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# Managing The Fiscal Implications Of Public-Private Partnerships In A Sustainable And Resilient Manner

## A Compendium of Good Practices and Lessons Learned from the COVID-19 Pandemic

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## PREFACE

Public-private partnerships (PPPs) can sometimes be perceived as a means for delivering infrastructure for free. A more nuanced but still inexact view is that they are a mechanism to overcome fiscal constraints. Some argue, perhaps rightly, that often governments enter PPP contracts without fully understanding their fiscal implications.

These misconceptions lead to several challenges. There is evidence 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 the impact of PPPs. Although the full extent of the fiscal commitments and contingent liabilities (FCCL) exposure caused by COVID-19 on PPPs is unclear, evidence from an analysis of the post-1997 Asian crisis has revealed that if countries such as the Republic of Korea had had better fiscal risk management frameworks in place on PPPs, they would have been better prepared to deal with the exacerbated impacts of the crisis when PPP contingent liabilities transformed into immediate obligations. It is likely that the ongoing COVID-19 impact on the economy will have similar effects—countries may need to step in to address existing FCCL, while getting ready to intelligently support new investments to boost a sustainable post-COVID-19 recovery.

In this context, this report aims to illustrate how to improve fiscal risk management and treatment of FCCL arising from PPP projects, to build better Infrastructure post-COVID-19. It intends to be a resource for World Bank client countries, including low income and fragile economies, to design their fiscal PPP management frameworks in a viable way that helps them develop their PPP programs while maintaining medium-to-long-term fiscal sustainability and resilience. With that in mind, Volume I highlights and contextualizes the main findings from a set of case studies that assessed the PPP fiscal risk management framework in select countries, and synthesizes the observable and qualitative results in managing the impact of crises, in particular the COVID-19 pandemic. Based on that, it also explores how this crisis has affected PPP projects and overall PPP programs, and suggests improvements to FCCL management frameworks in order to strengthen the capacity of countries to continue with their PPP programs in a sustainable fiscal manner. Volume II contains the detailed case studies on which Volume I is based.

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# EXECUTIVE SUMMARY



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## RATIONALE

This report aims to guide and inspire governments in the efficient and effective management of the fiscal exposure arising from public-private partnerships (PPPs). Thus, the report targets primarily ministries of finance throughout the world and, where applicable, PPP units. It seeks to strengthen fiscal management of PPPs as an integral part of a country's overall PPP framework, in order to address the need for suitable and adaptive government support to PPP projects, while taking into account prevailing market circumstances.

The PPP concept, originating from ancient times as an alternative mechanism to deliver and manage public infrastructure by deploying private capital and expertise, has gained substantial traction in the past three to four decades. PPPs can sometimes be perceived as a means for delivering infrastructure for free. A more nuanced but still inexact view is that they are a mechanism to overcome fiscal constraints. The primary reason for pursuing PPPs should be to achieve value for money (VfM) in terms of improved infrastructure at lower costs to society. On average, the use of PPPs has enabled countries to accelerate infrastructure investments and deliver projects more effectively and services more efficiently.

The misconceptions about PPPs lead to several challenges. For PPPs to be effective in terms of value for money, governments need to ensure that the projects are thoroughly prepared, competitively tendered, and, to the extent necessary, supported by the governments through co-financing and/or other means that ensure bankability. Such support needs to be duly structured to meet the requirements of investors and lenders that are driven by project-specific features and prevailing market circumstances, and duly managed to ensure fiscal sustainability. Structuring a PPP arrangement requires a careful and adaptive balancing of its bankability, affordability and value for money. Recognizing the complexity of this challenge, many governments have adopted PPP frameworks with a set of rules, decision criteria and institutional responsibilities to select, prepare and manage PPP projects, in order to minimize the risk of failure. Such frameworks help standardize proceedings, to enhance process efficiency and provide appropriate governance mechanisms to ensure quality and effectiveness.

The management of fiscal exposure is a critical element of such a framework. This refers specifically to the management of fiscal commitments and contingent liabilities (FCCL) in relation to PPP projects. That element is critical because the absence of an appropriate FCCL framework will expose a government to the risk of fiscal shocks. There is evidence to show that fiscal sustainability is often overlooked or ignored by countries with PPP programs, with long-term fiscal implications that 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 the impact of PPPs.

Consequently, governments are advised to include in their PPP frameworks a fiscal management framework (FMF), which refers to a set of rules and/or procedures to control a government's aggregated fiscal exposure to PPPs throughout the PPP life cycle. Other names used for this include fiscal commitment and contingent liabilities framework, fiscal commitments framework, or public financial management for PPPs. These terms can be used interchangeably.

Fiscal management of PPPs needs to be resilient in order to withstand unexpected conditions. Although the full extent of the fiscal exposure caused by COVID-19 on PPPs is unclear, evidence from the post-1997 Asian crisis analysis has revealed that if countries such as the Republic of Korea had had better fiscal risk management frameworks in place for PPPs, they would have been better prepared to deal with the exacerbated impacts of the crisis when PPP contingent liabilities transformed into immediate obligations. More recently, during the financial crisis in Europe in the mid-2000s, countries faced the fiscal implications of their PPP projects, with Portugal and Hungary placing a moratorium on new PPPs and reviewing existing ones. Portugal's crisis was exacerbated by the fact that the government had to make substantial payments to PPP companies as a result of large fiscal commitments to these companies made before the crisis. Additionally, the UK slashed its "Building Schools for the Future" private finance initiative (PFI)/PPP program and is reviewing its PPP policy. The crisis led to the materialization of some of the FCCL risks associated with PPPs—in some cases, risk allocated to the private partner bounced back to the government—and has accentuated the need for further fiscal support to enable PPP deals. The impact of the current global crisis on the financial sector, and subsequently on the PPP market, has emphasized the increased need for government direct and contingent support to enable the closing of PPP deals, consequently highlighting the importance of sustainable and resilient FCCL management. It is thus likely that the ongoing COVID-19 impact on the economy will have similar effects as previous crisis—countries may need to step in to address existing FCCL, while preparing to intelligently support new investments to boost a sustainable post-COVID-19 recovery.

## APPROACH

To manage these fiscal risks and avoid such unanticipated fiscal shocks, development finance institutions led by the World Bank and other international organizations such as the International Monetary Fund (IMF) have been providing ample guidance on the subject. Most notably, the 2006 IMF publication *Public-Private Partnerships, Government Guarantees, and Fiscal Risk* and the 2014 Operational Note from the World Bank on *Implementing a Framework for Managing Fiscal Commitments from Public Private Partnerships* have introduced the main principles of appropriate FCCL frameworks and have been frequently used as a starting point for designing such frameworks. However, these publications provided primarily a theoretical concept, encouraging governments to incorporate these principles in their PPP frameworks. The remaining question is to what extent these principles have proven to be effective and practical. And although the world has been suffering the impact of the COVID-19 pandemic, the situation has also provided an opportunity to test fiscal resilience to economic and social shocks. The World Bank has therefore taken the initiative to review the sustainability and resilience of FCCL frameworks in 10 selected cases in order to identify good practices and common denominators to confirm the suitability and practicality of these main principles.<sup>1</sup> The findings are not a benchmark reflecting the comparative quality of the FCCL frameworks in the respective cases, though; they are consolidated merely for inspiration and for guidance on strengthening countries' fiscal management frameworks.

The cases have been selected to represent a variety of economies and legal and administrative systems. The only criteria applied were a minimum (though varying) level of PPP maturity and a relevant PPP portfolio, in order to assess the practicality of the FCCL framework. The consequent selection includes Chile (CHL), Georgia (GEO), Jordan (JOR), Kenya (KEN), the Philippines (PHL), Peru (PER), South Africa (ZAF), Türkiye (TUR) and the provinces of Victoria (VIC) in Australia and Sindh (SIN) in Pakistan.




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<sup>1</sup> The review took place in the course of calendar year 2021.

## OVERVIEW

Good practices have been identified in applying the main principles underlying an effective FCCL framework. The table below summarizes the best practices generally acknowledged by the main development partners and the cases where the respective operationalization can be considered optimal.

**Table 1. Application of Rules for Sound Management of Fiscal Commitments**

		 Good Practice				 To Some Extent				 Absent or Negligible			
#	Principles	AUS	CHL	GEO	JOR	KEN	SIN	PHL	PER	ZAF	TUR		
<b>ANALYSIS: Identifying and quantifying fiscal commitments</b>													
1	Methodological guidance is in place to quantify fiscal impact												
2	Tools are in place to assess the potential fiscal costs and risks												
<b>CONTROL: Assessing affordability as an input to approval</b>													
3	Fiscal impact is evaluated by central budget authority throughout the PPP life cycle												
4	Value for money is considered to warrant fiscal commitments												
5	Thresholds have been defined to cap fiscal exposure from PPPs												
<b>BUDGET: Ensuring funding is available for fiscal commitments</b>													
6	Mechanisms are in place to plan and ensure funding is available for direct liabilities												
7	Mechanisms are in place to plan and ensure funding is available for contingent liabilities												
<b>REPORT: Accounting, monitoring and disclosure</b>													
8	Fiscal commitments are adequately accounted for and documented in a consolidated manner												
9	The legislature and other stakeholders are periodically informed of the jurisdiction's fiscal exposure from PPPs												
10	Periodic audits are undertaken to confirm reliability and compliance of fiscal exposure												
11	Fiscal management proceedings apply to all agencies that are under direct or indirect control of the government												

## PERFORMANCE UNDER CRISIS

The COVID-19 pandemic has provided an opportunity to assess the adaptability of the PPP frameworks and the resilience of the inherent fiscal management and identify good practices. COVID-19 has impacted global economies substantially, including, to some extent, PPP arrangements under preparation or under implementation. Considering the country examples and their responses to address COVID-19-related implications, but also their responses to previous crises, some key policies can be identified, highlighting that PPP crisis responses are carried out through the PPP framework as a whole and not specifically through the FCCL framework:

- Revisiting existing PPP policies and investment strategies
- Modifying and reviewing legal and regulatory settings
- Changing the institutional settings, with a clear focus on ministry of finance (MOF) roles and responsibilities<sup>2</sup>
- Focusing the FCCL management policies and strategies on risk response and mitigation actions
- Reviewing the pipeline development process, including project preparation, procurement, and financial closure
- Modifying contracts for existing projects to address the challenges (establishment of dialogue, contract amendments, and additional support actions) and sector specific actions for healthcare, transport and energy sectors, with the objective of avoiding renegotiations when possible, and if unavoidable, ensuring contractual provisions and gatekeeping proceedings are in place to sustain value for money and fiscal affordability.

The following table summarizes some of the selected country activities and strategies for these categories.

**Table 2. Activities and Strategies**

1. Revisiting the existing PPP policies and investment strategies	
Peru	With a growing PPP program, a prioritization of projects has been observed. In a series of emergency decrees, 52 projects were exempted from complying with certain guidelines. Likewise, in earlier years, the government declared 42 projects as being of national interest and authorized the expropriation needed for their execution. Additionally, 10 more projects were declared as being of national interest and were given priority in terms of budget allocations. The additional measures implemented by the government as a result of COVID-19 extend the previous measures to current PPP projects. In this sense, only the PPP projects originated by the national government, and that fall into the following categories, can take advantage of the previous measures defined in the emergency decree (No. 019-2019): (i) PPPs in the contract execution stage, (ii) PPPs that have already won the contract, or (iii) PPP projects that are planned to be awarded within the following three years.
Türkiye	Several actions have taken place to avoid the negative outcomes of two crises—COVID-19 and Turkish lira devaluation. These actions include policy changes in pipeline development; close collaboration with the Ministry of Treasury and Finance (MoTF) and other central public agencies; effective FCCL management actions; and continuing to limit fiscal risks, as well as supporting PPP projects for their risk-related losses.
2. Modifications and reviews of the legal and regulatory settings	
Jordan	Overall, the central government’s fiscal deficit (including grants and the use of cash) widened to 4 percent of gross domestic product (GDP) during the first five months of 2020, almost twice as high as during the same period in 2019. The sharp deterioration in government finances, together with

<sup>2</sup> The current crisis also increased MOF awareness and understanding of what might happen with fiscal risk at a political level, should a similar disruption occur again.

	<p>the slowdown in economic growth, has elevated levels of public debt in the central government to 105.3 percent of forecasted GDP at the end of May 2020. Most recently, in March 2021, the IMF concluded that Jordan’s IMF-supported program remains firmly on track, with strong progress on key reforms. The program will continue to provide flexibility to accommodate higher-than-expected COVID-19-related spending and protect the most vulnerable. It was reiterated that it is necessary to: strengthen debt sustainability, enhancing the efficiency of public spending; fully implement the new PPP Law to ensure effective selection and execution of viable projects in line with national priorities; and closely monitor contingent liabilities.</p>
Philippines	<p>The lessons learned in the Philippine PPP market during the Asian financial crisis serve as a warning about what could go wrong if fiscal commitments and contingent liabilities are not properly assessed, managed and reported. The regulatory system is mature and sound enough to respond to the risks in the country when the COVID-19 impact is assessed. The strong and robust project development and advanced and detailed analysis performed during the approval cycles, which created a sound project cost-risk assessment for performance under crisis, are observed also in the legal and regulatory settings.</p>
<p><b>3. Changes in the institutional settings, with a clear focus on the MOF roles and responsibilities</b></p>	
Philippines	<p>In 2020, the Philippines participated in the World Bank’s COVID-19 PPP Rapid Response Umbrella Program, with a focus on (i) studying high- and portfolio-level fiscal implications of COVID-19 on selected PPP projects (led by the MOF), and (ii) bringing global best practices on adjusting requirements for infrastructure contracts as a result of the pandemic (led by the National Economic and Development Authority [NEDA]). Both of these key areas are critical to strengthen the roles and responsibilities of the MOF and NEDA.</p>
Türkiye	<p>The MoTF continues to provide debt assumption to transport PPP projects. The current contingent liability stock due to committed debt assumptions has been closely monitored in aspects such as (i) project revenue payments, (ii) senior loan disbursements, and (iii) repayment realizations. In the contract modifications, the MoTF has also been involved in negotiations and has provided backstop oversight to healthcare projects for their re-structuring and contract management issues. The MoTF also continues to analyze the annual commitment limit specifications and provides policy advice in an intermediary role to international lenders, for originating PPP transactions and for restructuring existing financing and refinancing options.</p>
<p><b>4. Focusing the FCCL management policies and strategies</b></p>	
Australia	<p>The state of Victoria has demonstrated its capabilities regarding assessing risks that have the potential to derail the development of the PPP program, with 32 PPP projects totalling more than \$A30 billion contracted across a wide range of economic sectors, and four projects in the development stage. The Victorian government, through its “Investment Lifecycle and High Value High Risk Guidelines” published in December 2019, largely addressed PPP fiscal risks. Since March 2020, the Australian parliament has passed a series of additional standing appropriations and 2019-20 Appropriation Bills to fund COVID-19 response measures. In addition to funding agreed-upon measures, the additional 2019-20 Appropriation Bills increased the provisions.<sup>3</sup> COVID-19 policy proposals have been subject to the usual level of scrutiny, including in relation to the risks they create, although analyses have been done within a shorter time frame. Existing controls have not been identified as an impediment or delay to response implementation.<sup>4</sup></p>
Chile	<p>In response to the health emergency caused by the global pandemic, a Transitional Emergency Fund for COVID-19 was created to cover all kinds of related expenses. The fund has an initial contribution of US\$12 billion, and among other measures, it aims to support the recovery of the economy by promoting private investment through temporary tax incentives, regulatory</p>

<sup>3</sup> Additionally, the government decided to delay the 2020-21 Budget for five months (from May 12, 2020) due to the very high level of uncertainty over macroeconomic and fiscal forecasts and related challenges in formulating a new fiscal strategy post-COVID-19. At an operational level, existing processes and controls did not change during the crisis.

<sup>4</sup> OECD (Organisation for Economic Co-operation and Development). 2021. “Managing fiscal risks: Lessons from case studies of selected OECD countries.” OECD, Paris.

	simplicity, and speeding up of concessions investment. For instance, the ministries that execute resources from this fund for public investment or concession projects need to present a monthly report to the MOF to describe the status of the projects. <sup>5</sup>
Georgia	The COVID-19 crisis increased MOF awareness and understanding of what might happen with fiscal risk at a political level, should a similar disruption occur again. This includes better understanding of the role that the MOF plays in PPP/IPP decision making and approval processes, as well as future PPP policy setting from an FCCL perspective; the reaction of PPP projects to various external shocks is also clearer.
<b>5. Reviewing the pipeline development process</b>	
Kenya	The Public Debt Management Office within the National Treasury and Planning indicated <sup>6</sup> that the likely COVID-19 impact on PPP projects can include the following effects: diminished revenue collection; potentially large pay-outs; the possibility of bailouts of state-owned companies; sub-optimal reallocation of resources and reduced accountability; and institutional weakening post-COVID-19. The actual impact is yet to be assessed.
Philippines	The Philippine government ensured that the construction of PPP projects continued during COVID-19, thus supporting the move to open up the economy and bring in more jobs. Funding from the Duterte Government’s Build, Build, Build infrastructure plan has given new life to PPPs, and as of August 2020, there were 30 projects (out of 104 projects, or 29 percent) in the PPP pipeline. The key strategies to be implemented for the infrastructure sector in the Philippines were: (i) realign expenditure priorities in 2021 to provide more space for relevant health-related expenditures, and improve the digital infrastructure; (ii) conduct comprehensive vulnerability and risk assessment of critical infrastructure, particularly in areas considered to be COVID-19 hot spots; and (iii) construct or rehabilitate hospitals or designated quarantine holding facilities.
Türkiye	The transport PPP project developments are planned to continue in line with high-level transport planning and related to 2021 investment policies; the sub-sector master plans, project prioritization and infrastructure plans, and country-specific development targets are also aligned with PPP policies and incorporate demand forecasts and prioritizations post-COVID-19. Türkiye’s Health Transformation Program has targets to increase the number of city hospitals for the first time since 2019. Based on the experience gained through existing PPP projects in the sector, and a comparison with alternative models, it was decided that the next 10 city hospital projects, which were previously planned under PPP contracts, will instead use the public procurement method.
<b>6. Existing project contract modifications to address COVID-19 challenges</b>	
Chile	The measures taken by the government to contain COVID-19, such as reducing social mobility at the national and international levels, have had an impact on the Chilean concessions. In particular, the decrease in traffic demand has caused a reduction in the income received by the concessionaires. For instance, in concessions such as the Autopista Central, besides the decrease in traffic demand, the government took advantage of the situation to justify a decrease in the tariff level due to an off-peak tariff scheme interpretation. Although this case is now in being adjudicated by the courts, this event shows us the tip of the iceberg in what is shaping up to be a very difficult future for concessions. In fact, even in instances where the impact of COVID-19 on concessions has not been fully assessed, certain insights can be gleaned from this particular case—specifically, the low traffic demand was exacerbated by the decrease in the tariff level, decreasing the concessionaire’s annual income by 54 percent at its lowest point in June 2020.

<sup>5</sup> The recovery plan considers expediting the bidding and construction of 31 projects through the concession system, totalling an investment of US\$8.63 billion. For the period 2020-2022, the plan considers an investment of US\$4.15 billion in concession projects, while the pipeline of concession projects for the 2021-2025 period comes to 53 projects, and 37 of them represent an investment of US\$11.5 billion.

<sup>6</sup> Wafula, Ulwodi. 2020. “Managing Contingent Liabilities and PPPs in the Context of the COVID 19 Pandemic: the Case Study of Kenya.” Public Debt Management, National Treasury and Planning, September 22-23, 2020, slide 9. <https://www.cabri-sbo.org/uploads/files/Documents/Presentation-Dr-Ulwodi-Wafula.pdf>.

Peru	<p>The MOF established a channel through which the concessionaire of a PPP project can request compensation from the government for financial losses caused by the restrictive measures implemented in Peru (DS N ° 044-2020-PCM). The concessionaire needs to identify and show how the measures taken by the government generated an adverse effect on the financial performance of the project, and how the risk allocation established in the PPP contract makes the government the bearer of such risk (in cases where the government is in charge, at least partially, of the risk). The concessionaire must propose a way to fix the imbalance through a mechanism such as extension of the PPP term, monetary disbursement by the public entity, incremental increases to the toll rate, reduction of obligations, etc. Once the request is made by the concessionaire, the public entity must determine the best solution, whether by using the current contract to reconcile the differences or by amending the contract to include a different agreed-upon solution. In the first case, both parties renounce their rights to future litigations; in the second case, they must observe the process established by regulation RM N° 461-2017-EF/15.</p>
Türkiye	<p>In Türkiye, the years 2019 and 2020 were a full-test period for the country’s PPP projects, due to the national currency’s depreciation, followed by the pandemic. The operating PPP city hospitals had to become pandemic hospitals as well. In the first part of 2020, the COVID-19 circumstances further incentivized acceleration of these existing PPP healthcare transactions. In PPP airports, there has been a revenue payment deferral in contracts, whereby Türkiye provided airport operators with two-year extensions in operating periods and two-year lease deferrals as the general COVID-19 response policy. Moreover, the foreign-currency indexation frequency for unit price in motorway PPP contracts was changed from annually to semi-annually starting in 2019. Likewise, the minimum guarantee payments, which were designed to be realized annually, have been also modified to semi-annual instalments to increase the projects’ cash liquidity.</p>

### LESSONS LEARNED

Overall, the selected cases clearly demonstrate the need for management of fiscal commitments arising from PPPs. Most countries have either already operationalized these principles or are in the process of developing the rules and tools to implement them. When implementing these principles, a few important lessons can be learned.

- *An FCCL framework must be an integral part of the overall PPP framework.* It should not be developed in isolation and should be harmonized with the overall PPP framework. Governments may be tempted to address FCCL management as the exclusive responsibility of the ministry of finance, guided by regulations or guidelines that address the identification, quantification, control, accounting and monitoring of fiscal commitments arising from PPP arrangements. However, an effective PPP program requires a careful balancing of considerations with regard to bankability, value for money and affordability, which have to be duly addressed upon preparation and duly managed upon implementation. This balancing act requires a cohesive and consistent set of rules and decision criteria to address these considerations throughout the PPP life cycle, and also requires that an FCCL framework is an integral part of the overall PPP framework. For that integration to happen, there must be a shared understanding among all involved government agencies on an approach to PPPs in general and the related approach to their fiscal implications.
- *Capacity building is key to operationalization of FCCL management.* Whereas many countries have developed regulations or guidelines, often assisted by development partners and their advisors, these proceedings tend to remain largely theoretical and not used in practice because of government officials’ lagging understanding of how to apply the elements of the framework. A meaningful number of government officials need to be duly trained in applying the proceedings

and may even need to be supported through on-the-job assistance for a period of time. It cannot be expected that government officials will have the capacity to operationalize FCCL proceedings simply by adopting a set of regulations or guidelines, particularly given the intrinsic complexity of fiscal risk management. Moreover, the capacity building should not be limited to ministry of finance officials, and should include all relevant agencies involved in the identification, development, tendering and implementation of PPPs.

- *Political leadership must emphasize fiscal management.* It is tempting to pursue PPPs solely for the purpose of accelerating infrastructure investments and addressing public needs. Long-term sustainability demands that infrastructure investments be delivered in the most effective and efficient manner. PPPs may be the most suitable approach to achieve sustainability, but their use requires careful balancing of bankability, value for money and affordability. Governments should not ignore fiscal commitments in order to ensure bankability or accept PPP arrangements that do not appear to be more efficient than conventional delivery schemes. Countries' political leadership, including legislatures, should be instructed in the requirements for successful PPPs, and their greater knowledge and awareness should be followed by sensible and rational strategic guidance on the design and implementation of a PPP program.
- *Sophistication should be balanced with practicality.* Some of the cases have adopted state-of-the-art methodologies or tools for the quantification of value for money or the quantification of contingent liabilities. These approaches not only require a trained government apparatus to understand and apply them, but also often need a broad set of detailed assumptions to substantiate the corresponding assessments. In some cases, particularly considering the maturity and institutional capacities of the public authorities—while still working on building capacity—it may be more practical and more effective to initially use less sophisticated analytical tools, that are easier to understand and to apply, to support decision-making procedures with the appropriate reasoned analysis, i.e., qualitative considerations.
- *FCCL frameworks will strengthen control of fiscal risks but will not reduce fiscal impact from exogenous shocks.* It is important to recognize that, no matter the quality of an FCCL framework, the framework will not help to substantially reduce the fiscal implications of a crisis. Whether it is a currency crisis, an economic downturn or a pandemic, projects as well as businesses in general can be affected in terms of reduced revenues and/or increased costs. When this concerns essential services, governments may be required to provide financial or other kinds of support to ensure continuity while taking on the corresponding fiscal implications. An effective FCCL framework, ideally applied in close alignment with an effective PPP framework, can help governments to anticipate such contingencies and respond in a coordinated and structured manner, with a clear understanding of the fiscal implications. It provides governments with the necessary procedures and resources to act promptly in a transparent and accountable manner, but it does not make the potential fiscal impact disappear.

## RECOMMENDATIONS

The analysis of countries that have undergone crises has prompted several insights. One is that the process of reviewing and adjusting gatekeeping policies for the measures taken during project cycles for FCCL



management is of utmost importance. The key FCCL components are analysis, control, budgeting and reporting within a sound legal and institutional setting.

FCCL-related fiscal exposure needs careful assessment. As outlined in these principles, a clear responsibility within government for contingent liability management is a necessity, either as part of comprehensive government asset-liability management in the debt management offices, or in the budget office of the ministry of finance department that has a PPP mandate. The country's efforts need to be coupled with a clear fiscal risk management strategy, with the principles of setting fiscal risk targets and the separation of risk taking and risk appraisal functions. Moreover, there is also merit to the promotion of awareness of long-term fiscal costs and risks, both in local and central governments.

The key characteristics of a sound system for fiscal PPP commitments in managing fiscal policy are: widely available comprehensive and reliable information; open processes of budgeting; and accountability of policymakers for long-term fiscal risks and accuracy of fiscal information. A key recommendation for governments should be to use the identified FCCL Principles as a checklist:

- ANALYSIS: Identifying and quantifying fiscal commitments
  - *Methodological guidance for quantifying fiscal impact.* A duly authorized guideline can support a comprehensive, consistent, and accurate appraisal of the fiscal impact of a PPP, specifically for its contingent liabilities.
  - *Tools are in place to assess the potential fiscal costs and risks.* Spreadsheet-based applications, such as the PPP Fiscal Risk Assessment Model (PFRAM), can help to quantify the macro-fiscal implications of PPPs, understand the risks assumed by the government, and identify potential mitigation measures.
- CONTROL: Assessing affordability as an input to approval
  - *Fiscal impact is evaluated by a central budget authority throughout the PPP life cycle.* The fiscal impact is evaluated by a central budget authority (e.g., the Ministry of Finance), taking into account the level of development at initial project screening, before tender launch, before commercial close, and for any contract variations.
  - *VfM is the justification for fiscal commitments.* A regulatory requirement to assess value for money in a guided and consistent manner can support the decision making on the justification of any fiscal impact.
  - *Thresholds to cap fiscal exposure from PPPs.* A duly authorized ceiling, in terms of an overall liability limit (irrespective of the delivery scheme, i.e., debt including PPP fiscal commitments) provides a reference for the affordability of PPPs.
- BUDGET: Mechanisms in place to plan and ensure funding
  - *Ensure funding is planned and available for direct liabilities.* To provide comfort to the private partner and ensure bankability, as well as for the government to anticipate the known expenditures, mechanisms should be in place to allow the government to honor its financial obligations for the duration of the contract.
  - *Ensure funding is planned and available for contingent liabilities.* To provide comfort to the private partner and ensure bankability, as well as for the government to anticipate the unknown, mechanisms should be in place to ensure the government is able to fund contingent liabilities, should they materialize.
- REPORT: Accounting, monitoring and disclosure
  - *Fiscal commitments are adequately accounted and documented.* Appropriate accounting standards, such as International Public Sector Accounting Standards (IPSAS), are applied to

- determine whether and when PPP commitments should be recognized, and reflected as such in the financial statements.
- *The legislature and other stakeholders are periodically informed about PPP fiscal exposure.* A consolidated report encompassing all PPP projects, including their fiscal commitments (direct and contingent), progress and value for money, are appropriately disclosed to relevant stakeholders to facilitate oversight of the PPP program.
  - *Periodic audits are undertaken.* Regulatory and VfM audits by supreme audit entities can provide independent reviews of government finances and performance to parliaments and to the public, to confirm reliability and compliance of fiscal exposure.
  - *Fiscal management proceedings apply to all agencies.* To control and avoid unwarranted sub-sovereign fiscal exposure, the fiscal rules for PPPs should be applied to all levels of government.

Implementation of these fiscal policy principles requires additional safeguarding activities. These include adoption of improved tools, including the adoption of a multi-year timeframe for fiscal planning and forecasting, extending the coverage of the accounting system and ultimately also the budget system to cover all financial activities in line with the PPP portfolio.

# METHODOLOGY AND APPROACH



# METHODOLOGY AND APPROACH

## Objective: Guide the Enhancement of Fiscal Policies for PPPs

To support the aspiration of many countries around the world to use the public-private partnership (PPP) mechanism to deliver infrastructure and related services more effectively and efficiently, and in recognition of the need to ensure the fiscal sustainability of the commitments and risks arising from PPPs, it has been considered relevant and appropriate to provide further guidance on the management of fiscal commitments and contingent liabilities. This is particularly the case in view of COVID-19's implications for the development and performance of PPPs, and government responses to ensure ongoing bankability, affordability, and value for money from the use of PPPs.

The purpose of the study is therefore to evaluate fiscal risk management and the applications of PPP projects to build better infrastructure post-COVID-19. There are two specific objectives:

- Evaluate how the COVID-19 pandemic has affected PPP projects and the overall PPP program, and suggest improvements to the fiscal commitments and contingent liabilities (FCCL) management framework to strengthen the capacity of countries to continue with their PPP programs in a sustainable fiscal manner.
- Review the fiscal risk management framework in select cases, and synthesize the observable and qualitative results in managing the impact of crises.

This report builds on Timothy Irwin's publication, *Government Guarantees: Allocating and Valuing Risk in Privately Financed Infrastructure Projects*, released in 2007 by the World Bank, and the World Bank Working Paper on "Implementing a Framework for Managing Fiscal Commitments from Public Private Partnerships," published in 2014. These reports provided clear and comprehensive guidance on managing fiscal risks from PPPs during approval and implementation, based on a small sample of practices around the world. Other relevant sources were also consulted and are referenced throughout the report and detailed in the reference section. The contribution of this report is a more extensive sample of countries analyzed in terms of their FCCL frameworks and drawing lessons from government responses to COVID-19 that confirm the need for a sustainable and resilient framework that incorporates those recognized principles.

With that objective and context in mind, this report is divided into the two main parts that follow this chapter, which further describes the case selection and methodology. Part I of the report justifies the need for a sustainable and resilient fiscal management of PPPs. As explained in Chapter 1, adaptive government support is essential for successful PPPs, but this support needs to balance efficiency (value for money), bankability and fiscal affordability. Economic volatility particularly affects PPPs, as shown during the COVID-19 pandemic that will be the subject of Chapter 2. Part II then presents the approaches to sustainable and resilient fiscal management of PPPs based on the lessons learned from the conducted case studies. Chapter 3 describes the building blocks of an adequate FCCL framework, and the following chapters cover its main components: analysis (Chapter 4), control (Chapter 5), budgeting (Chapter 6) and accounting and reporting (Chapter 7). Chapter 8 concludes the report. Findings from the case studies have been used to inform the whole report, but for consistency purposes are brought in directly as concrete examples to illustrate the overall narrative. For further details on each of the cases, refer to Volume II, which contains the complete case studies along with a summary of each one.

## Case Selection Criteria to Ensure Diversity and Relevance

The study primarily draws on the experiences of 10 economies from all regions and different income groups that are at various stages of development of their FCCL frameworks and practices. In addition, a selective review of the infrastructure contingency fund in Colombia was performed for illustrative purposes without conducting a full-fledged country analysis. Countries with federalized political systems (Australia and Pakistan) were studied at the state level (Victoria state in Australia and Sindh province in Pakistan). The list of economies is presented in the table below. The review process and synthesis of the results took place during 2021.

**Table 3. Selected Cases**

Country / State*	Income Group	Region
Australia (Victoria state)	High income	EAP
Chile	High income	LAC
Philippines	Lower middle income	EAP
Pakistan (Sindh province)	Lower middle income	SAR
Kenya	Lower middle income	SSA
Georgia	Upper middle income	ECA
Türkiye	Upper middle income	ECA
Peru	Upper middle income	LAC
Jordan	Upper middle income	MENA
South Africa	Upper middle income	SSA

\*The infrastructure contingency fund in Colombia was reviewed separately without conducting a full country analysis.

Note: EAP = East Asia and Pacific; LAC = Latin America and the Caribbean, SAR = South Asia region; ECA = Europe and Central Asia; MENA = Middle East and North Africa; and SSA = Sub-Saharan Africa.

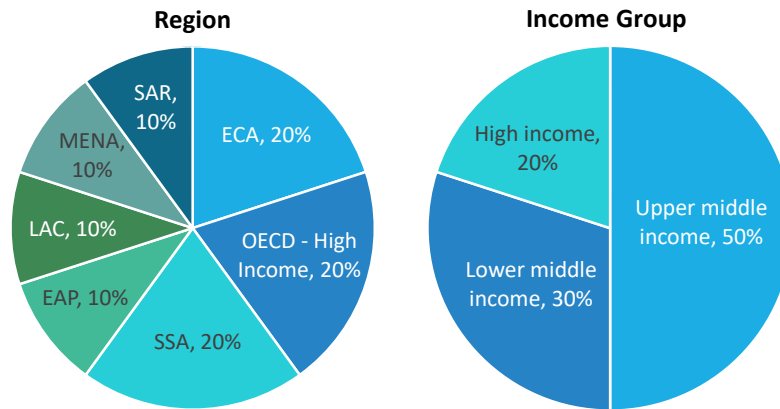
The main criteria used for country selections were:

- Regional and income group diversification
- Common law versus civil law jurisdictions
- Sovereign and sub-sovereign jurisdictions
- Varying levels of quality of PPP frameworks, as assessed by The Economist Intelligence Unit, using its Infrascope methodology that indicates readiness and conduciveness for PPPs
- Varying levels of development of FCCL frameworks, based on the data accumulated as part of the *Benchmarking Infrastructure Development 2020* (BID 2020) study
- Size of PPP program, as measured by number of projects and investment amounts relative to gross domestic product (GDP) in each economy.

### Regional and Economic Spread

The 10 selected economies allow for effective representation of various regions and income groups. The only income group that was not considered is the low-income group, because the PPP markets in these economies tend to be in a nascent stage, and their PPP frameworks, let alone management of fiscal commitments, are mostly not well advanced.

**Figure 1: Regional and Economic Spread of Selected Cases**



### Common Law Versus Civil Law Systems

The selected cases include both common and civil law systems. The nature of the legal system is relevant for the framing of the PPP framework and the related FCCL framework. Whereas civil law jurisdictions tend to regulate their PPP frameworks through the enactment of a PPP law and supporting implementing regulations, common law systems rely more on policy documents and guidance notes. Consequently, in the cases based on a common law system, such as Australia and South Africa, the description of the legal and regulatory framework will present the relevant policy documents and guidance notes, whereas in civil law jurisdictions, such as Chile, Peru and Georgia, the cases will highlight the legislative reforms implemented to facilitate PPPs. However, this distinction is not strict. There are common law countries such as Kenya that have adopted a PPP law, and there are civil law countries with a PPP program that did not adopt a PPP law.

### Varying Degrees of Capacity for PPPs

Because an FCCL framework is commonly part of a broader framework for the development and implementation of PPPs, it is relevant to also take into account the overall capacity for PPPs in the selected cases. The adequacy can be approximated through benchmarking exercises, as provided by the World Bank and the Economist Intelligence Unit.

The World Bank’s *Benchmarking Infrastructure Development 2020* (BID 2020) assesses the quality of regulatory frameworks worldwide to develop large infrastructure projects, benchmarking them with internationally recognized good practices, both for PPPs and for traditional public investments (TPIs). The PPP survey measures key characteristics of a regulatory framework applicable to PPPs at the different stages of a project cycle, including preparation, procurement, and contract management, with a special module on unsolicited proposals. Background information on the regulatory framework and institutional arrangements is also included in the report for contextual purposes. The assessment of the preparatory

stage includes several questions that are typically part of the FCCL framework, and is used as a proxy for quality of the FCCL framework. For more details, refer to <https://bpp.worldbank.org/>.

Since 2011, the Economist Intelligence Unit has evaluated the readiness and capacity of a jurisdiction with regard to PPPs using a methodology called Infrascopes. It evaluates key components of the PPP environment, including: (i) enabling laws and regulations, (ii) the institutional framework, (iii) operational maturity, (iv) investment and business climate, and (v) financing facilities. To date, 69 jurisdictions have been reviewed, with an average score of 57 on a scale of 0 to 100. Jurisdictions with a score of 80 and higher are considered mature; scores of 60 to 79 imply a developed PPP; and scores of 40 to 59, an emerging PPP market. Any score below 40 qualifies as a nascent PPP environment. The selected cases represent a mixture of mature, developed and emerging PPP markets.

Note that these scores are purely indicative and do not always reflect the latest state of the regulations and developments. In the case of Jordan, for example, *Benchmarking Infrastructure Development 2020* focuses on preparatory activities that take place prior to implementing a PPP project, ranking the country well below average, whereas Infrascopes rates the overall PPP environment as developed and above average.

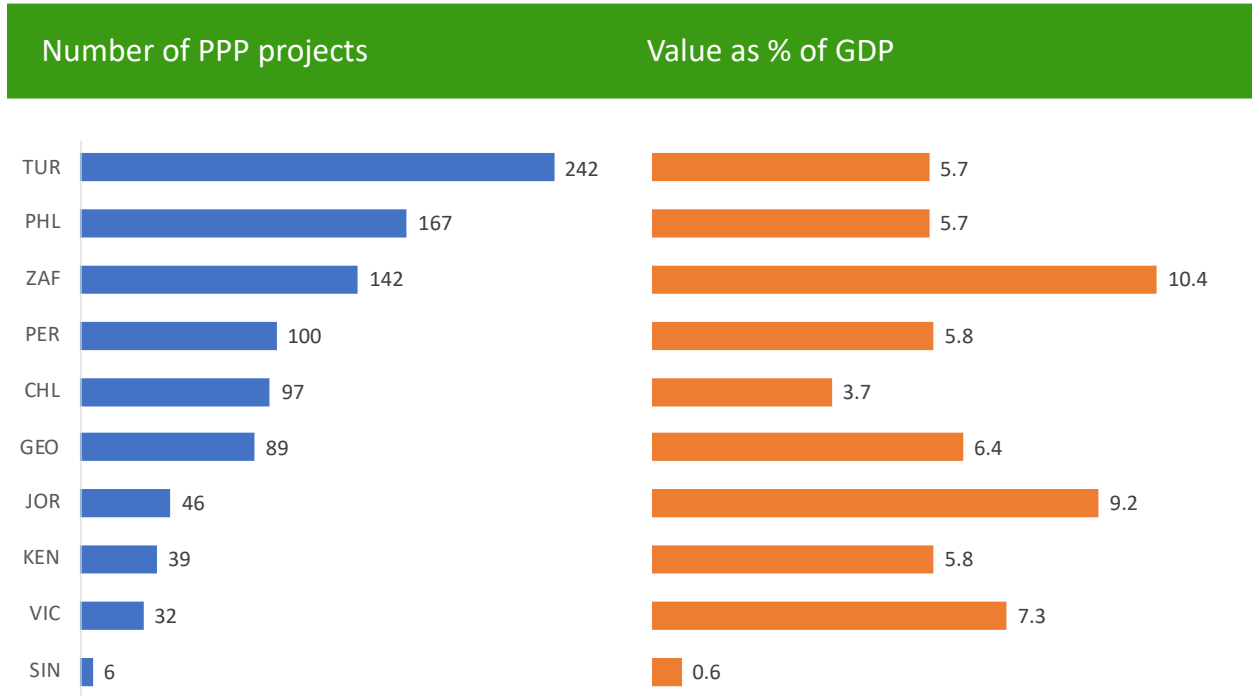
### Meaningful PPP Experience

It was important to select economies with meaningful PPP programs so they could, at least theoretically, have been exposed to fiscal risks related to PPP projects, and have either practical tools in place to manage those risks, or established FCCL frameworks. The intention was to identify cases with PPP programs that approximated a value of at least 5 percent of the size of the economy as measured by GDP.<sup>7</sup> The province of Sindh in Pakistan was added because it is a fairly established PPP market with an appropriate PPP framework, and its inclusion permitted an examination of the challenges of a sub-sovereign PPP jurisdiction. Chile was also included, even though the size of its PPP program in relation to GDP is less than that of its peers, because it is nevertheless quite substantial, and the Chilean approach to FCCL management is highly regarded worldwide.

