INFRASTRUCTURE

Quick Reads on InfraFinance

FISCAL RISK IN PPPs

DEFINING THE PROBLEM

Public-Private Partnerships (PPPs) can sometimes be perceived as a means for delivering infrastructure for free. A more nuanced view is that they are a mechanism to overcome fiscal constraints, a tool to realize public investments—especially large public infrastructure—when the government does not have the resources to implement these projects on budget. Some argue, and perhaps rightly so, that often governments enter PPP contracts without fully understanding their fiscal implications or impact.

How so?

- Since long-term contracts postpone payment obligations and spread them over very long periods, the fiscal consequences of PPPs are often overlooked in the short term.
- The full fiscal implications of PPPs become clear only once PPP-related payment obligations—from firm or contingent liabilities—affect the budget during operation.
- For countries that lack a long-term perspective on public finances, PPP projects may look attractive and affordable due to their delayed impact on the budget.

These misconceptions lead to several challenges. There is evidence to show that fiscal sustainability is often overlooked or ignored by countries with PPP programs with long-term fiscal implications the governments did not understand or manage well. Governments also struggle with perceptions that they are not fully transparent about the real, ultimate costs of PPP projects. This is especially true in cases where there is no systematic assessment of fiscal implications or impact.

Within the World Bank, the Infrastructure Finance, PPPs & Guarantees (IPG) Group helps governments achieve sustainable infrastructure investment through crowding-in the private sector, with particular attention to limiting fiscal risks. We are at the forefront of this very important work.

Why do we need to get PPPs right?

PPPs—if done for the right reasons and if managed well—can help to improve the efficiency of public investment because the private sector can help execute projects on time and on budget in addition to bringing efficiencies and innovative solutions to public service delivery. Governments need every tool in the infrastructure finance toolbox to meet the needs of their citizens and to achieve the Sustainable Development Goals. But it is critical the tools are used well and responsibly. This is not always straightforward and often requires a balancing act.

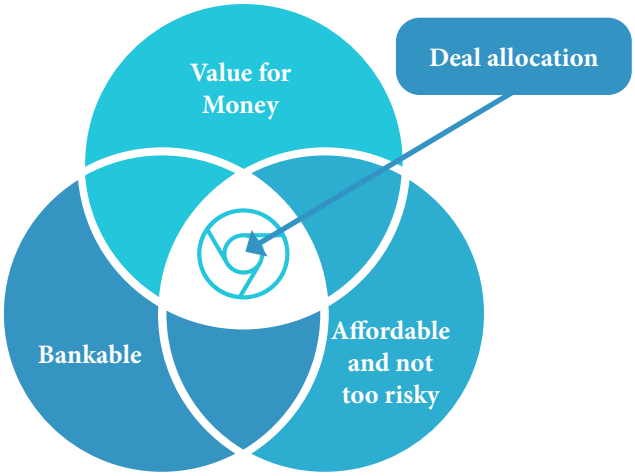
How *do* we achieve this balance?

The key element to achieve this balance is through the risk allocation in a project, which involves the distribution of risk among the contracting parties. A good source guide on this topic is the Risk Allocation Tool developed by the Global Infrastructure Hub, which can help governments and other stakeholders make appropriate allocation of project risks in a given PPP project, as well as identify potential risk mitigation measures.

There are additional tools and reference sources highlighted below that are also very useful while structuring PPPs. Section 3.3 of the World Bank's PPP Reference Guide discusses the main project risks and how to mitigate them during the structuring process. Additional resources are listed at the end of this *Quick Read.*

Essentially, most agree that an ideal risk allocation for a project accomplishes the following:

- Provides value for money
- Is affordable, with an acceptable level of fiscal risk
- Is bankable—that is, likely to attract private investors to provide financing



Introducing PFRAM 2.0

The International Monetary Fund (IMF) and the World Bank have updated an important tool to help governments assess fiscal costs and risks arising from PPPs: the Public-Private Partnership Fiscal Risk Assessment Model (PFRAM) 2.0. The tool goes further to help governments manage PPPs proactively—so that identified risks are allocated, managed, and priced correctly—and, ideally, so that they don't materialize. PFRAM has been in use since 2016 as part of IMF and World Bank technical assistance and has also been used by developing-country authorities working on these issues. Version 2.0 incorporates feedback from developers and users, is easier to understand by non-PPP experts, and extends the tool's coverage and functionalities.

Can PFRAM assess any kind of PPP project?

Almost. The tool is designed to accommodate PPP projects where the private partner invests in an asset used for delivering a public service. The asset is fully or partly delivered by the private partner and the government, the user, or both pay. This includes physical infrastructure, such as roads or airports, and social infrastructure, like hospitals or schools. PFRAM 2.0 can be used for both greenfield (started from scratch) and brownfield (modified or upgraded) projects as well as projects that are either in the concept stage or existing ones. If there are information gaps, users can make assumptions about missing data and discuss the potential fiscal implications of alternative scenarios.

