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

Key References

Public Financial Management for PPPs

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