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<sup>7</sup> The size of the economy reflects the 2019 GDP on a PPP basis, according to World Bank data.

Figure 2: Size of PPP Program in Selected Cases













Overview

The table below summarizes the relevant features of the selected country cases.

Table 4. Case Profiles

Case Selection										
Case										
Code	CHL	GEO	JOR	KEN	PER	PHL	ZAF	SIN	TUR	VIC
Jurisdiction <sup>1</sup>	C	C	C	C	C	C	C	P	C	S
Region	LAC	ECA	MENA	SSA	LAC	EAP	SSA	SA	ECA	EAP
Legal System <sup>2</sup>	CI	CI	CI	CO	CI	CI	CO	CO	CI	CO
GDP (PPP) (US\$, billions) <sup>3</sup>	512	58	106	238	436	1,006	763	76	2,347	343
Income Category <sup>4</sup>	H	UM	UM	LM	UM	LM	UM	LM	UM	H



Case Selection										
Case										
Code	CHL	GEO	JOR	KEN	PER	PHL	ZAF	SIN	TUR	VIC
PPP Preparation Benchmark <sup>5</sup>	44	65	19	50	78	79	76	55	37	87
PPP Readiness <sup>6</sup>	79	45	61	51	76	75	71	67	59	92
# PPP projects	97	89	46	39	100	167	142	6	242	32
PPP Investments (US\$, billions)	19.1	3.7	9.8	5.7	25.2	57.5	31.5	0.5	140.0	25.0
PPP Value as % of GDP	3.7	6.4	9.2	5.8	5.8	5.7	10.4	0.6	5.7	7.3

<sup>1</sup> C = Country, P = Province, S = State

<sup>2</sup> Cl = Civil Law, CO = Common Law

<sup>3</sup> World Bank, International Comparison Program database: GDP, PPP (current international \$)

<sup>4</sup> <https://datatopics.worldbank.org/world-development-indicators/the-world-by-income-and-region.html> (H = High, UM = Upper Middle, LM = Lower Middle)

<sup>5</sup> <https://bpp.worldbank.org> (country score in relation to global average score of 44; red = below average, and green = above average)

<sup>6</sup> <https://infrascope.eiu.com> (80-100 = mature, 60-79 = developed, 40-59 = emerging, and below 40 is nascent)

## Analysis Based on Desk Review and Authority Briefings

Cases were developed by using various sources of information, including public documents, questionnaires, and interviews. Data on the size of the PPP program, number of projects and investment amounts were collected by referring to several project databases, and information supplied by local counterparts, such as the ministry of finance, the national treasury, and the responsible PPP unit or agency, as well as their websites. The main databases used include:

- *World Bank Private Participation in Infrastructure (PPI) database*. The PPI database can be found at <http://www.ppi.worldbank.org/>. It records contractual arrangements for public infrastructure projects in low- and middle-income countries (as classified by the World Bank) that have reached financial close, in which private parties assume operating risks, across core infrastructure sectors of energy, transport, water, and information and communication technology (ICT). It classifies private infrastructure projects according to the following categories: management and lease contracts, brownfield projects, greenfield projects, and divestitures. The data are obtained from

publicly available sources, such as commercial news databases, industry publications, and government reports, and are reliant on the availability and accuracy of this source material (this can prevent coverage of small-scale projects due to lack of information). As a result, there may be some disparity between PPI database data and a country's PPP experience, depending on factors such as PPP definition, sectors, and project risk profile.

- *Infrastructure Journal (IJ) database*. The IJ database can be found at <https://ijglobal.com/data/search-transactions>. Principles used in data collection for the IJ database are like those used for the PPI database. However, the IJ database also covers social infrastructure, such as schools, hospitals, universities, and prisons. The universe of projects in the PPI and IJ databases overlap, yet certain projects can be found in one database but not the other. Therefore, using both provides a more comprehensive view of a country's PPP program, because the databases complement each other in a useful way.

In determining the number of projects, ICT projects of a purely commercial nature, such as cellular network licenses and the like, were excluded from the analysis due to not meeting the definition of PPPs.<sup>8</sup>

Information on the regulatory set-up of the FCCL framework in each economy was obtained from the local PPP laws and regulations and fiscal management-related rules and procedures. The team also consulted analytical reports issued by the international donor and expert community on FCCL topics where systems in different countries are analyzed, as well as analytical publications, news articles and other publicly available resources. Any missing information; data on the performance of PPP portfolios during COVID-19 and other crises; government responses to stress in terms of fiscal risk management; and insights were gathered through interactions with local decision-makers on PPP-related fiscal risk issues. These actors vary in each economy and might be officials at a PPP agency, ministry of finance or other responsible entity, depending on the economy. The present study is predominantly an analytical/qualitative review; however, simple quantitative analyses were performed where necessary to illustrate ideas from a quantitative perspective.

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<sup>8</sup> For the definition of PPPs, refer to the PPP Reference Guide, version 3: <https://openknowledge.worldbank.org/handle/10986/29052>.



**SETTING THE STAGE**





# 1 SETTING THE STAGE

## 1.1 PPPs can be an Effective and Efficient Mechanism to Improve Infrastructure

A country's infrastructure—the physical undergirding of its society—plays a large role in determining its long-term economic and social trajectory. High-quality infrastructure provides direct positive impacts, including higher efficiency, increased safety, decreased environmental impacts, and more effective delivery of public goods and services. Empirical evidence suggests that Infrastructure can be a catalyst for growth at a number of levels, but only if it is supported by a broader, stable institutional and regulatory environment.

It is widely acknowledged that the PPP concept provides opportunities to leverage the limited public resources typically available to improve infrastructure, in an efficient and effective manner. International experiences have demonstrated that such improvements can benefit from the use of PPPs in terms of: (i) timely and on-budget delivery of projects and reduced life cycle costs, and (ii) accelerating investments by shifting the financial burden to users or future budget appropriations, matching the effective period of service offerings (essentially moving from paying for assets to paying for services).

There is no one universally accepted definition of PPPs. The term can be used to describe very diverse contractual structures in which the public and private sectors collaborate. The World Bank Group (WBG) has its own definition that has been widely embraced: “A long-term contract between a private party and a government entity, for providing a public asset or service, in which the private party bears significant risk and management responsibility, and remuneration is linked to performance”.

If an investment is purely publicly financed, lack of know-how, experience and financing capacity can get in the way of the project's success, leading to potentially flawed design, inadequate maintenance, weak management, poor project selection, inadequate quality of service and/or value, and delays. In the case of a purely private project, the government cannot exercise any control over the design, nature, price, and quality of services. Also, importantly, due to the intrinsic economic nature of some infrastructure assets and related services, purely private provision at optimal levels of quality and quantity may be unattainable.

PPP contracts, and the financing agreements behind them, offer powerful tools that governments can use to leverage the private sector's knowledge, experience and financing, to improve the volume and quality of basic services provided to local populations. A firm that is responsible for later phases of an infrastructure project will be more inclined to make appropriate decisions at the outset of the project regarding its design and construction. Furthermore, firms engaged in PPPs will generally have less incentive to cut corners on construction costs, because the PPPs give the firms more “skin in the game,” encouraging better decision making.

## 1.2 Adaptive Government Support is Essential for Successful PPPs

One of the main axioms in economics states that “there is no such thing as a free lunch.” This applies also to PPPs. The cost of an infrastructure project must eventually be paid, either by the taxpayer or the user.



When firms are offering to pay the upfront costs of infrastructure investments, it can be easy to lose sight of this reality.

Moreover, most PPP arrangements are likely to have some form of fiscal impact, because without appropriate government support, they may not be bankable. For example, lenders may require that the government provide a minimum revenue guarantee to ensure that the project generates sufficient revenues to meet at least a substantial part of the debt service. On the other hand, with excessive government support, the value for money (in terms of more efficient project delivery due to the use of PPP) may be minimal. For example, if the government guarantees that the project will be able to meet its debt service through a debt payment guarantee, banks are less likely to assess the assumptions underlying the business case, or to diligently monitor the project's progress. Such acts of due diligence and monitoring by banks are critical drivers for delivering value for money, in terms of ensuring that a project is delivered on time and within budget, and meets the agreed performance levels. Notably, a priori, the project should deliver value to the people in terms of economic benefits outweighing costs, and contributing to development objectives.

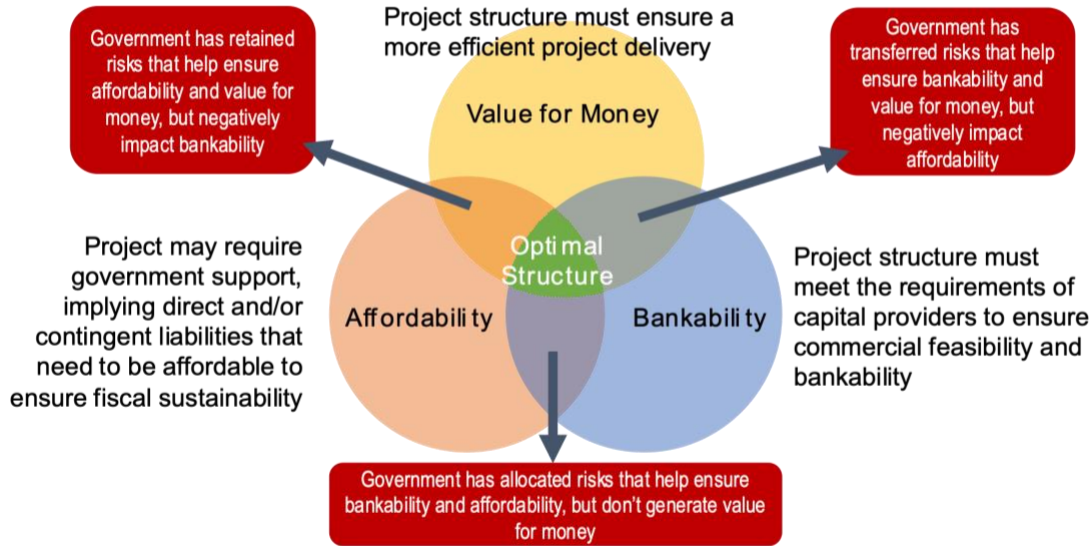
It is worth noting that a PPP arrangement can be made between either a government agency or a state-owned enterprise and a private entity. For example, in the power sector, power purchase agreements are often signed between an independent power producer and a publicly owned entity acting as off taker. Although the obligation to off-take the produced power may not directly impact the budget, there may be an indirect fiscal impact, for example if the publicly owned entity is not able to meet its financial obligation. This may require support from the government, in the form of guarantees or other actions that assure the private partner and its lenders that the financial obligations are being adhered to.

The nature and extent of government support needs to be carefully structured to balance (i) requirements from investors and lenders to ensure the commercial feasibility and bankability of the arrangement, (ii) the potential for efficiency gains from the arrangement (value for money), and (iii) the affordability of the government support mechanisms required to implement the transactions. In short, fiscal commitments often rely on government support to ensure bankability. At the same time, it is important to ensure that there is an incentive to achieve value for money, and that the project is affordable.

If the structure leads to a risk balance that is skewed too much in favor of the private sector—i.e., the government retains risks it cannot afford, or that do not contribute to more efficient project delivery—the project structure may be bankable but not meet the interests and capacity of the government. On the other hand, if the government is too aggressive in its risk transfer, the retained risks may be affordable, but the project itself may not be bankable, due to the likelihood that the project will end up in financial distress.

Figure 3: PPP Structuring

The optimal structure of a PPP allocates the risks to the party best able to manage balancing the requirements of capital providers, the constraints of government, and the interests of society



This balancing act is subject to market conditions, which tend to change over time or be impacted by crises, as illustrated by experiences in Pakistan and Australia, among others.

**In Pakistan, the Government Had to Set Aside Excessive Funding for Guarantees to Ensure the Bankability of the First Non-Power PPPs**



In Pakistan, the first public-private partnership (PPP) projects outside the power sector were not bankable without a cash deposit of the government guarantees, because banks wanted assurance that funding would be in place to meet the financial implications of any unforeseen events. Over time, the banks became more comfortable with the government’s capacity to arrange the necessary budget appropriations should the situation arise, and the requirement for a cash-funded guarantee dropped from more than 100 percent to about 50 percent of the project value.

**In Australia, the Government Had to Share Interest Risk During the Global Financial Crisis to Ensure Bankability**



In Australia, the government responded to reduced liquidity because of the global financial crisis by agreeing to share in market disruption risks. This meant that affected banks could increase their debt pricing in limited circumstances if, after financial close, two or more banks’ costs of funds were materially greater than the relevant reference rate. This provision was rescinded when the financial sector normalized.

Thus, any required government support has to be carefully evaluated in terms of affordability and in terms of the impact on value for money. Not only do PPPs need to be carefully structured based on thorough



preparations, but the fiscal implications arising from the government support schemes have to be carefully managed, in terms of their identification, evaluation, budgeting and reporting.

### 1.3 Different Forms of Government Support Correspond to a Variety of Fiscal Implications

To address the need for fiscal support, governments need to consider both project-specific features and market-specific circumstances, and structure the fiscal support accordingly. A broad array of instruments is available to governments to mitigate a PPP's risk profile and enable its financial viability, as shown in a table below.

**Table 5. Tools and Instruments that Support PPPs**

Type	Name	Liability	Country Examples
Up-front support	Project development fund	Direct	France, India, Indonesia, Kazakhstan, Pakistan, Philippines, South Africa, Republic of Korea, Thailand
	Viability gap funding	Direct	Bangladesh, India, Indonesia, Pakistan, China, Philippines, Sri Lanka, Thailand, United Kingdom
Finance guarantees	Loan, other debt instrument, and refinancing guarantees <sup>9</sup>	Contingent	Portugal, Belgium, Italy, Kazakhstan, Mexico
	Counter guarantees	Contingent	India
	Foreign exchange rate guarantees	Contingent	Colombia, Peru, Türkiye
PPP contract provisions	Performance-based revenue guarantees	Direct/contingent	Chile, Indonesia, Netherlands, Peru, Republic of Korea, United Kingdom
	Availability payments	Direct	Bangladesh, Brazil, Colombia, Chile, China, Georgia, India, Indonesia, Italy, Kazakhstan, Pakistan, Philippines, Peru, Thailand, Türkiye
	Minimum revenue guarantees	Contingent	Bangladesh, Germany, France, India, Indonesia, Italy, Kazakhstan, Pakistan, China, Chile, Philippines, Peru, South Africa, Thailand, Türkiye
	Change of law/regulation undertakings	Contingent	Australia, South Africa, Türkiye, United Kingdom
	Termination payments or debt assumption undertakings	Contingent	Australia, Colombia, France, Spain, Türkiye, India, Republic of Korea, United Kingdom, Colombia
	Residual value payments	Contingent	Italy

<sup>9</sup> Also covers the step-in-right commitments.



Type	Name	Liability	Country Examples
Special risks or events	Sub-sovereign creditworthiness guarantees <sup>10</sup>	Contingent	Greece, Belgium, Thailand, Türkiye, United Kingdom
	Convertibility risk coverage	Contingent	Vietnam
	Land acquisition and resettlement	Direct	India, Indonesia, Kazakhstan, Pakistan, China, Philippines, Sri Lanka, Thailand
	Tax subsidies / other In-kind support	Direct	Bangladesh, India, China, Philippines, Sri Lanka, Thailand, Türkiye

Government support mechanisms are reflected in public compensation or payment mechanisms and/or in risk allocations on a PPP. Public compensation (government payments) may be in the form of grants (to co-finance the capital expenditures) and/or service payments made to the private partner in the contract; these must adhere to all relevant conditions, including timing, indexation, and potential adjustments/deductions. Government support may also be present in other forms, such as the provision of financing support (guarantees and other credit enhancement measures; equity; or debt contributions). Any government support provided to a PPP project implies liabilities (i.e., a financial obligation that has to be met by the government), though the nature of the fiscal commitment depends on the type of instrument.

On the other hand, risk allocations are developed and implemented further along in the PPP contract process. This is done through appropriate provisions—elaborately defining risk events (detailing when a specific risk event has occurred for the purpose of risk allocation); specifying the extent to, and the form in which, each party assumes each risk; and specifying how the party that has not been allocated the risk will be compensated if the risk occurs.

Consequently, fiscal commitments to PPPs can be in the form of payments for services; co-financing through grants; subsidies to reduce costs for users; or various means to reduce the risk for the private sector. Even the contract itself can create implicit risk, if it is poorly designed—in particular, a PPP contract for a project with no financial sustainability can carry the most severe consequences, which are very difficult to foresee.

All these liabilities can be either direct or contingent, as follows:

- *Direct liabilities.* These are in general known payments that must be made if a PPP proceeds (although there may be some uncertainty regarding the value, due to adjusted bonuses or penalties related to performance). The most common direct liabilities include upfront "viability gap" payments such as capital subsidies, regular availability payments over the life of a project (usually conditional on the gained services or assets), or any other type of output-based payments.
- *Contingent liabilities.* These are payment commitments whose occurrence, timing and magnitude depend on some uncertain future event. Contingent liabilities can include guarantees on minimum guarantee payments; termination compensation; and debt or equity guarantees or other credit

<sup>10</sup> Liabilities of government-owned off-takers and sub-sovereign creditworthiness guarantees are applied if a commercial but government-owned entity (such as a power or water utility) contracts with a private generator or bulk water supplier; there are several guarantee types, such as input guarantees, state-owned enterprise control or sovereign indemnities, loan repayment guarantees, etc.





enhancements. The guarantee could cover a specific event or risk, such as demand risk, foreign exchange risk, or a discriminatory change in law. In the literature, contingent liabilities are divided into two main categories, based on the notion of obligation:

- *Explicit contingent liabilities.* These are legal or contractual government commitments to make certain payments if a particular event occurs. Most contracts will include at least a provision whereby the government provides compensation for early contract termination. Termination causes and corresponding amounts owed to the project company are described in the contract. It is not unreasonable for a government to provide such a guarantee, because even in the case of early termination, it will have received an asset in return. It is also a lender requirement to minimize their risk and to guarantee that a substantial portion, if not all, of the debt will be recouped from this compensation.<sup>11</sup>
- *Implicit contingent liabilities.* These are political or moral obligations of the government to intervene, in order to preserve the provision of the infrastructure related service, particularly in the event of a crisis or natural disaster. These implicit liabilities originate in the intrinsic complexity and risky nature of infrastructure investment projects implemented as PPPs. Deficient studies can lead to significant cost overruns, and lower than expected demand can trigger claims from the private sector for compensation. In this regard, it is not uncommon for contracts to be incomplete or subject to different interpretations. This can lead to disputes between contractual parties, and the settlement of these disputes can lead to unexpected compensation obligations from the government. Governments do not recognise these liabilities until a particular event occurs. Implicit contingent liabilities are difficult to assess and manage in a consistent manner, precisely because of their implicit nature.

**Table 6. Types of Government Liabilities**

Types of Government Liabilities	Origin	Examples	Impact on the Public Budget
Direct liabilities	Payments committed to by the government	Availability payments, viability gap payments, subsidies	Payments have to be budgeted every period, as committed to in the contract
Explicit contingent liabilities	Guarantees provided by the government to make the PPP project bankable	Minimum revenue guarantees, foreign exchange guarantees	May or may not impact the budget, depending on the behavior of the variables involved
Implicit contingent liabilities	Infrastructure projects are risky, and the materialization of some	Also called fiscal risk, can arise from risk retained by government, shared with the private partner,	Usually not anticipated and creates fiscal surprises; in some cases, can be severe

<sup>11</sup> Some countries, for example Nigeria and Ghana, have used a more sophisticated approach to compensation on early contract termination known as a put call option agreement (PCOA). The PCOA can require a government to buy a project (the “put”) if the project’s power purchase agreement (PPA) is terminated (thus providing a payment for the project, similar to a termination payment). The government is also given the option to purchase the project (the “call”) under certain circumstances, such as concessionaire’s default. It is argued that such a provision will have a different fiscal implication, though further analysis is suggested in the case of a PCOA, the government must or can compensate for early contract termination.

Types of Government Liabilities	Origin	Examples	Impact on the Public Budget
	risks can have fiscal consequences	or transferred to the private partner in the PPP contract; can be mitigated but not eliminated	

When using these government tools and assessing the effectiveness of existing financial instruments to be deployed for PPP projects, the following main challenges are observed:

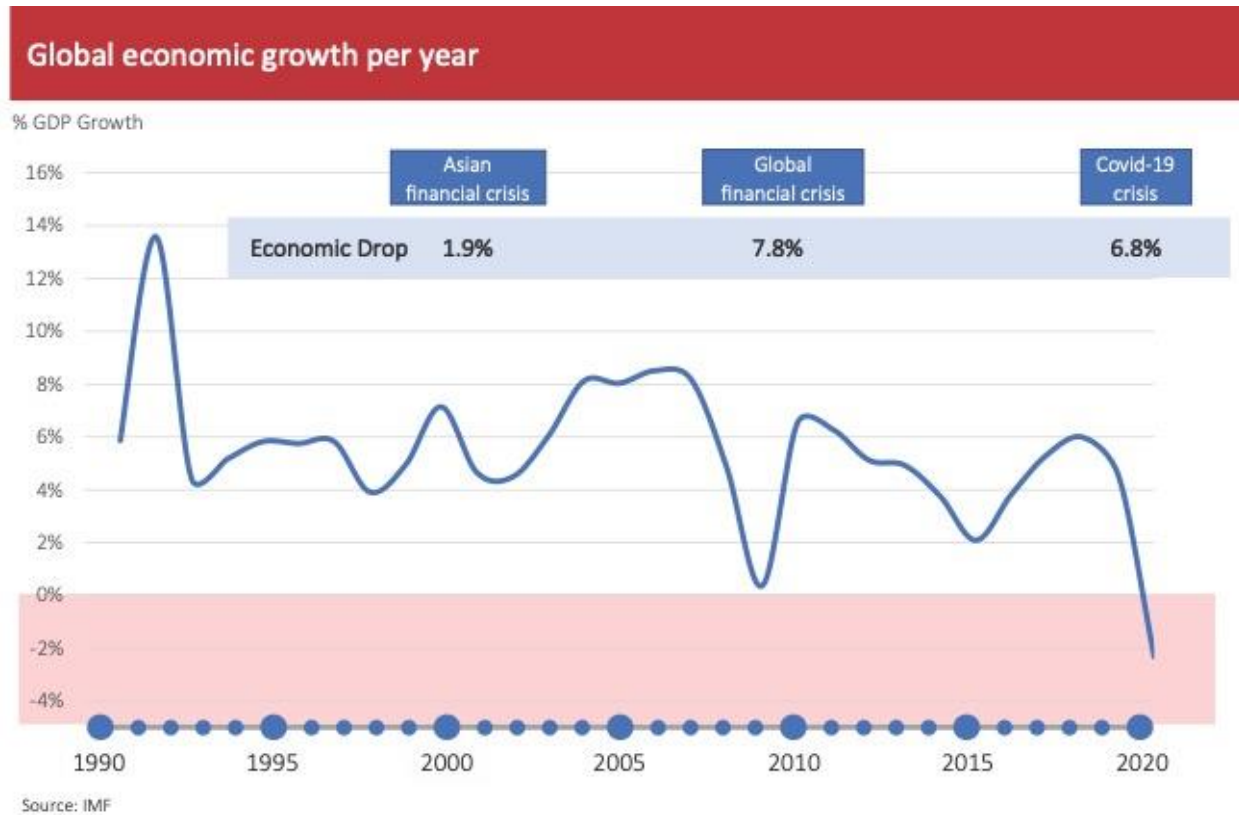
- *Regulatory constraints.* Country specific PPP regulations may limit which tools can be used under what types of contract models.
- *Limited capacity and understanding.* Improper evaluations of the risks and benefits of the support tools, and lack of understanding of PPP-related liabilities, are observed due to misinterpreted and misused support tools.
- *Process inefficiencies.* Inefficiencies can be caused by the involvement of a substantial number of ministries and line agencies, complicating the necessary review and approval proceedings.
- *Ignoring contingent liabilities.* Because of the complex and more latent nature of contingent liabilities, appropriate administrative proceedings and regulations tend to be lagging, therefore governments focus on direct liabilities and ignore contingent liabilities.

#### 1.4 The PPP Market is Sensitive to Economic Volatility

Private interest in and capacity for infrastructure investments correlates with economic context. In recessions, investors and lenders become more risk averse, and costs of capital increase, hindering the bankability of PPPs. This is illustrated through the PPP market trend over the years, which has experienced drops during crises, including the recent pandemic.



Figure 4: Impact of Crises on the PPP Market



### Asian Financial Crisis (1997-1999)

The proximate cause of the Asian financial crisis (which started in June 1997) was currency exchange rates. It began in Thailand and then swept through East and Southeast Asia. It heavily damaged currency values, stock markets, and other asset prices in many countries in the region. The ultimate causes of the crisis are complicated and disputable. During the late 1980s and early 1990s, many Asian countries—including Thailand, Singapore, Malaysia, Indonesia, the Philippines and Korea—achieved massive economic growth, with 8 to 12 percent increases in their GDPs.<sup>12</sup> Economic development in these countries was mainly boosted by export growth and foreign investment. Therefore, high interest rates and fixed currency exchange rates (pegged to the US dollar) were implemented to attract hot money, and exchange rates were pegged at rates favorable to exporters. However, both the capital market and corporations were exposed to foreign exchange risk, due to the fixed currency exchange rate policy.

Consequently, the cost of capital increased for privately financed infrastructure in the region, with a negative impact on the commercial feasibility of PPP initiatives, leading to a decrease in the PPP market.

<sup>12</sup> The GDPs of the affected economies even fell by double digits. From 1996 to 1997, the nominal GDP per capita dropped by 43.2 percent in Indonesia, 21.2 percent in Thailand, 19 percent in Malaysia, 18.5 percent in Korea, and 12.5 percent in the Philippines; Hong Kong SAR, China; Singapore; and Japan were also affected, but less significantly.



### Global Financial Crisis (2008-2009)

The global financial crisis (GFC) refers to the period of extreme stress in global financial markets and banking systems between mid-2007 and early 2009. During the GFC, a downturn in the US housing market was a catalyst for a financial crisis that spread to the rest of the world through the global financial system. Many banks around the world incurred large losses and relied on government support to avoid bankruptcy. Millions of people lost their jobs as the major advanced economies experienced their deepest recessions since the Great Depression in the 1930s.

According to the IMF, in the years following the financial crisis, economic activity declined in half of all countries. In many countries, output is still well below levels that would have prevailed had output followed pre-crisis trends. Moreover, there are also signs that the crisis may have had lasting effects on potential growth through its impact on fertility rates and migration, as well as income inequality.

This crisis impacted the PPP market on a global scale, and after a decade of constant growth, the market contracted, due to increased interest rates, liquidity constraints, and surging uncertainty regarding the costs and availability of the global supply chain.

### COVID-19 (2020-2021)

COVID-19 is not only a global pandemic and public health crisis; it has also severely affected the global economy and financial markets. For the first time since the Second World War, the global economy has experienced a contraction—GDP has shrunk by more than 2 percent. Significant reductions in income, a rise in unemployment, and disruptions in the transportation, service, and manufacturing industries are among the consequences of the disease mitigation measures that have been implemented in many countries. It has become clear that most governments around the world underestimated the risks of rapid COVID-19 spread and were mostly reactive in their crisis responses. Given that disease outbreaks are not likely to disappear in the near future, proactive international actions are required to not only save lives, but also to protect economic prosperity.

The shock has mainly propagated through three channels: (i) disruptions of global value chains; (ii) restrictions on international mobility, which affected economies and activities differently, depending on exposure and preparedness; and (iii) reductions in cross-country remittances.<sup>13</sup>

Aside from the overall fiscal impact of COVID-19, the pandemic also has substantially stalled the global PPP market. As per the World Bank's 2020 annual report on private participation in infrastructure, investment commitments in 2020 stood at US\$45.7 billion across 252 projects, marking a 52 percent decline from 2019 levels. Private investment commitments had not fallen to these levels since 2004, when investment totalled US\$31.3 billion. Nevertheless, despite the ongoing pandemic, investments in the second half of 2020 increased by 15 percent over the first half of the year. The impact of the pandemic in 2021 has not yet been assessed.

As such, this drop in PPP activity is similar to the impact of the Asian financial crisis and the GFC, when the number of PPP projects awarded dropped by 50 and 39 percent respectively, and investment commitments by 63 and 33 percent, respectively.

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<sup>13</sup> Yeyati, Eduardo Levy, and Federico Filippini. 2021. "Social and economic impact of COVID-19." Global Working Paper 158, Brookings Institution.



Because the COVID-19 pandemic is rooted in the real economy, its longer-term impacts are likely to be different from those of the 2008 financial crisis. At the time of the global financial crisis, banks became unwilling to provide long-term project finance, and any available financing came with shorter terms and higher interest charges.

A recent study reviewed the economic impacts of pandemics, using data going back as far as the Black Death in the 14th century.<sup>14</sup> Because pandemics affect people but not infrastructure, their economic impact (as indicated by their effect on real interest rates) was found to be different than that of crises such as wars or natural disasters that involve significant infrastructure damage as well as high death tolls. Wars and natural disasters increase demand for loans to replace damaged infrastructure, both from the public and private sectors. This tends to increase the cost of borrowing (i.e., interest rates). Interest rates also increase in the case of financial crises, but because of a contraction in supply of capital, rather than an increase in demand for loans. During a pandemic, however, demand for borrowing from the private sector should decline in response to economic contraction and uncertainty. As a result, real interest rates should fall, making it cheaper for governments and PPP investors to borrow. The authors of the study write: “We still expect a sustained period of low real interest rates .... (which) should then provide welcome fiscal space for governments to aggressively mitigate the consequences of the pandemic.” In terms of PPPs, therefore, falling real interest rates could allow governments to take on a greater share of the investment cost, funded by borrowing, to counteract the increased caution of lenders and investors.

The following chapter will go into further details on how the Covid-19 pandemic has impacted PPPs, and how this latest crisis has consolidated once more the case for a robust FCCL management framework that allows for the existence of adaptative government support to PPPs, while ensuring that fiscal affordability and value for money are preserved.

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<sup>14</sup> Jordà, Singh, and Taylor. 2020. “The Long Economic Hangover of Pandemics.” *Finance and Development* 57 (2).

# PPPs DURING CRISES—LESSONS FROM COVID-19



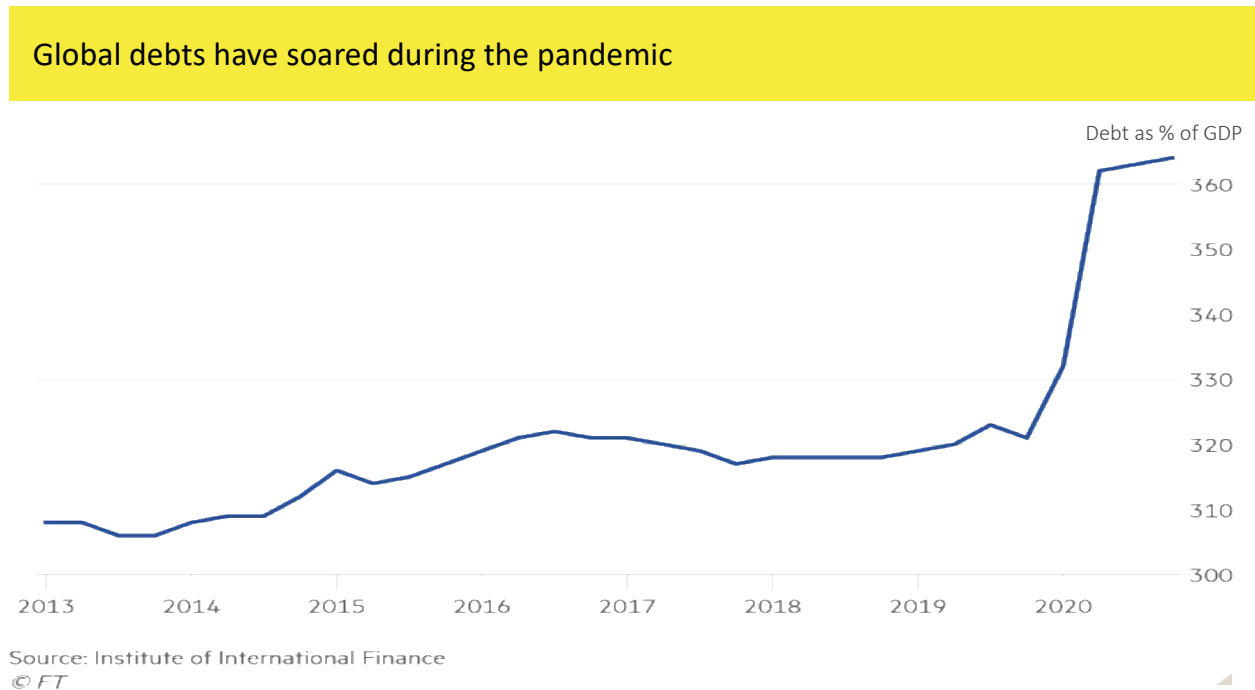
# 2 PPPs DURING CRISES—LESSONS FROM COVID-19

## 2.1 The Overall Fiscal Impact of COVID-19

The COVID-19 shock triggered an unprecedented and very heterogeneous response from governments across the globe. The increase of fiscal deficits in advanced economies was double that of emerging and middle-income countries, and five times higher than that of lower-income economies. The sizable discretionary fiscal support, along with the contraction in output and fiscal revenues, led to an increase in government debts.

The world has never been more indebted than after a year of battling COVID-19, and there’s even more borrowing ahead. According to the Institute of International Finance (IIF), governments, companies and households were expected to have to borrow US\$15 trillion in 2021 to offset the pandemic’s economic toll. The IIF expected total debt to reach 365 percent of global gross domestic product by the end of 2021, a surge up from 320 percent at the end of 2019.<sup>15</sup>

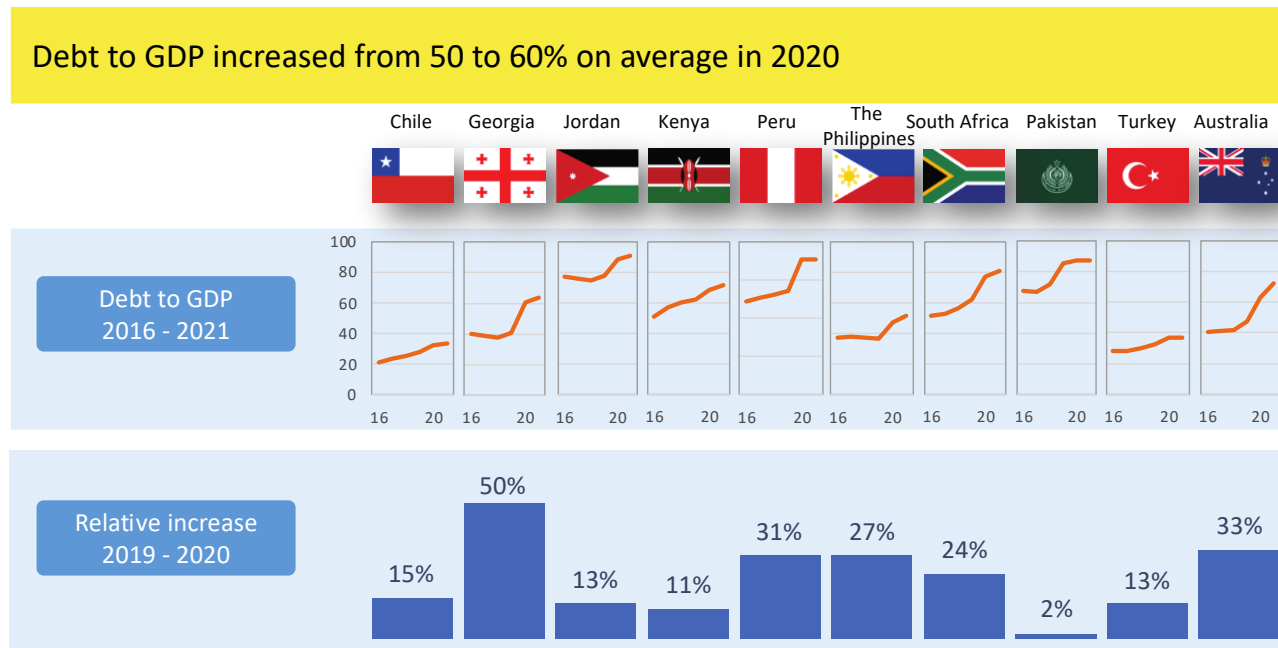
Figure 5: Impact of COVID-19 on Global Debt



<sup>15</sup>Institute of International Finance (<https://www.ft.com/content/18527e0c-6f02-4c70-93cb-c26c3680c8ad>).

The fiscal impact also has been substantial in the countries selected for our case studies. The average debt to GDP increased from 50 percent to 60 percent and is expected to further increase to 62 percent.<sup>16</sup> This reflects an approximately 20 percent increase in the debt stock. Georgia has hiked its debt the most, increasing it from 40 percent of GDP in 2019 to 61 percent of GDP in 2020, a 50 percent increase. At the other extreme was Pakistan, which had only a marginal increase of 2 percent of its sovereign gross debt; however, its debt was already at the 86 percent level, and the country was very much constrained in raising further debt.

Figure 6: Impact of COVID-19 on Debt-to-GDP Ratios in Selected Cases



International Monetary Fund, World Economic Outlook Database, April 2021

The situation also has significantly deteriorated in terms of structural balance. In 2019 the average deficit for the selected case countries was 2.9 percent, but it was estimated to increase to 4.8 percent for 2021, according to the IMF’s World Economic Outlook of April 2021.

## 2.2 The PPP-Specific Impact of COVID-19

In a recent survey of 157 PPP practitioners across 69 countries regarding their views of the challenges and opportunities that COVID-19 creates for PPPs,<sup>17</sup> respondents identified various concerns. Some of these are likely to be limited to the short or medium term, such as difficulties accessing project sites. However, other impacts may extend well into the longer term. Of particular note are the following concerns:

<sup>16</sup> For the sub-sovereign cases, the sovereign indicators have been applied for comparative purposes.

<sup>17</sup> Baxter. 2020. “157 PPP Practitioners from 69 Countries Share Their Insights on the Status of PPPs in the Pandemic Epoch.” LinkedIn, June 15, 2020.



- Weakening global financial markets and economic disruption that will consequently reduce project bankability
- Shift in government focus from long-term infrastructure plans to short-term crisis management
- Fiscal pressures affecting the ability of public sector partners to pay
- Economic pressures affecting the ability of users to pay.

Certain sectors were seen as more vulnerable, especially transport (cited by 53.9 percent of respondents), followed by tourism and leisure (16.9 percent). A second tier of sectors, cited by 6 to 7.5 percent, comprised energy, health, education and water. At the same time, healthcare PPPs were seen by 39.4 percent of respondents as presenting increased PPP opportunities. It is not expected that COVID-19 will have a materially adverse impact on the financial performance of healthcare PPPs, contrary to, for example, the performance of airport PPPs.

### Chilean Airport PPPs Have Initiated International Arbitration to Address Financial Distress Following COVID-19 Measures



On January 19, 2021, the main shareholders of a consortium controlling the billion-dollar concession for Santiago’s Arturo Merino Benítez international airport informed the Chilean president of their intention to initiate an international arbitration claim. The investors claimed they had suffered losses as a consequence of measures taken in response to the COVID-19 pandemic. France’s Groupe ADP and Vinci Airports have 45 percent and 40 percent stakes, respectively, in the Nuevo Pudahuel consortium, which won a 20-year concession for Santiago’s airport in 2015, with the Italian company Astaldi holding the remaining 15 percent.

