the discretion of the Ministry of Finance. In practice, the cap has not been binding.

Sources: ([IN 2013a](#)); ([IN 2017](#))

Budgeting for **long-term direct commitments**, such as availability payments, is more challenging. The mismatch between the annual budget appropriation cycle and the multi-year payment commitments exposes the private party to the risk that payments may not be appropriated when due. This problem is not unique to PPPs—many other types of contractual payment commitments extend beyond the budget year. In many jurisdictions, governments do not introduce any particular budgeting approach for direct, long-term PPP commitments on the assumption that a responsible legislature will always approve appropriations to meet the government's legally binding payment commitments.

Where appropriations risk is high—typically in systems with a strict separation of powers between the legislature and executive—mechanisms to reduce this risk may be warranted. In **Brazil**, at the federal level, Law No.101 of 2000 ([BR 2005](#)) requires subsidy payments to PPPs to be treated in the same way as debt service payments—that is, they are automatically appropriated. This means that once the subsidy is approved, the appropriations needed are not subject to further legislative approval. Although no federal subsidies have been disbursed yet, this policy should help reduce the likelihood that committed funds are retracted and provides investors with more certainty.

For more on budgeting for direct commitments to PPPs, see the **World Bank report on fiscal subsidies for PPPs** ([WB 2012a](#)). The study presents the appropriations mechanisms for Brazil at the Federal and State levels (see pages 15–16), Colombia (page 31), Mexico (page 46), and India (page 59).

The long-term nature of most governments' commitments to pay, under PPP contracts, suggest the need for incorporating them in the Medium-Term Fiscal Framework (MTFF). More countries have legislation requiring periodic analysis of a MTFF, such as Brazil, China, Colombia, India, Peru, and Poland—good practice consists of including PPPs in the MTFF.

Governments with prudent fiscal governance have felt the need to establish and continuously update a centralized register for all PPP commitments in the Ministry of Finance. This is good practice. All PPP commitments should be centrally recorded and monitored. This is relevant for unitary countries, but also for federal republics that have a history of subnational fiscal discipline issues. Monitoring currency exposures may be also relevant—PPP commitments may have foreign exchange implications.

Availability payments depend on effective availability of infrastructure. Although contingent upon availability, these payments should be considered as direct liabilities as their probability of occurring is almost certain in a well-designed PPP. Governments may commit to pay according to the volume of production or the amount and quality of services delivered, for instance healthcare services in a PPP hospital or electricity generated at a PPP power plant. Since these costs are variable, governments must budget for expected levels of delivery.

Budgeting for PPP Contingent Liabilities

Budgeting for contingent liabilities can be particularly challenging, because payments may become due unexpectedly. If savings cannot be found within the existing appropriations, government may need to go back to the legislature to request a supplementary appropriation—often a difficult and contentious affair.

To overcome these difficulties, some governments introduce particular mechanisms for budgeting for contingent liabilities under PPP projects. As described in **Cebotari's paper on managing contingent liabilities** ([Cebotari 2008](#), 26–28), the first option is to create additional budget flexibility. This can include creating a contingency line in the budget from which unexpected payments can be made. A contingency line could be specific to a particular liability—for example, to one considered relatively riskier—or cover a range of contingent liabilities. In **Chile**, the Ministry of Finance assesses the cost of guarantees (e.g. demand guarantees) provided to PPP operators and creates a budget line for those guarantees. Cebotari also notes that some countries allow spending in excess of the budget without need for additional approval in certain, defined circumstances.

A second option, also described in detail by **Cebotari** ([Cebotari 2008](#), 27–29), is to create a contingent liability fund. A contingent liability fund (or guarantee fund) is an account (which may be within or external to the government's accounts) to which transfers are made in advance, and from which payments for realized contingent liabilities will be made when due.

The following are examples of contingent liability funds for PPPs:

- **Colombia**—has developed a set of procedures for managing contingent liabilities arising from guarantees offered to toll road concessionaires. This includes assessing the fiscal impact of guarantees before these are granted and setting aside funds to cover the expected payments from the guarantees ([WB 2012a](#), 32–33). A Government Entities Contingent Liabilities Fund, established in 1998, is managed by La Previsora, a Trust Company. The fund is funded by contributions by various government entities, contributions from the national Budget, and the returns generated with its resources. The government entities carry out the contingent liabilities valuation which is then approved by the Public Credit Division of the Ministry of Finance. Once the PPP is approved and implemented, the division carries out ongoing assessments of the value of the associated contingent liabilities ([CO 1998](#), Articles 3–8).
- **São Paulo, Brazil**—in the State of São Paulo, the São Paulo Partnerships Corporation (Companhia Paulista de Parcerias—CPP) was established in 2004 using resources from the sale of the government's stake in State-Owned Enterprises ([SP 2004a](#), Articles 12–23). Section 5 of State Governor's Decree ([SP 2004b](#), Articles 11–12) describes the duties of CPP. The CPP manages its resources as a fiduciary fund that provides guarantees to PPP projects ([SP 2004b](#), Article 15). The CPP is governed by a directorate made up of up to three members selected by the governor of the state, a management council made up of up to five members selected by the state governor, and a fiscal council. The CPP is an independent legal entity. The government of the state can add capital to the fund using funds from the sale of shares in state-owned companies or government-owned buildings, public debt titles, other goods or rights that are directly or indirectly owned by the government. The World Bank review of Subsidy Funds for PPPs in LAC ([WB 2012a](#), 16) provides more background about the CPP.
- **Indonesia**—the Indonesia Infrastructure Guarantee Fund, or IIGF, is a state-owned enterprise established by government regulation and a 2009 Ministry of Finance decree. As one of the fiscal tools of the government, IIGF is under direct supervision of the Ministry of Finance and has mandate to provide guarantees for infrastructure projects under of PPP schemes. IIGF is part of the government's efforts to accelerate infrastructure development in Indonesia, by providing contingency support/guarantee for the risks caused by the government's action or inaction. The Fund operates as a single window for appraising, structuring, and providing guarantees for PPP infrastructure projects. The single window ensures a consistent policy for appraising guarantees and a single process for claims. It introduces transparency and consistency in the process which is critical for market

confidence. IIGF provides guarantees against specific risks based on private sector demand in a variety of sectors—including power, water, toll roads, railways, bridges, ports, and others ([IIGF](#)).

- **South Korea**—The Infrastructure Credit Guarantee Fund (ICGF) was established in 1994. It is being managed by a public financial institution. ICGF guarantees each project up to 300 billion won, for an annual guarantee fee capped at 1.5 percent of the total guarantee amount ([KR 2011](#)). Typically, the annual guarantee fees range between 0.3 and 1.3 percent. The guarantee operates as a subrogation—that is, ICGF pays back loans taken by the project company to financial institutions if it defaults on its debt obligations. If funds become insufficient, the government can provide additional contributions ([Kim et al. 2011](#)).

As well as providing a clear budgeting mechanism and thereby improving credibility, creating a fund can also help control the government's fiscal commitments to PPPs—depending on how the fund is designed. For example, Colombia's approach encourages discipline when deciding what liabilities to accept, as described in [Assessing Fiscal Implications of a PPP Project](#). Requiring a cash transfer from the implementing agency's budget when a contingent liability is incurred means the decision to accept a contingent liability has an immediate budget impact that must be considered. In Indonesia, the government policy requires IIGF to accept contingent liabilities based on a careful assessment of the risk by the fund's management. **The EPEC note on State Guarantees in PPPs** ([EPEC 2011a](#), Section 2) provides further detail on the different types of guarantees that governments may offer to PPP projects.

Related Content

- [INTRODUCTION](#)
- [PPP BASICS: WHAT AND WHY](#)
- [ESTABLISHING THE PPP FRAMEWORK](#)
- [PPP Policy](#)
- [PPP Legal Framework](#)
- [PPP Processes and Institutional Responsibilities](#)
- [Public Financial Management Frameworks for PPPs](#)
- [Broader PPP Program Governance](#)

- [Municipal and other subnational PPPs](#)
- [Key References - PPP Framework](#)
- [PPP CYCLE](#)

Additional Resources

- [Selected World Bank Tools](#)

Find in pdf at [PPP Reference Guide - PPP Framework](#) or visit the [PPP Online Reference Guide](#) section to find out more.

Disclaimer: *The resources on this site is usually managed by third party websites. The World Bank does not take responsibility for the accuracy, completeness, or quality of the information provided, or for any broken links or moved resources. Any changes in the underlying website or link may result in changes to the analysis and recommendations set forth on the Public-Private Partnership Resource Center. The inclusion of documents on this website should not be construed as either a commitment to provide financing or an endorsement by the World Bank of the quality of the document or project. If you have any comments on any of the links provided on the Public-Private Partnership Resource Center, please get in touch [here](#)*