

Public Financial Management Frameworks for PPPs

Full Description

Typically, PPP contracts have financial implications for governments. Payment commitments under PPP contracts are often long-term, and can be contingent on risk. Types of Fiscal Commitments to PPPs sets out the different categories of risk inherent to PPPs. Managing these risks can create challenges for public financial management, which is generally geared to annual appropriations for expenditure. For this reason, PPP-specific approaches to public financial management have been developed.

Types of Fiscal Commitments to PPPs

Fiscal commitments to PPPs can be regular payments constituting all or part of the remuneration of the private party, a means to share risk, or a combination of the two. Common types of government fiscal commitments to PPPs include the following:

Direct liabilities

Direct liabilities are payment commitments that are not dependent on the occurrence of an uncertain future event (although there may be some uncertainty regarding their value). Direct liabilities arising from PPP contracts can include:

- **"Viability gap" payments**—a capital subsidy, which may be phased over construction based on achievement of milestones, or against equity investments. Alternatively, subsidies can be used to lower tariffs for targeted end-users so that they become affordable to them.
- **Availability payments**—a regular payment or subsidy over the lifetime of the project, usually conditional on the availability of the service or asset at a contractually specified quality. The payment may be adjusted with bonuses or penalties related to performance.
- **Shadow tolls, or output-based payments**—a payment or subsidy per unit or user of a service—for example, per kilometer driven on a toll road.

Contingent liabilities

Contingent liabilities are payment commitments whose occurrence, timing, and magnitude depend on some uncertain future event. Explicit contingent liabilities under PPP contracts can include:

- **Guarantees on particular risk variables**—an agreement to compensate the private party for loss in revenue should a particular risk variable deviate from a contractually specified level. The associated risk is thereby shared between the government and the private party. For example, this could include guarantees on demand remaining above a specified level; or on exchange rates remaining within a certain range; or commitments to buy land needed for the project, or to pay compensation for relocation of people and activities.
- **Compensation clauses**—for example, a commitment to compensate the private party for damage or loss due to certain, specified, uninsurable *force majeure* events.
- **Termination payment commitments**—a commitment to pay an agreed amount, should the contract be terminated due to default by the public or private party—the amount may depend on the circumstances of default.
- **Debt guarantees or other credit enhancements**—a commitment to repay part or all of the debt used to finance a project. The guarantee could cover a specific risk or event. Guarantees are used to provide more security to a lender that their loan will be repaid.

- **Litigation**—potential litigation costs to government relating to PPP.

Every PPP contract also creates implicit contingent liabilities—moral obligations of governments reflecting public interest or political pressures. These include: cost of retendering or operating if operators go bankrupt; cost of expanding or redesigning service when PPP contract is overly rigid; and change in government policy.

Polackova and Schick’s edited volume on **Government Contingent Liabilities** ([Polackova 1998](#)) defines direct and contingent liabilities, and describes the fiscal risks posed by contingent liabilities in general.

[Infrastructure Challenges and How PPPs Can Help](#) describes some of the problems that commonly arise when the fiscal implications of PPPs are not carefully thought through. Without specific rules to address and manage fiscal risk, PPPs can be used to bypass budget constraints or borrowing limits and create hidden deficits for the Government, as illustrated by **Kharas and Mishra’s paper** ([Kharas and Mishra 2001](#)). Governments also often underestimate the cost of bearing risk under PPPs. This can result in significant levels of exposure to PPP-related risks that can jeopardize fiscal sustainability if not monitored and managed proactively.

This section provides guidance for practitioners on public financial management for PPPs, to help avoid these pitfalls. The following sections describe how governments can:

- Assess the fiscal implications of a proposed PPP project
- Control aggregate exposure to PPPs
- Budget for fiscal commitments to PPPs
- Reflect fiscal commitments to PPPs in government accounts and reports

Subsections

1. [Assessing Fiscal Implications of a PPP Project](#)
2. [Controlling Aggregate Exposure to PPPs](#)
3. [Budgeting for Government Commitments to PPPs](#)
4. [Fiscal Accounting and Reporting for PPPs](#)