The French concessionaires’ claim under the 1992 Chile–France Bilateral Trade Agreement (BIT) demands compensation for net losses of US\$37 million in 2020, as well as a contract renegotiation to prevent the expropriation of their investment. The consortium operators reported that profits had fallen 90 percent in 2020, as Chile lost 19 routes and 630 weekly flights since the pandemic broke out, which represented a drop of about 70 percent in passenger numbers.

The conflict escalated after the Chilean Ministry of Public Works refused the consortium’s request for financial aid and an extension to the concession to restore its economic viability and recover the investment made in the new terminal currently under construction. Nuevo Pudahuel argued that the airport’s revenue would be affected by the pandemic for at least a five-year period before an expected return to previous passenger traffic levels.

According to the website Pauta Bloomberg, the Minister of Public Works alleged the state itself had also suffered considerable losses via the revenue-sharing mechanism that stipulates that 77 percent of the airport’s profits should be handed over to the Chilean state. “For every peso that the concessionaire has lost, the state has lost three times as much,” he said. Furthermore, it was argued that renegotiation is not permitted by law and would require a new public tender.

In the notice of dispute, the French operators mentioned a Chilean government policy requiring additional sanitary measures to protect against the spread of COVID-19 at the airport, as well as the state’s repeated refusal to renegotiate the contract. They also refer to the BIT’s provisions on fair and equal treatment (FET), national treatment, and protection against expropriation. Groupe ADP CEO Fernando Echegaray pointed out that the refusal of the consortium’s request posed serious risks to the

concession, which would no longer be viable, because the contract does not assign the threat of pandemics to the consortium.

“The effects of the pandemic and the state’s refusal to restore the economic–financial balance of the concession, however, have caused unexpected damage that not only will not allow greater investments but also put the airport’s operation at risk. It is our opinion that Chile has not complied with its obligations to protect foreign investment under the agreement between the Government of the Republic of Chile and the Government of the Republic of France on the reciprocal promotion and protection of investments,” said Echegaray.

Conversely, the Minister of Public Works noted that the airport is not at risk because the concessionaire can be replaced if Nuevo Pudahuel is unable to continue. “The companies have to comply with what has been asked of them, and they cannot expect to use other mechanisms to receive what does not apply... what they are looking for is to extend the contract, which means billions,” he said.

Looking at the claim under the Chile–France BIT, the Chilean Undersecretary for International Economic Relations emphasized that the divergence between the consortium and the Ministry of Public Works within the framework of the concession contract does not mean that the Chilean state is breaching its international obligations in the Chile–France investment protection agreement. “An eventual trial before the International Centre for Settlement of Investment Disputes (ICSID) has the latter as its object and the recent award that put an end to the claim of the shareholders of Alsacia and Express against the state is very clear in distinguishing the actions of the state of a contractual nature and those carried out by the state in its sovereign capacity,” explained the Undersecretary for International Economic Relations to La Tercera. Before facing off with the Chilean state before the ICSID, the French controllers of Santiago’s airport have begun a six-month amicable negotiation period imposed by the Chile–France BIT.<sup>18</sup>

The World Bank’s PPP practitioners concur with these findings, stressing that COVID-19 impacted infrastructure projects around the globe in all sectors as supply chains have been disrupted, customer demand has fallen, and health regulations have forced a change in the way business is conducted. Many countries have taken actions to limit virus spread through social distancing policies, limiting work to only essential activities, closing schools, and restricting movement. Approximately 90 percent of the world’s population has faced travel restrictions amid the pandemic.

The main channels of COVID-19’s impact on infrastructure PPP projects are:<sup>19</sup>

- Low growth and macro-economic volatility
- Declines in demand
- Supply disruptions
- Added health and safety regulations and the need for a change in operations
- Government policy or sector decisions to implement stimulus or social safety nets (such as funding employee furlough schemes or emergency loan programs to private businesses).

These, in turn, can lead to important secondary consequences that increase costs and lower revenues for project companies. User-fee concessions (including roads, airports, ports, and ferries) are facing stress due

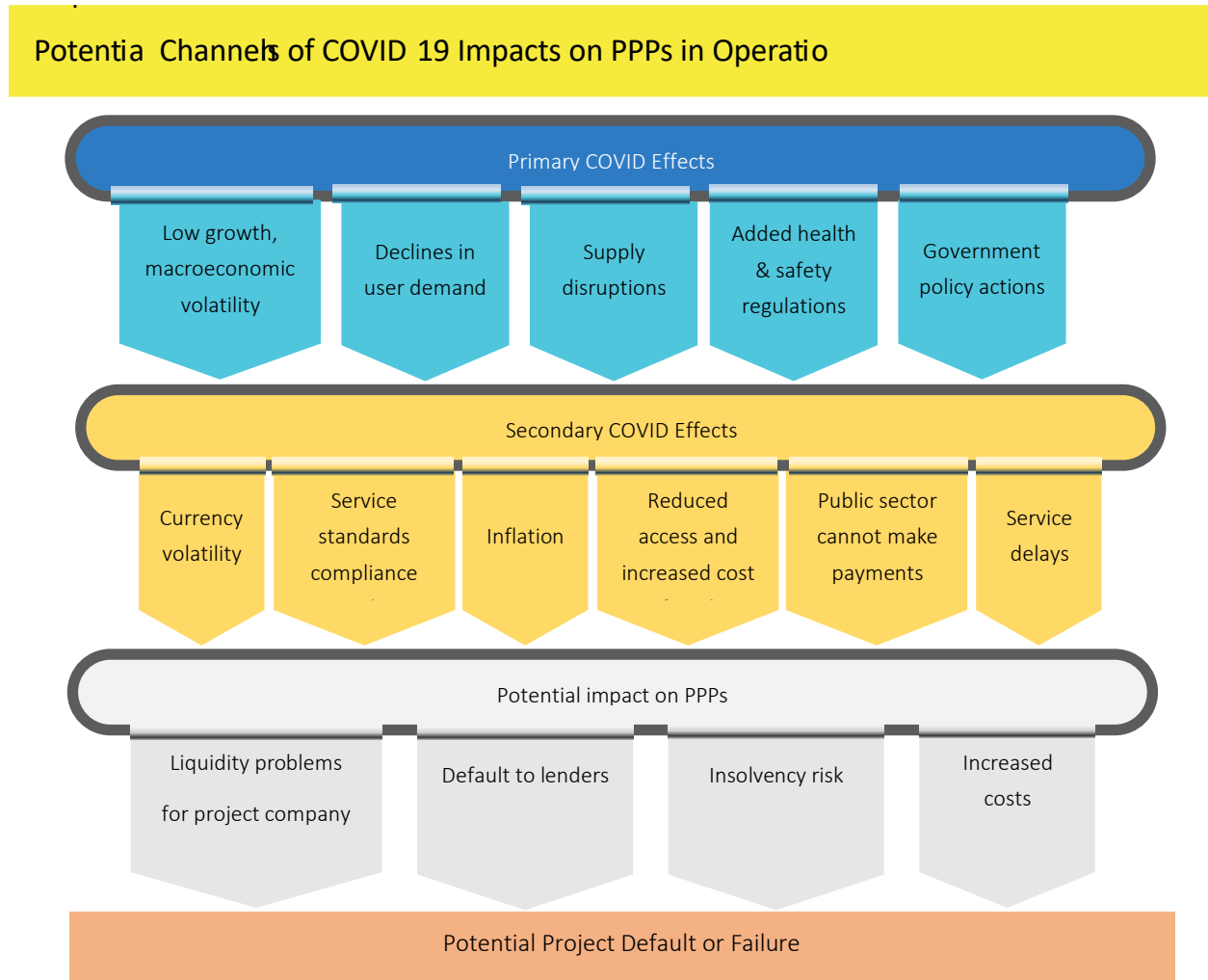
<sup>18</sup>International Institute for Sustainable Development. March 23, 2021. (<https://www.iisd.org/itn/en/2021/03/23/french-consortium-kicks-off-an-icsid-claim-against-chile-after-usd-37-million-loss-due-to-covid-19-pandemic/>).

<sup>19</sup>World Bank. “COVID-19 and Public Private Partnerships.” Practice Note, Assessing Operational PPP Portfolios.

to reduced demand, while availability fee-based projects may come under pressure as the public sector faces additional fiscal limitations due to competing demands on public spending during the pandemic.

While, thus far, the problem is one of drops in free cash and near-term liquidity, the long-term outlook for these assets could be placed in doubt under prolonged stress—threatening a project company’s ability to service debt; the provision of services according to contractual expectations, with potential resulting hardships to consumers; and the viability of the project itself. The figure below illustrates the multifaceted impact that COVID-19 and the resulting economic downturn can have on PPP projects.

Figure 7: Potential Channels of COVID-19 Impacts on PPPs in Operation



Source: World Bank: COVID-19 and Public Private Partnerships Practice Note, Assessing Operational PPP portfolios

The Asian Development Bank (ADB) also highlighted the impact on the pre-commercial stage, most notably from supply chain disruptions, but also from the constrained availability of expertise, and the changed

manner of performing work.<sup>20</sup> This has been confirmed by experiences in the UK, where COVID-19 has delayed project preparations.

For operational PPP projects, the main impacts have been in (i) supply chains, (ii) availability of expertise, (iii) manner of performing work, and (iv) access to capital, contributing to construction issues and reduced market appetite.

#### (i) Impact on Supply Chains

In contrast to the operations phase of projects, the construction phase is labor intensive and vulnerable to supply-side impacts, such as workplace restrictions for construction workers, the unavailability of materials and equipment, and resulting longer lead times. Swathes of factories and work sites deemed nonessential by governments have been ordered to either close or curb production activities for significant periods during the COVID-19 pandemic. These effects posed particular issues for PPP projects that were yet to reach their commercial operations date.

In early 2020, when China was among the countries worst affected by the pandemic, suppliers of materials and equipment for PPP projects could not fulfil their orders from factories in that country, and looked to Europe and the United States for alternative sources of supply. Shortages were seen in raw materials, key components, and machinery, leading to widespread impacts on all projects, and particularly PPPs in the construction phase. For example, bottlenecks in wind power supply chains created shortages of key components for wind turbines, which led to delays. China is estimated to account for 40 to 50 percent of the global wind energy supply chain. Vestas, the world's largest supplier of turbines, and Siemens Gamesa, a Spanish manufacturer, both have assembly facilities in China that were forced to shut down. Both recorded net losses in their midyear results, which were attributed to supply chain disruptions. Because European countries also ordered mass lockdowns and Chinese manufacturing has increased, there has been a pivot back to Chinese-sourced materials and equipment, but under a far more constrained supply capacity. Although China is specifically referenced in this paragraph, on the basis of its occupying an especially significant space in global supply chains, similar dynamics could also have been observed elsewhere across global supply chain networks, because of lockdowns and disruptions throughout different countries.

#### (ii) Impact on the Availability of Expertise

The closure of borders and the general reduction in the availability of international flights during the pandemic meant that it was increasingly difficult to bring in foreign experts to work on-site on complex PPP projects. For example, in some Pacific Islands nations, it was virtually impossible to mobilize foreign expertise because of the suspension of flights by commercial airlines.

The extent to which expertise can be made available to PPP projects will dictate the speed and cost at which PPP projects can be completed.

Although exceptions to travel bans may have been requested, border and flight restrictions might increase reliance on local workforces and remote working arrangements for work disciplines that are based on “desktop” activities. Although some of these effects might have been considered a boon for domestic labor forces (e.g., where construction workers are sourced locally), this did not overcome the shortfall in relevant expertise, which was likely to cause material delays in the progress of PPP projects.

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<sup>20</sup> ADB (Asian Development Bank). 2021. “COVID-19 and Public–Private Partnerships in Asia and the Pacific.” Guidance Note February 2021: 6.

### (iii) Impact on the Manner of Performing Works

The quarantining and social distancing measures being implemented in response to the COVID-19 pandemic necessarily change the way in which works are performed.

For example, in Singapore, a large number of infections have been diagnosed among certain migrant worker dormitories. As a result, affected workers have been housed in quarantine zones. During such quarantine periods, it has not been possible for the quarantined laborers to enter and work on construction sites, and there have been numerous instances where construction sites have been shuttered until the labor force can be remobilized.

Social distancing measures implemented by central governments, and indeed by corporations themselves, have significantly restricted the number of workers that may be relocated on-site at any given time. For example, whereas a site elevator may have previously carried up to 30 people, this number may now be restricted to four to six people, in keeping with proximity restrictions. Staggered work hours and workforce rotations have also contributed to a reduction in site productivity.

### (iv) Impact on Access to Capital

Responses to the 2008 financial crisis may shed light on the likely short-term implications of the COVID-19 pandemic for PPPs. A 2009 IMF survey of PPP practitioners (Burger 2009) found that “private partners in PPPs were less willing to retain certain risks, such as interest rate risk and financial closure risk and were seeking greater contributions or guarantees from the government.” This is a natural response to a perceived increase in risk. The paper also cites a PricewaterhouseCoopers survey of UK PPP lenders, which found that following the financial crisis there was a “marked shift in the preference of financial institutions away from long-term loans and towards loans with a much shorter term to maturity.”

Overall, this suggests that there is likely to be some negative impact of the pandemic on the availability, cost and terms of PPP financing over the short to medium terms. However, given the different natures of the two crises, this will be driven by lender concerns over project/demand/payment risk rather than the fundamental capital constraints that were a feature of the 2008 financial crisis. As a result, the disruption may be shorter and shallower than in 2008-09 and may be more easily addressed by government actions.

### Consolidation of Possible Impacts

The ratings agency Fitch highlighted in 2020 the risk that the pandemic puts on the construction stage of PPP projects, raising concerns over “the potential to cause completion delays and alter the finances of projects under construction.” This seems to be driven by the fact that PPP contracts traditionally assign construction risk to the private partner, and a concern that “pandemics are not typically covered under force majeure provisions.” Nonetheless, it could be argued that a pandemic would appear to fit the general definition of force majeure as an event that affects performance that was not caused by the investor or the government. If governments are unwilling to be flexible, this lack of clarity could lead to disputes, delays, renegotiation or, in the worst case, termination of PPP contracts.

How COVID-19 can affect ongoing PPP projects is considered the key question to understand its impact. The IMF states that the impact of COVID-19 will depend on the length of disruption and will be felt differently by each PPP project, depending on its specific conditions (country, sector, phase of the project cycle, design of the contract, etc.). For instance, PPP projects in the transportation and energy sectors will

face significant losses of revenues. Healthcare projects will be particularly affected (through reduced revenues and increased costs) if they include medical services. Some sectors such as water are likely to be less impacted by COVID-19 challenges, whereas for school projects, which usually cover only school facilities, the impact is still uncertain.<sup>21</sup>

As for new PPP projects, it has already been highlighted that PPP deal flow has been substantially reduced. This is driven by challenges for public authorities to properly develop projects, but also by reduced appetite from the private sector due to anticipated construction and financing issues, as well as possible issues with ongoing PPPs in the developers' portfolios.

### A Reduced Market Appetite for PPPs in Sindh



The government of Sindh has called for re-bidding for the Dhabeji Special Economic Zone (SEZ) after the developer, selected earlier through bidding, withdrew due to the disruption caused by the COVID-19 lockdown. "The preferred bidder was unable to move on with its commitment due to the severe impact of COVID-19," said Special Economic Zone Management Company (SEZMC) Chief Executive Officer Abdul Azeem Uqaili in an interview with The Express Tribune.

Based on these various considerations, the following implications of COVID-19 for PPPs can be identified for the different stages of the PPP lifecycle.<sup>22</sup>

**Table 7. COVID-19 Implications for PPPs**

Stage	Government	Investors	Possible Impact on PPPs
<b>Identification</b>	<ul style="list-style-type: none"> <li>• Slowdown in activity</li> <li>• Travel constraints</li> <li>• Budget constraints</li> <li>• Desire to boost infrastructure</li> <li>• Policy priorities may change</li> </ul>	(Investors not directly involved in this stage)	<ul style="list-style-type: none"> <li>• Delays</li> <li>• Pressure to speed up the process, take shortcuts</li> <li>• Pressure to minimize preparation/ advisor costs</li> <li>• Review past decisions and priorities</li> </ul>
<b>Appraisal &amp; structuring</b>	<ul style="list-style-type: none"> <li>• Slowdown in activity</li> <li>• Travel constraints</li> <li>• Budget constraints</li> <li>• Work constraints relaxed</li> <li>• Desire to boost infrastructure</li> <li>• Budget constraints</li> <li>• Policy priorities may change</li> </ul>	(Investors not directly involved in this stage)	<ul style="list-style-type: none"> <li>• Difficult to access sites</li> <li>• Desire to cut preparation cost</li> <li>• Pressure to speed up the process, take shortcuts</li> <li>• Pressure to minimize preparation/ advisor costs</li> <li>• Greater attention paid to risk allocation; government may have to take on more risk</li> </ul>

<sup>21</sup>Monteiro, Rui and Ozlem Aydin Sakrak, April 30, 2020. "What is the COVID-19 Crisis Impact on Public-Private Partnerships." *IMF Public Financial Management Blog*. <https://blog-pfm.imf.org/pfmblog/2020/04/-what-is-the-covid-19-crisis-impact-on-public-private-partnerships-.html>.

<sup>22</sup>NCP (National Center for Privatization). 2020. "Impact of COVID-19 on Public Private Partnerships." Research paper, NCP, Saudi Arabia. Adapted and refined by authors.

Stage	Government	Investors	Possible Impact on PPPs
<b>Tender</b>	<ul style="list-style-type: none"> <li>• Slowdown in activity</li> </ul>	<ul style="list-style-type: none"> <li>• Travel constraints</li> <li>• Review resources, strategy</li> <li>• Financing uncertainty</li> <li>• Flight to quality</li> <li>• Problems in other markets; bankruptcies</li> <li>• Financing constraints relaxed</li> </ul>	<ul style="list-style-type: none"> <li>• Delays in the tender process</li> <li>• Extensions to lenders in financial close</li> <li>• Delays to financial close</li> <li>• Fewer bidders</li> <li>• Shift towards locally-based bidders and lenders</li> <li>• Failed tenders</li> </ul>
<b>Construction</b>	<ul style="list-style-type: none"> <li>• Slowdown in activity</li> <li>• Travel constraints</li> <li>• Work constraints relaxed</li> <li>• Policy priorities may change</li> </ul>	<ul style="list-style-type: none"> <li>• Supply chain disruptions</li> <li>• Lockdown/quarantine measures</li> <li>• General economic downturn</li> <li>• Problems in other markets; bankruptcies</li> </ul>	<ul style="list-style-type: none"> <li>• Delays in decisions and permits</li> <li>• Equipment and materials delays</li> <li>• Risk of contractor/sub-contractor bankruptcy</li> <li>• Force majeure claims and disputes, and PPP contract renegotiation</li> <li>• International partners wish to exit riskier projects.</li> </ul>
<b>Operation &amp; hand-back</b>	<ul style="list-style-type: none"> <li>• Budget constraints</li> <li>• Slowdown in activity</li> <li>• Less effort on contract management</li> </ul>	<ul style="list-style-type: none"> <li>• Lockdown/quarantine measures</li> <li>• General economic downturn</li> <li>• Fall in demand for services (especially transport, user-pays)</li> <li>• Problems in other markets; bankruptcies</li> <li>• Shift towards less risky markets</li> <li>• Financing constraints relaxed</li> </ul>	<ul style="list-style-type: none"> <li>• Payment delays (government-pays).</li> <li>• Falling demand, revenue risk (user-pays).</li> <li>• Risk of special purpose vehicle (SPV) bankruptcy</li> <li>• Force majeure claims and disputes, and PPP contract renegotiations</li> <li>• Claims on government guarantees</li> <li>• Decline in service quality</li> <li>• Risk of contractor/sub-contractor bankruptcy</li> <li>• Shareholders wish to exit</li> </ul>

### 2.3 PPPs Persevere Through Adversity

Despite the adverse impact of COVID-19 on PPPs, most governments have tended to continue with or even intensify their use of PPPs. Overall, it has been rare for government-procured projects to be cancelled because of COVID-19. There are a number of notable examples of governments directing the slowdown or suspension of government projects, including the possible termination of the PPP for Sangley Point International Airport in the Philippines.

## Early Contract Termination Because of COVID-19 Considered for Philippine Airport PPP



However, looking more broadly, governments are generally resisting any delays to PPP projects and are instead looking at ways to expedite them. The reasons for this may include the following:<sup>23</sup>

- **PPP projects have long gestation periods.** The timeline for procurement of a PPP project can range from 20 to 36 months in experienced markets, and many years in less experienced ones; if one were to take into account all of the phases of a PPP project, commencing from policy setting and regulatory due diligence to selection of the winning bidder and implementation, this timeline may stretch even further in some cases. These timelines require governments to take a long-term view (beyond short-term economic cycles), whereas COVID-19, and the resulting financial and contractual implications for these projects, would hopefully be a shorter-term issue by comparison.
- **PPP projects (and infrastructure projects in general) are considered to be vehicles for effective public investment that can achieve a fiscal multiplier effect, and key drivers of economic stimulus efforts that may catalyze increased fund flows within and across slowing economies, and offset poorly performing sectors** such as retail; food and beverage; entertainment, and other sectors that depend on discretionary spending by customers. Indeed, many governments see the continuation of shovel-ready infrastructure and PPP projects as a feature of their recovery efforts (e.g., PPP program announcements have been made in Australia, the Philippines, China, and Thailand). Noting the need for immediate stimulus, government spending is expected to also focus on smaller-scale projects that might be advanced more quickly.
- **Compared to the 2008 global financial crisis, there is anecdotal evidence that the COVID-19 pandemic has not materially affected the availability of credit for PPP projects**, with private banks still registering an appetite to lend to quality, creditworthy projects. This observation also applies to lines of credit extended to governments for more bandwidth to support their economies—the level of public sector credit activity has increased overall as a direct response to the effects of the pandemic (though the specific proportion allocated to PPP projects has not yet been confirmed).

## South Africa Wants to Intensify PPP Spending for Post-COVID-19 Recovery



In South Africa, the government plans to partner with the private sector, multilateral development banks and development finance institutions to augment its skills, expertise and funding to boost infrastructure spending. The 2021 budget, presented by Finance Minister Tito Mboweni on February 24 of that year, outlines that R93.1 billion has been earmarked for economic regulation and infrastructure, from a consolidated government expenditure of R2.02 trillion per year over the medium term.

Mboweni said much of the country's infrastructure needs repair or replacement, and that the government has committed to a R791.2 billion infrastructure investment drive towards this end. "We are already partnering with the private sector and other players to roll out infrastructure through

<sup>23</sup> ADB (Asian Development Bank). 2021. "COVID-19 and Public–Private Partnerships in Asia and the Pacific." Guidance Note February 2021: 6.



initiatives such as the blended finance Infrastructure Fund. However, all these efforts to expand infrastructure will be wasted if the end-user does not pay a cost-reflective tariff for usage," he said. The government is transforming its approach to the planning and implementation of capital projects by bringing in private-sector skills and expertise, while increasing the resources available to fund infrastructure.

COVID-19 restrictions in March 2020 significantly affected revenues for several PPP projects. Presently, the effects on risks to the fiscal and contingent liabilities are considered manageable. Operational public-private partnerships (PPPs)—such as the Gautrain Rapid Rail Link project, the Sanral toll roads, and Chapman’s Peak—have lost revenue. Other operational concessions, such as the Renewable Energy IPP Programme, have not been affected by the pandemic, and there is no risk that they may affect the fiscus. The project terms of independent power producers (IPPs) that are in the construction stage have been extended, whereas PPPs that are in the planning stage may face delays in reaching financial closure owing to the pandemic.

The 34 PPPs in operation account for 2 percent of the total public-sector infrastructure expenditure budget, and therefore do not pose significant risks to the fiscus. Over the medium term, it is anticipated that this share will increase as projects are developed in partnership with the private sector through the Infrastructure Fund. The budget process will ensure the selection of projects that balance the much-needed boost to economic development and job creation with the country’s present debt-constrained fiscal position. Financing arrangements with the private sector will be done in such a way that they do not lead to further public debt escalation, the Treasury said.

## 2.4 COVID-19 has Highlighted the Need for Adaptive PPP Programs

The COVID-19 pandemic has brought about the realization that PPP survival and recovery strategies will require a paradigm shift, whereby risks are appropriately shared and allocated between project partners vis-à-vis unforeseeable future adverse events.<sup>24</sup>

Governments are encouraged to continue the development of PPPs to enhance the quality of public service delivery and accelerate infrastructure investments. However, this aspiration needs to take into consideration the challenges brought forward by the pandemic and PPP programs in terms of how governments plan to use PPPs, and needs to be revisited. Reassessing the existing pipeline of appraised infrastructure projects, or developing one if it does not exist, becomes a priority during the post-COVID-19 recovery. Infrastructure needs and gaps have most likely changed due to the crisis, calling for an overall reassessment of the government’s role and capacity to provide much needed infrastructure assets, as well as the role and effectiveness of PPPs. Specific actions observed in this area are:

- Adjusting investment plans to new infrastructure needs
- Reassessing governments’ risk tolerance and fiscal space
- Reviewing the existing pipeline of appraised or under-procurement-stage projects
- Considering new PPP contractual structures to accommodate changes.

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<sup>24</sup> Gallagher. 2020. “Public-Private Partnerships in a COVID-19 World.” <https://www.ajg.com/uk/news-and-insights/2020/december/public-private-partnerships-in-a-covid-19-world/>.

To provide governments with strategic short-term advice on the impacts of the pandemic, the Public-Private Infrastructure Advisory Facility (PPIAF), in collaboration with other units of the World Bank's Infrastructure Finance, PPPs & Guarantees (IPG) Group, established a Rapid Response Program. Through this program, national PPP units, ministries of finance, sector ministries, and utilities can request short interventions of remote, targeted technical advice to undertake a fast assessment of the impact of COVID-19 on their PPP programs, including:

- Stock-take of PPPs at all stages under different potential stress scenarios
- Review of PPP contractual provisions to assess potential responses to disruptions caused by COVID-19
- Identification and options assessment of associated fiscal impacts
- Presentation of options for initial review of a government's possible actions for PPP projects or rapid mobilization of knowledge and resources for PPP policymakers.

#### The Philippines Approached PPIAF About the World Bank's PPP Rapid Response Umbrella Program



Taking a leaf from the impact of previous economic disruptions (such as the Asian financial crisis and the global financial crisis) on public-private partnership (PPP) projects, the Philippine government took the initiative to approach Public-Private Infrastructure Advisory Facility (PPIAF) about benefitting from the World Bank's COVID-19 PPP Rapid Response Umbrella Program, aimed at providing remote, targeted technical advice to assess the impact of COVID-19 on the Philippines' PPP programs. The program focuses on the study of high- and portfolio-level fiscal implications of COVID-19 on selected PPP projects, and on applying global best practices to the adjustment of infrastructure contract requirements as a result of the pandemic.

Although such a rapid response helps countries to respond to the pandemic crisis, it is also recommended that a contingency plan be in place, should another pandemic or similar crisis arise, and that governments prepare for the unknown in order to strengthen the framework's resilience. For example, the National Center for Privatization in Saudi Arabia has prepared a publication detailing possible (i) short-term/immediate strategic responses, (ii) general government responses, and (iii) responses of public sector PPP agencies. Such a plan can guide the relevant government agencies on how to prepare for and respond to crises. Investors and lenders are comforted to see governments anticipating and preparing for such possibilities. These suggestions have also been observed in some of the selected cases, confirming their suitability.

#### COVID-19 Impact Mitigation Policies in Peru for Sustainable PPPs



In Peru, two policy measures have been established to mitigate the impact of the pandemic on public-private partnership (PPP) projects. The first relates to projects that are currently being executed (RD N° 003-2020-EF/68.01); the second to new PPP projects that seek to promote investment in public infrastructure in the country (DL N° 1500).

This second policy measure partially resembles what was enacted in 2008 as the response to the global financial crisis. At that time, a series of emergency decrees declared 52 projects to be of national interest and exempted them from complying with certain guidelines. In this case, however, the emergency

measure is not the result of the crisis, because the emergency decree dates from 2019; rather, it is the result of the National Infrastructure Plan for Competitiveness (PNIC, per its acronym in Spanish). On the other hand, similar to the response to the global financial crisis, the PNIC declared 42 projects to be of national interest and authorized the expropriation needed for execution. Additionally, 10 more projects were declared to be of national interest, and they were given priority in terms of budget allocations.

The additional measures implemented by the government as a result of the global pandemic extend the previous decrees to PPP projects (DL Nº 1500). Only PPP projects originated by the national government that fall into the following categories can take advantage of the measures defined in the emergency decree (No. 019-2019): (i) PPPs in the contract execution stage, (ii) PPPs that have already won the contract, or (iii) PPP projects that are planned to be awarded within the following three years.

### Chilean Emergency Policies to Fund the Most Vulnerable Sectors During COVID-19



In response to the health emergency caused by the global pandemic, Chile established the Transitional Emergency Fund COVID-19 (FET COVID-19) to cover various related expenses. The fund has an initial contribution of US\$12 billion, and among other things, it aims to support the recovery of the economy by promoting private investment through temporary tax incentives, regulatory simplicity, and sped-up concessions' investments. For instance, the ministries that use resources from this fund for public investment or concession projects need to present a monthly report to the ministry of finance (MOF) on the status of the projects. The recovery plan was aimed at expediting the bidding and construction of 31 projects through the concession system, totalling an investment of US\$8.63 billion. For the period 2020 to 2022, the plan considers an investment of US\$4.15 billion in concession projects; for the period 2021 to 2025, the pipeline of concession projects totals 53, of which 37 represent an investment of US\$1.5 billion.

## 2.5 Contractual Basis for Addressing COVID-19 Impact on Operational PPPs

Although government-led projects are often insulated from liquidity shocks, increased government indebtedness is expected to eventually affect the financing of future infrastructure and PPP projects, particularly once the full economic impact of COVID-19 is better understood. This is amplified in cases where the contractual PPP arrangements require governments to make payments under an availability payment structure (particularly for operational facilities), given strains caused by significant pandemic-related drops in governments' tax revenues and user fee collections. Likewise, governments may be forced to prioritize necessary upgrades to existing projects over new ones, to meet post-COVID-19 requirements for infrastructure usage (e.g., maximum user densities in public transport in accordance with social distancing requirements, and reserved capacity in public hospitals for the isolation of patients with infectious diseases).

Ideally, PPP contracts provide the basis for compensating project companies for any adverse impacts from COVID-19 as a result of government restrictions to reduce the risk of disease spread, which may reduce revenues and/or increase expenditures. The underlying principle is that project companies are entitled to financial equilibrium or rebalancing in cases of materially adverse government actions. Financial equilibrium provisions entitle an operator to changes in key financial terms of the contract to compensate for certain types of events beyond its control. Adjustments are based on a mutually agreed-upon financial

model that is maintained over the lifetime of the contract. Three causes of unexpected changes that merit financial equilibrium revisions are typically defined as force majeure (major natural disasters or civil disturbances), *factum principis* (government action), and *ius variandi* (unforeseen changes in economic conditions).<sup>25</sup>

Governments are encouraged to refer to the applicable contractual provisions to address COVID-19 related impacts for contracted PPPs, whether directly resulting from COVID-19 or from government responses to mitigate the risk of disease spread. This obviously requires that contracts are drafted in a comprehensive and cohesive manner, reflecting a suitable allocation of risks, and with recognition of possible events such as pandemics. The 2019 edition of the World Bank's *Guidance on PPP Contractual Provisions* provides suitable references for this purpose, and it is recommended to adequately incorporate such guidance in the operational PPP framework and align the FCCL with it in terms of explicit and implicit contingent liabilities. Incorporating this guidance in the PPP and FCCL frameworks will provide for a transparent and consistent approach to unanticipated events and contribute to the resilience of the FCCL framework, as well as provide comfort to investors and lenders on what to expect in case of crises. The text box below provides additional details on the respective provisions that may apply, depending on the situation. More information and contractual guidance can be found in the World Bank Group (WBG) *PPP Reference Guide* and the PPP Legal Resource Center (PPPLRC).<sup>26</sup>

### Possible Contractual Provisions to Address COVID-19 Impacts

#### 1. Material Adverse Government Action

The concept of material adverse government action (MAGA) is applicable to contracts, such as PPP contracts, where one of the parties is a public sector entity, or government. MAGA events typically:

- Delay or prevent the private partner from performing its contractual obligations; and/or
- Have a material adverse financial impact on the private partner; and
- Are within the public sector entity / government's control, or are best managed by the public sector entity / government as opposed to the private partner, and therefore the risks associated with such events are allocated to the public sector entity / government.

MAGA events are also referred to as political risk or political force majeure. Depending on the specific PPP project circumstances, some forms of political force majeure may be treated as shared force majeure risks (or in some cases even private partner risks).

Because MAGA risk is typically allocated to the contracting authority, market practice is that the private partner should be kept in the position it would have been in had the MAGA event not occurred. This principle applies equally in public-private partnership (PPP) contracts which do not have a specific MAGA clause but provide a more general regime for time and/or cost relief for the private partner as a result of contracting authority acts or omissions.

<sup>25</sup> <https://pppknowledgelab.org/guide/sections/64-adjustment-mechanisms>.

<sup>26</sup> <https://ppp.worldbank.org/public-private-partnership/resource-library>.

The PPP contract typically provides that the private partner is granted relief from breach of contract and from its obligations to perform under the PPP contract to the extent it is affected by the MAGA event. If the event occurs during the construction phase, the private partner will usually be contractually entitled to an extension of time for meeting key dates, such as the scheduled date for commencing operations.

The PPP contract also often expressly provides that the private partner will continue to receive payment from the contracting authority under the PPP contract as if it were still performing, and related deductions under the payment mechanism will be suspended.

The contracting authority will typically accept an obligation to compensate the private partner for losses and additional costs incurred as a result of a MAGA event. These will include any loss of revenue to the extent the contracting authority may not receive any payments after the MAGA event (and financing costs incurred due to any inability to meet payments as a consequence), and may incur costs to mitigate and rectify the effects of the MAGA event (i.e., increased PPP project costs). The private partner should still be obliged to mitigate its loss and, as with force majeure, its right to relief will be subject to its compliance with its notice and mitigation obligations.

## 2. Change in Law

All contracting parties must operate within the law and so must factor the cost, time and any other implications of complying with applicable laws into the performance of their contractual obligations. Over the course of a long-term contract, changes in laws may be introduced that were unanticipated at the outset of the contract. These changes may take different forms, such as the implementation of new or amended statutes, or the introduction of mandatory codes of practice, or new binding case laws, and may be related to COVID-19. They will vary across jurisdictions according to the applicable legislative frameworks. How contracts treat such consequences of changes in laws will depend on a number of factors, in particular how pricing is fixed under the contracts and the length of the contract terms.

An unexpected change in a law as a result of COVID-19 may, for example, make the private partner's performance of its contractual obligations easier or less costly, or it may render the project wholly or partially impossible, delay it, or render it more expensive. Through no fault of its own, it may find itself in breach of contract, as well as unable to earn its expected income and also required to incur additional costs to comply with the change.

It is market practice for contracts in both civil and common law jurisdictions to contain provisions expressly allocating the risk of certain changes in laws that occur after a specified date (typically linked to when the private partner's pricing is set) and that satisfy certain criteria regarding foreseeability. They also address how the consequences of changes in laws are to be managed. Depending on the jurisdiction, changes-in-law provisions generally provide the private partner with relief from contractual breach to the extent that compliance with the new law affects the private partner's ability to perform its obligations, and they also spell out how any resulting costs of compliance or necessary changes to the PPP contract scope are to be treated. Treatment may vary depending on the type of law change and the PPP project circumstances.

The private partner should be protected from breach of contract to the extent that (i) its performance is prevented or delayed by a change in a law it does not bear the risk of, and (ii) a variation in PPP project scope is required in order to comply with a change in a law (in which case the PPP contract should include

a mechanism for implementing such variations, for example by means of a contracting authority requested variation).

As for cost compensation, the PPP contract will need to set out how any compensation to which the private partner is entitled would be implemented. This will depend on the payment model, but could include:

- An increase in the availability payment paid by the contracting authority
- A permitted increase in the toll or tariff paid by the end users
- A reduction of any fees payable by the private partner (as applicable)
- A lump sum payment by the contracting authority to the private partner
- An extension to the term of the PPP contract.

If the event occurs in the construction phase, the private partner will usually be contractually entitled to an extension of time for meeting key dates, such as the scheduled date for commencing operations, to the extent any delay is attributable to the change in law.

### 3. Force Majeure

Force majeure essentially refers to events or circumstances that:

- Are beyond the control of the contracting parties, and
- Make it impossible for one party to fulfil all or a material part of its contractual obligations (i.e., they are prohibitive in nature, as far as contractual performance is concerned).

The aim of force majeure provisions in a PPP contract is to allocate the financial and timing consequences of force majeure events between the contracting authority and its private partner. The starting assumption for both parties should be that the risk of a force majeure event occurring is shared because it is outside both parties' control, and neither is better placed than the other to manage the risk of such an occurrence or its consequences.

In a traditional commercial contract, for example between two private sector entities, shared force majeure risk would typically include "acts of God," such as natural disasters and epidemics (often referred to as natural force majeure), as well as political events such as general strikes, nationalizations, and a public sector refusal to grant licenses (often referred to as political force majeure).

In a long-term PPP contract in which one of the parties is a public sector entity, there is close scrutiny of the types of political force majeure events that may arise during the life of the PPP contract, and how each risk should be allocated. This is because political force majeure is seen as more within the control of the public sector (and entirely beyond the control of the private partner).

In some jurisdictions (such as Australia and the UK), there is no need for a specific MAGA provision, because private partners accept that the types of political risks likely to arise are limited and can be dealt with through the force majeure shared risk provisions, together with separate provisions dealing with specific events for which risk is allocated either to the contracting authority (such as contracting authority breach of contract and change in law) or to the private partner.

If a force majeure event—such as an epidemic—occurs, the parties need to discuss how, and the extent to which, performance of the PPP contract can continue, and how the effects of the force majeure event can be mitigated or managed. The PPP contract may include an express provision to this effect, but in practice this should happen anyway (and will be necessary to properly assess any relief given to the private partner under the relevant provisions). These discussions may include actions such as contracting authority step-ins, where applicable.

Contracting authorities are likely to be asked to consider whether the private partner should be entitled to any relief if a force majeure event occurs and prevents it from performing. Apart from being unable to meet its contractual obligations, the private partner may incur additional costs and suffer loss of revenue to the extent that it is unable to commence or continue to provide the service. During the construction phase, a delay in completion may also cause the private partner to incur additional financing costs (e.g., additional interest during construction, or if it has to reschedule its repayment obligations). In the operating period, it is likely to still be incurring fixed costs (in particular debt service costs), which it may be unable to meet, and its financial position may be materially affected. This applies regardless of whether the user-pays or government-pays payment model is used.

Although the underlying principle of force majeure is that losses lie where they fall, and parties should bear their own costs and damages, different approaches can be taken.

The contracting authority should assess the extent to which it is prepared to pay compensation to the private partner to prevent a payment default under its project or financing agreements while a force majeure event subsists (e.g., by continuing to pay an availability payment or other compensation) and/or to enable it to make up for lost revenues and costs incurred if the PPP contract is to resume (e.g., via an extension of the operating period or increased tariff).

Although it is typical for a PPP contract to expressly include some additional relief (particularly with respect to force majeure events occurring during the construction phase), it is impossible to know in advance what will be appropriate following every force majeure occurrence, because the effects may vary greatly (some may have a greater or longer-term impact than others). In practice, if a force majeure event occurs, the parties will be discussing how to facilitate continued performance of the PPP contract (including agreeing at the time on any additional relief), and a contractual provision reflecting this is often included.

Typically, the party claiming relief for a force majeure event will be obliged to take reasonable action to mitigate its effects and provide a mitigation strategy to the other party. Failure to do so may affect its rights to relief. In some cases, the parties may agree to exclude certain measures from the mitigation requirement. Possible types of relief include:

- Relief from breach of contract
- Extension of time for performance
- Increased finance costs pre-completion
- Continued availability payments
- Tariff increases
- Extension of the operating period
- Interim costs / lump sum compensation

- Performance regime relief.

