Principles for PPP Effectiveness in Developing Countries

Part 1: Principles for Public Private Partnerships (PPPs) effectiveness in Developing Countries

A note prepared by the WBG for the G20 High Level Development Working Group (Pillar 1: Infrastructure)

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Further to the G20 Development Working Group request, the purpose of this note is to identify key issues that can help ensure successful access to and use of Public Private Partnerships (PPPs) in developing countries. This aims to help PPPs bring in associated additional resources, efficiency gains and better infrastructure development planning.[1]

There is no universally accepted definition of Public Private Partnerships (PPPs)[2]. In a broad context it entails an arrangement between public and private sectors on provision of services in traditional infrastructure sectors, as well as health, education, agriculture, etc. The following summarizes the steps required to implement PPP successfully in developing countries, based on global experience, with a particular focus on infrastructure.[3]

Economic Fundamentals –

- fit with a country's growth and development strategy,
- meet essential economic requirements (such as demand for services)
- enjoy political buy-in, and
- comply with sound fiscal management and public finance practices.

An example of rigorous assessment of projects is India's national highway program, part of the national investment program and rooted in the country's growth and development strategy.

Legal & Regulatory Fundamentals - Legal and regulatory frameworks for PPP must provide adequate protection and obligations for all parties involved in a PPP arrangement--government, investors and lenders alike. Necessary elements of a PPP program include: the existence of a clear framework for approval processes, procurement rules specific to PPP, government financial support, enforcement of government obligations, and general investment issues (like dispute resolution, contract rights, tax, etc.) associated with PPP.

Political Commitment and Institutional Framework - A strong, sustained political commitment at the highest levels is required to attract private finance and provide the necessary assurances to build investor confidence. Institutional frameworks must provide the support and incentives for proper PPP implementation, with coordination between the different parts of government involved

[1] Jeffrey Delmon, World Bank, PPIAF, & Wolters Kluwer, 2009, *Private Sector Investment in Infrastructure, 13*
[2] Jeffrey Delmon, "Understanding Options for Public Private Partnerships in Infrastructure: Sorting out the forest from the trees - BOT, DBFO, DCMF, concession, lease . . ." (World Bank Working Paper 2010).
[3] These steps are fully consistent with multilaterally-agreed principles for PPP investment – such as the OECD *Principles for Private Sector Participation in Infrastructure*, which were developed by practitioners from OECD and developing countries.

and without adding excessive complexity and red tape, including mechanisms for the assessment and management of contingent liabilities and fiscal risks linking back to the Ministry of Finance. One option for inter-ministerial coordination is the establishment of a dedicated PPP unit. This Unit should serve as the single point of contact for all PPP-related issues for

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Competition and Transparency -

Environmental and Social Safeguards -

Government Financial Support -

[5] www.equator-principles.com
[6] www.pppinindia.com

Contract monitoring -

Finance -

Part 2: Overview of PPPs in Infrastructure in Developing Countries

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1. Further to the agenda and action plan agreed at the G20 Seoul meetings in November 2010, the purpose of this note is to identify how countries can improve their access to PPP investment, with a special focus on infrastructure. Hereafter, Section 1 provides background information and a quick survey of infrastructure finance and PPP globally, Section 2 discusses the challenges faced by countries seeking to expand PPP, and Section 3 describes some of the actions that multi-lateral agencies "MLAs" (including multilateral development banks "MDBs") and bilateral agencies "BLAs" can take to help countries meet these challenges.

Background and global context

2. There is no universally accepted definition of the meaning of Public Private Partnerships (PPP)[7]. In a broad context it entails an arrangement between public and private sectors on provision of services in traditional infrastructure sectors, as well as health, education, agriculture, etc. As illustrated by Figure 1 below, the first two chevrons show the typical arrangement for public sector only, the arrow marked 'PPP space' shows the broad spectrum of PPP arrangements with a growing role for the private sector until reaching full divestiture of assets from a public to a private owner.

3. In the absence of a universal definition of PPP, this note is making use of the World Bank/PPIAF Private Participation in Infrastructure (PPI) database for the analysis of trends in private investment in infrastructure that follows, hence the use of the abbreviation "PPI" in this first section.[8]

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[7] The term public-private partnership (PPP) does not have a legal meaning and can be used to describe a wide variety of arrangements involving the public and private sectors working together in some way. Policy makers have invented an ingenious array of terms to summarize what they are trying to achieve. It is therefore necessary for them to be very clear about *why* they are looking to partner with the private sector, *what* forms of PPP they in have in mind, and *how* they should articulate this complex concept.

[8] See ppi.worldbank.org.

