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Guarantees

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Guarantee Mechanisms in PPPs

Guarantees are essential instruments in public-private partnerships (PPPs), helping to mitigate risks and enhance the bankability of infrastructure projects. They are particularly important in emerging markets, where private sector confidence may be constrained by macroeconomic volatility, regulatory uncertainty, or project-specific risks. While guarantees can unlock private capital, they must be carefully structured to avoid excessive fiscal exposure and moral hazard.

Guarantees in PPPs can be broadly categorized into:

1. Government Guarantees

These guarantees represent public sector commitments to absorb specific risks associated with a PPP project, such as revenue shortfalls, political instability, or regulatory disruptions. The risks covered by such guarantees span a wide spectrum that can significantly affect a project's viability.

- **Political risks** may involve government actions like expropriation, contract breaches, or abrupt legal changes that negatively impact the project.
- **Regulatory risks** stem from delays or refusals in granting essential approvals—such as tariff adjustments or licenses—which can jeopardize projected revenues. **Macroeconomic risks** relate to broader financial conditions, including currency inconvertibility, inflation fluctuations, or volatile interest rates, all of which can undermine the project’s financial stability.
- **Project-specific risks** are tied to the execution and operation of the project itself, including construction delays, lower-than-anticipated demand, or unforeseen force majeure events.

By addressing these risks, government guarantees can substantially enhance investor confidence and reduce financing costs. Common forms of such guarantees include:

- **Payment Guarantees:** Ensure that the private partner receives agreed payments, such as Minimum Revenue Guarantees or Availability Payments.
- **Termination Compensation:** Guarantees compensation to the private party in case of early termination due to political or other specified risks.
- **Tariff Adjustment Guarantees:** Protect investors from regulatory changes that affect project revenues, such as delayed or denied tariff increases.

- **Currency Convertibility and Transfer Guarantees**: Ensure the ability to convert local currency revenues into foreign currency and transfer them abroad, mitigating foreign exchange risk.

2. Contingency Supports Instruments

These instruments do not involve upfront funding but commit the government to absorb certain risks if they materialize (For more detail see *Government Support*).

3. International Financial Institutions (IFIs), Bilateral, and Export Credit Agency Guarantees

In situations where government guarantees alone do not provide sufficient reassurance to investors or lenders—often due to concerns about the issuing government's creditworthiness—additional support from international institutions can play a critical role. For countries most in need of private investment, particularly in high-risk or frontier markets, International Financial Institutions (IFIs), bilateral donors, and Export Credit Agencies (ECAs) can offer complementary guarantees. These instruments are frequently combined with concessional financing or technical assistance to enhance project viability and attract private capital.

- **Partial Risk Guarantees (PRGs):** Mitigate specific political and regulatory risks, such as breach of contract, expropriation, or restrictions on currency transfer.
- **Partial Credit Guarantees (PCGs):** Improve a project's credit profile by covering a portion of scheduled debt service, thereby facilitating access to commercial financing.
- **Blended Finance Instruments**: Integrate guarantees with concessional loans or grants to reduce overall project risk and improve financial sustainability.

The World Bank Guarantee Platform, through instruments offered across the World Bank Group, IFC and MIGA, provides a comprehensive suite of risk mitigation tools that help governments and private investors manage political, regulatory, and credit risks, thereby enabling infrastructure projects that might otherwise be unbankable.

See the section titled *Guarantee and Risk Insurance Products Provided by International Financial Institutions* for more details.

Policy Considerations in Guarantee Structuring

Irwin underscores that government guarantees should be treated with the same rigor as direct pubic expenditures - subject to budgetary ceilings, transparency requirements, and legislative oversight. In his analysis Government Guarantees Allocating and valuing risk in privately financed infrastructure projects, he identifies several key challenges in the design and implementation of government guarantees.

- **Fiscal Transparency:** Guarantees create contingent liabilities that may not be immediately visible in public accounts, complicating fiscal oversight and budget planning. Governments should adopt accrual-based accounting and disclose guarantees in fiscal reports.
- **Moral Hazard:** Over-reliance on guarantees can reduce the incentive for lenders and investors to conduct rigorous due diligence, especially when they perceive the government as the ultimate backstop. Risk-sharing mechanisms must be carefully calibrated to maintain private sector discipline.
- **Unclear Trigger Mechanisms:** Ambiguities in the conditions under which guarantees are called can lead to disputes and delays. Clearly defined, objective, and enforceable trigger events are essential for effective implementation.
- **Inadequate Pricing:** Guarantees are often provided without charging a risk-based premium, leading to inefficient use of public resources. Pricing should reflect the underlying risk and incentivize efficient risk management by the private sector.

The World Bank report "Government Guarantees for Mobilizing Private Investment in Infrastructure", developed with support from PPIAF and GIF, underscores the importance of carefully structuring government guarantees to attract private investment while maintaining fiscal responsibility. Effective guarantees should align incentives, allocate risks appropriately—focusing on those the private sector cannot manage, such as political or regulatory risks—and include performance-based triggers to avoid unconditional payouts. They must also be time-bound and financially capped to ensure fiscal predictability.

The report highlights the need for a strong institutional framework, recommending centralized oversight (typically within the Ministry of Finance), clear legal authority, and coordinated interagency processes. To manage fiscal implications, governments should adopt probabilistic valuation methods, establish reserve funds, and ensure transparency through regular disclosure of contingent liabilities. Guarantees should be actively managed throughout the project lifecycle, from pre-issuance appraisal to post-completion evaluation.

Importantly, the report distinguishes between financial guarantees—which often transfer full risk to the government—and performance guarantees, which are more targeted and commonly used in PPPs. Misunderstanding these distinctions can lead to unintended fiscal exposure. Additionally, the legal form and wording of support instruments—such as letters of support or comfort—can significantly affect their enforceability and fiscal impact.

Ultimately, guarantees should be issued only after rigorous project analysis, market sounding, and close coordination among government entities. When used strategically and managed prudently, government guarantees can play a pivotal role in bridging the infrastructure financing gap and supporting economic recovery, especially in times of crisis.

Related Content

- **Infrastructure Finance**
- **Financing Mechanisms**
- **Government Support**
- **Private Sector Mobilization**
- **Blended Finance**

Additional Resources

- Using government guarantees carefully as the private sector redefines bankability
- Managing PPP risks with a new guide on guarantees
- PPP Online Reference Guide

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