A prolonged force majeure event (typically in excess of six to 12 consecutive months) may trigger a right of either party to terminate the PPP contract, if it is unlikely that circumstances will return to normal and the parties cannot agree to a solution within the specified period.

### Contract Modifications in Türkiye for Concession Fee Payment Deferrals



Türkiye’s government deferred an airport public-private partnership’s (PPP’s) concession fees because of COVID-19’s effects. The Fraport TAV Antalya’s airport concession was extended by two years, and payment of the annual concession fee will be deferred from 2022 to 2024. This agreement will help the Fraport TAV Antalya joint venture to relaunch Antalya Airport on a steady course, maintaining continuity during such a critical time in air travel. Since early 2020, and continuing in 2021, the global pandemic and the resulting travel restrictions have severely impacted the air travel sector. In close cooperation with all authorities, Fraport TAV Antalya responded quickly, by implementing comprehensive COVID-19 hygiene and health protection measures for travelers, while maintaining operational capabilities. Recovery from COVID-19 related traffic losses requires continuity and commitment, along with time and patience from all stakeholders. Antalya airport served nearly 35.5 million people in 2019, reaching an all-time record number of passengers. In 2020, Antalya’s traffic dropped by nearly 73 percent year-on-year to about 9.7 million, amid the impact of the global pandemic.<sup>27</sup>

### Liquidity Concerns of the Private Sector are Taken into Account in Contract Modifications in India



In India, the government has taken a number of measures to ameliorate the impact of COVID-19 on infrastructure projects. The government has accepted that COVID-19 would be considered a force majeure event. As per the Indian Model Concession Agreements, the remedy for a force majeure non-political event is extending the concession period to the extent of the force majeure period. To address immediate liquidity concerns, the Reserve Bank of India allowed a moratorium on debt payments for six months. Accordingly, the deadline for fulfilment of contractual obligations of all government projects, including public-private partnerships (PPPs), which were due for completion on or after February 2020, were increased by up to six months in light of the COVID-19 crisis.<sup>28</sup>

### An Effective Dialogue With the Private Sector as Applied in Peru is Helpful for Contract Management



In Peru, the Ministry of Finance established a channel through which the concessionaires of a PPP project can request compensation from the government as a result of the financial losses caused by the restrictive measures implemented in the country (DS N ° 044-2020-PCM).

<sup>27</sup>*Financial Times*, February 16, 2021. <https://ftnnews.com/news-from-Türkiye/41238-fraport-tav-antalya-s-airport-concession-extended-by-two-years>.

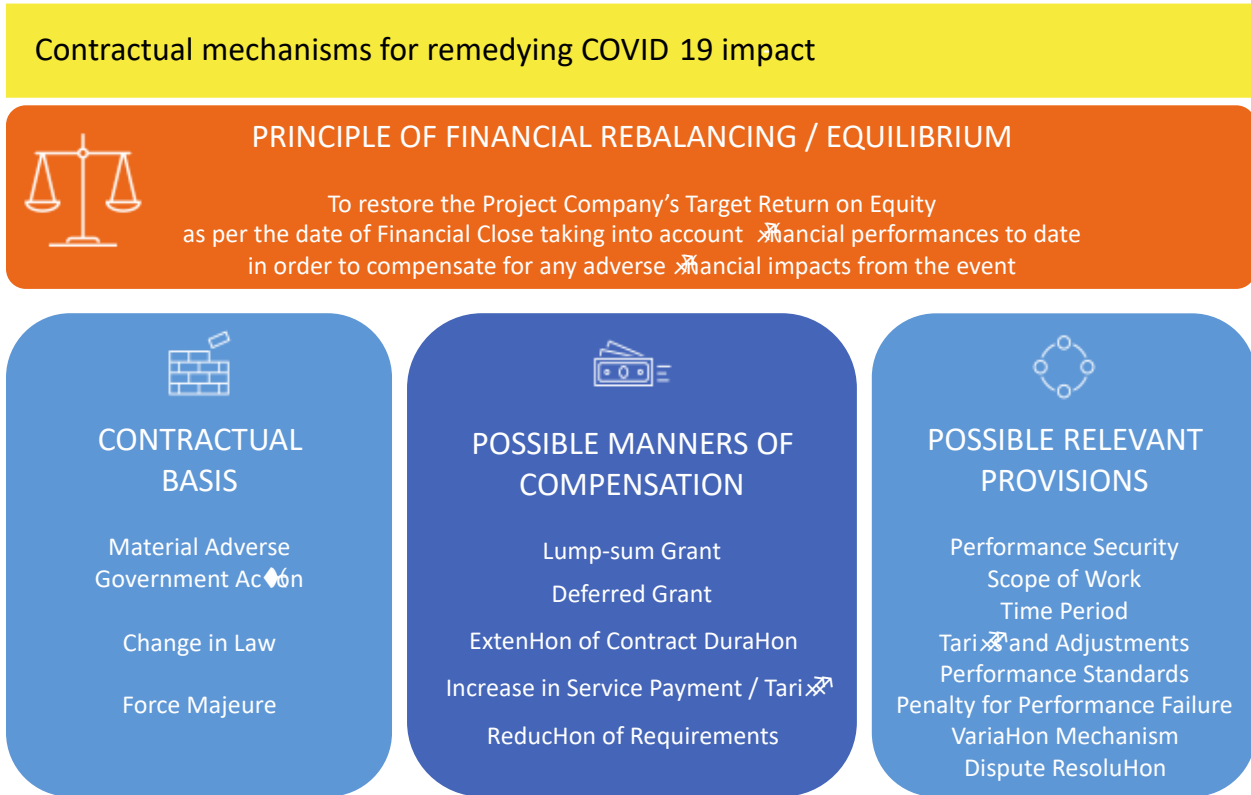
<sup>28</sup><https://www.financialexpress.com/opinion/public-private-partnership-ppp-project-failures-dont-put-zombies-on-life-support/2146855/>.



The concessionaire can request compensation only in cases in which it can show a clear causal effect from the measures adopted by the government to the financial performance of the PPP project. For this, the event date is defined as the date on which the restrictive measures were published in the Official Gazette (March 15, 2020, according to DS N ° 044-2020-PCM). Since that date, the concessionaire has needed to identify and show how the measures taken by the government created an adverse effect on the financial performance of the project, and how the risk allocation established in the public-private partnership (PPP) contract makes the government the bearer of such risk (in cases where the government is in charge, at least partially, of the risk). The concessionaire must propose a way to fix the imbalance through a mechanism such as extension of the PPP term, monetary disbursement by the public entity, increase in the toll rate, or reduction of obligations. The compensation mechanism is considered as long as it maintains the economic-financial balance between the parties and the allocation of risks. Once the request is made by the concessionaire, the public entity must determine which is the best solution—using the current contract to solve the differences, or amending the current contract to include a different agreed-upon solution. In the first case, both parties renounce their rights to future litigation; in the second case, they must observe the process established by regulation RM N° 461-2017-EF/15 (i.e., guidelines for the evaluation of proposals for contractual modifications to PPP contracts).

In summary, if PPP contracts are well structured, mechanisms should be in place for dealing with unexpected situations such as health emergencies. Some of the COVID-19 challenges can be addressed by interpretation of existing contractual provisions and provisions in the existing law. Changes in circumstances are usually covered by several PPP contractual provisions, including force majeure, which usually implies the suspension of penalties for non-performance, and compensation for higher costs and losses. An overview of contractual mechanisms to address any adverse impact of COVID-19 is depicted in the figure below.

Figure 8: Contractual Mechanisms for Remedying COVID-19 Impact



To ensure continued operation of PPP assets, governments may need to define emergency measures and discuss with PPP companies how to lessen their financial burdens. For instance, contract managers in line ministries may allow PPP operators to reduce services and change performance standards, temporarily relieving the companies of performance penalties. If services cannot be delivered due to the crisis or emergency measures, despite the best efforts of the PPP company, there can be also a temporary suspension of performance-related penalties and an extension of deadlines until services are re-established.

PPPs, as partnerships with government entities, are generally better protected from COVID-19 impacts than other private businesses. They are either government-funded projects or, if user-funded, they usually benefit from the above-mentioned contractual provisions or other tools that require governments to share or cover costs created by the crisis. Nonetheless, they may still need swift action by governments to safeguard public health, protect users and staff, and manage fiscal costs. For contracts in which force majeure is not well addressed, governments may need to quickly announce the protection they will guarantee to PPP companies. PPP projects with a heavy debt burden may need immediate support, which would involve public funds or government guarantees. The finance ministry should work with the contracting authorities to assess the current and future fiscal costs of those measures.

# **BUILDING BLOCKS OF AN ADEQUATE FCCL FRAMEWORK**



# 3 BUILDING BLOCKS OF AN ADEQUATE FCCL FRAMEWORK

## 3.1 Adaptative Government Support for PPPs Requires Adequate FCCL Management Frameworks to Ensure Fiscal Sustainability

Given the market's sensitivity to economic volatility, and the need for governments to respond through corresponding financial support to sustain PPP implementation, it is obvious that governments' fiscal exposures resulting from PPP-related liabilities is uncertain and may result in fiscal shocks.

In other words, PPP-related fiscal commitments imply fiscal risks, in particular those arising from contingent liabilities, because they are less clearly understood and thus require proper evaluation. Effective management of fiscal risks arising from contingent liabilities has long been a concern for country debt management offices, because realization of these risks has direct consequences for governments' fiscal positions, and thereby for public debt managers' debt and cash management policies and operations.

Fiscal risks are deviations of fiscal outcomes from what was expected when the budget was produced or when other forecasts were made. They relate to factors that can result in a government's fiscal performance deviating from what was originally forecasted in the medium term, or undermined sustainability over the long term. In fact, lower than usual economic growth rates trigger claims for bailouts from PPP projects in distress; therefore these deviations imply more expenses when fiscal revenues are lower, worsening the overall fiscal position.

It is common for unanticipated budget appropriations to be needed for operational PPP projects, to ensure the continuation of critical public services. Such additional fiscal needs can have a detrimental impact on a government's debt sustainability and development program, as has also been observed during crises. Such elements include potential shocks to government revenues, taxes, expenditures, assets and liabilities, which have not been factored in a government's fiscal forecasts or reports. Governments recognize that such risks cannot be left to chance and should be recognized and addressed as much as possible.

Thus, although PPPs generally do not immediately increase government debt, subject to an appropriate risk transfer to the private sector and depending on a country's accounting standards,<sup>29</sup> they do create liabilities and hence a fiscal commitment or exposure. Moreover, contingent liabilities are often problematic, because they frequently escape proper fiscal scrutiny as a result of their non-cash, long-term nature. In addition, they decrease the credibility and predictability of fiscal policy, and they may contribute to threats to long-term fiscal sustainability.

The historical record offers lessons for the design of PPP-related commitments. In particular, governments often have gotten into trouble by guaranteeing risks that investors were better placed to manage. Instead of covering particular risks, governments typically guaranteed total returns in the 1970s and 1980s.

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<sup>29</sup> Some mature economies have already adopted International Public Sector Accounting Standards (IPSAS) for accrual accounting, which indicates that most of the PPP projects will have to be accounted for on a government's balance sheet (see IPSAS 32 for further information), though most countries have not yet implemented such an accounting regime.

Recognizing the problem in the late 1970s, governments took precautionary actions to eliminate these generously provided liabilities and the resulting problems they faced. Following these policies, in the late 1980s, modern PPP support measures were developed, whereby performance-based methods and revenue- and risk-sharing mechanisms with the private sector were initiated. Key lessons from the history of PPPs and similar commitments are that the government should: ensure that its PPP commitments preserve investors' incentives to manage risks they can best manage; check that what it promises is what it wants; and manage the risks it assumes by providing the necessary commitments.

Moreover, as illustrated in the previous chapters, country evidence shows that a resilient framework for FCCL management of PPPs is critical also during crises. Crises can diminish the reliability of project appraisals, reduce the number of qualified and interested service providers, and increase costs or decrease revenues, increasing the probability of financial distress.

### 3.2 Fiscal Management is an Integral Part of the Overall PPP Framework

A sound framework—with clear procedures, decision criteria and institutional responsibilities for the identification, appraisal, structuring, tendering, implementation, and monitoring of PPPs—is therefore key. Such a framework ideally provides for implementing principles, a framework for process management, an institutional framework, and a framework for the management of FCCL. Other governance-related matters also must be addressed, such as quality assurance, transparency, and communication.

Developing such a framework requires a substantial effort from governments and might take years to mature. This makes sense when governments are considering the use of PPPs on a programmatic basis, but not when PPPs are considered only for some ad-hoc initiatives. The framework will help to standardize, facilitate, institutionalize, and guide the complex process of developing and managing PPP projects. If well developed and applied, it can help minimize the risk of project failure and also the related fiscal risks. It is to be recognized, therefore, that an FCCL framework does not stand in isolation, but is part of a broader framework geared towards ensuring effective and efficient development of PPP projects, balancing bankability, value for money, and affordability of associated fiscal commitments.

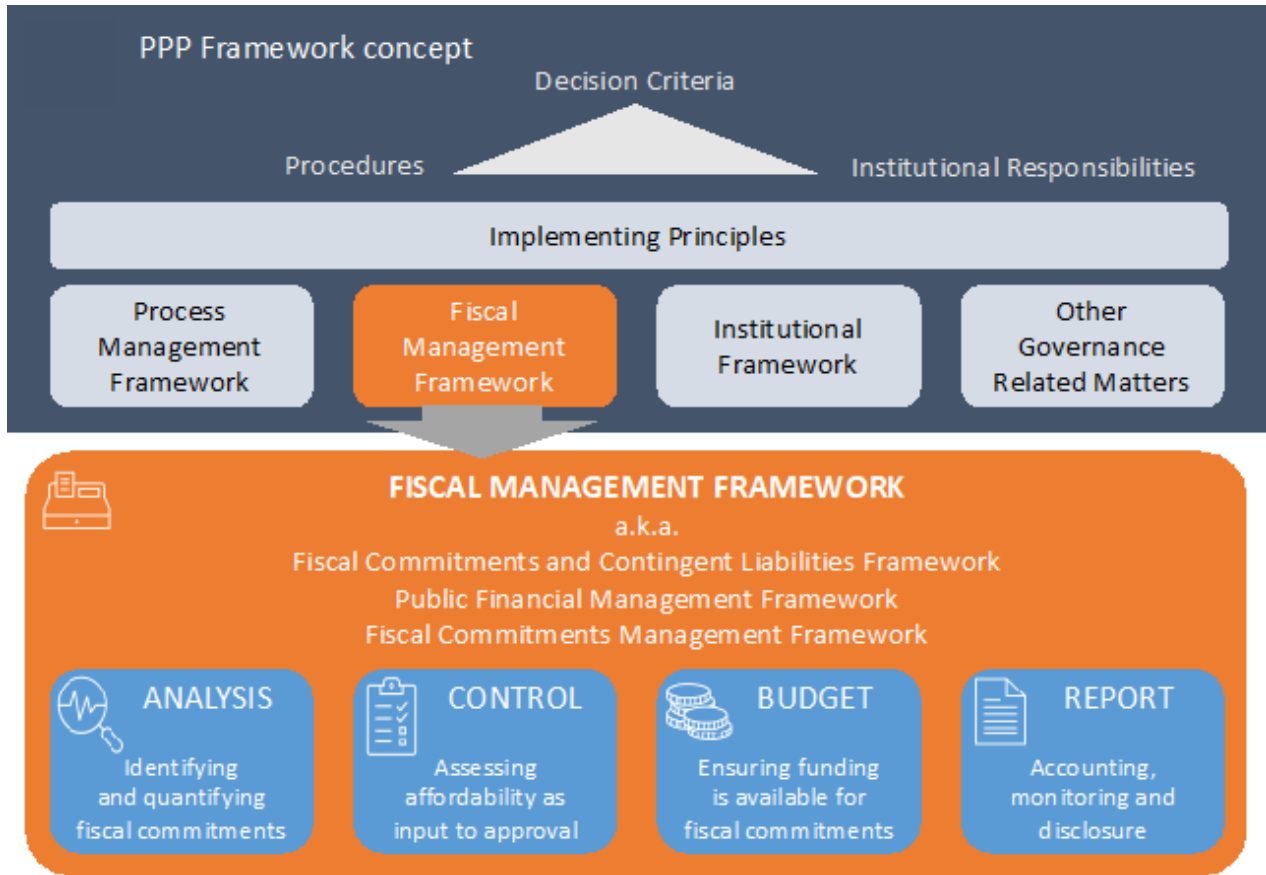
Budget risks from PPP-related liabilities increased during the last decade in developing countries with mature PPP portfolios, thereby impacting government debt levels. These risks also increased the importance of effective policies and tools to manage the fiscal commitments arising from PPPs. This type of framework typically includes measures to (i) identify and quantify the fiscal implications of PPPs, (ii) approve them based on clear and transparent decision criteria applied by the relevant government institutions, (iii) ensure appropriate funding is in place when the commitments materialize, and (iv) account and report on the fiscal implications to facilitate monitoring. Such a framework is referred to as a public financial management framework,<sup>30</sup> a fiscal commitments framework,<sup>31</sup> or a fiscal commitments and contingent liabilities framework. These terms will be used interchangeably throughout this report.

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<sup>30</sup> APMG PPP Certification Guide. <https://ppp-certification.com/ppp-certification-guide/18-public-financial-management-ppps> and <https://pppknowledgelab.org/guide/sections/33-public-financial-management-frameworks-for-ppps>.

<sup>31</sup> World Bank, International Finance Corporation, World Bank Institute, and Multilateral Investment Guarantee Agency. 2014. "Implementing a Framework for Managing Fiscal Commitments from Public Private Partnerships."

Figure 9: Fiscal Management Framework as Part of Overall PPP Framework



In general, FCCL tools and policies are developed according to a country’s needs, experience, and the lessons learned from the challenges it has faced. Typically, policies and practical arrangements have evolved and are heavily influenced by political demands, legal and regulatory frameworks, institutional arrangements, administrative tools, budgetary arrangements, and financial support.

To effectively operationalize an FCCL framework, it is good practice to incorporate it into the overall regulatory and institutional framework for the development and management of PPPs. This also helps mitigate any potential challenges to overall fiscal sustainability that a failed PPP could create. PPP fiscal treatment provisions have to be designed to increase the transparency of existing commitments and to avoid fiscally unsound deals. Economies with such provisions are expected to have more financially resilient PPP portfolios and fewer hidden liabilities arising from PPPs, which may be particularly relevant in times of turmoil.

### International Perspectives on FCCL Management

The relevance of proper fiscal management of public-private partnerships (PPPs) is also emphasized by international organizations in order to create sustainable and resilient PPP programs. To ensure fiscal sustainability and not be exposed to unanticipated fiscal shocks or place an undue burden on future

generations, sound and resilient fiscal management of PPPs is a condition sine qua non<sup>32</sup> for any PPP framework.

- *International Monetary Fund (IMF)*. PPPs can help improve public services. Yet strong governance institutions are needed to manage risks and avoid unexpected costs from PPPs. Although in the short term, PPPs may appear cheaper than traditional public investment, over time they can turn out to be more expensive and undermine fiscal sustainability, particularly when governments ignore or are unaware of their deferred costs and associated fiscal risks. To use PPPs wisely, governments should (i) develop and implement clear rules for their use; (ii) identify, quantify, and disclose PPP risks and expected costs; and (iii) reform budget and government accounting frameworks to capture all fiscal costs comprehensively.
- *United Nations Economic Council for Europe*. The huge needs of achieving the Sustainable Development Goals and the related effort to generate private financing to fill that gap through PPPs will increase the long-term funding and fiscal obligations of governments and could burden future generations further. Care must therefore be taken to ensure PPP funding is sustainable and not stressing public budgets.
- *APMG PPP Certification Guide*.<sup>33</sup> Strong public financial management is desirable, because poor financial management of PPPs can have wide-reaching economic impacts. Rating agencies will examine the overall financial health of governments, including the implications of PPP fiscal commitments, when assigning a rating to government debt. If a government is not managing the financial commitments of its PPP contracts, that government's bonds may be seen as a risky investment, increasing the overall government cost of debt.

Overall, in many countries around the world, the regulatory context for an FCCL framework is an area of concern. The World Bank's *Benchmarking Infrastructure Development 2020* concludes that only 17 of the 140 surveyed economies (12 percent) have a fairly comprehensive framework prescribed in their regulatory frameworks, including provisions for accounting, budgeting, and reporting of fiscal commitments. Thirty-six percent of the economies have introduced some type of regulatory provision regarding the accounting treatment of PPPs, and 37 percent have specific provisions about the budgetary treatment of PPPs. Reporting comes in as the least regulated instrument, with only 27 percent of economies having a legal provision concerning the matter.

### 3.3 Main Principles to Facilitate Management of Fiscal Commitments

Ideally fiscal commitments are to be managed through a framework approach that encompasses analysis, approvals, budgeting and reporting, wherein these procedures are also an integral part of an overall ideal PPP framework. This applies particularly to jurisdictions that deliberately pursue a program of PPP projects, which is highly desirable, because such a program implies repetition and allows for standardization and reaping the benefits of learning from experience. Such a program allows governments to offset the

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<sup>32</sup> A condition without which not; a necessary condition.

<sup>33</sup> The APMG Guide is an innovation of the World Bank, EBRD, ADB, IsDB and IDB, designed to be the new definitive reference for the PPP profession. It is being introduced as the body of knowledge for the Certified PPP Professional (CP3P) program.

substantial costs of developing a PPP framework and corresponding FCCL framework, with the value for money achieved from using PPPs.

The objectives of the FCCL framework should ideally be set out in a framed and well-structured policy or piece of legislation. Whether the framework is created through policy or legislation depends largely on a country's legal system or traditions. Countries with a common law system, such as Australia, tend to rely more on policy statements and guidelines, whereas countries with a civil law system, such as Chile, Peru and Türkiye, regulate their PPP frameworks and related FCCL frameworks more through legislation, i.e., an overarching PPP law and supporting implementing regulations or bylaws. Irrespective of the nature of the regulatory context, it should include normative and enforceable proceedings for the identification, measurement, and disclosure of fiscal commitments, as well as their management by the related project implementation agencies (national, local, or sub-national), central planning, and fiscal authorities, including PPP units, the ministry of finance (MOF), and high-level approval authorities.

Considering the institutional settings for an effective FCCL in PPP governance, the following common policies are observed in the case studies (these are also in line with the IMF's 2017 guidance on developing institutional mechanisms):

- Develop a policy framework for PPP commitments, specifying when and for what purposes they can be considered, and integrate decisions with the budget process, whereby the MOF plays the key role in examining guarantee proposals for appropriateness, cost-effectiveness, and fiscal impact, and develop capacity to evaluate the commitments.
- Focus on the risk management functions together with the other government debt and risk management frameworks, to assess credit risk in the context of debt and investment management.
- Establish adequate budgetary mechanisms and a centralized method or medium for recording and monitoring of information about guarantees, and ensure regular disclosure, especially of the government's exposure from these liabilities.

Based on the case studies, and taking into account recognized guidance materials from multilateral development partners, commonalities have been identified reflecting universal principles that constitute a sound fiscal management framework for PPPs under the four key categories listed below.

**Table 8. Rules for Sound Management of Fiscal Commitments**

#	Principles	Clarifications
ANALYSIS: Identifying and quantifying fiscal commitments		
1	Methodological guidance is in place to quantify fiscal impact	A duly authorized guideline can support a comprehensive, consistent, and accurate appraisal of the fiscal impact from a PPP, specifically for contingent liabilities
2	Tools are in place to assess the potential fiscal costs and risks	Spreadsheet-based applications, such as PFRAM, can help quantify the macro-fiscal implications of PPPs, understand the risks assumed by the government, and identify potential mitigation measures
CONTROL: Assessing affordability as an input to approval		
3	Fiscal impact is evaluated by a central budget authority throughout the PPP life cycle	The fiscal impact is evaluated, taking into account the level of development upon initial project screening, before tender launch, before commercial close, and for any contract variations





#	Principles	Clarifications
4	Value for money is considered to warrant fiscal commitments	A regulatory requirement to assess value for money in a guided and consistent manner can support the decision-making on the justification of any fiscal impact
5	Thresholds have been defined to cap fiscal exposure from PPPs	A duly authorized ceiling, in terms of an overall liability limit (irrespective of the delivery scheme, i.e., debt including PPP fiscal commitments) provides a reference for the affordability of PPPs
BUDGET: Ensuring funding is available for fiscal commitments		
6	Mechanisms are in place to plan and ensure funding is available for direct liabilities	To provide comfort to the private partner and ensure bankability, as well as to allow the government to anticipate the known, mechanisms should be in place to allow the government to honor its financial obligations for the duration of the contract
7	Mechanisms are in place to plan and ensure funding is available for contingent liabilities	To provide comfort to the private partner and ensure bankability, as well as to allow the government to anticipate the known, mechanisms should be in place to ensure the government is able to fund contingent liabilities, should they materialize
REPORT: Accounting, monitoring and disclosure		
8	Fiscal commitments are adequately accounted for and documented in a consolidated manner	Appropriate accounting standards, such as IPSAS, are applied to determine whether and when PPP commitments should be recognized and reflected as such in the financial statements
9	The legislature and other stakeholders are periodically informed on the jurisdiction's fiscal exposure from PPPs	A consolidated report is prepared on all PPP projects, including their fiscal commitments (direct and contingent), progress and value for money, and is appropriately disclosed to relevant stakeholders to facilitate oversight of the PPP program
10	Periodic audits are undertaken to confirm reliability and compliance of fiscal exposure	Regulatory and value for money audits from supreme audit entities can provide independent reviews of government finances and performance to parliaments and to the public
11	Fiscal management proceedings apply to all agencies that are under direct or indirect control of the government	To control and avoid unwarranted sub-sovereign fiscal exposure, the fiscal rules for PPPs should be applied to all levels of government

### 3.4 Case Studies Illustrate Good Practices on Management of Fiscal Commitments

Aside from the commonalities on the main proceedings that need to be in place for the sound management of fiscal commitments, the case studies have also allowed for the identification of good practices for the key components of an FCCL framework. These are commonalities that can guide governments in designing their FCCL frameworks, knowing that these principles are being applied in practice. These good practices, with their pros and cons, also may inspire governments to consider improving their FCCL frameworks. The manner of applying these principles in practice will be further elaborated on in this section of this report, which takes the ample guidance already available on the subject of fiscal commitments management to a more practical level, by describing not only the theoretical concepts, but how different jurisdictions have operationalized them.

The table below encapsulates the findings with regard to the level of application of the main principles for the different cases. The purpose of the table is not to provide a comparative assessment of the respective capacity to manage FCCL, but more to highlight appropriate references for specific elements of the FCCL framework.

Table 9. Application of Rules for Sound Management of Fiscal Commitments

		 Good Practice				 To Some Extent				 Absent or Negligible			
#	Principles	AUS	CHL	GEO	JOR	KEN	SIN	PHL	PER	ZAF	TUR		
<b>ANALYSIS: Identifying and quantifying fiscal commitments</b>													
1	Methodological guidance is in place to quantify fiscal impact												
2	Tools are in place to assess the potential fiscal costs and risks												
<b>CONTROL: Assessing affordability as an input to approval</b>													
3	Fiscal impact is evaluated by a central budget authority throughout the PPP life cycle												
4	Value for money is considered to warrant fiscal commitments												
5	Thresholds have been defined to cap fiscal exposure from PPPs												
<b>BUDGET: Ensuring funding is available for fiscal commitments</b>													
6	Mechanisms are in place to plan and ensure funding is available for direct liabilities												
7	Mechanisms are in place to plan and ensure funding is available for contingent liabilities												
<b>REPORT: Accounting, monitoring and disclosure</b>													
8	Fiscal commitments are adequately accounted for and documented in a consolidated manner												
9	The legislature and other stakeholders are periodically informed on the jurisdiction's fiscal exposure from PPPs												
10	Periodic audits are undertaken to confirm reliability and compliance of fiscal exposure												
11	Fiscal management proceedings apply to all agencies that are under direct or indirect control of the government												

# IDENTIFYING AND QUANTIFYING FISCAL COMMITMENTS



# 4

## IDENTIFYING AND QUANTIFYING FISCAL COMMITMENTS

### 4.1 Financial and Risk Structures Define Fiscal Risk Exposure

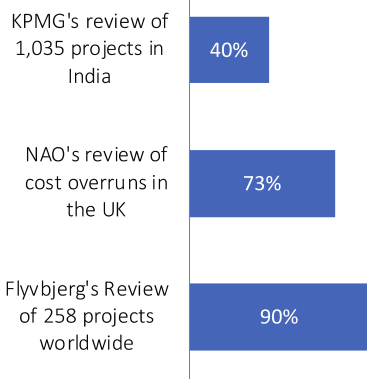
The analysis of a government’s fiscal exposure begins with understanding the risk a government is exposed to in a PPP arrangement, or, more specifically, the risk and responsibilities retained by the government in a PPP arrangement, and the manner of government support. The allocation of risks is the main principle that distinguishes a PPP from traditional public investment. Whereas traditional public investments essentially imply that project risks are allocated to the public authority, the PPP arrangement aims to transfer those risks to the private partner that can be better managed by that partner. This applies particularly to construction and demand risks, which are typically quite substantial in infrastructure development. Project cost overruns and delays are typical, and demand forecasts are rarely accurate.

Figure 10. Research on Main Project Risks

Infrastructure development is inherently uncertain

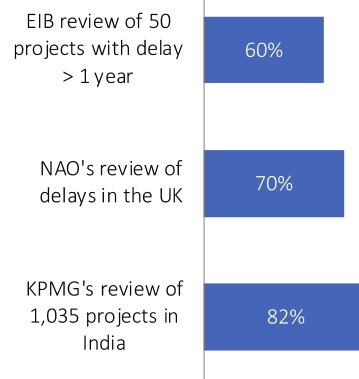
#### Cost overruns are more common than uncommon

Percentage of projects with cost overruns



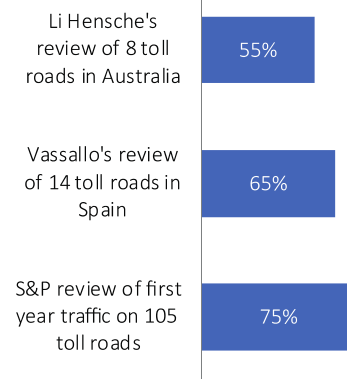
#### ... as are delays

Percentage of projects with delay



#### ...and traffic forecasts are rarely accurate

Actual as percentage of forecast



Sources: Flyvbjerg 2003, KMG 2010, NAO 2005, EIB 2005, Vassallo 2007, Standards & Poor 2005, Li & Hensche 2009

Transferring the life-cycle responsibility also typically adds value for money. Whereas traditional public investments focus on the lowest construction costs, the focus of a PPP arrangement is more on the lowest cost over the life of the project. Moreover, in a PPP arrangement, the private partner is obligated to ensure maintenance and meet contractually agreed-upon minimum performance standards, thus providing

satisfactory service over the life of the contract. Such contractual obligations are typically not in place with traditional public investments, for which maintenance and service delivery are subject to budget appropriations risks and political prioritization, and may imply less resilient infrastructure services.

PPPs do not eliminate project risks, but they do feature a business-oriented implementation partner that is able to make swifter managerial decisions, and that is incentivized to deliver the project on time and within budget, and to optimize operations performance to maximize profits. The involvement of lenders provides an additional layer of risk management. Lenders want to ascertain that the business case for the project is realistic and achievable, through appropriate due diligence and project monitoring.

PPPs also foster in government a more comprehensive and holistic approach to project risks prior to drafting contracts. With a long-term contract transferring to a private entity the immediate responsibility for project development and implementation, PPPs give the private partner the responsibility for major project risks, such as design, construction, maintenance, and operational risks. Thus, a well-structured PPP allocates to the private partner the risks that such a partner can manage better than the public partner (such as the ones that it can directly influence through business-minded project management).

The risk allocation is typically embedded in the PPP agreement. The challenge is to seek the optimal risk structure based on the principle of allocating risks to the party best able to manage them, while also taking into account the requirements of investors and lenders, and the fiscal implications of the retained and shared risks. The optimal transfer of risk is key. If the government retains too much risk, the project will not bring value for money and may become fiscally unaffordable. On the other hand, if the private party is not able to manage the risk and gets into a situation of financial distress, the government will be forced to intervene if it wants to continue the service provision. The government intervention might be either bailing out the private entity or terminating the contract and seeking a new solution to deliver the service.

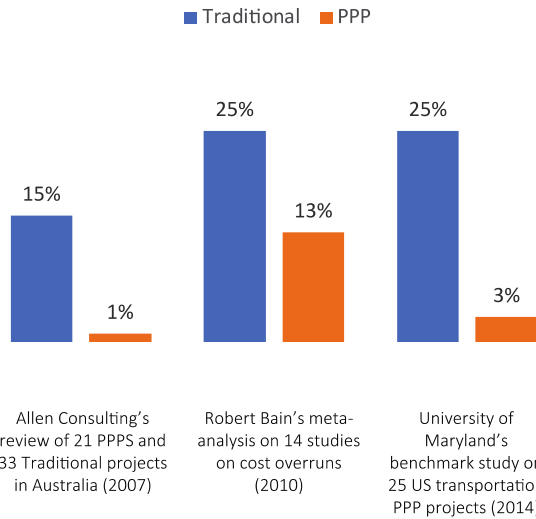
Although these principles do not guarantee that every PPP will be a success, empirical research demonstrates that, on average, PPPs are less prone to cost overruns and delays.

Figure 11: Impact of PPPs on Main Project Risks

On average, PPPs reduce major project risks

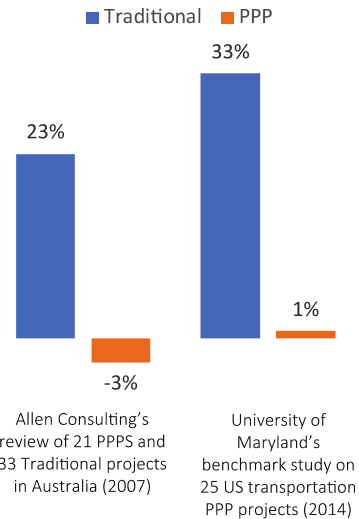
Less cost overruns

Value of cost overruns per contract type



... and less delays

Extent of delays per contract type



Sources: Allen Consulting (2007), Robert Bain (2010), University of Maryland (2014)

Transferring some risks to the private partner reduces a project's fiscal risks and makes the implicit contingent liabilities more explicit (though it does not necessarily reduce the fiscal burden, given the risk premium imposed by the private partner). Whereas in traditional public investment, the government is exposed to cost overruns and delays, or to demand shortfalls or substandard performance, the financial implications of such uncertainties are rarely quantified in advance, let alone formally evaluated, accounted for, and reported. With PPPs, these uncertainties are addressed in the formal risk allocation underlying the PPP arrangement through guarantee provisions or payment mechanisms, and the retained or shared risks for the public authorities can be subjected to the proceedings of an FCCL framework.

Generally, design, construction, commissioning, operations, maintenance, revenue, and financial risks are transferred to the private partner, unless a risk assessment clearly recommends the opposite. Risks related to responsibilities not naturally embedded in the scope or revenue regime are typically retained, as well as direct actions by the public partner affecting or changing obligations (contract changes and discriminatory changes in law). Risks beyond the respective responsibilities and capabilities of either party should generally be shared. The table below presents the most common occurrences of the main project risks in PPPs and their typical risk allocation (or options) between the public and private partners, as guided by international organizations and applied in numerous countries. It clearly indicates the risks that can be transferred to or shared with a private partner, that in the case of a traditional public investment would be retained by the public authorities. As such, the risk allocation defines the risks to be retained or shared by the government, and thus the fiscal exposure from the corresponding direct and or contingent liabilities, and is essentially the starting point for the FCCL evaluation.

Table 10. Common Risk Allocation Matrix<sup>34</sup>

Category	Description	Public	Private	Shared
<b>Construction</b>				
Land	Land is not available upon commencement of work, or cost of acquisition and/or expropriation is higher than estimated.	✓		
Site	Uncertain or adverse geotechnical conditions, archaeological findings, contamination and/or hazardous materials; utility relocation, latent defects, and/or squatters.		✓	
Environmental	Materially adverse impact in terms of contamination or pollution (gas emission, noise pollution during construction, water contamination, etc.), or materially adverse impact on the natural environment, such as impacts on biodiversity or visual impact on the landscape. Such circumstances mean that the project has to be changed, causing delays and especially cost increases.		✓	
Design	Defects in the design that result in the asset being built, but failing to meet the prescribed standards, legal requirements, and/or any conditions imposed by environmental or other stipulations. Such circumstances mean that the project has to be changed, causing delays and especially cost increases. Defects or failures in the design that result in the project not meeting the service standards requested in the contract, or that result in an increase in operation and maintenance costs in order to meet the service requirements.		✓	
Permits	Permits—typically based on final design—and/or licenses have not been obtained or are delayed, leading to delay in construction.		✓	
Construction	Actual project costs or construction time exceeds projections. This could be caused by defects or mistakes in design, a lack of appropriate planning, a lack of proper project and schedule management of the construction program, defects in the methods used, or other causes related to under-performance or even negligence by the private partner (or its contractors).		✓	
Commissioning	Failure to meet the construction outcome as prescribed, and/or the project as constructed failing to meet the completion acceptance criteria, thereby causing a delay in earning revenue.		✓	
<b>Operations</b>				
Demand	Demand not correctly estimated because of forecasting errors/uncertainty regarding economic development,	✓	✓	✓

<sup>34</sup> For a more detailed discussion of risk allocation in several sectors, the Global Infrastructure Hub risk matrices are available at <https://ppp-risk.gihub.org/>.



Category	Description	Public	Private	Shared
	population, network issues, competing alternatives, or, in the case of user charges, the willingness to pay.			
Revenue	Inability to fully capture the proceeds from the usage of the asset, because of leakage, fraud, counterparty default or other causes.		✓	
Performance	Improper maintenance resulting in a lack of performance, or cost for maintenance and operations is higher than expected.		✓	
Political	Materially adverse government actions, such as changes in laws/regulations, or changes in specifications/standards.		✓	✓
Force majeure	Events that are, by their nature, impossible to assess in terms of impact estimates, and very difficult to estimate in terms of likelihood. They are always caused by external agents (wars, riots, natural disasters, etc.).			✓
<b>Financial</b>				
Financing	Financing not available at financial close, or only available at a significantly worse price (margin and fees) and with worse conditions (including debt service cover ratio or maximum term) than anticipated.		✓	
Interest	Uncertainty in fluctuations of interest rate.		✓	✓
Inflation	Uncertainty in fluctuations of costs because of inflation.		✓	✓
Exchange rate	Uncertainty in fluctuations of costs because of currency depreciation.		✓	✓

The most contentious risk is the allocation of the demand risk. Whereas it may be opportune to allow a private entity to generate revenues from making the asset available to users, it may not always be possible to charge users—in the case of social infrastructure, for example—or it may not be manageable, because a private entity cannot control the level of demand. Examples include when demand is driven by economic developments and/or when the private entity has no tariff-setting mandate. A careful consideration of possible options for allocating and managing demand risk should always be addressed upon project preparation.

PPPs also introduce risks, most notably financial risks. Will the private partner be able to raise the necessary financing? What will be the terms, what if exchange rates change, etc.? Essentially such risks are the responsibility of the private partner, and it will include a risk premium for these uncertainties in its financial proposal. However, as indicated, there may be a need for the public authority to provide support in order to ensure bankability (as some countries experienced during the global financial crisis) or to bridge gaps in access to capital, otherwise the risk premium would be unaffordable for the users or government. Such support has to be properly evaluated, along with any other retained risks that may imply a fiscal exposure, in accordance with the appropriate use of the FCCL framework. Also, transferring a risk to the private partner does not eliminate the fiscal risk involved in that risk factor; during the COVID-19 crisis, in several countries, some risks allocated to the private partners bounced back to the governments via bailouts initiated in order to keep the services going, or via compensation claims related to force majeure or materially adverse government actions.