The tool can assess the most common and straightforward type of PPPs, namely, projects that include the asset creation and delivery of services in one contract—and have a fixed term. There are some exceptions that PFRAM 2.0 cannot assess, however. For example, specific power purchase agreements (PPAs) that do not involve the transfer of assets to the contracting authority. PFRAM 2.0 is also not suitable for assessing contracts with a flexible duration, where the interest rate and the financing cost cannot be calculated.

What information do we need to begin the assessment?

PFRAM 2.0 requires a minimum set of information on the project, including:

- Contract parameters—when does the contract start and end?
- Funding—who pays for the service?
- Financing—how will the investment be financed? What portion will be financed by debt and equity?
- Asset details—what is the value of the total investment, the length of the construction period, and its expected useful life?
- Service to be provided—what is the demand? Price per unit?
- Cost—what are the maintenance and operation costs?
- Guarantees, if they exist—does the government provide any debt or minimum revenue guarantee?

Cool fact: PFRAM 2.0 records information on a project-by-project basis, but one file can assess the fiscal impacts of up to 30 projects, with up to 10 assets and revenue streams per project. Even these limits can be modified, but hardware requirements to run the model will be higher.

We're considering this small project. Should we bother?

Yes, we strongly recommend preparing the risk matrix in all cases. It is important to go through this assessment to avoid the pitfalls mentioned earlier. But keep in mind: for most individual projects, the fiscal implications as a percentage of GDP will be very small (except in the case of a very big project in a country with a small GDP). The fiscal implications will be bigger when a program of projects is being assessed. And indeed, a holistic, programmatic approach to managing PPPs is best practice.

So, if we just use PFRAM, all our PPP risk issues will be solved?

No, certainly not. While PFRAM is an essential tool for structuring PPPs, there's a lot that PFRAM 2.0 *can't* do, such as:

Justify a project's economic or social relevance. PFRAM 2.0 does not help assess whether a project should be considered for implementation or whether decisions should be made based on a rigorous project appraisal, which is part of a comprehensive public investment management process. Indeed, PFRAM 2.0 does not replace a comprehensive project assessment, nor does it constitute a cost-benefit analysis. It does not assess the quality or relevance of a project or help prioritize a group of projects.

Ascertain a project procurement option (PPP versus publicly financed investment). PFRAM 2.0 looks at the fiscal implications of a project when carried out as a PPP. It does not look at the implications of the same project being carried out with public financing.

Substitute for a complete financial project evaluation. PFRAM 2.0 does not assess project viability, which is usually done by means of a comprehensive business plan that includes a detailed financial model. PFRAM 2.0 provides some high-level presentations of the financial flows for the project company. However these are not meant to replace the financial model.

A few words on contingent liabilities

PFRAM 2.0 estimates the potential fiscal impact of contingent liabilities related to PPPs—namely, debt, equity and debt, and minimum revenue guarantees. These contingent liabilities can turn into fiscal costs and must be taken into consideration. For example, a debtor may not service the debt guaranteed by the government, or actual demand for the project may be much lower than forecast at the time of contract awarding. PFRAM 2.0 estimates the fiscal impact under the worst-case scenario to incentivize prudent management of PPPs.

What standards apply when assessing fiscal impacts?

PFRAM 2.0 assesses the fiscal implications of PPPs in line with International Public Sector Accounting Standards (IPSAS), the IMF's Government Finance Statistics Manual 2014 (GFSM 2014), and the Public Sector Debt Statistics 2012 (PSDS 2012).

Let's say we do the assessment. Then what?

PFRAM 2.0 delivers standardized information and summary reports, allowing users to follow the implementation of projects over time and throughout the project cycle. It also allows users to make comparable assessments across projects.

We expect the assessment to facilitate communication and discussion about projects among different levels and parts of government. This is because PFRAM 2.0 generates information about the impacts on the government's deficit and gross debt—in addition to information about the net worth of:

- individual PPPs, such as a power plants
- a specific set of projects, such as in the transport sector
- the overall PPP portfolio, including transport, energy, water and sanitation, health, education, and other sectors

Results are generated automatically and presented in standardized tables and graphs that can be used for fruitful conversations, even with non-PPP analysts.

Where can I learn more?

In addition to PFRAM 2.0, the World Bank's PPP Refence Guide, and the Global Infrastructure Hub's PPP Risk Allocation Tool already mentioned, the preeminent PPP Certification Program and Guide can be downloaded from https://ppp-certification.com/ and the World Bank's e-learning on Infrastructure, PPPs, and Fiscal Management is at https://olc.worldbank.org/content/infrastructure-public-private-partnerships-and-fiscal-management-self-paced.

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This Quick Read is produced by IPG's Infrastructure Programs and Analytics Unit, led by Fatouma Toure Ibrahima. The unit brings together IPG's infrastructure analytics with its three global programs—the Global Infrastructure Facility (GIF), the Public-Private Infrastructure Advisory Facility (PPIAF), and the Quality Infrastructure Investment Partnership (QII).

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