Key References

Public Financial Management for PPPs

- [Polackova, Hana. 1998. "Contingent Government Liabilities: A Hidden Risk for Fiscal Stability." Policy Research Working Paper 1989. Washington, DC: World Bank.](#) Provides the conceptual structure used by many subsequent articles to describe different types of government liabilities—distinguishing between contingent and direct liabilities, and explicit and implicit liabilities.
- [Schwartz, Gerd, Ana Corbacho, and Katja Funke, eds. 2008. *Public Investment and Public-Private Partnerships: Addressing infrastructure challenges and managing fiscal risks*. Washington, DC: International Monetary Fund.](#) A collection of papers on managing the fiscal impact of PPPs, drawing from an IMF conference held in Budapest in 2007. Part Two: “Fiscal Risks from PPPs,” and Part Four: “PPP Accounting, Reporting, and Auditing” are particularly relevant to public financial management for PPPs.
- [OECD. 2008a. *Public-Private Partnerships: In Pursuit of Risk Sharing and Value for Money*. Paris: Organisation for Economic Co-operation and Development.](#) Identifies best practices for maximizing value-for-money for PPP projects, including accounting for fiscal impacts and affordability. The book

also covers issues with regulatory reform, governance, and developing institutional capacity.

- [IMF. 2007. *Manual on Fiscal Transparency*. Washington, DC: International Monetary Fund.](#) Manual for public sector disclosure of fiscal reporting. The manual provides a framework for responsibilities for transparency, the transparency of the budget process, and openness and integrity of information. The 2014 Fiscal Transparency Code elaborates on this further (IMF 2014c).
- [Irwin, Timothy C., and Tanya Mokdad. 2010. *Managing Contingent Liabilities in Public-Private Partnerships: Practice in Australia, Chile, and South Africa*. Washington, DC: World Bank.](#) Describes the approach in the State of Victoria, Australia, Chile, and South Africa, to approvals analysis, and reporting of contingent liabilities (and other fiscal obligations) under PPP projects, and draws lessons for other countries.
- [Irwin, Timothy C. 2007. *Government Guarantees: Allocating and Valuing Risk in Privately Financed Infrastructure Projects*. Directions in Development. Washington, DC: World Bank.](#) Covers topics relating to fiscal impacts of PPP projects and provides frameworks to guide policymakers. Offers lessons learned in managing liabilities, direct or contingent, and case studies.
- [Liu, Lili, and Juan Pradelli. 2012. "Financing Infrastructure and Monitoring Fiscal Risks at the Subnational Level." Policy Research Working Paper 6069. Washington, DC: World Bank.](#) Proposes a more rigorous monitoring framework of fiscal risks imposed by PPP debt by using a minimum set of five subnational debt indicators which also considers the SPV's debt.
- [Posner, Paul L., Shin Kue Ryu, and Ann Tkachenko. 2009. "Public-Private Partnerships: The relevance of budgeting." *OECD Journal on Budgeting* 2009 \(1\).](#) Examines the budgetary treatment and issues raised by PPPs. Reviews the unique budgetary and accounting issues posed by privately financed capital services.
- [WB. 2012a. *Best Practices in Public-Private Partnerships Financing in Latin America: The Role of Subsidy Mechanisms*. Washington, DC: World Bank.](#) Provides a framework for why subsidies are sometimes needed for PPPs. The report includes case studies of PPP subsidy programs in Brazil, Colombia, Mexico, and India.
- [Cebotari, Aliona. 2008. "Contingent Liabilities: Issues and Practice." IMF Working Paper WP/08/245. Washington, DC: International Monetary Fund.](#) A seminal paper on managing contingent liabilities, including to PPP projects. Includes case studies to illustrate management challenges and practices from different countries and issues. Case studies also highlight best practices.
- [Kim, Jay-Hyung, Jungwook Kim, Sunghwan Shin, and Seung-yeon Lee. 2011. *Public-Private Partnership Infrastructure Projects: Case Studies from the Republic of Korea. Volume 1, Institutional Arrangements and Performance*. Manila: Asian Development Bank.](#) Reviews the PPP program in Korea, including case studies of BTO and BTL PPP projects.
- [IMF. 2014b. *Government Finance Statistics Manual 2014*. Washington, DC: International Monetary Fund.](#) IMF guidelines on how to report government fiscal statistics.
- [OECD. 2015a. *Recommendation of the Council for Budgetary Governance*. Paris: Organisation for Economic Co-operation and Development.](#) A tool designed to help countries to increase transparency in their budget process, based on best practices.
- [Akitoby, Bernardin, Richard Hemming, and Gerd Schwartz. 2007. "Public investment and public-private partnerships." *Economic Issues* 40, Washington, DC: International Monetary Fund.](#) A short booklet describing the implications of PPPs for public investment, including how PPP commitments should be managed and controlled.
- [ZA. 2004a. *Public Private Partnership Manual*. Pretoria: South African Government, National Treasury.](#) Module 4, Part 6: "Demonstrate Affordability" describes the methodology and requirements to demonstrate affordability of a PPP project.
- [VIC. 2016. *Partnership Victoria Requirements*. Melbourne, Australia: State of Victoria, Department of Treasury and Finance.](#) These PPP guidelines set out the objectives, principles, and processes for the PPP program in the State of Victoria, Australia. The guidelines highlight the need for a comprehensive test of affordability for the project before project is considered.
- [CO. 1998. *Ley 448 de 1998*. Bogotá: Congreso de Colombia.](#) Establishes the Contingent Liabilities Fund, defines where the resources will come from, states how its operative costs will be covered, and