## The Philippines Has Adopted a Default Risk Allocation Matrix



In the Philippines, on December 7, 2010, the Investment Coordination Committee (ICC) Cabinet Committee adopted a Generic Preferred Risk Allocation Matrix (GPRAM). It was based on the results of studies conducted under the Philippines-Australia Partnership for Economic Governance Reforms (PEGR) Facility. Several modifications were made to the matrix and were noted by the ICC Cabinet Committee in 2014 and 2016. The GPRAM identifies the party that could best handle the risks involved in undertaking a public-private partnership (PPP) project, including some proposed mitigation strategies and contractual provisions for each risk. It is intended to be recommendatory and envisioned to serve as a reference for the ICC and the proponent agencies during the ICC review of PPP projects.

### 4.2 Risk Based Valuation Techniques to Quantify Liabilities

After identifying the allocation of responsibilities and risks, the fiscal impact must be quantified. For retained responsibilities, this typically leads to direct liabilities. This also includes any co-financing that is required to make the project commercially feasible, whether through grants or revolving instruments such as equity or debt.

The value of these direct payment commitments is driven by the project costs and any non-government revenues. The value of the direct fiscal contribution required is usually the difference between the cost of the project (including a commercial return on capital invested) and the revenue the project can expect to earn from non-government sources such as user fees.

The fiscal cost can be measured in the following ways:

- *Estimated annual payments.* The amount the government expects to have to pay during each contract year, given the most likely project outcomes. This is the most useful measure when considering the project's budget impact.
- *Net present value of payments.* If the government is committed to a stream of payments over the lifetime of the contract, such as availability payments, it is often helpful to calculate the net present value of that payment stream. This measure captures the government's total financial commitment to the project, and it is often used if incorporating the PPP in financial reporting and analysis (such as debt sustainability analysis). Calculating the net present value requires choosing an appropriate discount rate (the choice of discount rate to apply when assessing PPP projects has been a subject of much debate).<sup>35</sup>

Regarding shared risks and consequently contingent liabilities, assessing the cost is more challenging due to the uncertainties. The APMG PPP Certificate Guideline<sup>36</sup> refers to two common approaches:

- *Scenario analysis.* This involves making assumptions about the outcome of any events or variables that affect the value of the contingent liability, and calculating the cost given those assumptions.

<sup>35</sup> Many countries use the local risk-free rate, which is in theory incorrect, because many of these payments occur during crises when the cost of capital is higher.

<sup>36</sup> APMG, PPP Certification Guide. <https://ppp-certification.com/ppp-certification-guide/182-identifying-and-quantifying-fiscal-commitments-ppp-project>.

For example, this could include working out the cost to the government in a “worst case” scenario, such as default by the private party at various points in the contract. It could also include calculating the cost of a guarantee based on a certain variable, such as demand (different costs for different levels of demand outturns).

- *Probabilistic analysis.* An alternative approach is to use a formula to define how the variables that affect the value of the contingent liability will behave. A combination of mathematics and computer modelling is then used to calculate the resultant costs. This enables analysts to estimate the distribution of possible costs, and then calculate measures such as the median (most likely) cost, the mean (average) cost, and various percentiles (for example, the range of values within which the cost falls 90 percent of the time). To be useful, probabilistic models need reliable data from which to estimate the probability distributions of the underlying risk variables.

Due to the complexity of these analyses, rarely are observations available of how different countries have addressed the identification and appraisal of contingent liabilities. However, there are some cases where this is being done through highly sophisticated approaches, for example in Chile and Peru.

As the simpler, more intuitive approach, scenario analysis may be more practical for assessing PPP fiscal commitments. Probabilistic analysis requires a lot of information (such as from empirical research or a risk panel) on the underlying risk variables, and it can be difficult to implement and interpret. In practice, only a few countries use this approach to assess exposure to some specific risks, such as Chile’s analysis of exposure to revenue and exchange rate guarantees, or the Black Scholes option theory in Kenya.

**Table 11. Key Analysis of Fiscal Commitments**

Type of Fiscal Commitment	Suggested Analysis
All PPP projects	Estimate/compute the value of the PPP project debt
Direct fiscal support (such as availability payments)	<ul style="list-style-type: none"> <li>• <b>Annual cost</b> over the project life (both upfront and ongoing commitments)</li> <li>• <b>Present value</b> of the payment stream for long-term commitments.</li> </ul> Both values should be calculated under “base case” assumptions, and under “downside” scenarios for key assumptions.
Guarantees on particular risk variables (such as demand or exchange rate variables)	At a minimum, a scenario analysis approach should include: <ul style="list-style-type: none"> <li>• <b>Estimated annual cost</b> in different scenarios for each guaranteed risk variable (base case and downside rate scenarios)</li> <li>• <b>“Trigger points”</b> for relevant risk variables—that is, the change from the base case at which contingent liabilities become payable (for example, percentage drop in demand from base case at which a demand guarantee is payable), and qualitative analysis of the likelihood of reaching these values.</li> </ul> Over time, and for variables for which the government is building up significant exposure, this could move toward a probabilistic approach (to determine “expected” value and range).

Type of Fiscal Commitment	Suggested Analysis
<b>Payment guarantees</b> (guarantees on payments by state-owned enterprises (SOEs) or local/subnational governments)	Value of underlying payment requirements (“face value” of guarantees), in terms of: <ul style="list-style-type: none"> <li>• <b>Annual cost</b> over the project life</li> <li>• <b>Present value</b> of the payment stream.</li> </ul> Analysis of transfers likely to be required to meet payments in different scenarios for key variables (for example, sector tariffs), and a qualitative estimate of likelihood of each scenario.
<b>Termination payment commitments</b> (payments in case of contract termination by either party)	<ul style="list-style-type: none"> <li>• <b>Maximum value</b> of the termination payment, under base case assumptions (value will vary over the project lifetime; maximum typically occurs at project commissioning, when debt has been drawn down and repayments have yet not started).</li> <li>• For any termination payments triggered by concessionaire default, <b>trigger points</b> for relevant key assumptions at which default might occur (for example, percentage drop in demand that would mean insufficient cash for debt service), and a qualitative analysis of the risk of default.</li> <li>• <b>Expected value</b> in terms of likelihood and impact. The likelihood can be based on country-specific experiences with project cancellations or even global experiences with cancelled PPP projects (as per the PPI database, some 4 percent of the recorded PPP agreements worldwide have been cancelled after award). The impact refers to the possible compensation schemes upon early contract termination.</li> </ul>

### Regulations in Peru to Quantify Contingent Liabilities

In Peru, since 2015, contingent liabilities have been regulated by a guideline that proposes a methodology to measure quantifiable contingent liabilities at two different stages in the public-private partnership (PPP) cycle—ex-ante contract awarding and ex-post contract signing. Recording of direct and contingent commitments is also regulated by the same guideline. These commitments are recorded according to the type of payment, guarantee, or contingency that was established in the PPP contract, and the sum of each type of commitment is reported in the Multi-Annual Macroeconomic Framework.

The guideline proposes estimating the underlying value as a function of a fixed and variable component, as follows:

$$SFV,t=f_t(CFa1FV,t,CFa2FV,t, \dots CFarFV,t; X1FV,t, X2FV,t, \dots, XmFV,t)$$

where,

$SFV,t$  is the underlying value at valuation date  $t$  (i.e.,  $FV,t$ );

$f_t$  is a functional form described below;

$CFarFV,t$  is the  $r$ -th fixed component that is adjusted at valuation date  $t$ ; and

$XmFV,t$  is the variable component  $m$ -th at valuation date  $t$ .

For the first set of variables (Cfa), the assessment consists of getting for the r-th fixed component a convenient flow of values that reflects the adjustment undergone during the passage of time. This adjustment is usually done using one particular forecast of the price index or the exchange rate. In the guidelines defined by Peru, those values are forecast using a program evaluation and review technique (PERT) probability density function (pdf), with parameters defined in some way by the monetary policy for the price index (i.e., [min, mean, max] = [1%, 2%, 3%]), and using bootstrap simulations with monthly data from the last 15 years for defining the parameters of the PERT pdf for the exchange rate (i.e., [min, mean, max] = [ E[min1-10,000], E[mean1-10,000], E[max1-10,000]]). Then, the Cfa flow is merely the initial value—which is usually defined in the PPP contract (e.g., initial traffic revenue)—adjusted by the forecasted price and exchange rate values.

Regarding the second set of variables (X), the assessment is a little more complicated, and the guideline poses two scenarios, one in which there exists enough historical information—requiring at least 30 years of annual observations—and another in which there is not enough information, or information is non-existent.

### 4.3 PFRAM to Appraise and Consolidate Fiscal Commitments<sup>37</sup>

Beyond understanding risks from individual guarantees or portfolios of guarantees, both in terms of a government's general fiscal activities and in terms of PPP policies, a more comprehensive and integrated assessment of the potential impact of the realization of guarantees (or other contingent liabilities) on public finances—including government solvency, liquidity, and financing needs—is helpful in establishing an FCCL framework. The PPP Fiscal Risk Assessment Model (PFRAM), developed by the IMF and the WBG, is an analytical tool to assess fiscal costs and risks arising from PPP projects. It is designed to assist governments in assessing the fiscal implications of PPPs, as well as in managing these projects in a proactive manner. Since it was launched in April 2016, PFRAM has been used in the context of IMF and WBG technical assistance, as well as by country authorities (PPP units, MOFs, and public corporations) to better understand the medium- to long-term fiscal implications of PPPs.<sup>38</sup>

PFRAM also estimates the potential fiscal impact of contingent liabilities related to PPPs, namely debt and minimum revenue guarantee. These contingent liabilities can turn into fiscal costs if a specific situation occurs—for example, if the debtor does not service the debt that has been guaranteed by the government, or if actual demand for the project is much lower than forecast at the time of the contract awarding. PFRAM estimates the fiscal impact under the worst-case scenario to incentivize more prudent management of PPPs. By assessing both fiscal costs and risks in PPPs, PFRAM allows the government to make informed decisions about public investments, ensuring that (i) the fiscal impacts of existing PPPs are well understood and appropriately managed, and (ii) new PPPs are only awarded if they do not undermine the long-term sustainability of public finance.

<sup>37</sup> PFRAM is available at <https://library.pppknowledgelab.org/documents/document-group/106>.

<sup>38</sup> IMF and WBG (International Monetary Fund and World Bank Group). 2019. PPP Fiscal Risk Assessment Model (PFRAM) Guideline V.2.

## Risk-Based Guarantee Fees

Several other tools for public-private partnership (PPP) guarantees are commonly used to mitigate and control commitment exposures, such as risk-based guarantee fees. Charging a risk-based fee can moderate the demand for guarantees and force greater discipline in their use (OECD 2013). A risk-based fee recognizes that not all guarantees are equally risky, and therefore riskier projects and loans should invite higher guarantee fees.

These types of risk-based guarantee fees are more applicable to sub-sovereign public agencies and their PPP supporting tools. Moreover, the PPP company will bear the cost of the fee. Countries such as Australia, Chile, Colombia, Israel, Peru, Sweden, and the United States levy risk-based fees on guarantees. Country practices vary in terms of fee structures used in overall support policies that are not directly linked to PPP guarantees. Denmark and South Africa charge flat fees, upfront and on an annual basis, respectively. In Türkiye, risk-based and upfront fees are linked to expected losses but capped at 1 percent of the nominal amount guaranteed. In Colombia, guarantee fees are set at half the guarantee's market value. In Thailand, fees are differentiated by risk and maturity of the underlying borrowing instrument. In the Philippines, guarantee fees are complemented by foreign-exchange risk fees, in the case of borrowing in foreign currencies. In Tunisia, the government applies fixed fees for guarantees for both local and external loans, and retains the right to charge borrowers a premium for taking on exchange-rate risk in on-lending transactions, dependent on the beneficiary's financial situation and the terms of the transaction.

### 4.4 Guidance Supports Analysis of Fiscal Exposure

Whereas control, budget and reporting are typically regulated through government regulations, the methodology and approach to the identification and quantification of fiscal commitments, particularly contingent liabilities, is more typically provided for through guidelines, and ideally supported through specific tools such as PFRAM.

However, though many governments have highlighted the overall mechanisms for the FCCL framework in their regulatory frameworks, only a few have operationalized this through guidelines and tools. In several of the cases reviewed, draft recommendations for an FCCL framework were in place, though they have not been adopted or operationalized. Often it is left to advisors to value the fiscal exposure. However, without clear instructions, this may lead to an inconsistent appraisal and thus ineffective control.

Figure 12: FCCL Analysis Tools in Selected Cases



It is advisable to have in place a practical, comprehensive, and cohesive set of guidelines and tools to identify fiscal commitments and contingent liabilities, ideally aligned with or embedded in overall guidelines for the development and management of PPP projects.

FCCL management and operational strategy should be defined in a public document and comprise principles and/or requirements for taking over certain risks; guidelines for prevention and mitigation approaches; and an indication of how fiscal commitments and analyses will be considered in fiscal policy formulations.

Kenya PPP Framework Provides for Explicit Policy on Government Support Measures



In 2018, thanks in no small part to the World Bank Infrastructure Finance Public Private Partnership (IFPPP) project, important regulatory additions were adopted, including the “Policy on the Issuance of the Government Support Measures in Support of Investment Programmes” (hereafter, GSM Policy) published by the National Treasury and Planning in October 2018, and the “PPP Fiscal Commitments and Contingent Liabilities Management (FCCL) Framework” (hereafter, FCCL Framework) published by the same agency in April 2018. In the area of FCCL management, these two documents were especially important, because they provided much-needed detailed guidance. Specifically, the GSM Policy: provided a useful analysis of the existing regulatory and procedural gaps related to the practice of issuing GSMs and the rationale for the adoption of the GSM Policy; laid out 10 policy statements; listed all possible GSM instruments and types of risks for which GSMs could be issued; clarified conditions under which those GSMs could be approved, including limited effectiveness dates and restrictions on transferability to third parties; and described procedural steps for application, approval, monitoring, reporting and accounting for the issued GSMs and the direct and contingent liabilities associated with them. Finally, the GSM Policy provided for the establishment of the GSM Risk Register and Risk Management Committee, to ensure early awareness of potential problems and their timely management. The FCCL Framework is cross-referenced in the GSM Policy and provides step-by-step guidance for identification, assessment, monitoring, reporting and disclosure of FCCL risks related to PPP projects.

### Georgia Has Developed a Comprehensive Set of Guidelines for the PPP Cycle, Including FCCL Proceedings



In Georgia, following the enactment of the Public Private Partnerships (PPP) Law, the government prepared and issued Decree № 426 “On Approval of Rules of Developing and Implementing Public-Private Partnership Projects” in 2018. These PPP Regulations clarify that the PPP project cycle consists of five stages, including: (i) project identification and initiation, (ii) project preparation, (iii) selection of a private partner, (iv) project implementation, and (v) post-implementation assessment. They provide a standardized process for preparation of PPP projects, as well as some details on separate procurement processes for concession and non-concession PPPs. In addition to the PPP Law and PPP Regulations, the government adopted PPP Guidelines for all phases of the PPP project cycle through the Order of Minister of Finance № 100 in April 2020. These guidelines were developed with the support of the Asian Development Bank (ADB) and the US Agency for International Development (USAID) Georgia Good Governance Initiative (GGI), and are intended to ensure the fiscal sustainability of Georgia’s PPP program, as well as include value for money (VfM) methodology. On the fiscal commitments and contingent liabilities (FCCL) side, the guidelines provide basic definitions used in the management of fiscal risk, introduce various instruments of government support to PPPs, and place the general obligation on the Ministry of Finance (MOF) to assess the reasonableness of providing support through specific instruments, with certain step-by-step instructions on how to make such decisions. They also provide operational support to public and private partners in preparing PPP projects in line with international good practice, and add further detail on institutional responsibilities, processes and outputs within each phase of the PPP cycle, as well as evaluation criteria permitting a project to advance from one phase to the next. The finalization of the PPP Guidelines and VfM methodology in 2020 was an important milestone for the future of PPPs in Georgia, because the International Monetary Fund (IMF) had earlier put restrictions on expansion of the country’s PPP pipeline until VfM methodology, in accordance with recommendations of IMF technical assistance (TA), was approved and incorporated in the PPP VfM guidelines. However, the PPP Guidelines remain mostly theoretical, because not many new projects came in after adoption of the guidelines and, hence, practical experience is yet to be gained with the process.

# ASSESSING AFFORDABILITY AS AN INPUT FOR APPROVAL





# 5 ASSESSING AFFORDABILITY AS AN INPUT FOR APPROVAL

## 5.1 The Ministry of Finance is Key for Gatekeeping

The quantified fiscal commitments and contingent liabilities have to be assessed for approval. This implies that ideally rules are in place regarding (i) which entity reviews and approves the fiscal commitments and contingent liabilities; (ii) when in the project life cycle the assessment takes place; and (iii) how the project's affordability is assessed (i.e., the decision criteria for judging the affordability of the fiscal impact of the PPP and acceptability of the risk).

In terms of entity, providing gatekeeping authority to the MOF or central budgetary authority is a key ingredient to establishing a robust FCCL framework. The MOF or central budgetary authority, being responsible for the overall fiscal sustainability of a country, is the agency best positioned to decide if a PPP is in fact fiscally sustainable, and to act as a counterbalance to spending agencies that usually take on the role of procuring authorities. The IMF suggests:

*“In each country, the Ministry of Finance and the Finance Minister—as the guardians of fiscal sustainability—should be provided with a clear legal mandate on PPPs. The fiscal risk oversight functions of the Ministry of Finance should be underpinned by a robust legal framework providing for clear institutional arrangements and an explicit legal mandate to the Finance Minister to manage fiscal costs and risks stemming from PPPs—contracting authorities must seek the Finance Minister’s approval (or nihil obstat) for the selection of PPP projects, for the draft contract (and explicitly for any deviations from standard clauses), and for contract award (or renegotiation). The Minister of Finance should also be given the legal authority to require the relevant information from different government entities, agencies, and state-owned enterprises to identify and analyse the risks. The absence of a formal authority may mean that the Ministry of Finance will have to rely on moral suasion over line ministries and other contracting authorities.”<sup>39</sup>*

Thus, the MOF plays a critical part in ensuring the affordability of the government's PPP program. Given that PPP strengthening is at an early stage of development, there is a need for MOFs and other ministries to increase their capacities to understand all the risks associated with PPP contracts and their fiscal implications. Although the MOF is primarily concerned with fiscal risk, understanding other PPP policy-related project risks and general PPP program governance risks is encouraged, because they can affect the probability and impact of fiscal risk.

Moreover, with effective PPP fiscal risk governance, the MOF should have key responsibility for the following tasks:

- Providing guidance in relation to fiscal aspects of pre-feasibility and feasibility assessments

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<sup>39</sup> Fouad, M., C. Matsumoto, R. Monteiro, I. Rial, and O.A. Sakrak. 2021. “Mastering the Risky Business of Public-Private Partnerships in Infrastructure.” Departmental Paper 2021/010. IMF (International Monetary Fund).

- Developing PPP market-related, long-term financing and innovative tools and de-risking policies
- Managing direct and contingent liabilities
- Developing accounting procedures for PPP projects and establishing accounting principles
- Providing guidance to the sub-national (local government, provincial, and state-owned enterprise [SOE]) level, and collecting and monitoring direct and contingent liability data
- Setting national-level project reporting standards in relation to PPP projects.

These key tasks have become applicable within the last decade of PPP legal developments, including secondary legislation. In line with regulatory developments, moreover, principle setting and operational strengthening of PPP and FCCL related departments and units in MOFs have also been observed, especially for the countries that have more developed or mature PPP programs. The following table summarizes the key institutional roles and their coordination in the gatekeeping process.

**Table 12. PPP Institutional Roles in FCCL**

Government Department or Agency	Key Responsibility	Typical Role During PPP Life Cycle
<b>Contracting authority</b>	A contracting authority may be a government department, agency, municipality, or state-owned enterprise. It is the signatory to the PPP contract from the government side. Sometimes line ministries delegate procurement responsibility to a central procurement agency, but typically they retain responsibility for policy.	<ul style="list-style-type: none"> <li>• Monitors the project and regularly obtains information needed from the PPP sponsor for fiscal commitment tracking over the life of the project</li> <li>• Monitors and responds to fiscal commitment-related project risks</li> <li>• Includes fiscal commitment payments in budget requests submitted to the government</li> <li>• Reports the data for FCCL occurrences to the PPP unit for the PPP database and to the MOF/Treasury units.</li> </ul>
<b>PPP unit</b>	The entity or unit responsible for PPP policy formulation and coordination; technical assistance for PPP projects; standardization and dissemination of tender documents; and PPP promotion and marketing.	<ul style="list-style-type: none"> <li>• Supports identification of PPP projects</li> <li>• Screens PPP initiatives for PPP suitability</li> <li>• Reviews project appraisals and proposed PPP structures</li> <li>• Supports PPP tenders and contract awards</li> <li>• Monitors PPP implementation to ensure ongoing value for money</li> <li>• Oversees the PPP database.</li> </ul>
<b>Ministry of Finance / Treasury -Public debt unit -General budget unit --Macroeconomic forecast unit</b>	The central budgetary authority approving PPP projects and responsible for budgetary treatment of PPPs, accounting and/or reporting treatment, and fiscal affordability assessment, including identification of the required long-term public commitments (explicit and implicit).	<ul style="list-style-type: none"> <li>• Monitors the impact of PPP fiscal commitments (particularly contingent ones) on fiscal risk</li> <li>• Incorporates updated fiscal commitment estimates into debt and fiscal sustainability analyses, and discloses them in reports</li> <li>• Creates provisions for PPP contingencies and fiscal rules on the use of any resources that are set aside to respond to these contingencies</li> <li>• Allocates and releases budgets for direct payments and realized contingent liabilities</li> <li>• Incorporates updated PPP liabilities in macro/fiscal projections</li> </ul>

Government Department or Agency	Key Responsibility	Typical Role During PPP Life Cycle
		<ul style="list-style-type: none"> <li>Undertakes scenario analyses and stress tests.</li> </ul>
<b>PPP council<sup>40</sup></b>	High-level decision-making body that typically involves entities such as the finance minister, cabinet, the Ministry of Planning and International Cooperation. May be supported by the PPP unit acting as its secretariat and gatekeeper, responsible for checking that all the procedures have been followed.	<ul style="list-style-type: none"> <li>Approves any key PPP governance policies, PPP project decisions, limits and procedures, and renegotiates PPP contracts.</li> </ul>
<b>National audit agency</b>	On behalf of the government or the parliament, the supreme audit agencies responsible for ensuring that information being provided to parliament is complete and relevant.	<ul style="list-style-type: none"> <li>Performs regular audits, which can include auditing the financial statements of government entities and auditing decision-making processes for compliance and probity (i.e., checking whether the proceedings comply with the regulations)</li> <li>Performs VfM audits, reviewing the government’s effectiveness and efficiency based on the selected projects/programs.</li> </ul>
<b>Parliament</b>	The key legislative oversight authority in FCCL management, approving ceilings for fiscal exposure and monitoring the government’s performance with regard to PPPs.	<ul style="list-style-type: none"> <li>Reviews and monitors the framework, including fiscal limitations such as commitment ceilings, justifications, and additional regulatory and institutional amendments, and approves the budget appropriations for meeting the FCCL.</li> </ul>

<sup>40</sup> Generally formed as a collective high-level decision-making authority for overall PPP governance and the full PPP life-cycle period, including PPP approval, procurement, and contract management. The finance minister generally has veto power in this process.



Figure 13. Institutional Setup for PPPs in Selected Cases

Institutional setup for PPP for the selected cases										
	Chile	Georgia	Jordan	Kenya	Peru	The Philippines	South Africa	Pakistan	Turkey	Australia
Contracting authority	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
PPP unit	✓	✓	✓	✓	✓	✓	✓	✓	✗	✓
Ministry of Finance	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
PPP council	✓	✗	✓	✓	✓	✓	✗	✓	✓	✗

This institutional arrangement for gatekeeping is largely applicable for all the cases reviewed for this report.

### Sindh Has Defined an Effective Governance Structure for Developing PPPs



In Pakistan’s Sindh province, the 2010 Sindh Public Private Partnership (PPP) Act, amended in 2011, 2014 and 2018, defined the framework and established a PPP Policy Board to develop policies based on strategic goals. It also established a PPP Unit within the Finance Department, to assist contracting agencies in the preparation and execution of projects. The act outlines the institutional arrangements for PPPs; stipulates the rules, procedures and responsibility for selecting private-sector partners; lists the main terms and conditions of PPP agreements; outlines the types of government support; and defines cost recovery and risk-sharing principles. Roles and responsibilities have also been defined between the unit and different provincial government agencies, and the PPP Policy Board must approve all projects undertaken by the PPP Unit in coordination with various government agencies.

### Kenya Rationalizes PPP Approval Process



Legislative reforms in the new Public Private Partnership (PPP) Act 2021 centralize certain approvals in the PPP process within the PPP Committee, while pushing others down to the PPP Directorate. For example, the PPP Committee takes over some oversight functions from the Debt Management Office, and final approval for a contracting authority to enter into a PPP agreement now rests with the PPP Committee rather than with the Cabinet or the Parliament. These institutional changes are expected to be received positively by the private sector—doing away with PPP Nodes creates a more centralized approach,

allowing for the development of PPP expertise in one place instead of it being spread across numerous nodes. Furthermore, by reducing the direct role of the government in PPPs (by removing the Cabinet approval function), projects are de-politicized and are less susceptible to being derailed to meet competing political objectives.<sup>41</sup>

## 5.2 Gatekeeping is Required Throughout the PPP Lifecycle

With the MOF as a key gatekeeper, it is also important to recognize that gatekeeping is essential throughout the PPP lifecycle. Given the somewhat different definitions for the phases in a PPP process, guidance is provided by the World Bank's *PPP Reference Guide* and the APMG's Certification Guide to harmonize the boundaries of the respective stages in the following manner.

1. *Identification and screening.* A technical solution or possible option is described, and its relevance and sensibility, as well as its suitability for a PPP, have been tested, including a tentative indication of the affordability of the fiscal implications.
2. *Appraisal.* A comprehensive and thorough assessment of technical, economic, legal, social, environmental and commercial feasibility has been undertaken to confirm the investment and procurement decision.
3. *Structuring.* The structure of the envisaged PPP has been finalized, in terms of risk allocation and financial structuring from the public sector, and an appropriate set of tender documents has been drafted.
4. *Tendering.* A tender has been launched, qualifying suitable interested partners, selecting a preferred bidder, concluding the agreement, and securing the financial resources.
5. *Implementation.*<sup>42</sup> The asset and its operations have been commissioned and delivered, and the asset has been handed back upon contract expiry.

The World Bank's *Benchmarking Infrastructure Development 2020* indicates that, in most cases, the MOF's approval requirement entails an approval before embarking on the PPP procurement process, i.e., to conclude phase 3, a majority of the surveyed economies (64 percent) require such approval. This initial PPP approval process can have an important impact on the quality of project preparation and shape the way the financial structure of the PPP is designed. However, only 36 percent of the surveyed economies require a second approval by the same authorities before the PPP contract is signed, i.e., to conclude phase 4. This may also be necessary to ensure that the project is still fiscally affordable after any significant changes that may have occurred during the tendering process. Only 40 economies (less than 30 percent of the total) require both approvals, giving the MOF a more complete gatekeeping authority.

In addition, gatekeeping is also continuously required upon implementation in order to approve contract modifications, because these might have fiscal implications due to altered risk allocations or compensation events. It is good practice to have in place rules to ensure that contract modifications are properly evaluated in terms of their fiscal implications (direct and contingent) and their justification, and are authorized as such by the MOF as the fiscal gatekeeper. This is particularly important in cases of renegotiation, which are quite common in PPPs. On the one hand, this third-party intervention by the Ministry of Finance acts as a deterrent to potential strategic behavior by contracting parties. On the other

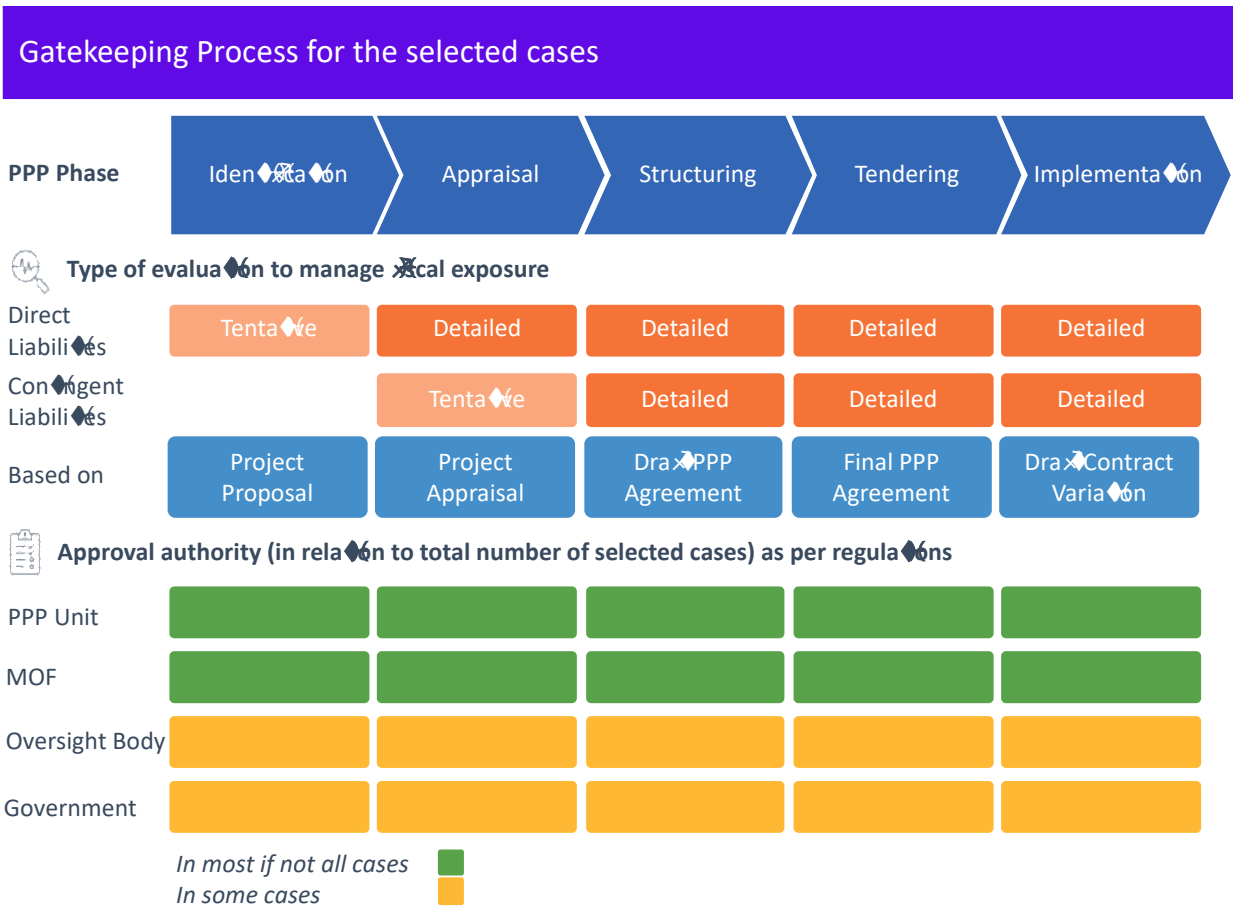
<sup>41</sup> Barclay, Claire and John Woolley. "Kenya proposes 'investor friendly' PPP law reforms." *Out-Law Analysis*. Pinsent Masons. 9 April 2021. <https://www.pinsentmasons.com/out-law/analysis/kenya-proposes-investor-friendly-ppp-law-reforms>.

<sup>42</sup> APMG's PPP Certification Guide separates the implementation phase into two distinct phases—(i) commissioning and delivery and (ii) operations and handback—but for the purposes of this report, these phases have been addressed jointly.

hand, even when there are good grounds to introduce changes to existing contracts, the Ministry of Finance’s gatekeeping role will ensure that the renegotiated terms preserve the fiscal sustainability of the PPP contract.

The review of selected cases illustrates that almost all cases have adopted regulations or policies that assign approval authority for all phases to the PPP units as well as the MOF. Some cases also have assigned approval authority for specific phases to an oversight body such as a PPP council or board, and/or to the government.

Figure 14: PPP Gatekeeping Process for Selected Cases



Some countries only require MOF approval for direct liabilities. However, as suggested by international studies in Organisation for Economic Co-operation and Development (OECD) member countries,<sup>43</sup> “there is an urgent need for more active involvement by public debt managers in the management of PPP contingent liabilities,” which can be considered relevant also for non-OECD countries. According to OECD studies, MOFs, treasuries, and debt management offices can collaborate with the central budget authorities and PPP units in data consolidation, forecasting and reporting practices on PPP contingent liabilities, or include this information in their debt reporting.

<sup>43</sup> OECD (Organisation for Economic Co-operation and Development). 2016. “Contingent Liability Management Debt Office Responsibilities.” OECD Working Paper 8.

**Victoria Has Designed an Elaborate Gatekeeping Process from Inception to Implementation of PPPs**



In Victoria (Australia), organizations requiring permission to undertake a public-private partnership (PPP) proposal must create a comprehensive business case that covers all facets of the project, and PPP proposals are subject to a gateway review that requires all high-quality, high-risk investments to be examined. In the legal framework, unless the government delegates the authority for tendering milestone approvals to ministers, approval by the government is usually obtained from a cabinet subcommittee. Further approvals by the government are applicable when there is: (i) a major project adjustment, including modification of project goals or operation scope; (ii) significant change in the final business case assumptions, including economic and financial evaluations; or (iii) substantial improvement in the risk profile of a project after the final phase of government approval, such as changes in consumer demand, input or reaction; changes to legislation or regulations; changes in public sector comparators (PSCs) or budget funding requirements; or major public-interest issues.

**Kenya Has Sought to Balance Efficiency and Regulation**



Kenya undoubtedly has a relatively well-developed public-private partnership (PPP) regulatory and institutional framework, with many elements present that are absent in other developing economies, including a Project Facilitation Fund, fiscal commitments and contingent liabilities (FCCL) and disclosure frameworks, and other features. Nevertheless, the country is still in the process of finding the right setup for its PPP program and keeps refining related processes, procedures and organizational structures to ensure effective realization of the PPP mechanism in its local context. It appears that decision-makers came to the realization that “more doesn’t always mean better,” especially when it comes to bureaucracy and related procedures. In this vein, it’s commendable to see an effort to streamline the PPP process and reduce the red tape associated with it. Although having a proper system of checks and balances is crucial for the overall sustainability of the PPP program, finding the right balance between efficiency and regulation is important.

**South Africa’s Treasury Has a Reviewer Role, and Municipal Councils Give Final Approval for Municipal PPPs**



In South Africa, the Municipal Public-Private Partnership (PPP) Regulations of 2005 and the Municipal Service Delivery and PPP Guidelines of 2007 govern municipal PPPs. Similar to Treasury Regulation 16 for PPPs at the national and provincial levels, the Municipal PPP Regulations provide step-by-step guidance at different stages of the PPP project cycle for accounting officers in municipalities interested in conducting PPP projects. These also include requirements to conduct a feasibility study and create PPP agreements, as well as the necessary consultations, reviews and approvals. The Municipal Service Delivery and PPP Guidelines are an analogue of the PPP Manual for municipal level PPPs, which expand the provisions contained in the Municipal Systems Act, the Municipal Finance Management (MFM) Act, the Municipal PPP Regulations and other pertinent legislation, and provide detailed guidance on a number of issues.

At the national level, the National Treasury assumes the gatekeeping role at important milestones in the PPP approval process. At the municipal level, the approval process is somewhat different, with the relevant treasury having a reviewer role and the municipal council being the final approver. Approval of municipal PPP projects, though somewhat similar to that of national projects, has a few important differences. Thus, at the local level, the national and relevant provincial treasuries have a more advisory role; accounting officers of a municipality seeking to enter into a PPP contract are required to solicit views and recommendations of these treasuries instead of having to receive their approval. Instead, the final approver role is moved to the municipal council, which must give “in principle” approval to continue with the project at the preparation stage and pass a resolution authorizing execution of a PPP contract before the final agreement with the private party is signed.

In terms of the fiscal risks, the Municipal PPP Guidelines require a feasibility study, including a detailed description of the municipal and general government’s fiscal obligations related to a project, as well as firm and contingent fiscal obligations. Additionally, a sub-section on firm fiscal obligations discusses the benefits and limitations of using municipal infrastructure grants, and establishes that a municipality’s contribution must not cover all capital costs and should only use funds for the provision of ring-fenced project assets that will either immediately or on termination of a PPP contract become the property of the state. Furthermore, based on ongoing reviews of the municipal PPP framework, it is specifically recommended that there is a need to reduce the number of public consultations and increase the involvement of the Municipal Infrastructure Support Agency.

### 5.3 Early Consideration of Fiscal impacts, Along with Priority Alignment and PPP Suitability, is Encouraged

It is recommended that evaluating the envisaged fiscal impact of fiscal commitments and contingent liabilities take place as early as possible. Initial screening of projects is paramount to avoid sinking resources into developing projects that do not make sense or are not affordable. This applies as much to PPPs as to publicly financed investments. Ideally, at the time of project conception, no decision has yet been made regarding the delivery scheme, because this should arise from a detailed appraisal of the project. In reality though, it is not uncommon for projects to be identified with the assumption that a PPP is the only possible mode of implementation in light of budgetary constraints. However, it is strongly recommended during project conception to focus on the merits and costs of the project irrespective of the delivery scheme (i.e., is it a sensible project?), and to develop an initial understanding of the project’s suitability for a PPP. As such, the initial screening exercise for the gatekeeper is to review (i) the relevance of the project initiative, (ii) whether the benefits are likely to outweigh the costs, (iii) whether the project can be delivered as a PPP, and (iv) whether the indicative fiscal implications are affordable. It is obvious that upon project conception, no detailed quantification of the fiscal impact is possible, though a tentative indication could help to prevent development of projects that are not likely to be affordable from a fiscal perspective.

PPP projects can originate in different ways. Ideally, the required government intervention for the development or improvement of infrastructure assets should be identified in a strategic document that outlines the most efficient and effective approach to achieve policy objectives. This could be a national, sectoral or regional development plan (or master plan) that provides a cohesive, consolidated and comprehensive perspective on the required strategy. Alternatively, projects can be originated through unsolicited proposals or in an ad-hoc manner, though it is good practice to always relate such initiatives to the envisaged strategy for achieving development priorities, and make sure they are consistent with them.



A project’s economic soundness, and its alignment and consistency with the public sector’s strategic objectives, are paramount factors before deciding to move forward with a technical alternative. All selected projects should be tested for economic feasibility, regardless of the procurement route/method (PPP or traditional). Therefore, initial screening should overlap with the considerations for developing traditional public investment projects. In this sense, some countries have opted to align the regulatory context for the identification stage for PPPs with that of traditional public investment projects.<sup>44</sup>

### Jordan Has Set Up an Integrated Framework for Public Investment and PPPs



In Jordan, the alignment of screening a public-private partnership (PPP) proposal with the public investment management process is regulated through the integrated Public Investment Management (PIM)–Public Private Partnerships (PPP) Governance Framework, as approved by Cabinet Decision No. 7968 in 2018. It was designed to strengthen the framework for managing public investments, in order to improve the efficiency and efficacy of capital expenditures, and to maximize finance for development through leveraging PPPs, where appropriate. Public investment planning and the management of fiscal commitments and contingent liabilities (FCCL), two key building blocks in ensuring strategic use of public resources, are ingrained in this integrated framework. The framework develops the project life cycle, which is the process of transforming a project idea into a concrete solution, through an economic analysis of alternatives, to select the most profitable solution to meet the country’s economic development goals, either via public procurement or a PPP. The PIM-PPP Governance Framework incorporates four phases, including the national strategic planning phase and the pre-investment phase, which are aligned with the PPP Law and form part of the preparation process for all PIM and PPP projects. It includes development of an effective mechanism for the selection and prioritization of infrastructure investments and implementation of the Government of Jordan’s integrated PIM-PPP Governance Framework and its FCCL framework; the latter links project prioritization with the budget process, and creates a standardized process for the assessment, management, and monitoring of the government’s FCCL obligations. The PIM-PPP Governance Framework is also reflected in a PIM-PPP policy that was approved by the Parliament in August 2019.