Figure 1. The PPP Spectrum

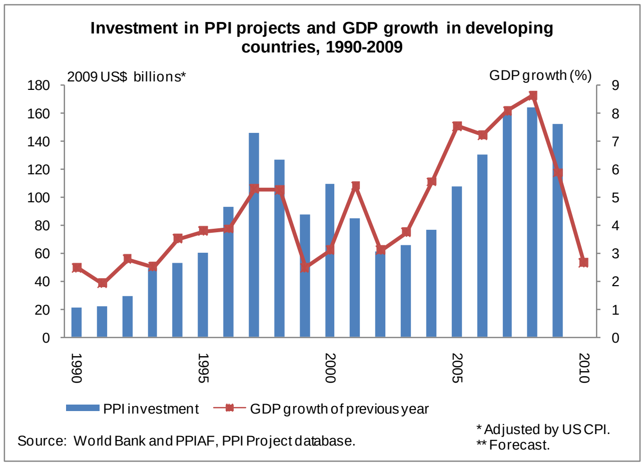
Shifting global financing trends

4. Several trends in financing infrastructure have emerged in recent years in low-income and developing countries. Traditionally, public funding of infrastructure is the largest source of capital for infrastructure, estimated at about two thirds of total funding with private funding and official development assistance filling in the remainder.[9] During the Global Financial Crisis, which struck in 2008, and in its aftermath, multilateral donors, including the World Bank Group have stepped up their assistance to infrastructure projects in an effort to avoid the erosion of progress achieved in the preceding years. In 2010, the WBG provided a record support of $28 billion financing for infrastructure, nearly doubling its support over a three year period. Going forward, in view of existing and future capital constraints within the IBRD, it is anticipated that a ceiling has been reached and the upward trend will not continue.

5. On the other hand, there has been renewed interest in private sector participation in infrastructure in developing countries since the onset of the Global Financial Crisis. After experiencing a significant slowdown in 1999–2004, annual investment commitments in infrastructure projects with private participation more than doubled between 2004 and 2009, reaching their highest level ever in 2008 before the global credit freeze (Figure 2).

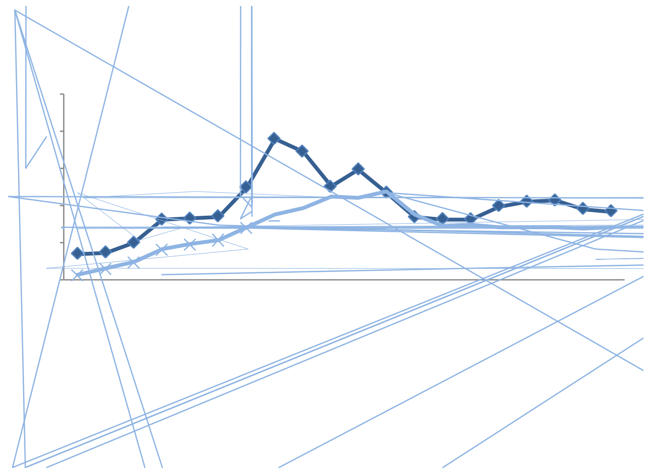
period (Figure 3).[10] Best available estimates, based on PPI database figures, suggest the following: on an annualized basis, it can be inferred that PPI investment contributed between 15% and 20% of total investment in infrastructure in 2005–09, a share similar to that of the previous five years (but 30% lower than the share in 1995–99). The bulk of this private investment was directed to telecommunications. If this sector is excluded, total investment in PPP would have grown from 0.41% of the GPD in 2005 to 0.56% in 2009 and the annualized PPI investment from 0.24% to 0.35%.

Figure 2



Source: World Bank and PPIAF, PPI Project database.

Figure 3



Flight to quality

6. Private investment in infrastructure is selective, focusing on the most financially viable infrastructure businesses. While it remains concentrated on telecommunications, other sectors such as energy and transport have experienced fast investment growth in 2005–09 (Figure 4). By contrast, water and sanitation—the sector in which it has been the most difficult to implement cost recovery tariffs and commercial discipline on service providers—has seen investments decline in absolute and relative terms.

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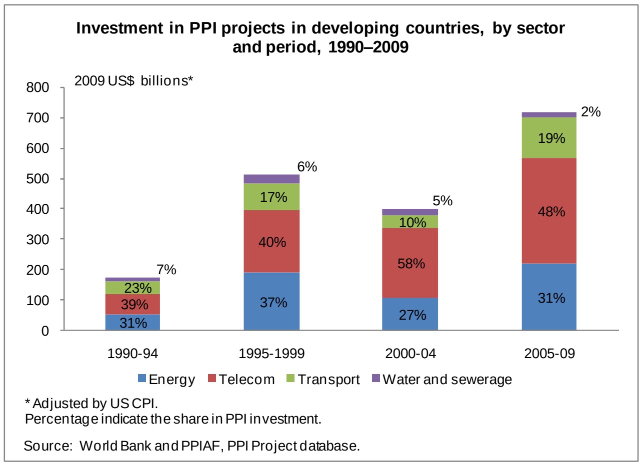
[10] PPP investment includes investment in physical infrastructure and payments to the government for the right to providing the infrastructure services. It records total project investment in the year of financial closure.