describes how it will monitor the contingent liabilities throughout the duration of the project.

- [PE. 2014. *Ley No. 30167: Ley que Modifica el Decreto Legislativo 1012*. Lima: Presidente de la Republica del Peru.](#) Sets out the entire PPP process (from appraisal to tendering and the implementing the contract), and it also defines the institutional framework for PPPs in infrastructure—this includes defining the role of the Ministry of Finance and the PPP promotion Agency Proinversion).
- [BR. 2004. *Lei No. 11.079 de 30 de dezembro de 2004*. Brasília: Presidência da República, Casa Civil.](#) Sets out the tendering process and assigns roles for the Ministry of Finance, the Ministry of Planning, and establishes the Federal PPP Management Council. The law also sets the limits of the government's financial commitments.
- [SP. 2004a. *Lei No. 11.688 de 19 de maio de 2004*. São Paulo: Governo do Estado de São Paulo.](#) Establishes how the CPP is funded, its composition, organizational structure, and its role.
- [SP. 2004b. *Decreto No. 48.867 de 10 de agosto de 2004*. São Paulo: Governo do Estado de São Paulo.](#)
- Defines in detail the specific duties of the CPP, including the management of the CPP fund.
- [KR. 2011. *Basic Plan for Public Private Partnerships*. Seoul: Korea Development Institute, PIMAC.](#) Sets the PPP policy, identifies the areas of PPP project development, and specifies the legal framework governing the PPP procurement process.
- [IFAC. 2011. "IPSAS 32 - Service Concession Arrangements: Grantor." Including amendments issued up to January 15, 2013. New York: International Federation of Accountants.](#) Sets out the accounting requirements for the government party to a PPP contract. Specifies when and how PPP assets and liabilities should be recognized as assets and liabilities of the government.
- [IFAC. Accessed March 7, 2017. "International Federation of Accountants website."](#) Sets out the accounting requirements for the government party to a PPP contract. Specifies when and how PPP assets and liabilities should be recognized as assets and liabilities of the government.
- [CL. 2016. *Informe de Pasivos Contingentes 2016*. Santiago: Gobierno de Chile, Ministerio de Hacienda, Dirección de Presupuestos.](#) Describes the conceptual framework for assessing contingent liabilities and the government's contingent liability exposure in the given year. This includes quantitative information (maximum value and expected cost) on government guarantees to PPPs.
- [EPEC. 2010. *Eurostat Treatment of Public-Private Partnerships: Purposes, Methodology and Recent Trends*. Luxembourg: European Investment Bank, European PPP Expertise Centre.](#) Clarifies the process for determining the impact of PPPs on government debt and deficit, for EU countries.
- [IMF and WB. 2016. *PPP Fiscal Risk Assessment Model \(PFRAM\)*. Washington, DC: International Monetary Fund and World Bank.](#) Evaluates the fiscal impact of PPPs and allows users to identify and assess their fiscal risks, and corresponding mitigation strategy.

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