### In Georgia, Initial Screening of Project Initiatives Is Harmonized for PPPs and Public Investment Projects



In Georgia, according to the Public Investment Management (PIM) Guidelines and the Public Private Partnership (PPP) Guidelines, the PPP option is first given consideration during the project concept note (PCN, or project pre-selection) stage, where potential procurement methods are indicated. The PCN must also contain an initial fiscal impact assessment. This assessment should, at a minimum, discuss the impact of the proposed PPP arrangement on the budget of the contracting authority over the lifetime of the project in the case of public financing. If possible, the assessment should also discuss any guarantees or other fiscal risks that may be associated with any public entity commitment to enable private sector participation in the project.

<sup>44</sup> WBG. *PPP Reference Guide* version 3. 2017. <https://pppknowledgelab.org/guide/sections/5-establishing-the-ppp-framework>.

The initial scan of the project’s suitability for a PPP can be determined by answering the following questions:<sup>45</sup>

- Are there significant risks or uncertainties within the project that are not manageable by a private partner? Is there a risk of non-availability of the land or right of way, and of land acquisition cost overruns?
- Can the project be accommodated within the legal framework as a PPP? Have all relevant laws been taken into consideration?
- Is the project’s size big enough to justify the implicit costs of the transaction (to justify structuring and managing a complex tender)? Is it not too big for the market? Is it too large for local construction companies to take on, or so costly that it could not be successfully financed?
- Would there be investor market appetite? Are there competitors interested in the bid process? Are there precedent transactions that were already developed as PPPs for this type of project in the country/region, or in similar countries?
- Does it make sense to bundle construction and operations and/or maintenance in a single contract?
- Are the output requirements clearly identifiable?

Furthermore, it is encouraged to consider affordability: If the project is developed as a PPP, can the public sector afford the necessary payments (capital and operating expenditures)? In this case, there are several issues that need to be considered, depending on the circumstances:

1. Can the project be funded, in the sense that the required user charges and/or long-term call on the government budget are affordable? This question has to be considered before screening for PPP potential.
2. If the answer to question 1 is “no,” traditional delivery is not possible, but the project can still be screened for PPP potential, in which case there is an additional question that must be answered: Are innovative structures available that can make the project affordable if delivered as a PPP? For example, a PPP may give synergistic commercial development opportunities to the private sector that reduce the need for user charges or budget funding.

Assuming the project is affordable in the long term, the final question relates to cash flow for the government in the short term. It should be considered in the context of both traditional and PPP deliveries. The question is: Are there constraints on government financing (for example, borrowing restrictions), such that, even though the project is affordable in the long term, the government cannot finance its investment in the project in the short term? If the answer is “yes,” then we finally arrive at the issue of whether a PPP can be structured to overcome this.

#### 5.4 Clear Decision Criteria to Evaluate Affordability

An OECD publication on PPPs defines affordability as the “ability to be accommodated within the inter-temporal budget constraint of the government.”<sup>46</sup> For most government expenditures, affordability is assessed by considering the annual budget constraint, and in some cases the medium-term (typically three-

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<sup>45</sup>APMG, PPP Certification Guide. <https://ppp-certification.com/ppp-certification-guide/10-testing-ppp-suitability-and-affordability>.

<sup>46</sup> OECD. 2012. Recommendation of the Council on Principles for Public Governance of Public-Private Partnerships.

year) expenditure/fiscal framework. This definition and approach are also followed in the World Bank's *PPP Reference Guide* and the APMG's PPP Certification Guide.

Specifically, to manage fiscal implications effectively, governments need to have a complete understanding of their portfolios of direct commitments, guarantees and associated risks; develop tools and techniques for evaluating project proposals; consider appropriate risk mitigation measures; and adopt suitable budgeting and accounting practices based on their own country-specific circumstances. The MOF should be especially attentive to the risks created by PPPs when contracting agencies have little experience with them and when the government measures its deficit and debt in a way that makes PPPs seem much less expensive than traditional public investments.

When evaluating affordability, approval authorities need to be provided with a point of reference, i.e., criteria for approving the fiscal impact of a project. The three most common criteria are:

- *Is the fiscal impact of the arrangement warranted in terms of adding value to society?* This implies that the project needs to demonstrate that the economic benefits outweigh the costs (independent of the proposed delivery scheme). This concept can also be defined as value for people.
- *Is the fiscal impact of the arrangement warranted in terms of adding value to government?* This implies that the proposed PPP arrangement needs to demonstrate that the envisaged efficiency gains from using private expertise and resources outweigh the incremental transaction costs and cost of capital associated with the PPP. This concept is widely known as value for money.
- *Is the fiscal impact of the arrangement affordable in terms of not exceeding a government's fiscal space?* This can be addressed in several ways:
  - *The fiscal implications of the arrangement can be accommodated within the long-term budget.* In other words, the incremental fiscal implications as a result of the implementation and management of the project do not exceed the available budgetary resources. The project should not lead to an unacceptable increase of the budget deficit in the medium term. This approach requires conservative assumptions about how overall budget limits will evolve, and considers whether the estimated annual payments for a PPP (under a reasonable range of scenarios) could be accommodated within those limits. Limits on the total stock of fiscal commitments to PPPs may also affect decision-making for particular projects.
    - In Brazil, project studies must include a fiscal analysis for the next 10 years.
    - In the UK, procuring authorities have to demonstrate the affordability of a PPP project, based on agreed-upon departmental spending figures for the years available, and on cautious assumptions of departmental spending envelopes thereafter.
    - In France, the affordability of a PPP is demonstrated by reference to a ministerial program—a multi-year indicative budgeting exercise.
    - The PPP Manual of South Africa section on affordability (ZA 2004, Module 2) also describes a similar approach.<sup>47</sup>

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<sup>47</sup> Government of South Africa, National Treasury. 2004. Public Private Partnership Manual.

- *The fiscal implications of the arrangement fall within limits set to control the budget.* That is, the affordability of PPP commitments is considered in the annual budget process.
  - In the State of Victoria, Australia, a department considering a PPP must first seek approval for the capital spending that would be required if the project received public funds, as required by the National PPP Guidelines (AU 2017) and described in the review of PPP contingent liability management (Irwin & Mokdad 2010).<sup>48</sup>
  - Colombia's law on contingent liabilities (CO 1998, Article 6) requires implementing agencies to make a cash transfer to a contingency fund when a PPP agreement is signed. The cash transfer is equal to the expected cost of the program, including any guarantees provided. The payments may be spaced out over several years. This means the decision to accept a contingent liability has an immediate budget impact that must be considered.
- *The fiscal implications of the arrangement fall within limits set to control its fiscal sustainability.* These limits are typically set by the legislature and essentially reflect the government's maximum debt capacity.

An alternative way of setting a clear criterion for evaluating PPP affordability is by setting a specific PPP limit. There are various approaches to using limits to cap fiscal exposure from PPPs. Some countries align such limits with fiscal policy, and others with fiscal policy on government debt. Some countries set the limit as a percentage of GDP, while others set it as a percentage of annual budget expenditures or revenues. Some countries use the flow of fiscal commitments, while others use the stock of fiscal commitments. Serbia and Vietnam have set limits on guarantees as a share of GDP, whereas Brazil and Thailand have set limits on the new guarantees as a share of budget expenditure (see more details in the appendix). An overview of some practices is listed below.

**Table 13. Fiscal Limit Applications in Certain Countries**

Country	FCCL-Fiscal Limit Applications
<b>Brazil</b>	Brazil's Federal PPP Law (BR 2004a, Law 11079) initially limited total financial commitments pertaining to all PPP contracts to a maximum of 1 percent of annual net current revenue. In 2009 Law 12024 raised this limit to 3 percent, and in 2012, Law 12766 raised it again to 5 percent. However, it only applies to direct liabilities; no limit is officially imposed for contingent commitments.
<b>Colombia</b>	The law imposes a limit of US\$4.5 billion or the equivalent (about 1.6 percent of GDP) on the stock of guarantees. A second limit (0.4 percent of GDP) is applied to cap the annual obligations arising from PPP projects, including annuity payments and called guarantees.
<b>Hungary</b>	Act 38 of 1992 (Article 12) limits the total nominal value of multi-year commitments in PPPs to 3 percent of government revenue (Irwin 2007).
<b>India</b>	The fiscal responsibility legislation places an annual cap on central government guarantees of 0.5 percent of GDP, though there are no specific regulations capping fiscal exposure from PPPs.
<b>Peru</b>	Peru's Legislative Decree No. 410-2015-EF (PE 2015) states that the present value of the total fiscal commitments to PPPs, excluding governmental finance entities, shall not exceed 12 percent of GDP. However, every three years, the president may, with the endorsement of the Ministry of the Economy and Finance, issue a decree to revise this limit, depending on the country's infrastructure needs.

<sup>48</sup> Irwin and Mokdad 2010, 10-11.

Country	FCCL-Fiscal Limit Applications
Türkiye	According to the Law on Debt and Risk Management (Law 4749), an annual limit is set by the government for the debt assumption commitments to be provided annually in cumulative terms. This indicates the amount of loans that will be under the payment commitment of the Treasury in the event of an early termination compensation and also controls the aggregate exposure, because the limit is decided based on the stock of existing commitments. Furthermore, annual limits are prescribed each year in budget laws—a single limit covering credit guarantees, a single limit for PPP debt assumptions, and a limit on on-lent domestic debt.

Setting a specific PPP limit may be challenging. It ultimately implies a definition ex-ante on what proportion of investment should be allocated to PPPs versus direct provision by the government, whereas ideally such determinations should be made on the basis of value for money of the PPP options for projects. Moreover, specific PPP limits offer an additional layer of control when PPPs do not fall under the overall applicable fiscal/debt rules, which would be the optimal situation (i.e., because they are treated off balance sheet). Therefore, harmonization of mechanisms to control fiscal exposure is necessary to facilitate benchmarking exercises and compare performance. A possible approach is to set a ceiling for the government debt, including the fiscal commitments arising from PPPs—a so-called debt plus PPP ceiling.<sup>49</sup> The benefit of such a merged cap is that it allows the government to focus on value-for-money considerations for using PPPs rather than fiscal considerations. With a PPP-specific ceiling, the situation can arise that a project is suitable for a PPP but cannot be pursued as such, because the government has already reached its maximum level of fiscal commitments from PPPs. With a debt plus PPP ceiling, a decision to opt for a PPP would not be driven by the availability of space in either the PPP fiscal capacity or the debt capacity, but instead would primarily be driven by value for money. However, not all countries have debt limits to begin with, and even in those that do, it might not always be meaningful or feasible to include the PPPs within it, because it is a discussion that goes far beyond PPPs and links with the fiscal rule discussion.

<sup>49</sup> APMG PPP Certification Guide. <https://ppp-certification.com/ppp-certification-guide/186-controlling-aggregate-fiscal-exposure-ppps>.



# PLANNING AND ENSURING FUNDING IS AVAILABLE FOR FISCAL COMMITMENTS



# 6 PLANNING AND ENSURING FUNDING IS AVAILABLE FOR FISCAL COMMITMENTS

## 6.1 PPPs Require Long-Term Budgeting

Budgeting for PPPs involves ensuring that money is appropriated and available to pay for whatever cost the government has agreed to cover for its PPP projects. Because such costs may be contingent or occur in the future, PPP budgeting can be challenging in traditional annual budget cycles. It is essential to have credible and practical budgeting approaches, and to assure private partners that they will be paid by the due dates. Different approaches are used depending on whether the liabilities are direct or contingent.

Three possible solutions can be considered:<sup>50</sup>

- **A medium-term budget framework** that treats PPPs in the same way as publicly financed projects and therefore ensures that PPPs require the same approvals in the budget and budget plans as publicly financed investments;
- **Commitment budgeting**, in which the legislature approves not only the government's cash expenditure in the budget year, but also its commitments to spend money in later years; or
- **A two-stage budgeting process**, in which all projects must first be approved in budget planning, on the assumption that they will be publicly financed, and only then is a decision made about the method of financing those projects that have been deemed affordable.

Establishing adequate budgetary mechanisms for meeting payment obligations when they arise is critical. To make fiscal control and management comprehensive, the assumption of long term and contingent liabilities should be integrated into the national budgetary process. Because the cost of all government fiscal actions must be financed from a pool of public finance resources, decisions about both cash spending and other fiscal commitments and contingent liabilities should be made jointly as part of a holistic plan.

In the budgeting principles, direct and contingent expenditures should be evaluated in a comparable manner. For example, issuing guarantees should be an explicit budget choice rather than an off-budget activity,<sup>51</sup> requiring consideration of two main issues: making explicit the cost of guarantees at the time of their issuance, and making sure adequate budgetary provisions exist for making payments if a guarantee is called.

### Victoria Budgets for PPPs in the Same Manner as Public Investment Projects



<sup>50</sup> Funke, Irwin and Rial. 2013. "Budgeting and Reporting for Public-Private Partnerships." OECD/ITF Joint Transport Research Centre Discussion Paper 2013/07.

<sup>51</sup> IMF (International Monetary Fund). 2017. "How to Strengthen the Management of Government Guarantees." <https://www.elibrary.imf.org/view/journals/061/2017/001/article-A001-en.xml>.

In the budgeting process, a distinction can be made between the treatment of direct and contingent liabilities.

As indicated, direct liabilities to PPPs may include ongoing payments such as availability payments or shadow tolls, as well as capital subsidies during project construction.<sup>52</sup> When governments provide capital subsidies to PPPs, the payments 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. In many jurisdictions, governments do not introduce any particular budgeting approach for direct, long-term PPP commitments, on the assumption that a responsible administration will always approve appropriations to meet the government's legally binding payment commitments. The long-term nature of most governments' PPP commitments to pay suggests the need for incorporating them in the medium-term fiscal framework. Most countries (such as Brazil, China, Colombia, India, Peru, Poland and Türkiye) have legislation requiring periodic analyses of the frameworks; good practice consists of including PPPs in these medium-term fiscal frameworks.

Budgeting for a contingent liability can be particularly challenging, because payments may become due unexpectedly. If savings cannot be found within the existing appropriations, the government may need to go back to the legislature to request a supplementary appropriation. To overcome these difficulties, some governments introduce particular mechanisms for budgeting for contingent liabilities under PPP projects. To create additional budget flexibility, a government can consider adding a contingency line in the budget from which unexpected payments can be made. Such a contingency line could be specific to a particular liability—for example, to one considered relatively riskier—or could 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. In the Philippines, contingent liabilities are funded from next year's budget appropriations, which implies a severe counterparty risk for the private partner.

#### Funding for Contingent Liabilities is Subject to Appropriation Risk in the Philippines



In the Philippines, national government agencies (NGAs) can only source funds from budget appropriations. If there is no budget appropriation for a contingent liability that materializes in the middle of the year, the implementing agency has to include that in its proposed budget for the following year. If Congress approves the proposed appropriation, the implementing agency can make the payment one to two years after the liability has materialized. If Congress rejects the proposed appropriation, the implementing agency will have to try again the following year. Investors and lenders are therefore subject to appropriation risk and are likely to price this into their bid and lending rates.

<sup>52</sup> <https://pppknowledgelab.org/guide/sections/55-assessing-fiscal-implications>.



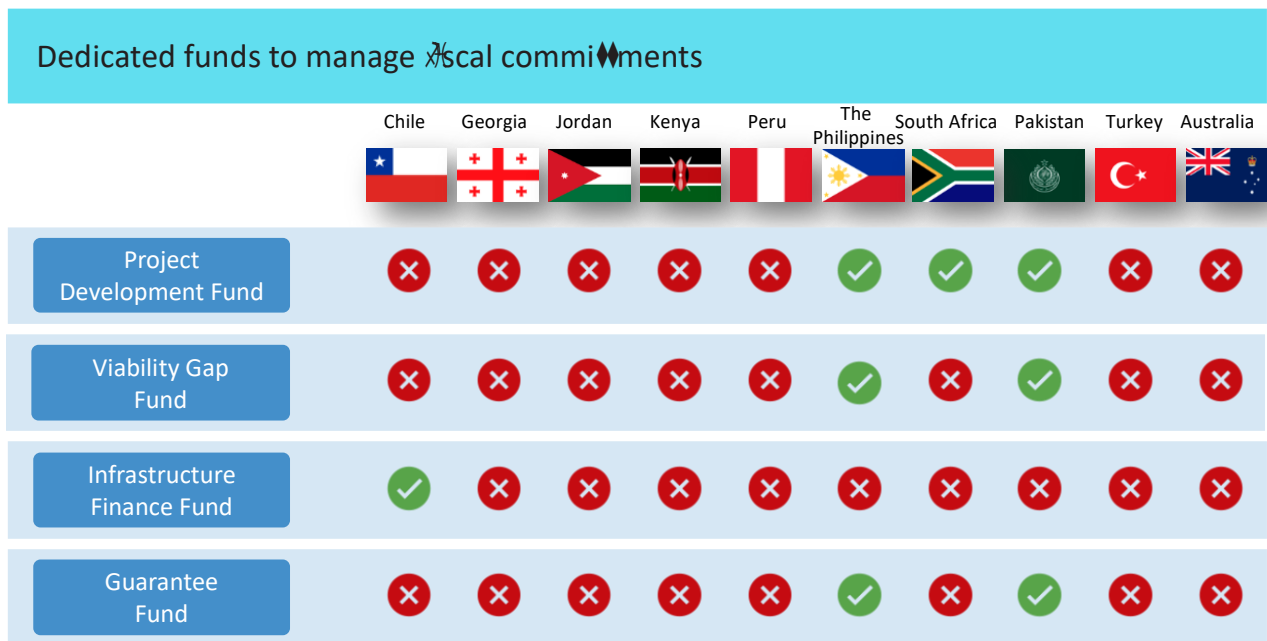
## 6.2 Dedicated Funds Can Reduce Budgetary Discretion

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 and facilitate the development of PPPs. Generally, four types of funds can be distinguished:

- Project development fund (PDF)
- Viability gap fund (VGF)
- National infrastructure banks (NIBs)
- Guarantee fund.

Though not yet widely applied in the selected cases, each such mechanism has been opted for in at least one of the cases.

Figure 15: Facilitating Financial Instruments



Though these facilities tend to be off-balance-sheet and provide benefits through a more independent and rationalised governance structure, they do have a fiscal impact that needs to be recognized. Firstly, the initial capital contribution from the government will require a budget appropriation, and subsequent capital contributions need to be carefully planned based on the scheduled PPP pipeline. Secondly, the facility will be exposed to an implicit fiscal risk. Though the funds are scheduled to be fully revolving, the situation might arise that the proceeds are not sufficient to recover the costs; it is neither likely nor preferable to allow such a facility to become bankrupt, because there would be an implicit bailout responsibility for the government to sustain the facility. To minimize the risk of financial distress, appropriate investment criteria and risk management proceedings need to be in place, along with a competent management and governance structure.

### 6.2.1. Project Development Fund

The primary purpose of a project development fund is to provide funding for project preparation. It is generally acknowledged that project preparation is key to successful implementation of a PPP. In addition to dedicated government resources, PPP project preparation requires support from external advisors, because of the complex nature of PPP project analysis and structuring, and the consequent need for, most notably, financial and legal specialists.

Such support could be funded with government resources or on an ad-hoc basis by development partners—though countries' experiences illustrate that either government resources are not appropriated or only marginally appropriated in practice, and arranging such funds with development partners can be a lengthy and cumbersome process that is subject to various political priorities and country limits. Thus, budgetary constraint, and/or dependency on the willingness and procedures of development partners, can hamper a government's ambitions to swiftly demonstrate results with its PPP policy.

To overcome such barriers and ensure that sufficient resources can be made available swiftly, some countries have established a facility to fund project development, e.g., the India Infrastructure Project Development Fund (IIPDF), the Project Development and Monitoring Facility (PDMF) in the Philippines, the PPP Technical Assistance Facility (PPPTAF) in Bangladesh, and the Infrastructure Project Development Facility (IPDF) in Pakistan.

For the purpose of a fiscal commitments management framework, the concept of a PDF is encouraged, because it contributes to the gatekeeping process, i.e., most of these PDFs have defined eligibility criteria and appropriate approval authority to ensure that only sensible projects that are likely to be suitable for PPPs are further developed, which reduces fiscal risks. Furthermore, a PDF allows for clear accounting and reporting on the preparation costs related to a PPP.

#### In the Philippines, the Project Development Fund Facilitates the PPP Project Development Cycle



The Project Development and Monitoring Facility (PDMF) was established in the Philippines in 2013. The general objective of the PDMF is to provide a facility to fund and facilitate pre-investment activities of potential public-private partnership (PPP) projects. Specifically, the PDMF may be utilized for, but not limited to, the following:

- Preparation of project pre-feasibility and feasibility studies
- Project structuring
- Preparation of bid documents and draft contracts
- Transaction advisory
- Assistance in the tendering process, including bid evaluation and awarding of PPP projects through competitive selection.

The Philippine government allocated ₱300 million (equivalent to about US\$7 million) to the PDMF as its initial working contribution, and the Australian government contributed US\$6 million. The Australian government's grant co-financing is to be administered by the Asian Development Bank (ADB).

A PDMF Board is responsible for setting the policy and implementation guidelines for the use of the PDMF, and for approving PDMF applications. It is composed of the National Economic and Development Authority (NEDA) as chair, the Department of Finance (DOF), the Department of Budget and

Management (DBM), and the PPP Center. The PPP Center oversees the administration and management of the PDMF.

The PDMF is structured as a revolving fund. On successful completion of the bidding process, the project development cost plus an administrative fee of 10 percent would be recovered from the successful bidder. That administrative fee is used to ensure the sustainability of the revolving fund. The collection and remittance mechanisms are subject to existing budgeting, accounting and auditing rules and regulations.

However, there are some cases in which the reimbursements need to be recovered directly from the government through the normal budgetary process, i.e., the implementing agencies (IAs) will repay the project development costs incurred in full, plus the administrative fees, when due to reasons that fall within the IAs' areas of responsibility, the IAs fail to:

- Bid out the project;
- Conclude the bidding process; and/or
- Sign the contract with the winning bidder.

#### 6.2.2. Viability Gap Fund

Projects that are not commercially feasible or bankable may still be suitable PPPs. Governments can consider providing financial support to such projects if certain conditions are met, most notably the economic relevance of the project. Such support could be provided as pure co-financing, which is defined as a non-reimbursable/non-revolving provision of funds or in-kind support provided by the government (for which the cost of capital to the private partner is zero). These funds are considered public financing in the fiscal sense (even when the funds will come under a deferred payment mechanism).

This pure co-financing can be provided through conventional budget appropriations, possibly supported by specific guidelines for application and evaluation. Some countries have opted to set up a special facility to control viability gap funding. The pathfinder for such a mechanism is India, which established its VGF facility in 2005. Similar initiatives have followed in the Philippines, Bangladesh, Indonesia, and Pakistan (Sindh).

In terms of fiscal implications, a VGF is sourced periodically through budget appropriations (and possible grant support from development partners). The appropriation is based on the estimated accumulated VGF required for the PPP projects to be awarded in the budget year, and is refined based on the actual VGF required as an output of the tender process; this is due to the fact that a VGF is typically the primary bid parameter (at least for user charge-based PPPs, because a VGF for a government-pays PPP is typically set by the government upfront) and the respective payment schedule for disbursing the VGF. Whereas in the Philippines, the VGF is essentially a mechanism to control the required budget appropriations for direct liabilities, in Sindh, the VGF facility also ensures funding of contingent liabilities.

From an FCCL management perspective, a VGF is useful for strengthening the control of FCCL by introducing clear gatekeeping proceedings, including appropriate decision criteria. This will provide comfort to private investors that the required budget appropriations for ensuring funding of at least direct liabilities are in place. The reporting on a VGF can help to consolidate information sent to concerned agencies and legislators regarding fiscal implications, though generally a VGF is not used for contingent liabilities (except in Sindh).

### The Philippines Has Established a VGF Mechanism to Co-finance PPP Projects



In the Philippines, viability gap funding (VGF) is a form of financial support given by the implementing agency for solicited concession-based public-private partnership (PPP) projects that are economically viable but not commercially feasible. VGF is sourced from the General Appropriations Act, and allocated annually by the Department of Budget and Management to the implementing agencies. The Build Own and Operate (BOT) Law and Revised Implementing Rules and Regulations (2012) stipulate cost sharing as one form of government support. In order to define the purpose, scope, and applicability of VGF, the Public-Private Partnership Governing Board Policy Circular No. 01A-201635 institutionalized VGF as financial support to capital expenditures of PPP projects, for the purpose of improving commercial attractiveness.

VGF is applied in the form of a cash subsidy made available to the private sector as a contribution of the government to the project. The VGF cannot exceed 50 percent of the project cost, and it must bear a portion of capital expenses, such as partial financing of the project, provision of right-of-way, or transfer of ownership of the building. Key principles for government support, including VGF, are as follows:

- Government support can be given to PPP projects that have economic value but are not bankable by themselves
- Government support must be minimized by evaluating the contingent liability risk, estimating its real cost to the national budget, and formulating a management system to monitor the risk
- Provision of government support should be made in a transparent manner.

The financial proposal is the final factor in determining the winning bidder. For projects to which VGF is applied, the amount of VGF is the only parameter in the financial evaluation, whereby the lowest VGF or the highest premium becomes the winning bid.

### In Sindh, the VGF Facility Provides Co-financing in Different Modes, Including Equity and Cash Deposits for Guarantees



The Government of Sindh (GoS) established the Viability Gap Fund (VGF) in 2008. The VGF has turned into a vehicle that assures commercial banks and investors that they will not be affected by changes and volatility in the province's annual budget estimates. The fund is not used in the usual VGF manner (i.e., providing grants), but rather for project support in the form of sub-debt, quasi-equity, credit enhancements, funded guarantees, co-financing, availability payments, etc.

The fund is managed by the Ministry of Finance through its Sindh Fund Management House (SFMH) and is funded through Government of Sindh budget appropriations. The SFMH, in coordination with the PPP Unit and Budget Wing, estimate on a semi-annual basis the contingent liabilities (including guarantees and warranties) related to the VGF. The Finance Department publishes on a semi-annual basis the total amount of contractually committed payments from the VGF and an estimate of all non-contractually committed contingent liabilities.

From the fund's 2008 inception until June 30, 2019, the amount released was PRs 33.41 billion (US\$216 million). Fund expenditures during that period totaled PRs 27.75 billion (US\$180 million). The accumulated value of fund investment as of June 30, 2019, was PRs 7.66 billion (US\$50 million). Fund expenditures have advanced several projects undertaken as public-private partnerships (PPPs), such as

the Hyderabad-Mirpurhas Dual Carriageway, the Jhirk-Mullahkatiyar Bridge Project, the Karachi-Thatto Dual Carriageway, and the Nooriabad Power Project.

In accordance with the 2018 amendments to the PPP Act, the fund is scheduled to be replaced in 2022 by a privately managed Project Support Fund (PSF), providing a more suitable term for the scope of the facility and making it less prone to political interference. The PSF will be a non-profit company to be established by the GoS under section 42 of the Companies Act 2017. All project initiatives will have to be approved by the PSF before being presented to the PPP Board. Its CEO will be part of the PPP Board.

### 6.2.3. National Infrastructure Banks

Infrastructure finance funds, also known as national infrastructure banks, are defined as wholly or partially publicly owned financial institutions, set up to support government policies in the infrastructure space.

Characteristics of NIBs, which can be used to define them, include:

- A major or exclusive focus on infrastructure through the provision of long-term capital, most typically debt, although several NIBs can now also offer equity and mezzanine products
- Government equity investment into the institution with paid-in capital (sometimes with additional callable capital), with or without additional budgetary appropriations
- Credit enhancement of a large proportion of any debt issues by the NIB, either through the provision of callable capital or through explicit guarantees—without the host government providing a guarantee—charging a risk-commensurate fee
- The absence of deposit-taking and often the absence of any dividend payments, with profits typically being used to build up reserves and the scale of the balance sheet.

Reasons for creating an infrastructure finance fund can vary based on a country’s context, though typically the primary reason is to enhance access to long-term debt facilities. This is particularly relevant for emerging markets and developing economies, where the domestic project finance capacity tends to be underdeveloped and/or where the country risk profile is constraining access to international debt markets. In mature markets, national infrastructure banks can help governments to focus development on certain sectors and/or to support institutional investors in tapping into the infrastructure market.

Notable examples include Chile (Fondo de Infraestructura S.A.), Indonesia (PT Sarana Multi Infrastruktur, PT SMI), India (National Investment Infrastructure Fund, NIIF), Bangladesh (Bangladesh Infrastructure Finance Fund, BIFF), Ghana (Ghana Infrastructure Investment Fund, GIIF) and Nigeria (Nigerian Sovereign Investment Authority, NSIA). All these initiatives were largely driven by lack of long-term debt and limited access to international debt markets. Whereas Chile’s infrastructure finance fund is not yet effective to the extent envisaged, the funds in India and Indonesia have successfully contributed to the implementation of their PPP programs.

#### Chile Has Established a National Infrastructure Fund Though it is Facing Challenges in Operationalization



In Chile, an infrastructure fund known as Fondo de Infraestructura S.A. was established by law in 2018. The fund is a public limited company constituted by the Treasury (99 percent) and the Production Promotion Corporation—CORFO (1 percent). The purpose of the fund is financing and investment related

to infrastructure projects, including services annexed to them, such as their construction, extension, repair, conservation, exploitation and development.

As of December 31, 2020, the paid capital of Fondo de Infraestructura S.A. amounted to US\$25 million, and the subscribed and unpaid capital as of December 31, 2020, was equivalent to US\$41 million. Projects such as the Bulnes Bicentennial Building Project, the transoceanic fiber-optic cable, and the RED terminals improvement project are under consideration, though no investments have yet been made.

Although the law that created it was published in 2018, it still faces difficulties in being put into practice, in part because the regulations present deficiencies that need to be corrected, for which the Executive will need to send a new bill to Congress. These deficiencies show a lack of clarity in the drafting of the original law, which was the responsibility of both the then-government and the parliamentarians. For example, the regulations do not allow the fund to pledge toll resource flows, which limits access to financing by potential concessionaires; such a pledge option was an essential aspect of the 1996 Concessions Law, which allowed the development of the first generation of the industry. Another error was to point out that the treasury would contribute national assets for public use—roads and other works—to the fund, which is legally questionable; it should be pointed out that these assets are given in concession.

#### 6.2.4. Guarantee Funds

A contingent liability fund (or guarantee fund) is a facility (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. These budgeting approaches are essentially allocating an appropriation each year to the required budget to meet the direct liabilities, and a contingency line in the budget to provide for the funding of PPP commitments, should they arise. Such facilities can be designed to align with their purpose and can be either a government-led initiative or a privately led initiative.

The Contingency Fund for Public Entities in Colombia is one of the examples (Box 1) of a best practice for a government-led initiative for the financing of PPP commitments.

#### Box 1. Colombia's Fund for Contingencies

The Contingency Fund for Public Entities in Colombia (FCEE) is a trust fund established in 1998 as a fast way to meet contingent obligations granted contractually by the Public Entities of the National Government (within 10 days of requesting the payment). Although the fund was initially administered by a mixed-economy financial institution within the Ministry of Finance (MOF), in recent years, the MOF has assumed the administration of the fund, and a lead role in approving, enforcing, investing, and monitoring the resources deposited in the FCEE.

The FCEE operates like a savings account for public entities, requiring a cash transfer from the public entity's budget according to the assessment of the contingency granted. In this regard, a scheduled contributions plan is elaborated by the public entity for each contractual obligation in which a contingent commitment is granted. The contribution plan is then approved by the MOF, which oversees enforcement of the timely deposit of resources; the management and investment of those resources; and the approval

of the annual monitoring of the contingent risks, to determine if the contribution plan needs to be modified.

The FCEE is restricted to certain sectors and types of risks specified in different public documents. For instance, the National Council for Economic and Social Policy (CONPES) describes the types of risks in which a contingent commitment can be granted (e.g., commercial and construction). Likewise, a subset of sectors in which this type of commitment can be granted is restricted to transport infrastructure, energy, basic sanitation, drinking water, and communications. Recently, the legislation has included contingencies arising from COVID-19 vaccine contracts as an additional sector covered by the FCEE.

The assessment of the contingencies is performed in two steps by the public entities, using the guidelines provided by the MOF. First they perform a qualitative classification, placing each contingent obligation within a probability of occurrence-impact matrix. Then, only those contingent commitments that are located within a range of values are assessed quantitatively and included in its contribution plan. In this sense, the annual monitoring is of utmost importance, because risks are dynamic and can change the qualitative and quantitative composition over time.

There is a system of accounts and sub-accounts within the FCEE in which each public entity opens an account within the FCEE, and each account has as many sub-accounts as the number of contracts/risks that figure into its different contributions plans. It is possible to transfer resources from one sub-account to another within the same account to meet the contingent obligations. In case of a lack of resources, the MOF can provide liquidity that must be paid by the public entity. Because contingencies are budgeted as debt service, they have priority within the public entity's budget. Hence, granting a contingent commitment generates an immediate impact on the budget (due to the contribution plan deposit), even if the contingency is never triggered. The deposited resources are reimbursed to the public entity once the risk that generates the provision has expired. The assessment of contingencies and the resources deposited in the FCEE is reported periodically in the Medium-Term Macro Fiscal Plan, which contributes to the fiscal prudence and transparency of the government. Due to the declared COVID-19 emergency, public entities can pause their contributions to the FCEE; however, the amounts owed to the FCEE, in accordance with their contribution plans, must be deposited within two months after the emergency expires.

It is to be noted that the mechanisms established in the Philippines and Pakistan are more private initiatives, albeit supported by government. They reduce the implicit fiscal risks and strengthen bankability by providing privately funded guarantee facilities. Other countries have opted to establish such facilities as government-led interventions, most notably Indonesia, Brazil and Korea.

- *Indonesia Infrastructure Guarantee Fund (IIGF)*. In Indonesia, the intention is that the government will no longer bear any contingent liabilities under its PPP projects; these will instead be borne by the IIGF. The fund aims to improve the creditworthiness of PPPs by providing guarantees on the financial obligations of public contracting agencies participating in PPP consortia. The IIGF provides compensation if the economic feasibility of the PPP project is compromised due to events such as early termination or project default, or as a result of changes in laws, expropriations, currency inconvertibility, or force majeure. In the IIGF example, it is observed that creating a fund can help

control the government's fiscal commitments to PPPs as well as provide a clear budgeting mechanism, thereby improving credibility. This single window provides certainty, because it ensures a consistent policy for appraising guarantees, as well as a single process for claims that introduces transparency and consistency.<sup>53</sup>

- *Brazil—São Paulo Partnerships Corporation.* In the state of São Paulo, the São Paulo Partnerships Corporation was established in 2004, using resources from the sale of the government's stake in state-owned enterprises (SP 2004a, Articles 12–23). The São Paulo Partnerships Corporation is governed by a directorate made up of up to three members selected by the state governor, a management council made up of up to five members selected by the state governor, and a fiscal council. The corporation is an independent legal entity, whereby the state government can add capital to the fund using funds from the sale of shares in state-owned companies or government-owned buildings, public debt titles, and other goods or rights that are directly or indirectly owned by the government.
- *Korea—The Infrastructure Credit Guarantee Fund (ICGF).* Established in 1994, under the provisions of the Act on Private Participation in Infrastructure, it was initially operated by three institutions: the Korea Development Bank, the Korea Technology Credit Guarantee Fund, and the Korea Credit Guarantee Fund (KODIT). Then in January 1999, KODIT took over the funds of the other two institutions and became the ICGF's sole operator. The objective of ICGF is to help private investment corporations obtain funds for facility construction. ICGF services have played a significant role in securing the financing of private investment corporations that lack the collateral for loans but have acceptable credit standings and strong prospects. The ICGF is managed by a public financial institution and guarantees each project up to ₩300 billion, for an annual guarantee fee capped at 1.5 percent of the total guarantee amount. Typically, the annual guarantee fees range from 0.3 to 1.3 percent. The guarantee operates as a subrogation—that is, the 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.<sup>54</sup>

#### In the Philippines, the Privately Managed LGU Guarantee Corporation Provides Credit Enhancement to Local Governments



In the Philippines, the LGU Guarantee Corporation (LGUGC) was incorporated in March 1998 as a private corporation to help local government units (LGUs) access private sources of capital through credit enhancement of LGU debts. After 2004, LGUGC started providing guarantee services to infrastructure development projects covering water districts, electric cooperatives, renewable energy technology projects, and medium and large enterprises. It is owned by the Bankers Association of the Philippines and the Development Bank of the Philippines.

The facility provides the following lines of business:

- *Guarantees.* It provides a guarantee service with fees ranging from 0.25 to 2 percent per annum, depending on the risk profile of the borrower and the project.

<sup>53</sup> Indonesia Infrastructure Guarantee Fund (IIGF) website: <https://www.iisd.org/credit-enhancement-instruments/institution/indonesia-infrastructure-guarantee-fund/>.

<sup>54</sup> Kim et al. 2011. *Public–Private Partnership Infrastructure Projects: Case Studies from the Republic of Korea*.



- *Credit ratings.* It implements an internal LGU credit screening and rating system.
- *Project management.* It offers program management services.

The borrower has to undergo a pre-qualification process and must pass a minimum credit score that is determined by the LGUGC.

### In Pakistan, the Privately Managed Infrazamin Provides Credit Guarantees for Infrastructure Debt



In Pakistan, InfraZamin Pakistan (InfraZamin) was established as an initiative by the Private Infrastructure Development Group (PIDG), developed by PIDG company GuarantCo, to create a for-profit credit enhancement facility.

The core equity providers for InfraZamin, in the amount of US\$25 million, are InfraCo Asia Investments, via its indirect wholly owned subsidiary Indus Guarantees, and Karandaaz Pakistan, a non-profit that promotes access to finance for micro, small and medium-sized businesses, as well as financial inclusion for individuals. GuarantCo is providing a contingent capital facility.

InfraZamin will issue credit guarantees for infrastructure-related debt instruments based on its (expected and forthcoming) AAA rating from PACRA, a local credit rating agency, and will thereby attract private capital that would otherwise not participate in lending to infrastructure-related sectors in Pakistan.

# ACCOUNTING, MONITORING AND DISCLOSURE



# 7 ACCOUNTING, MONITORING AND DISCLOSURE

## 7.1 IPSAS-Based Accrual Accounting is Promoted

There is a common misconception that PPPs will not impact the financial statements of the government (i.e., they can be accounted for off the balance sheet). The exact manner of accounting for PPPs depends on the accounting standards that governments apply. However, the underlying principle for any accounting standard is that governments should not pursue or structure PPPs to avoid fiscal restrictions, but to achieve value for money in terms of more effective and efficient delivery of public infrastructure and related services.

Thus, governments need to decide whether and when PPP commitments should be recognized—that is, formally recorded in financial statements as creating public assets, liabilities, or expenses. This is important because limits or targets are often set on the government's liabilities and expenditures. Whether or not PPP commitments are recognized as expenses or liabilities can therefore influence a government's decision to pursue PPPs, or how to structure them, in a way that is not driven by the fundamental objective of achieving value for money.

Most governments do not currently recognize PPPs on their balance sheets or treat investment in PPPs as public investment in fiscal data. Some present fiscal data only on a cash basis and do not have a balance sheet prepared according to any particular standard. Other governments apply accrual or partial-accrual standards and treat most PPPs as off-balance sheet.

To improve the consistency and transparency of the recognition of fiscal commitments related to PPPs, countries are encouraged to comply with international standards. For accounting purposes, the International Public Sector Accounting Standards (which are similar to International Financial Reporting Standards but are adapted to governments) are recommended, whereas for reporting purposes, compliance with the IMF's *Government Finance Statistics Manual 2001* (updated *GFSM 2001*, November 2012 draft) and *Public Sector Debt Statistics: Guide for Compilers and Users* (PSDSG 2011) is encouraged. European Union (EU) member states are to comply with the European System of Integrated Economic Accounts (ESA 201), which regulates how the EU member states are to prepare national accounts and produce comparable and homogeneous fiscal statistical information. The *Manual on Government Deficit and Debt* provides further explanations for EU members through more specific rules on the classification of the assets (and corresponding liabilities), regarding whether they should be included in the national or government balance sheet or not. Regrettably the ESA approach is not fully consistent with the IPSAS approach, implying that some risk allocations underlying a PPP are considered off-balance by ESA standards though not by IPSAS. Because the case studies for this report are outside the EU, the suggested accounting principles will follow IPSAS, though at the end of this section some notes will be presented on ESA and its differences from IPSAS.

IPSAS sets the criteria for including PPP infrastructure assets in government accounts (IPSAS 32, Service Concession Agreements: Grantor, 2011). PPP assets are considered public assets, and therefore are to be

included in the government's accounts, if the public partner controls them, which is known as the "control approach." The public partner is regarded as controlling the PPP assets if it has the ability to define the utilization of the assets, who can use them, and how much should be paid for their use or availability. If the public partner controls the assets, the latter are deemed to be public infrastructure, regardless of which entity legally owns them. Sometimes this appears to be confusing, because the private partner is the operator of the infrastructure, but the public partner can control the aforementioned variables through the PPP contract.

Under IPSAS 32, which is similar in approach to International Financial Reporting Interpretation Committee 12—Service Concession Arrangements, when certain conditions are met, the impact of a PPP on the main fiscal aggregates is similar to that of publicly financed projects. Under these rules, debt and overall deficit indicators will both increase as the PPP asset is constructed. This is a major improvement in government accountability, because it prevents PPP-related assets and corresponding liabilities from being treated off the government's balance sheet. As such, IPSAS 32 provides a framework for accounting for and reporting PPP transactions in a government's accounts that considerably reduces the bias in favor of PPPs.

Regarding accounting for contingent liabilities, there are two broad approaches according to the IMF research:

- **An accrual-based approach** requires an upfront recognition of liabilities likely to arise from the issuance of guarantees. International Public Sector Accounting Standards (IPSAS 19) require that if it is likely<sup>55</sup> that a guarantee will require future payment(s), and the amount(s) can be reasonably estimated, then a provision should be recognized in the financial statement. An expense is recorded in the operating statement, and an equivalent liability in the balance sheet. In the case of existing guarantees—previously disclosed as contingent liabilities—provisions are recognized in the accounting period in which the change in probability occurs. Payments made in settlement of guarantee claims are set off against the liability. Any likely reimbursement is recognized in the financial statements as an asset only when it is virtually certain to be received (IMF 2017).
- **A cash-based approach**, which most countries follow, does not recognize guarantees until they are called.

The accrual-based approach—which is the preferred approach—supports upfront recognition and disclosure; however, it is technically more demanding and may not be a realistic option for low-capacity environments, at least in the short-to-medium term. In such cases, the focus should be on enhancing the disclosure of information on guarantees. The IMF's *Fiscal Transparency Code* requires that a government's exposure from guarantees is regularly disclosed and authorized by law. Countries should be encouraged to disclose the following information on guarantees (IMF 2008):

- A brief description of their nature, intended purpose, beneficiaries, and expected duration
- The government's gross financial exposure—that is, the maximum amount guaranteed, in nominal terms
- The possibility of any reimbursement, recovery, or counterclaim by the government
- Where possible, an estimate of the likely fiscal cost (the net present value of expected payments) and likely timing of flows

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<sup>55</sup> IPSAS 19 does not define "likely" in terms of probability; some could say that a greater than 50 percent chance is likely, whereas more risk-averse individuals might consider 10 percent to be likely.

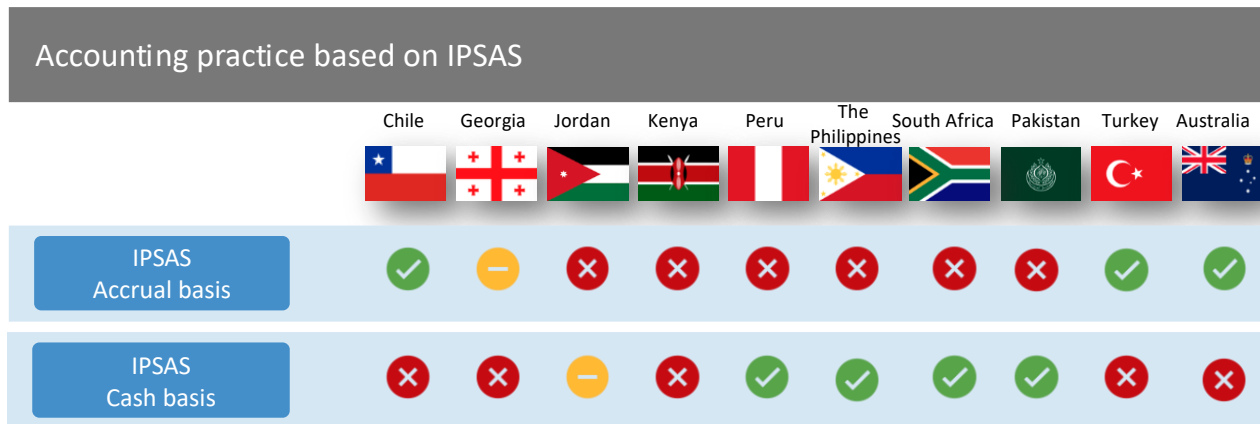
- Payments made during and up to the year for settlement of called guarantees, claims established on defaulters, and payments received in recovery from defaulters
- Any fees charged for guarantees
- Receivables from guarantees.

**Table 14. Summary of Main Accounting Requirements for Contingent Liabilities**

	Recognition	Disclosure
<b>Cash accounting</b>	Only when the contingency is called and cash payments need to be made	Not specific requirements
<b>Accrual accounting (IPSAS 19)</b>	The expected cost of a contingent obligation should be recognized if (i) it is more likely than not that the event will occur, and (ii) the amount of the obligation can be measured with sufficient reliability; liabilities that do not satisfy these criteria should not be recognized	Required for the remaining contingent liabilities, unless the likelihood of the payments is remote
<b>Statistical reporting (GFS 2001)</b>	Only when the contingency is called and cash payments need to be made	Required as a memorandum item to the balance sheet

Since these relevant international accounting standards were published, an increasing number of countries have been adopting the standards in practice, though approaches vary to some extent. As for the selected cases, IPSAS appears to be the leading standard, though it is mostly limited to cash basis, with accrual basis under development, with the exceptions of Chile, Türkiye and Victoria (Australia).

**Figure 16: Use of IPSAS Accounting Standards in Selected Cases**



**Türkiye Has Implemented Specific Regulations for Accounting Treatment of PPPs**

In Türkiye, the MOF published in 2015 the General Communiqué on Accounting Treatment of PPP Projects (the communiqué) which is applicable for public-private partnership (PPP) projects conducted by all public authorities except state-owned enterprises. Per the communiqué, the commitments,

realizations, cost updates due to escalations, acquired assets, and liabilities undertaken by granting authorities will be monitored under this regulation. The global amounts under demand guarantees, purchase guarantees and debt assumption commitments are monitored in the off-balance sheet accounts, while any accrued payment under these arrangements will be placed in the on-balance accounts and will be linked to the budget in the year of realization. The communicate also requires granting public authorities, which extend debt assumption commitments, to monitor the disbursements and repayments of foreign financings for specific projects off-balance sheet. Once an underlying concession is terminated, the undertakings of public authorities are linked to the relevant budget account, based on the project phase, and it is under the responsibility of the public agency that commits to the PPP supporting instrument.

### Australia Has Adopted Accrual-Based IPSAS for PPPs



In 2005, the Australian Heads of Treasuries Accounting and Reporting Advisory Committee recommended the approach in which public-private partnership (PPP) assets and liabilities appear on the balance sheet of the party that bears the most risks and rewards associated with ownership—an approach based on the UK Financial Reporting Standards. Under this approach, the assets and liabilities associated with many PPPs were put on the government’s balance sheet.

In line with the State of Victoria’s direction on application of AASB 1059 Service Concession Arrangements: Grantors, the state adopted AASB 1059 on July 1, 2019. Prior to the issuance of AASB 1059, there was no definitive accounting guidance in Australia for service concession arrangements, which include a number of PPP modalities. The AASB issued the new standard to address the lack of specific accounting guidance, basing it broadly on its international equivalent—IASB 32 Service Concession Arrangements: Grantors, which affects how PPPs impact the budget.

The state also adopted AASB 16 Leases. The standard fundamentally changes accounting for lessees. Lessees will be required to recognize all leases on the balance sheet as right-of-use assets with an associated lease liability. Only finance leases were previously recognized on the balance sheet. Thus, certain arrangements with the private sector were assessed and disclosed as PPPs. Most of the assets and liabilities for these PPPs were recognized on the state's balance sheet when construction was completed, if they satisfied the definition of a finance lease under the old standard. However, not all PPPs were classified as finance leases, so their assets and liabilities were not all brought to account. This was mostly the case where arrangements allowed the private operator to charge the public directly for the use of an asset. These are now referred to as grant of a right to the operator (GORTO) liabilities. All such arrangements are now brought to account.

Under ESA principles, there is a clear distinction between user-pays PPPs and government-pays PPPs: user-pays PPPs (generally called concessions, as per national accounting principles in the EU) are generally treated as off the government balance sheet. ESA rules define a concession as a design, build, finance, operate and maintain (DBFOM) contract for which more than 50 percent of the revenues are user payments.

The focus of ESA regulations is government-pays PPPs, which are any PPP type of transaction where more than 50 percent of revenues come from the public budget. The contract will be assessed so as to classify the asset as public or private, following risk-reward principles.

Three risks (or groups of risks) are defined for this purpose. They are construction, availability, and demand risks.

For a PPP asset to be regarded as private and not recorded as a public asset together with a corresponding public liability, the contract should transfer to the private party the construction risk and either the availability or volume risk. This test does not imply a full risk allocation, but it is necessary for most of the risk to be transferred. Although no guideline provides a precise definition of when the majority of the risk has been transferred, in general terms, it may be said that some risk retention by the public partner may be compatible with a private asset consideration, when those retained risks are clearly of an extraordinary nature (for example, force majeure).

The following are situations that generally require a classification of the asset in the government accounts:

- Any project for which more than 50 percent of the financing is public finance (that is, grant financing, even if it is deferred, as long as those deferred construction payments are irrevocable and not conditional on performance)
- Government-pays projects based on volume, for which variations in demand do not impose a material financial impact on the project company and/or for which there is a floor limit or a minimum guaranteed level of payments that cover a substantial part of the financial package regardless of the actual level of demand
- Government-pays projects based on availability, for which the failure to meet performance requirements does not impose a material financial impact on the project company and/or for which there is a floor limit or a minimum guaranteed level of payments that covers a substantial part of the financial package, regardless of the actual level of performance
- Government-pays PPPs with public PPP project companies (that is, the project is an institutional PPP as described in chapter 1), that are not constituted as independent companies with their own sets of accounts and their own management materially independent of the government.

The implication is that, for example, a government-pays PPP arrangement, for which the performance risk is materially transferred to the private partner, would be recorded off-balance in the EU, but on-balance outside the EU, in countries that have adopted IPSAS—a regrettable dissimilarity in light of the need for global consistency in accounting practices that requires further attention from the global accounting sector.

## 7.2 A Sound Monitoring and Reporting Framework is Needed

Governments need to account for and report on their financial commitments, including those under PPP contracts. Fiscal reporting on PPPs needs to be consistent with fiscal reporting generally. There are three main types of fiscal reporting:

- *Government finance statistics.* These are summary statistics on the state of a government's finances, which are intended to be internationally comparable. These statistics may follow regional or international standards, such as those set by Eurostat for European Union countries, or the IMF publication *Government Finance Statistics Manual (GFSM)*, published in 2001.
- *Government financial statements.* Most governments publish audited financial statements. There are internationally recognized standards regarding what should be in those statements, i.e., International Public Sector Accounting Standards, as referred to in the previous section, although in practice few governments meet those standards.

- *Budget documentation and reporting.* Most governments prepare reports on financial performance as part of budget preparation and reporting. These are not subject to any international standards, although there are international guidance materials that promote transparency, such as the IMF's *Manual on Fiscal Transparency* (2007) and the OECD's *Best Practices for Budget Transparency* (2002).

Most international reporting and statistical standards agree that even when PPP commitments are not recognized as liabilities, they should be disclosed in notes to the accounts and reports. The IMF Manual on Fiscal Transparency (2007) states that budget documentation should include a statement indicating the purpose of each contingent liability, its duration, and the intended beneficiaries, and that major contingencies should be quantified where possible. In practice, the type of contingent liabilities disclosed varies across countries; relatively few countries disclose PPP-specific contingent liabilities such as minimum revenue guarantees or exchange rate guarantees.

Disclosing useful information on the value of contingent liabilities is complicated. In principle, it would be useful to disclose the expected value of payments. The expected value of a contingent liability is difficult to predict. It is therefore also useful if the magnitude and the likelihood of a liability being incurred are disclosed. Such disclosure could usefully be substantiated by a report with additional information.

#### Peru Provides for Multi-Year Budgeting and Programming for PPPs



In Peru, the recording of direct and contingent commitments is regulated by the guidelines RM N° 048-2015-EF/52 Annex C, dating from 2015. These commitments are recorded according to the type of payment, guarantee, or contingency that was previously established in the public-private partnership (PPP) contract. For instance, regarding direct commitment, the payment could be linked to the investment or to the operation and maintenance stage. Meanwhile, the information regarding contingent liabilities is assessed and recorded under the type of contingency (e.g., emergency maintenance or minimum revenue guarantee (MRG)). The sum of both types of commitments is the stock of PPP commitments reported in the Multi-Annual Macroeconomic Framework (MMM, for its abbreviation in Spanish).

In addition, the national public budget system law considers a type of special programming called Multiannual Budget Assignment (APM, for its abbreviation in Spanish), which seeks to determine the maximum amount up to which no additional expenses can be programmed. The APM presents the schedule for the next three fiscal years (binding for the first year, and informative for the second and third years). Moreover, according to Directive No. 001-2020-EF / 50.01, the public entity must list in the APM each of the projects that is in any of the PPP cycle stages. For those projects that are prior to the contract execution stage, an estimated payment schedule must be indicated. Projects in the contract execution stage must report the payment schedule, as well as their updates, in case of contractual modifications.

In the case of contingent liabilities, although the most common practice is to disclose only explicit loan guarantees, some countries—such as Australia, Chile, Peru, the Philippines, and Türkiye (limited to projects with Treasury commitments)— also disclose other types of guarantees. In terms of the value disclosed, the reported information ideally should include any realized costs, as well as the maximum or worst-case value,



where this can be calculated. However, there are cases where more comprehensive information is disclosed, such as:

- Classification of contingent liabilities by category
- Explanation of the reasons for taking on the contingent liabilities
- Total exposure—aggregate information on all guarantees
- Expected fiscal cost (net present value of expected payments or annual cash flows)
- Risk associated with contingent liabilities
- Information on major individual guarantees—purpose/reason, terms, and beneficiaries
- Information on events representing realized risks and associated payments
- Information on how claims against guarantees will be paid (e.g., contingency funds or specific funds).

In relation to monitoring and reporting frameworks, several governments take a holistic approach, by linking debt and risk management frameworks. As an overall assessment on managing fiscal risks related to guarantees (including ones for PPP guarantees), the Philippines, Brazil and the Netherlands provide key examples:

- The Philippines issues one-off debt guarantees to financial and non-financial public corporations. The authority to issue guarantees is vested in the Secretary of Finance, and the Department of Finance is responsible for managing risks from contingent liabilities, including guarantees. The stock of guarantees on foreign currency borrowing is limited by law to US\$7.5 billion. Guarantee fees are set in a circular issued by the Department of Finance. Although policy decisions are made by the Department of Finance, some of the analytical work to support decision-making is undertaken by the Bureau of the Treasury, an agency of the Department of Finance. Before new guarantees are issued, the Bureau of the Treasury reviews the debt service track record of prospective guarantee beneficiaries and assesses whether or not the guarantee could be issued without violating the ceiling for guarantees on foreign currency borrowing. The stock of government guarantees is disclosed in the annually published fiscal risk statement.<sup>56</sup>
- In Brazil, the Debt Management Office improved its processes to register, monitor, and report on guarantees after 2014. The office also set up procedures to deal with materialized guarantees in cases where beneficiaries failed to meet their financial obligations in due time and to the full extent. From the debt manager's point of view, it was important to understand and monitor the guaranteed debt characteristics in terms of costs and risks. According to Law No.101 of 2000 (BR 2005), it is required that subsidy payments to PPPs be treated in the same way as debt service payments. To do so, the office registers all debt agreements for guaranteed debts consisting of more than 500 contracts with different characteristics in terms of currency, capitalization, and amortization schedules. Additionally, the office validates the information with debtors and creditors. Following initial registration, regular monitoring requires updates on disbursements and potential amendments to the original terms with creditors, debtors, and their legal representatives. The Treasury regularly (every four months) publishes a guaranteed debt report that details the federal government's guarantee exposure, the composition of the guarantee portfolio, and the status of called guarantees.

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<sup>56</sup> The Secretary of Finance retains the final authority to set (or waive) guarantee fees. The Philippines' Fiscal Risk Statements can be accessed here: <https://www.dbm.gov.ph/index.php/dbcc-matters/dbccpublication/fiscal-risk-statement>.

- In the Netherlands, the Budget Memorandum, presented on Budget Day in September to the House of Representatives, along with the national budget and the tax plan, describes the financial and economic situation of the Netherlands, explaining the Cabinet's plans for the coming year and the associated spending plans. The Budget Memorandum contains an annex (Annex 12 in the 2020 Budget) that provides a list and short analysis of the government's contingent liabilities—i.e., the government's direct and indirect guarantee schemes. In 2019, the government deepened its analysis of explicit and implicit contingent liabilities using the IMF's guidance and methodology (OECD 2021).

### 7.3 Supreme Audits Improve Transparency and Accountability

The mandate of supreme audit entities varies by jurisdiction, but generally includes two levels of audits related to PPP activities. The first is regularity audits, which can include auditing the financial statements of government entities and of the government, and auditing decision-making processes for compliance and probity. The second is performance or VfM audits, reviewing the government's effectiveness and efficiency based on the selected projects or programs.

When carrying out regularity audits of contracting authorities, audit entities will typically check that PPP commitments are appropriately reflected in the accounts, and that PPP processes have been followed. Audits can occur at any stage of the PPP process, including during project preparation or after procurement.

#### Structural Regulatory Audits in Chile



In Chile, the Comptroller General of the Republic (CGR) participates in the approval of the tendering documents, verifying the constitutionality and legality of the decrees and resolutions. In addition, the CGR not only guarantees compliance with the concession system regulations and public resource audits, but also issues recommendations that could have a fiscal impact. For instance, recently, the CGR has suggested a change to the regulation in order to include a way in which private initiatives that are complemented by public projects could be tendered jointly.

Performance audits of PPP projects and programs cover whether processes have been appropriately followed, whether the project is providing VfM, and so on. The International Organization of Supreme Audit Institutions (INTOSAI) recommends that performance audits of PPP projects be conducted soon after procurement, and that further reviews should be carried out over the project's lifetime, covering the following information:

- All major aspects of the deal that have a bearing on value for money, such as required actions, outputs, and timing of delivery
- How the PPP was identified
- How the transaction process was managed
- Which tender process was adopted
- How the contract was finalized
- Ongoing management of the PPP contract.

Although the remits of supreme audit entities vary, they typically extend only to government agencies, local governments and SOEs. Supreme audit entities typically do not have the right or responsibility to audit PPP companies, but the lenders commonly request independent audit agencies for the project-specific and/or SPV-financial auditing as a mandatory obligation. To ease the central auditing, the PPP legislation or the contracts include requirements that the SPV provide audited accounts and any other relevant data the government may require. These audit results and elaborations are also publicly disclosed and used as key information for transparency and understanding the resilience of the PPP programs from an FCCL perspective.

Good examples of how to effectively use the audit results as the monitoring, evaluation and learning activities can be observed in the UK (program-based audit) and Australia (project-based audit). Moreover, there are also several other countries that increased the roles and responsibilities of the audit and ex-post evaluation functions and the available information in order to effectively manage the FCCL controlling functions.

#### Periodic Performance Audits in Victoria



In 2007, the Victorian Auditor-General examined two examples of major public-private partnership (PPP) projects: the Melbourne Convention Centre Development and the Southern Cross Station redevelopment. The former was still under construction at the time, whereas the latter was completed and had moved into its operational and service delivery phase. Both audits demonstrated effective implementation of the Partnerships Victoria framework.

The Melbourne Convention Centre Development had successfully delivered the government's requirements for business case preparation, procurement, risk allocation, probity and project management. The Gateway Review Process had also assisted in clarifying project outcomes, improving costs and benefits modelling, and refining the functional specifications for an enhanced convention center. Although the Southern Cross construction dispute had been effectively resolved, there remained the need to develop more effective key performance indicators, to enable better supervision of the ongoing management of the concessionaire's delivery of expected services over the lengthy term of the PPP contract.

### 7.4 A Central Database Facilitates Consolidated Reporting and Monitoring

Several countries have initiated a central registration of PPP projects in a database. The purpose of such a database is to organize the relevant information on PPP projects so that it can easily be accessed, managed, updated and consolidated. Registering the project in a central database will also allow the relevant authorities to track it through various stages of the development process.

#### Jordan Establishes a Central PPP Database for Pipeline Development and Reporting



In Jordan, the 2019 PPP Law provided for the establishment of a public-private partnership (PPP) database, entitled the National Registry of Investment Projects (NRIP). However, this database is not yet operational. On the Ministry of Planning and International Cooperation Facebook page, it was stated on April 26, 2021



that the NRIP was to be launched next month. The NRIP will manage follow-up, preparation, planning, and implementation for public projects at a strategic level. It will also further enhance the management process for public investment projects and the partnership between the public and private sectors.

The Minister of Planning and International Cooperation, Nasser Shraideh, explained that the registry will provide comprehensive data for all government investment projects, as well as preserve, archive, and organize documents, studies, and reports for these projects. The registry will also determine priorities and monitor performance indicators during various stages of the project, with the overall goal of improving the quality of outputs and achieving developmental goals, in line with outlined financial costs and approved timelines, in an effort to better manage and control public expenditures.

Ideally, such a database should include all PPP projects that imply a fiscal commitment, whether direct or contingent. This implies that for most countries, this encompasses any PPP project, irrespective of the level of jurisdiction, whether central or sub-sovereign. Only federal systems, where states have no recourse to the central budget authority, may consider excluding registration of PPP projects from a central database, though it is advocated nevertheless to allow for a consolidated recording and reporting of PPPs for insight into the effectiveness of countrywide PPP programs and benchmarking.

It is furthermore recommended that the reporting mechanism for FCCL be aligned with the overall PPP disclosure framework. Further suggestions for designing a PPP disclosure framework are available in the World Bank's technical guidance for systematic, proactive pre- and post-procurement disclosure of information in PPP programs.<sup>57</sup>

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<sup>57</sup> WBG. 2015. "A Framework for Disclosure in Public Private Partnerships."



# THE WAY FORWARD



# 8 THE WAY FORWARD

The objective of this study is to guide the enhancement of fiscal commitments and contingent liabilities for PPPs, in recognition of the need to ensure the fiscal sustainability of such commitments and risks. The management of the fiscal exposure arising from PPPs (to include direct fiscal commitment as well as contingent liabilities, or FCCL) is a critical element of an overall PPP framework. There is evidence 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 the impact of PPPs.

The World Bank has taken the initiative to review the practicality, sustainability and resilience of FCCL frameworks in 10 selected cases, in order to identify good practices and common denominators to confirm the suitability and practicality of the main principles, particularly in light of the risks associated with COVID-19 on the development and performance of PPPs and government responses.

Considering the maturity of the PPP programs and the level of PPP governance in the selected countries, most of the countries have adopted some relatively good regulatory provisions regarding FCCL, and some countries also have a comparatively high-level baseline for PPP benchmarking. Although several observations also highlight that there is a significant level of detail in the FCCL process in legal and regulatory documents, there is still a lack of PPP experience, which makes it challenging to assess the overall country practices.

In this section, the key findings and the lessons learned based on these findings will be presented, along with a set of actions for the continuous development of the FCCL frameworks. These are designed to allow for the incorporation of good practices into the overall regulatory and institutional frameworks, considering the dynamic aspects of the need to mitigate any potential challenges to overall fiscal sustainability.

## 8.1 Government Responses to Crises Should be Guided by Overall PPP Frameworks, Including FCCL Principles

A sound framework, with clear procedures, decision criteria and institutional responsibilities for the identification, appraisal, structuring, tendering, implementation, and monitoring of PPPs, is important. Such a framework ideally provides for implementing FCCL principles in line with the other existing frameworks for process management, institutional frameworks and public finance frameworks. The first and foremost lesson from the observed cases is that an FCCL framework does not exist in isolation. It's an integral part of an overall PPP framework that must reflect effective, efficient and practical FCCL principles. This includes rules, responsibilities and decision criteria to identify and quantify fiscal commitments, to evaluate fiscal commitments for approval, to budget for them, and to report and monitor the fiscal exposure from PPPs. In the event of a crisis such as COVID-19, such proceedings are to make sure that any impact from such a pandemic or the government response to reduce disease spread are (i) identified and quantified in terms of direct and contingent liabilities; (ii) reviewed for approval by the Ministry of Finance, taking into account

any debt ceilings and the extent to which the enhanced government support is warranted from a value-for-money perspective; (iii) sufficiently provided for through necessary budget appropriations in the short and long term, whether through regular budget provisions or through separate dedicated financing mechanisms; and (iv) accounted for based on recognized standards, and appropriately reported on to facilitate accountability and transparency. To confirm accuracy and regulatory compliance, consideration may be given to applicable audit proceedings from concerned agencies.

Thus, adequate PPP fiscal management will continue to be crucial in the post-COVID-19 world.<sup>58</sup> Governments should build the institutions and capacities required to manage the FCCL perspective of their PPP programs as part of overall PPP frameworks. A strong infrastructure governance framework calls for establishing a gateway process governing the development, preparation and procurement of PPP projects, in which the MOF has the authority to suspend or limit a project at any stage of the life cycle if the unaffordability or risk event from an FCCL perspective is increasing. A sound FCCL management process to identify, estimate, and manage fiscal commitments and risks from PPPs should be set up in the MOF and related central authorities. This should be aligned with the guidance provided under the overall PPP framework for risk allocations, driven by case- and time-specific bankability considerations, affordability restrictions, and value-for-money aspirations. Likewise, as framed under the FCCL management process, governments should improve their budgeting, accounting, and reporting standards and practices to ensure transparency and accountability in long-term monitoring activities of PPP lifecycles. These activities and resilience factors should be supported by a consistent and enabling regulatory environment and effective institutional capacity and operational settings.

COVID-19 has impacted global economies substantially, including to some extent PPP arrangements under preparation or under implementation. Considering the country examples and their responses to COVID-19 related effects, as well as their responses to previous crises, some key policies can be identified, highlighting that PPP crisis responses are carried out through the PPP framework as a whole and not specifically through the FCCL framework:

- Revisiting existing PPP policies and investment strategies
- Modifying and reviewing legal and regulatory settings
- Changing the institutional settings, with a clear focus on MOF roles and responsibilities<sup>59</sup>
- Focusing the FCCL management policies and strategies on risk response and mitigation actions
- Reviewing the pipeline development process, including project preparation, procurement, and financial closure
- Modifying contracts for existing projects to address COVID-19 challenges (establishment of dialogue, contract amendments, and additional support actions) and sector-specific actions for the healthcare, transport and energy sectors, and to avoid renegotiations where possible (and if unavoidable, to ensure contractual provisions and gatekeeping proceedings are in place to sustain value for money and fiscal affordability).

The following table summarizes some of the selected country activities and strategies in these categories.

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<sup>58</sup> IMC 2021, OECD 2021.

<sup>59</sup> The current crisis has also increased MOF awareness and understanding of what might happen with fiscal risks at a political level, should a similar disruption occur again.

**Table 15. Summary of Main Crisis Response Measures for PPPs**

1. Revisiting existing PPP policies and investment strategies	
Georgia	Depending on the usage of PPP models in infrastructure services, it has been observed that the PPP agenda was not directly affected by COVID-19 in instances where sectoral policies remained the same, and there was a limited shift in focus to certain sectors. Overall, there is still a political drive to increase PPP investments to increase foreign direct investment (FDI) to attract long-term investments, similar to what was achieved in the energy sector.
Pakistan	As a result of COVID-19 and related cuts in federal transfers, the Sindh government also had to reduce its budget. COVID-19 is endangering the financial sustainability of PPP arrangements through reduced financial capacity of sponsors. This increases the probability of calling on the government for assistance and highlights the need to prioritize the development of a fiscal framework to ensure such fiscal exposure is identified, warranted and affordable.
Peru	With a growing PPP program, a prioritization of projects has been observed. In a series of emergency decrees, 52 projects were exempted from complying with certain guidelines. Likewise, in earlier years, the government declared 42 projects as being of national interest and authorized the expropriation needed for their execution. Additionally, 10 more projects were declared as being of national interest and were given priority in terms of budget allocations. The additional measures implemented by the government as a result of COVID-19 extend the previous measures to current PPP projects. In this sense, only the PPP projects originated by the national government, and that fall into the following categories, can take advantage of the previous measures defined in the emergency decree (No. 019-2019): (i) PPPs in the contract execution stage, (ii) PPPs that have already won the contract, or (iii) PPP projects that are planned to be awarded within the following three years.
Philippines	The Local Reform Strategy was launched in 2020 in order to support a robust pipeline of local PPP projects in expanded priority sectors. The short-term institutionalization reforms are the development of sector-specific PPP guidebooks and enhancement of the network of collaborative alliances. For the medium term, a successful showcase of projects for replication and the development of an updated capacity-building PPP agenda are the key actions presented. Finally, for the long term, acquisition of expertise for continuous project development, network building and nationwide operationalization of the PPP Project Information Management System are the key focus areas of the revised strategy.
Türkiye	Several actions have taken place to avoid the negative outcomes of two crises—COVID-19 and Turkish lira devaluation. These actions include policy changes in pipeline development; close collaboration with the Ministry of Treasury and Finance (MoTF) and other central public agencies; effective FCCL management actions; and continuing to limit fiscal risks, as well as supporting PPP projects for their risk-related losses.
2. Modifications and reviews of legal and regulatory settings	
Jordan	Overall the central government's fiscal deficit (including grants and the use of cash) widened to 4 percent of GDP during the first five months of 2020, almost twice as high as during the same period in 2019. The sharp deterioration in government finances, together with the slowdown in economic growth, has elevated levels of public debt in the central government to 105.3 percent of forecasted GDP at the end of May 2020. Most recently, in March 2021, the IMF concluded that Jordan's IMF-supported program remains firmly on track, with strong progress on key reforms. The program will continue to provide flexibility to accommodate higher-than-expected COVID-19-related spending and protect the most vulnerable. It was reiterated that it is necessary to: strengthen debt sustainability, enhancing the efficiency of public spending; fully implement the new PPP Law to ensure effective selection and execution of viable projects in line with national priorities; and closely monitor contingent liabilities.
Philippines	The lessons learned in the Philippine PPP market during the Asian financial crisis serve as a warning about what could go wrong if fiscal commitments and contingent liabilities are not properly assessed,



	<p>managed and reported. The regulatory system is mature and sound enough to respond to the risks in the country when the COVID-19 impact is assessed. The strong and robust project development and advanced and detailed analysis performed during the approval cycles, which created a sound project cost-risk assessment for performance under crisis are observed also in the legal and regulatory settings.</p>
Türkiye	<p>Since 2016 there has been an ongoing effort to enact a general PPP Framework Law. Regarding the dynamic PPP market in Türkiye, it is believed that a tailor-made legal framework is needed for sector-specific PPP governance. According to the 2021 Economic Reform Program, which also covers several COVID-19 response plans, the PPP Framework Law preparations were intended to be finalized by the end of 2021.</p>
<b>3. Changes in institutional settings, with a clear focus on MOF roles and responsibilities</b>	
Philippines	<p>Since 2009, the Philippines has undertaken various reforms in the financial sector, including rehabilitation of the central bank and increased capitalization ratios for commercial banks; these institutional reforms also generate a more efficient pattern of investment. The Philippines crisis experiences in 1997 and 2008 offered valuable lessons for the nation, the rest of Asia, and indeed, emerging markets around the world. The lesson is that policies matter: economic reform, policy reform and institutional settings, particularly of the financial system, can have a demonstrable impact on a country's ability to weather a crisis, even if the crisis originates elsewhere and is spread by contagion. Had the Philippines not undertaken its financial sector reforms, the crisis undoubtedly would have been worse. In 2020, the Philippines participated in the World Bank's COVID-19 PPP Rapid Response Umbrella Program, with a focus on (i) studying high- and portfolio-level fiscal implications of COVID-19 on selected PPP projects (led by the MOF), and (ii) bringing global best practices on adjusting requirements for infrastructure contracts as a result of the pandemic (led by the National Economic Development Authority (NEDA)). Both of these key areas are critical to strengthen the roles and responsibilities of the MOF and NEDA.</p>
Türkiye	<p>The MoTF continues to provide debt assumption to transport PPP projects. The current contingent liability stock due to committed debt assumptions has been closely monitored in aspects such as (i) project revenue payments, (ii) senior loan disbursements, and (iii) repayment realizations. In the contract modifications, the MoTF has also been involved in negotiations and has provided backstop oversight to healthcare projects for their re-structuring and contract management issues. The MoTF also continues to analyze the annual commitment limit specifications and provides policy advice in an intermediary role to international lenders for originating PPP transactions and for restructuring existing financing and refinancing options.</p>
<b>4. Focusing the FCCL management policies and strategies on risk response and mitigation actions</b>	
Australia	<p>The state of Victoria has demonstrated its capabilities regarding assessing risks that have the potential to derail the development of the PPP program, with 32 PPP projects totalling more than \$A30 billion contracted across a wide range of economic sectors and four projects in the development stage. The Victorian government, through its "Investment Lifecycle and High Value High Risk Guidelines" published in December 2019, largely addressed PPP fiscal risks. Since March 2020, the Australian parliament has passed a series of additional standing appropriations and 2019-20 Appropriation Bills to fund COVID-19 response measures. In addition to funding agreed-upon measures, the additional 2019-20 Appropriation Bills increased the provisions.<sup>60</sup> COVID-19 policy proposals have been subject to the usual level of scrutiny, including in relation to the risks they create, although analyses have been done within a shorter time frame. Existing controls have not been identified as an impediment or delay to response implementation.<sup>61</sup></p>

<sup>60</sup> Additionally, the government decided to delay the 2020-21 Budget for five months (from May 12, 2020) due to the very high level of uncertainty over macroeconomic and fiscal forecasts and related challenges in formulating a new fiscal strategy post-COVID-19. At an operational level existing processes and controls have not been changed during the crisis.

<sup>61</sup> OECD 2021.

Chile	In response to the health emergency caused by the global pandemic, a Transitional Emergency Fund for COVID-19 was created to cover all kinds of related expenses. The fund has an initial contribution of US\$12 billion million, and among other measures, it aims to support the recovery of the economy by promoting private investment through temporary tax incentives, regulatory simplicity, and speeding up of concessions investment. For instance, the ministries that execute resources from this Fund for public investment or concession projects need to present a monthly report to the MOF on the status of the projects. <sup>62</sup>
Georgia	Georgia's MOF has become more conservative and has resisted a push to sign more power purchase agreements (PPAs) in the energy sector, and any consideration for a new guarantee/PPA has become very strict. According to the MOF, this position helped it cope with the situation and prevented deterioration. The current crisis also increased MOF awareness and understanding of what might happen with fiscal risk at a political level, should a similar disruption occur again. This includes better understanding of the role that the MOF plays in PPP/IPP decision making and approval processes, as well as future PPP policy setting from an FCCL perspective; the reaction of PPP projects to various external shocks is also clearer.
Jordan	In 2006, the MOF launched a wave of reforms of treasury functions, which included the introduction of a Government Financial Management Information System. Other elements addressed cash management and the revision of the chart of accounts. In parallel, work on external audits gained speed with the reform efforts of the Audit Bureau. In this context, the growing size of public financial management—in the wake of scaled-up government operations—showed the limits of the traditional approach to financial management control, which was highly centralized and relied on ex ante expenditure control with overlapping control layers. The government also started to reform the internal control function, with the aim of allowing the audit to withdraw from ex ante expenditure control.
Pakistan	The ADB is advising on how the already established Pakistan Development Fund could be operationalized to effectively address market imperfections, though the initiative has been put on hold.
<b>5. Reviewing the pipeline development process</b>	
Kenya	The Public Debt Management Office within the National Treasury and Planning presented <sup>63</sup> that the likely COVID-19 impact on PPP projects can include the following effects: diminished revenue collection; potentially large pay-outs; the possibility of bailouts of state-owned companies; sub-optimal reallocation of resources and reduced accountability; and institutional weakening post-COVID-19. The actual impact is yet to be assessed
Philippines	The Philippine government ensured that the construction of PPP projects continued during COVID-19, thus supporting the move to open up the economy and bring in more jobs. Funding from the Duterte Government's Build, Build, Build infrastructure plan has given new life to PPPs, and as of August 2020, there were 30 projects (out of 104 projects, or 29 percent) in the PPP pipeline. The key strategies to be implemented for the infrastructure sector in the Philippines were: (i) realign expenditure priorities in 2021 to provide more space for relevant health-related expenditures, and improve the digital infrastructure; (ii) conduct comprehensive vulnerability and risk assessment of critical infrastructure, particularly in areas considered to be COVID-19 hot spots; and (iii) construct or rehabilitate hospitals or designated quarantine holding facilities.

<sup>62</sup> The recovery plan anticipates expediting the bidding and construction of 31 projects through the concession system, totaling an investment of US\$8.6 billion. For the period 2020-2022, the plan anticipates an investment of US\$4,148 million in concession projects, while the pipeline of concession projects for the 2021-2025 period totals 53 projects, of which 37 represent an investment of US\$11.5 billion.

<sup>63</sup> Wafula, Ulwodi. 2020. "Managing Contingent Liabilities and PPPs in the Context of the COVID 19 Pandemic: the Case Study of Kenya." Public Debt Management, National Treasury and Planning, September 22-23, 2020, slide 9. <https://www.cabri-sbo.org/uploads/files/Documents/Presentation-Dr-Ulwodi-Wafula.pdf>.

South Africa	Transport projects were the hardest hit PPPs, while energy IPPs were not impacted significantly. Operational PPPs, especially in the transport sector—such as the Gautrain Rapid Rail Link project, the SANRAL toll roads, and Chapman’s Peak—all lost revenue. The project terms of IPPs that were in the construction stage at the time were extended, while PPPs in the planning stage were expected to face delays in reaching financial closure as a result of the crisis.
Türkiye	The transport PPP project developments are planned to continue in line with high-level transport planning and related to 2021 investment policies; the sub-sector master plans, project prioritization and infrastructure plans, and country-specific development targets are also aligned with PPP policies and incorporate demand forecasts and prioritizations post-COVID-19. Türkiye’s Health Transformation Program has targets to increase the number of city hospitals for the first time since 2019. Based on the experience gained through existing PPP projects in the sector, and a comparison with alternative models, it was decided that the next 10 city hospital projects, which were previously planned under PPP contracts, will instead use the public procurement method.
<b>6. Modifying contracts for existing projects to address COVID-19 challenges</b>	
Chile	The measures taken by the government to contain COVID-19, such as reducing social mobility at the national and international levels, have had an impact on the Chilean concessions. In particular, the decrease in traffic demand has caused a reduction in the income received by the concessionaires. For instance, in concessions such as the Autopista Central, besides the decrease in traffic demand, the government took advantage of the situation to justify a decrease in the tariff level due to an off-peak tariff scheme interpretation. Although this case is now in being adjudicated by the courts, this event shows us the tip of the iceberg in what is shaping up to be a very difficult future for concessions. In fact, even in instances where the impact of COVID-19 on concessions has not been fully assessed, certain insights can be gleaned from this particular case—specifically, the low traffic demand was exacerbated by the decrease in the tariff level, decreasing the concessionaire’s annual income by 54 percent at its lowest point in June 2020.
Georgia	COVID-19 did not especially affect the fiscal risks of existing PPP projects, but hit hard the operations of the two airports, Tbilisi and Batumi. <sup>64</sup> At the same time, based on data from the MOF, there was no attempt from the operators of either airport to renegotiate or amend the contracts during the pandemic, or to obtain additional support from the government, because neither airport received any government support or guarantees at inception, and neither is paying concession fees to the government. In the energy sector, the major policy change prompted by the pandemic was the introduction of a “green tariff” as an alternative to signing more PPAs in the future. The MOF confirmed that the COVID-19 crisis presented a chance to push for adoption of this support scheme, which, in essence, limits losses for energy companies to US 1.5 cents per 1 kWh in the environment of deregulated electricity prices. <sup>65</sup>
Peru	The MOF established a channel through which the concessionaire of a PPP project can request compensation from the government for financial losses caused by the restrictive measures implemented in Peru (DS N ° 044-2020-PCM). The concessionaire needs to identify and show how the measures taken by the government generated an adverse effect on the financial performance of the project, and how the risk allocation established in the PPP contract makes the government the bearer of such risk (in cases where the government is in charge, at least partially, of the risk). The concessionaire must propose a way to fix the imbalance through a mechanism such as extension of

<sup>64</sup> According to the 2020 full year financial and operational results report of the special purpose vehicle, the number of passengers served in 2020 by both Tbilisi and Batumi airports dropped 85 percent year over year (YoY). Furthermore, according to data provided by the MOF, Tbilisi airport experienced a reduction in revenues of approximately GEL 100 million (about US\$29 million) in the first six months of 2020.

<sup>65</sup> Government Resolution on Premium Tariff № 403 “On Approval of the Support Scheme for Production and Use of Energy from Renewable Sources” was approved in July 2020. The switch to the Green Tariff from power purchase agreements would eliminate direct agreements with SPVs. Budgeting for this subsidy is also expected to become more straightforward because Parliament would directly approve subsidy amounts as opposed to no direct provisioning or reserving for potential losses under existing PPAs.

	<p>the PPP term, monetary disbursement by the public entity, incremental increases to the toll rate, reduction of obligations, etc. Once the request is made by the concessionaire, the public entity must determine the best solution, whether by using the current contract to reconcile the differences or by amending the contract to include a different agreed-upon solution. In the first case, both parties renounce their rights to future litigations; in the second case, they must observe the process established by regulation RM N° 461-2017-EF/15.</p>
South Africa	<p>Transport projects were the hardest hit PPPs. Activity restrictions imposed in late March 2020 to contain COVID-19 significantly affected the revenues of several PPP projects in the energy sector, even though energy IPPs were not impacted significantly. In April 2020, the National Treasury, supported by the World Bank, engaged with key stakeholders to assess potential PPP risks and contingent liabilities and solutions, and concluded that risks to the fiscal and contingent liabilities were manageable. At the same time, operational PPPs—such as the Gautrain Rapid Rail Link project, the SANRAL toll roads and Chapman’s Peak—all lost revenue and are under close monitoring as of the date of reporting. As an example, SANRAL is operating three PPPs: the N3 toll road, the N4 East toll road, and the N4 West toll road. The effect of lower traffic volumes and revenue due to restrictions varied; however, all three PPP agreements specify that any loss emanating from traffic volumes is to be borne by the private operator. In other projects, there are also several ongoing dialogues with public authorities about loss claims.</p>
Türkiye	<p>In Türkiye, the years 2019 and 2020 were a full-test period for the country’s PPP projects, due to the national currency’s depreciation, followed by the pandemic. The operating PPP city hospitals had to become pandemic hospitals as well. In the first part of 2020, the COVID-19 circumstances further incentivized acceleration of these existing PPP healthcare transactions. In PPP airports, there has been a revenue payment deferment in TOR contracts, whereby Türkiye provided airport operators with two-year extensions in operating periods and two-year lease deferrals as the general COVID-19 response policy. Moreover, the foreign-currency indexation frequency for unit price in motorway PPP contracts was changed from annually to semi-annually starting in 2019. Likewise, the minimum guarantee payments, which were designed to be realized annually, have been also modified to semi-annual instalments to increase the projects’ cash liquidity.</p>

In these cases, emergency measures have differed in several sectors, and have had a variety of impacts on the FCCL frameworks. The IMF states that the impact of COVID-19 will depend on the length of disruption and will be felt differently by each PPP project, depending on its specific conditions, such as country, sector, phase of the project cycle, and design of the contract. For instance, PPP projects in the transportation and energy sectors face significant losses of revenues, whereas healthcare projects are particularly affected by the increased costs or the need for COVID-19-specific treatments needs if the PPPs included medical services. Additional service/standard requirements (e.g., safety, disinfection, cleaning, and additional safety measures) also impacted the service providers' abilities to operate, and additional costs may have to be compensated by the contracting authorities. Some sectors such as water are likely to be less impacted by COVID-19 challenges, whereas for school projects, which usually cover only school facilities, the impact is still uncertain.

## 8.2 Necessity of Drawing Lessons for Future FCCL

In general, FCCL tools and policies are developed according to a country’s needs, experiences, and lessons learned from its challenges, and, typically, policies and practical arrangements have evolved and are heavily influenced by existing market factors. To effectively operationalize an FCCL framework, it is good practice to incorporate it into the overall regulatory and institutional framework for the development and

management of PPPs, considering the dynamic aspects of finances and demand forecasts. This also helps mitigate any potential challenges to overall fiscal sustainability that a failed PPP could create.

Although several countries had successfully recovered from previous global, regional and/or in-country crises in the past two decades, and had implemented debt and fiscal management reforms before the pandemic struck, the COVID-19 crisis and the oil price shock have caused governments to face additional fiscal risks, due to increased expenditures; a sharp fall in revenues and increasing operational losses from SOEs; urgent healthcare recovery needs; and limited fiscal space.

As presented in the cases, due to COVID-19, declining fiscal revenues and increasing fiscal recovery expenditures have resulted in a shortfall in the availability of government funding for projects, not only in the short term, but in the medium and long terms as well. As a result, implementation of new fiscal rules had to be temporarily frozen, or to a certain degree deferred until 2022. Although public debt levels were in general under control in the country-specific policies, additional caution is now required for monitoring risks and ensuring that the targets of the public debt management strategy and fiscal consolidation efforts are not overturned. There also need to be: (i) timely and effective monitoring of the COVID-19 active response, expenditure support program implementation, FCCL commitments, and additional burdens on these fiscal and debt management systems, and (ii) strengthening of the healthcare systems and the social security systems, and service delivery to effectively cover the poor and vulnerable populations.

During crises, the legislative framework is in general re-evaluated, and several prevention and mitigation strategies have been presented to cover the principles for taking on certain risks and recovering related costs. That is the case, for example, in Finland and the Netherlands, where calling large guarantee schemes in the wake of the 2008 financial crisis and the subsequent impact on public finances have led to a tightening of the legislation. In the Netherlands, defining prevention and mitigation strategies for certain fiscal risks also allowed for the creation of safeguards and for “channelling” government interventions in the event of a crisis. For example, ceilings of existing national government guarantee schemes have been increased as part of the COVID-19 crisis response, but no new schemes have been approved.

### 8.3 Continuous Review of the Regulatory Framework is Necessary to Apply the FCCL Principles

In line with the outlined FCCL framework principles, the objectives of the FCCL framework are set out in a framed and well-structured policy or legislation. Whether that is through policy or legislation depends largely on a country’s legal system and/or tradition. However, the framework should include normative and enforceable proceedings for the identification, measurement, and disclosure of fiscal commitments, as well as their management by the related institutional settings and high-level approval authorities. As outlined in the country case review, there are several common features of an FCCL-based legal framework, such as establishment of a limit on the overall exposure from FCCL; the general scope to address which authority is defined for approving and issuing guarantees; disclosure requirements; and clarification of the mandates for collecting, recording, monitoring, and reporting on guarantees.

An ongoing review and modification of the procedures and specifications for the general terms for extending guarantees and monitoring FCCL parameters—including the approach to risk identification, cost estimation, mitigation activities, etc.—will improve efforts to address challenges.

Considering the maturity of the PPP programs and the level of PPP governance in the selected countries, most of the countries have adopted relatively good regulatory provisions regarding FCCL, and some

countries also have a relatively high-level baseline for PPP benchmarking.<sup>66</sup> Although several observations also highlight that there is a significant level of detail in the FCCL process in legal and regulatory documents, there is still a lack of PPP experience, and therefore it is difficult to assess the overall country practice.

#### 8.4 Common Aspects of FCCL Framework-Related Responses Post COVID-19

In line with the presented FCCL principles, in reviewing COVID-19-related impacts on PPPs, the country cases include (but are not limited to) certain common aspects, which are summarized below:

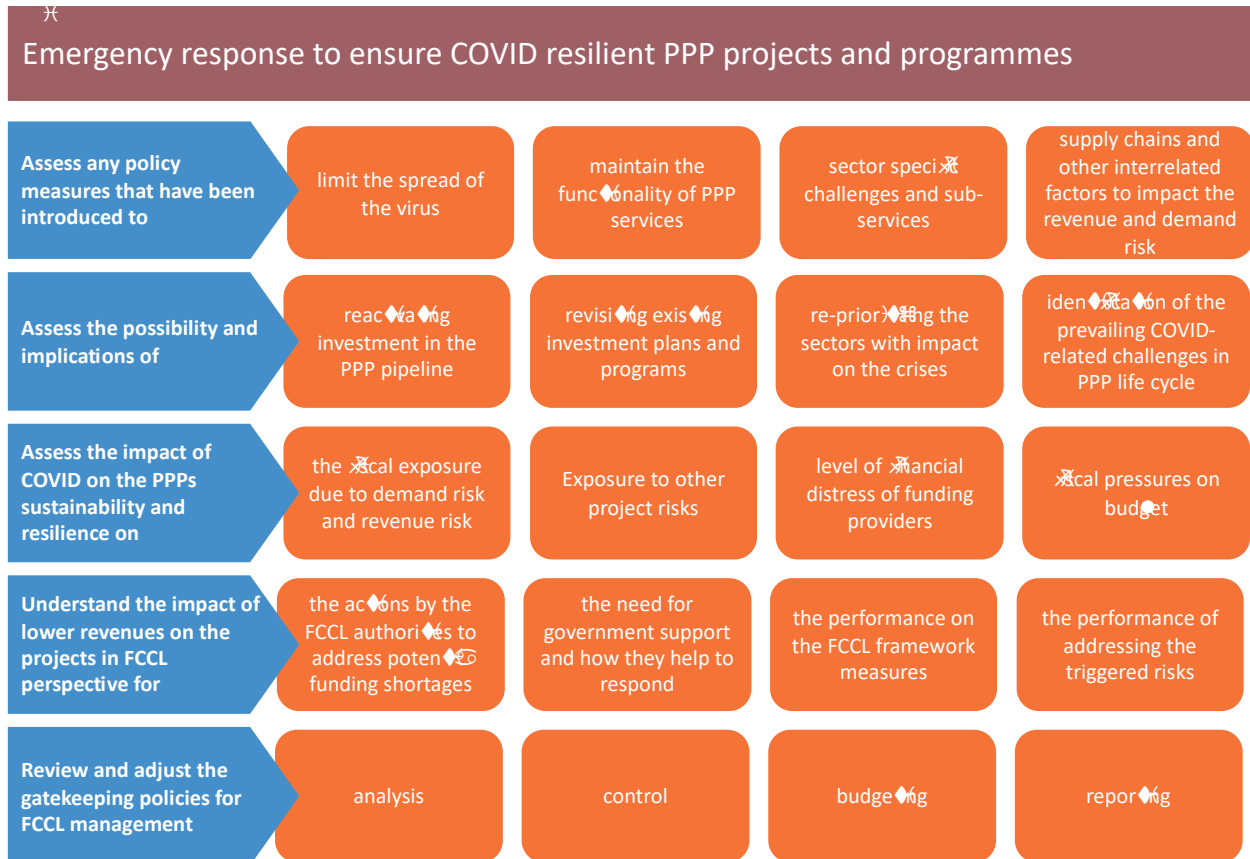
- **Assess any policy measures that have been introduced** to limit the spread of the virus, and maintain the functionality of PPP services, sector-specific challenges, and supply chains and other interrelated factors that would impact revenue and demand risk.
- **Assess the possibility and implications of** reactivating investment projects in the PPP pipeline; existing investment plans and programs for greenfield projects; and potential PPP opportunities for brownfield projects through limited concession schemes, that might be stalled or temporarily suspended. Also consider re-prioritizing the sectors and services applicable to PPP models (hospitals, education, connectivity, roads, ports, and airport projects) with the largest potential impact on crisis management. Finally, ensuring appropriate identification of the prevailing COVID-19-related challenges in the PPP life cycle to project development, procurement, financial closure, construction and operation.
- **Assess the impact of COVID-19 on the sustainability and resilience of the PPP project, with a clear lens** on the identification and understanding of the fiscal exposure due to project risks (related to demand, revenue, supply-chain cost increases, equipment, employment, etc.).
- **Taking into account pre-COVID-19 financial stress, assess the level of financial distress** of funding providers, increased fiscal pressures on the national budget, and fiscal needs and actions for SOEs' budgets.
- **Understand the impact of lower revenues on existing projects from an FCCL perspective and observe:**
  - Country actions and policies implemented by FCCL authorities to address potential funding shortages
  - The need for temporary increases in government support tools and subsidies, and how they help to respond to crisis-related risks
  - Performance on FCCL framework measures
  - Soundness in addressing the crisis-related triggered risks
  - Additional precautions and policy actions to mitigate these risks.

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<sup>66</sup> WBG. Benchmarking Infrastructure Development (see <https://bpp.worldbank.org>).

- **Review and adjust gatekeeping policies** for the measures taken during project cycles for FCCL management for:
  - Analysis—identifying and quantifying fiscal commitments
  - Control—assessing affordability as an input to approval
  - Budgeting—ensuring funding for fiscal commitments
  - Reporting—accounting, monitoring and disclosure.

**Figure 17: Common Aspects of PPP Actions During Crises**



### 8.5 The Way Forward for Ongoing Development of the FCCL Framework

Country evidence shows that a resilient framework for fiscal management of PPPs is critical, whether during the Asian financial crisis of 1994-1998, the global financial crisis of 2007–2009, or the COVID-19 pandemic of 2020-2022. All such crises can exacerbate the fiscal management situation—they can diminish the reliability of project appraisals, reduce the number of qualified and interested service providers, and increase costs and/or decrease revenues, leading to enhanced probability of financial distress.

The analysis of countries with different post-crisis responses and lessons learned has led to the observation that reviewing and adjusting gatekeeping policies for measures taken during project cycles for FCCL management are of utmost importance. As outlined above, the key features of analysis, control, budgeting and reporting, with a sound legal and institutional setting, are the basis of the key FCCL principles.

FCCL-related exposure needs careful assessment. As outlined in these principles, a clear responsibility within the government for contingent liability management is a necessity, either as part of comprehensive government asset-liability management in debt management offices or in the budget office of the Ministry of Finance department that has a PPP mandate. The country's efforts need to be coupled with a clear fiscal risk management strategy, having the principles of setting fiscal risk targets and separation of risk taking and risk appraisal functions. Moreover, there is also merit to promotion of awareness of long-term fiscal costs and risks, both in local and central governments.

It has been observed from best practices that the key characteristics of a sound system for fiscal PPP commitments in managing fiscal policy are widely available comprehensive and reliable information, open processes of budgeting and accountability of policymakers for long-term fiscal risks, and accuracy of fiscal information. A key recommendation for governments should be to assess a regular policy- and process-oriented FCCL application, with the following FCCL principles as a checklist:

- ANALYSIS: Identifying and quantifying fiscal commitments
  - *Methodological guidance for quantifying fiscal impact.* A duly authorized guideline can support a comprehensive, consistent, and accurate appraisal of the fiscal impact of a PPP, specifically for its contingent liabilities.
  - *Tools are in place to assess the potential fiscal costs and risks.* Spreadsheet-based applications, such as PFRAM, can help to quantify the macro-fiscal implications of PPPs, understand the risks assumed by the government, and identify potential mitigation measures.
- CONTROL: Assessing affordability as an input to approval
  - *Fiscal impact is evaluated throughout the PPP life cycle.* The fiscal impact is evaluated, taking into account the level of development at initial project screening, before tender launch, before commercial close, and for any contract variations.
  - *VfM is the justification for fiscal commitments.* A regulatory requirement to assess value for money in a guided and consistent manner can support the decision making on the justification of any fiscal impact.
  - *Thresholds to cap fiscal exposure from PPPs.* A duly authorized ceiling, in terms of an overall liability limit (irrespective of the delivery scheme, i.e., debt including PPP fiscal commitments) provides a reference for the affordability of PPPs.
- BUDGET: Mechanisms in place to plan and ensure funding
  - *Ensure funding is planned and available for direct liabilities.* To provide comfort to the private partner and ensure bankability, as well as for the government to anticipate the known expenditures, mechanisms should be in place to allow the government to honor its financial obligations for the duration of the contract.
  - *Ensure funding is planned and available for contingent liabilities.* To provide comfort to the private partner and ensure bankability, as well as for the government to anticipate the unknown, mechanisms should be in place to ensure the government is able to fund contingent liabilities, should they materialize.
- REPORT: Accounting, monitoring and disclosure
  - *Fiscal commitments are adequately accounted and documented.* Appropriate accounting standards, such as IPSAS, are applied to determine whether and when PPP commitments should be recognized, and reflected as such in the financial statements.
  - *The legislature and other stakeholders are periodically informed about PPP fiscal exposure.* A consolidated report encompassing all PPP projects, including their fiscal commitments



(direct and contingent), progress and value for money, are appropriately disclosed to relevant stakeholders to facilitate oversight of the PPP program.

- *Periodic audits are undertaken.* Regulatory and value for money audits by supreme audit entities can provide independent reviews of government finances and performance to parliaments and to the public, to confirm reliability and compliance of fiscal exposure.
- *Fiscal management proceedings apply to all agencies.* To control and avoid unwarranted sub-sovereign fiscal exposure, the fiscal rules for PPPs should be applied to all levels of government.

Implementation of these fiscal policy principles requires additional safeguarding activities. These include adoption of improved tools (including a multi-year timeframe for fiscal planning and forecasting), and extending the coverage of the accounting system and ultimately also the budget system, to cover all financial activities in line with the PPP portfolio.

# Appendix A: Setting Limits for FCCL in PPPs



## Appendix A: Setting Limits for FCCL in PPPs

Setting limits for fiscal commitments and contingent liabilities generated by PPP projects is often used by countries to rationalize the use of PPPs. However, setting such limits only represents a second-best solution to achieve this objective. The ideal way is to decide to procure a project as a PPP based on an analysis of efficiency gains, such as a value for money assessment.

This appendix provides a brief review regarding the different ways in which governments around the world have implemented their PPPs' fiscal ceilings. Some governments introduce specific limits on direct fiscal commitments to PPPs in order to achieve better fiscal management of PPPs. PPP fiscal ceilings are set, generally, to give the market confidence that a fiscally sustainable PPP program is in place, and to provide adequate incentives to select the right projects, because the ability to commit public resources is restricted by the PPP fiscal ceiling.

The ceiling must be clear to communicate, and easy to monitor and enforce, thereby providing an accurate picture of reality, and enough confidence in the PPP program's sustainability.

There is no special rule of thumb for setting a PPP ceiling. The assessment should take into account the affordability of the PPP program in terms of direct and contingent commitments in the short, medium, and long term.<sup>67</sup>

A PPP ceiling is a combination of two elements:

- *The method for computing the base of commitments that will be monitored.* Countries around the world have followed two main methods—one is based on stock (or overall) commitments (direct and contingent), and the other is based on flow (or annual) commitments (direct and contingent).
- *The reference.* The indicator used as a benchmark to establish the ceiling value, either based on the gross domestic product (GDP), the public revenues, the public expenditure, or the capital expenditure.

Governments have varied in their policy decisions regarding the PPP ceiling, particularly in terms of which method they will use to monitor the ceiling (i.e., stock or flow method), and which reference will represent the benchmark of such monitoring (i.e., the value and the reference indicator).

Each method and reference chosen by a government in defining its PPP ceiling will also generate different decisions that the government will need to make—for instance, the method, the reference indicator, the discount rate, or the methodology for contingent commitments or revenue projections.

A PPP fiscal ceiling does not need to be inflexible to be credible, but it must be clear in the legislation under which circumstances it can be modified. Countries that are allowed by their own legislation to modify the ceiling usually start with a manageable number, and then increase it accordingly, or as well as anchoring the ceiling to an overall public debt objective, if it exists.

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<sup>67</sup> Funke, K., T. Irwin, and I. Rial. 2013. "Budgeting and Reporting for Public-Private Partnerships." Discussion Paper 2013-7. International Transport Forum.

## GDP as the Reference Indicator

There are three main ways in which countries have included the GDP in computing the PPP ceiling: (i) the GDP from the previous year (i.e., Uruguay); (ii) the projection of the GDP for the current year (i.e., Peru); and (iii) although it has not been employed using the GDP, the average forecasted GDP from the years considered in the country's medium-term macroeconomic framework, usually three to five years (i.e., in its previous PPP ceiling, Mexico employed a reference indicator based on the next five-year forecasted average of the infrastructure expenditure). The table below summarizes the PPP ceilings based on GDP. Column 6 lists estimates of the equivalent stock ceiling based on the flow ceiling (in the cases of Colombia, Paraguay and Uruguay), assuming a horizon of 15 years and a discount rate of 4 percent.

**Table 16. PPP Ceilings for Selected Countries Based on GDP**

Country (1)	2019 GDP (US\$, billions) (2)	PPP rule (3)	Type of method (4)	Ceiling (% GDP) (5)	Est. stock ceiling (% GDP) (6)
Argentina	444.458	The accumulated amount of the firm and contingent payments, net of income, assumed in the PPP contracts, calculated at present value, may not exceed 7% of GDP.	Stock	7%	7%
Cambodia	26.728	The Ministry of Economy and Finance (MEF) has introduced a 4% GDP limit on guaranteed payments for PPPs in the electricity sector.	Stock	4%	4%
Colombia	323.375	Limit on the flow of new PPP obligations for the maximum annual amount of authorizations, currently set at 0.55% of GDP. There is no limit on the stock of PPP obligations.	Flow	0.55%	7.2%
Dominican Republic	89.032	The accumulated amount of the firm and contingent payments, net of income, assumed in the PPP contracts, calculated at present value, may not exceed 3% of GDP.	Stock	3%	3%
El Salvador	27.023	The present value of the cumulative amount of quantifiable firm and contingent future payments, net of revenue, assumed under PPPs cannot exceed 5% of GDP.	Stock	5%	5%
Honduras	24.921	The accumulated amount of the firm and contingent payments, net of income, assumed in the PPP contracts, calculated at present value, may not exceed 5% of the GDP of the previous year.	Stock	5%	5%

Country (1)	2019 GDP (US\$, billions) (2)	PPP rule (3)	Type of method (4)	Ceiling (% GDP) (5)	Est. stock ceiling (% GDP) (6)
Jamaica	15.808	The indebtedness of a government-pays PPP shall comprise part of the public debt. User-pays PPPs shall not comprise part of the public debt. However, the indebtedness of user-pays is classified as contingent liabilities and shall not exceed 3% of GDP (from April 1, 2014 to March 31, 2017). The contingency ceiling shall be 8% of GDP (from April 1, 2017 to March 31, 2026). If at any time during the nine-year period (April 1, 2017 to March 31, 2026) there is a reduction in the public debt below 60% of GDP, then the 8% may be increased by the amount by which the public debt has been reduced below 60%. The contingency ceiling for user-pays shall not apply to the following PPPs: (i) user-pays in existence as of March 31, 2014; (ii) user-pays with minimal contingent liabilities accruing to the Government of Jamaica; and (iii) user-pays with contingent liabilities that become probable (the quantifiable amount of that contingent liability shall thereupon form part of the public debt).	Stock	8%	8%
Paraguay	38.145	The accumulated amount of the firm and contingent payments, net of income, assumed in the PPP contracts, calculated at present value, may not exceed 2% of the GDP of the previous year. Similarly, the assumed amount of firm and contingent payments annually may not exceed 0.4% of the GDP of the immediately preceding year.	Stock + Flow	Stock below 2% / annual flow below 0.4%	2%
Peru	230.746	The accumulated amount of the firm and contingent payments, net of income, assumed in the PPP contracts, calculated at present value, may not exceed 12% of GDP. The previous ceiling was set at 7%.	Stock	12%	12%
Uruguay	62.212	The total amount of firm and contingent commitments, in net present value, cannot exceed 7% of the GDP from the previous year, and the annual commitments cannot exceed 0.5% of the GDP from the previous year.	Stock + flow	Stock below 7%/ annual flow below 0.5%	7%

### Ceilings Based on Percentages of Public Revenues

In this case, the ceiling only accounts for the annual commitment amounts (rather than the stock ceiling rules, which account for the overall amount of commitments). For example, in Hungary, the PPP ceiling is set at 3 percent of the public revenues for any given year. This ceiling applies only to the central government, and not to other entities that form part of the general government (i.e., local government).

In this sense, rather than defining a term in which the rule applies, the Hungarian rule left the term horizon (i.e., the total length of the PPP portfolio) open.

### Case of Brazil

In Brazil, a very decentralized country in which the states and municipalities have an important share of the PPP market, the PPP law has established two types of ceilings—one at the national level, and the other at the subnational level. In particular, the PPP law instructs the federal government on how to proceed if the respective ceilings are reached. For instance, at the national level, the federal government can only sign new PPP contracts if the annual expenses due to PPP commitments, in the previous year, are not greater than 1 percent of their net current revenues, or the annual expenses of their contracts in execution, in the 10 subsequent years, do not exceed 1 percent of the net current revenue projected for the respective fiscal years (Art. 22, PPP Law). Moreover, at the subnational level, the federal government can't grant additional guarantees or carry out voluntary transfers<sup>68</sup> to the states, federal district and municipalities if the sum of PPP expenses contracted by these entities has exceeded, in the previous year, 5 percent of their net current revenue, or if their annual expenses of the contracts in force in the 10 subsequent years exceed 5 percent of the projected net current revenue for the respective fiscal years (Art. 28)<sup>69</sup>.

The first thing to note in the case of Brazil is that, although the ceiling imposed at the subnational level does not explicitly restrict states or municipalities from signing new PPP contracts if they have reached the ceiling, not having the support of the federal government, either through federal guarantees, or voluntary transfers, may not be the best signal to the market, and could act as a clearly dissuasive measure to not exceed the ceiling.

The second characteristic from the Brazilian ceiling is that it takes, either for the national or subnational ceiling, the ratio between the PPP annual expenses over the net current revenues<sup>70</sup> from the most recent previous year as a starting point to check for compliance with the ceiling, and then computes the same ratio for the subsequent 10 years using the projection of both figures to guarantee compliance (the latter is typical in a flow-type PPP ceiling, in which the PPP annual expenses need to be below the ceiling in each year of the PPP portfolio, however, Brazil only considers a 10-year period in its rule instead of the length of the PPP portfolio).

### Contract-Based Commitment Approach

For example, Guatemala has followed a different approach in limiting the fiscal risk of PPP projects. In its PPP regulation, it established that the commitments and contingencies agreed in the contracts will not

<sup>68</sup> Voluntary transfers are cash transfers that the federal government sends to states and municipalities to support certain activities and projects, however the resources are not earmarked, and thus, the federal government is not obliged to maintain those transfers. Voluntary transfers totaled as much as 0.027 percent of GDP in 2018. Rocha, A. 2019. *Brazilian Federal Transfers to States and Municipalities: a quick reference guide*. Texto para Discussão nº 263, Senado Federal. <https://www12.senado.leg.br/publicacoes/estudos-legislativos/tipos-de-estudos/textos-para-discussao/td264-b>.

<sup>69</sup> Lei Nº 11.079 (PPP Law) 2004. [http://www.planalto.gov.br/ccivil\\_03/Ato2004-2006/2004/Lei/L11079.htm](http://www.planalto.gov.br/ccivil_03/Ato2004-2006/2004/Lei/L11079.htm).

<sup>70</sup> Receita Corrente Líquida (RCL), in Portuguese. <https://www.camara.leg.br/noticias/51956-entenda-o-que-e-receita-corrente-liquida/>.



exceed 20 percent of the total investment of the project, except in fully justified cases, in which it may not exceed 40 percent, and must have the express approval of the PPP council (CONADIE) (Article 72). Rather than imposing a fiscal ceiling on the overall or annual amount of commitments, Guatemala uses a ceiling in which it limits its exposure per contract (either direct or contingent exposure). This type of rule, although it draws a clear line to what extent the government can offer support (either directly or contingently), does not do much to limit the total number of fiscal commitments, because the commitments can grow (less than proportionally) as the portfolio of PPP projects grows. In this way, the commitments can be located in a range of 0 to 40 percent of the total investment in PPP projects.

### Cyclical Adjusted Reference

Before it adopted its current PPP ceiling, Mexico used to have a ceiling based on a reference indicator, computed as the average of the subsequent five years of its infrastructure spending. This was particularly useful for mitigating the influence of an outlier year (either bad or good) in the computation of the ceiling. However, it was also noted that every forecast was based on assumptions that were not always very clear to the public, and needed to be viewed with scepticism in order to avoid over-optimistic forecasting. In particular, the Mexican regulation mentioned the following:<sup>71</sup>

*“In the Federal Budget Bill, the programmable spending of the Public Sector associated with Public-Private Partnership contracts, excluding State-Owned Enterprises, may not exceed in each year 10% of the annual average of infrastructure investment foreseen for the next five years in the General Criteria of Economic Policy<sup>72</sup> of the year prior to the one of the Federal Budget Bill.”*

Although the ceiling was not explicit in the PPP law or regulation, it was part of the criteria used for the Ministry of Finance to grant the admissibility of the project into the PPP portfolio, thereby allowing it to receive government support. The criteria were changed in 2017 to feature a much simpler ceiling, based on the programmable spending (of the previous year), which did not need forecasts. Additionally, this new ceiling is now an explicit part of the PPP Regulation (Art. 32, PPP Regulation of the Law<sup>73</sup>).

### Expenditure Based Reference Ceiling

There are other types of PPP ceilings that are based on public expenditures. Because the commitments in a PPP project are potential public expenses, having a reference indicator based on expenses can provide a clearer understanding of how big those potential expenditures (or PPP commitments) are within the total expenditure or any of its items (e.g., current or capital expenditure).

However, the advantage of choosing expenditures over revenues is less significant in the aggregate. Indeed, when the public revenues include the revenues from financing operations (or debt), then public

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<sup>71</sup> Criterios para la realización de proyectos bajo un esquema de Asociación Público-Privada. [http://www.contratacionpublica.mx/static/normatividad/asociaciones-publico-privadas/disposiciones-varias/4.-CRITERIOS\\_ProYAPP\\_24Jul2015.pdf](http://www.contratacionpublica.mx/static/normatividad/asociaciones-publico-privadas/disposiciones-varias/4.-CRITERIOS_ProYAPP_24Jul2015.pdf).

<sup>72</sup> The General Criteria of Economic Policy is the document that provides the government with the official forecasting of macroeconomic indicators. These forecasts are used to expand upon the Federal Budget Bill that will be in place the subsequent year.

<sup>73</sup> Reglamento a Ley de Asociaciones Público-Privado. [http://www.diputados.gob.mx/LeyesBiblio/regley/Reg\\_LAPP\\_200217.pdf](http://www.diputados.gob.mx/LeyesBiblio/regley/Reg_LAPP_200217.pdf).

expenditures perfectly match public revenues, and they will equal the same amount at the aggregate level, which causes the same volatility in the reference indicator.

Although it is normal to define the ceiling in the aggregate, there are some countries that have defined their reference indicator based on a particular item within the aggregate. For instance, Brazil chose its reference indicator to be the net current revenues (i.e., receita corrente líquida [RCL]<sup>74</sup> in Portuguese, which is mainly composed of tax revenues), whereas Mexico based its first ceiling on the expenditure for physical (or infrastructure) investments.

The table below presents the ceilings based on expenditures from our selected sample of countries. As was the case in revenues-based rules, expenditure-based rules only consider the annual PPP commitments; that is, they are computed as a flow-type ceiling.

**Table 17. PPP Ceilings Based on Public Expenditures**

Country	2019 GDP (US\$, billions)	PPP Limit	Type of Ceiling	Base <sup>b</sup> (% GDP) <sup>1</sup>	Est. Ceiling (% GDP)	Est. Stock Ceiling <sup>c</sup> (% GDP)
(1)	(2)	(3)	(4)	(5)	(6) = (2)*(5)	(7)
China <sup>d</sup>	14,340.600	In each province, the total expenditure on PPPs cannot exceed 10% of annual public spending.	Flow	19.66%	1.96% (2006)	25%
Ireland	398.379	No more than 10% of aggregate capital expenditure, in any given year, can be used to service annualized payments for PPP contracts.	Flow	1.25% (2019)	0.125% (2019)	1.636%
Korea, Rep.	1,646.739	The total annual government payment for PPP projects is limited to less than 2% of total government expenditures.	Flow	23.12% (2019)	0.46% (2019)	6%
Mexico	1,268.868	The maximum annual amount of programmable expenses for PPP projects may not exceed 1% of the programmable expenses in the expenditures budget for the immediately preceding fiscal year.	Flow	17.55% (2019)	0.18% (2019)	2.4%
United Kingdom <sup>d</sup>	2,833.301	Individual limits for each department are specified, ranging from 6% to 7% of total annual spending.	Flow	36.84% (2019)	2.58% (2019)	33%
India <sup>d</sup>	2,870.504	An inter-ministerial task force was constituted to recommend budgetary ceilings for annuity commitments under PPP projects. The task force's September 2010 report proposed that the sum of total annuity commitments for a	Flow - Adjusted	-	-	-

<sup>74</sup> The Fiscal Responsibility Law in Brazil establishes some expenditure limits (e.g., bureaucracy, or current expenditures) based on the RCL as well. Perhaps for this reason, it chose the RCL as its reference indicator, because it was already well known among the public and thus easy to communicate.



Country	2019 GDP (US\$, billions)	PPP Limit	Type of Ceiling	Base <sup>b</sup> (% GDP)	Est. Ceiling (% GDP)	Est. Stock Ceiling <sup>c</sup> (% GDP)
(1)	(2)	(3)	(4)	(5)	(6) = (2)*(5)	(7)
		particular grant or scheme of any department for the next five years should not exceed 25% of the department's current five-year plan outlay for the grant or scheme. However, no cap is set for guarantees issued specifically for PPPs.				
<sup>a/</sup> Regular (R); Special (S)						
<sup>b/</sup> China: Local government expenditure is reported for 2006 for China Mainland in the IMF Government Finance Statistics Manual. Ireland: General government expenditure on consumption of fixed capital in 2019 as a percent of GDP from the IMF <i>Government Finance Statistics Manual</i> . The ceiling on PPPs was eliminated in 2016, and it starts to include the PPP commitments on the government balance sheet. Republic of Korea and Mexico: Expenditures come from the IMF <i>Government Finance Statistics Manual</i> . UK: Central government expenditure from the IMF <i>Government Finance Statistics Manual</i> .						
<sup>c/</sup> Estimates use a discount rate of 5%, and a 20-year term.						
<sup>d/</sup> Duarte, D. "Presentation on PPP fiscal commitments ceiling." World Bank.						

## Updating the Fiscal Ceiling

### Colombia

Colombia defines an annual fiscal ceiling in a two-step process by a special council. In particular, the PPP regulation mentions (Art. 2<sup>75</sup>):

*"...Each year, at the time of approval of the primary surplus target for the non-financial public sector consistent with the macroeconomic program, the National Council for Economic and Social Policy (Conpes), prior opinion of the Superior Council for Fiscal Policy (Confis), will define the maximum annual amount for which authorizations may be granted to commit future budget for the execution of projects under the public-private partnership scheme."*

There are a few things to highlight. First, the ceiling is determined after the primary surplus target, consistent with the macroeconomic program, is defined. In this sense, it is making sure that the country aims in the medium term towards a sound fiscal shape, even when it could have some rough years. That is, although the country has planned an increase in the primary deficit (which in part was caused by the social measures implemented by the government amid the global pandemic), in its medium-term planning, it is targeting normalization of the net debt levels by 2032.

<sup>75</sup> Decreto 1610 de 2013 (Decree that regulates article 26 of Law 1508 of 2012, or PPP Law). <https://www.alcaldiabogota.gov.co/sisjur/normas/Norma1.jsp?i=54031#0>.

Second, the authorizations (or commitments) are granted for the total length of the PPP projects, with the approval of two councils in charge of different areas of the macroeconomic policy. That is, it takes into account the long-term projections of commitments that are informed through the medium-term fiscal framework. This ceiling is (almost) binding for much of the subsequent years, and it is planned to decrease progressively until it reaches 0.40 percent of GDP in 2034. Then, much of the annual commitments for the PPP contracts in execution will decrease sharply, giving space to new PPP projects in case they require government support.

#### Peru

Peru updates its fiscal ceiling every three years. The country established a PPP ceiling based on a stock-type rule (i.e., using the overall PPP commitments). It was set initially in its first PPP law<sup>76</sup> at 7 percent of the GDP, and later increased to 12 percent of the GDP (in its second<sup>77</sup> and third PPP laws<sup>78</sup>). This, and any other changes in the level of the ceiling, are contemplated in the law, however, the ceiling can only be modified every three years. In particular, the law establishes the following (Art. 27):

*“27.1 The stock accumulated by firm and quantifiable contingent commitments, net of revenues, that have been granted by the Non-Financial Public Sector in Public Private Partnership contracts, at present value, cannot exceed 12% of gross domestic product.*

*“27.2 This limit can be revised every three (3) years, and can be modified by Supreme Decree with the endorsement of the Minister of Economy and Finance, once that has been taken into account the infrastructure requirements and public services in the country, as well as the impact of commitments on public finance sustainability.”*

Because the last change in the limit was approved through the second PPP law (2015), and remained in its third PPP law (2018), Peru would be able to change its limit again in the year 2021. In case of any change, it needs to have the endorsement of the minister of finance, and be published as a Supreme Decree, which needs the approval of the president.<sup>79</sup> However, there has not been a sign of this at the time of report preparation. The current stock of commitments in present values and net of revenues was reported to be 2.47 percent of the GDP in its 2020 Multi-Annual Macroeconomic Framework.<sup>80</sup>

<sup>76</sup> Decreto Legislativo 1012. <https://leyes.congreso.gob.pe/Documentos/DecretosLegislativos/01012.pdf>.

<sup>77</sup> Decreto Legislativo 1224. <https://leyes.congreso.gob.pe/Documentos/DecretosLegislativos/01224.pdf>.

<sup>78</sup> Decreto Legislativo 1362. <https://leyes.congreso.gob.pe/Documentos/DecretosLegislativos/01362.pdf>.

<sup>79</sup> Various classifications apply in Peru; a Supreme Decree is a decree prepared by the president that has the standing of a law, although it does not need to be approved by Congress (as is the case with Laws or Legislative Decrees). For more information regarding the different classifications of forms of legislation, see

[https://www.mef.gob.pe/index.php?option=com\\_content&view=category&id=672&Itemid=100357&lang=es](https://www.mef.gob.pe/index.php?option=com_content&view=category&id=672&Itemid=100357&lang=es).

<sup>80</sup> [https://www.mef.gob.pe/es/?option=com\\_content&language=es-ES&Itemid=100869&lang=es-ES&view=article&id=3731](https://www.mef.gob.pe/es/?option=com_content&language=es-ES&Itemid=100869&lang=es-ES&view=article&id=3731).



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The World Bank Group provides assistance to governments in developing countries to improve access to infrastructure and basic services through public-private partnerships (PPPs). When designed well and implemented in a balanced regulatory environment, PPPs can bring great efficiency and sustainability to the provision of such public services as water, sanitation, energy, transport, telecommunications, healthcare, and education.

The World Bank Group's unique value proposition rests with its capacity to provide support along the entire PPP cycle—upstream policy and regulatory guidance, transaction structuring advice, as well as financing and guarantees to facilitate implementation.



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