Figure 4



7. Within each sector, the infrastructure businesses that have been able to increase or maintain their shares in total PPI investment are those whose markets are the most dynamic and have the most commercial tariffs (such as mobile access and combined mobile and fixed access). Other contributing factors for PPI investment are rapidly growing demand; tariffs set on, or linked to, a hard currency (such as in the case of ports and airport); or services sold through wholesale agreements with public or private entities (electricity generation power plants, transmission lines, and water treatment plants) (Figures 5 and 6). By contrast, infrastructure business serving end-users and traditionally having difficulties reaching and maintaining cost reflective tariffs (such as electric, natural gas, and water utilities, as well as railways) have seen their share in total investment decline in 2000–09 compared to the period 1990–99.

8. The reduced appetite for new investment in electric utilities becomes more noticeable when it is considered that more than half of the investment in the sector in 2000–09 was directed to PPI projects implemented in the 1990s. In the water sector, the existing limited private activity was heavily supported by public funding. A recent study on sources of funding for PPI projects found that almost half of the investment in the water sector in 2006–09 obtained only one third of its funding from private sources while the remaining two thirds of funding came from (domestic or foreign) public sources.[11]

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[11] Izaguirre, Ada Karina and Supriya Prakash (2011) Findings of a pilot study on key sources of funding for infrastructure projects with private participation in developing countries, PPIAF and World Bank, forthcoming.

Figure 5

Figure 6

9. Traditionally, infrastructure services that have been less successful at attracting private investment have also been more prone to cancellations. While only 5% of total PPI projects were cancelled by 2009, 10% of PPI contracts for water utilities, representing 37% of committed PPI investment in water utilities, were cancelled by 2009. Similarly 12% of projects involving standalone electric distribution utilities were cancelled. These projects accounted for just 2% of investments as most cancellations involved electric utilities with limited investment commitmenttyentellth. W171ng1(W161d.)-12 pr72(F)15itedent6.59 T12tyentell1li20

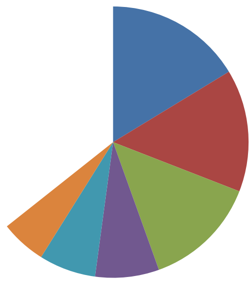
Figure 7

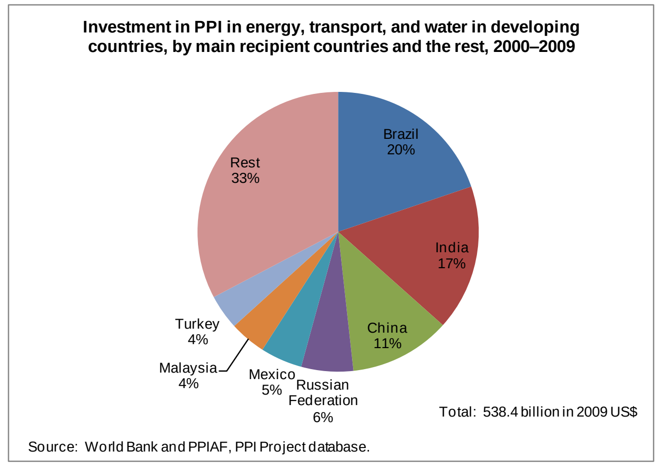
Figure 8

Uneven picture of PPP investments across the regions

11. While PPI investment is spread across all developing regions, it still remains highly concentrated. The two most active developing regions in the 1990s, East Asia and Pacific (EAP) and Latin America and the Caribbean (LAC), saw a slowdown in PPI investment in 2000–09 while the other developing regions experienced significant growth (Figure 9). However, most of the investment growth in those regions was concentrated i

Figure 11





13. Developing regions continue to use different approaches to private participation in electricity. Following the Chilean model, most Latin American countries introduced private participation in electricity in the 1990s as part of broader reforms that typically included the establishment of a more competitive market structure. The approach involved vertical separation of the electricity sector into three basic business units (generation, transmission, and distribution), transfer of at least generation and distribution to the private sector and establishment of new regulatory frameworks, and introduction of market mechanisms to encourage competition.

14. A ramp-up in new power plant investment in Latin America and the Caribbean was nearly contemporaneous or in close succession to the transfer of public sector assets to private management (figure 12). East and South Asian countries introduced private participation in electricity mainly through private financing of new generation capacity in the form of independent power producers (IPPs) and continue to use this approach in 2000–09 (figure 13). This approach reflects the priority given to expanding capacity to keep pace with demand growth.

15. Other forms of private participation have played a marginal role. Divestitures have consisted primarily of sales of minority stakes though initial public offerings (IPOs). One notable exception is the Philippines, which changed its approach by concessioning its national transmission company and divesting most of its power generation capacity in the last few years. Progress on introducing broader reforms to ensure long-term sustainability of the sector has varied significantly across developing Asia. India and the Philippines--the countries in this region that have been most successful at attracting private investment in the last five years--are the ones that have progressed further in introducing competitive market structures.

Figure 12

Figure 13

16. Most countries in Europe and Central Asia have followed the Latin American approach, with the exceptions of Turkey and Russian Federation. After attracting private investment through IPPs in the 1990s, Turkey has introduced reforms to create a competitive market and is focusing on concessioning distribution companies to create a financially sound distribution and retail sector, which is expected to encourage privatepanesprivate 15und

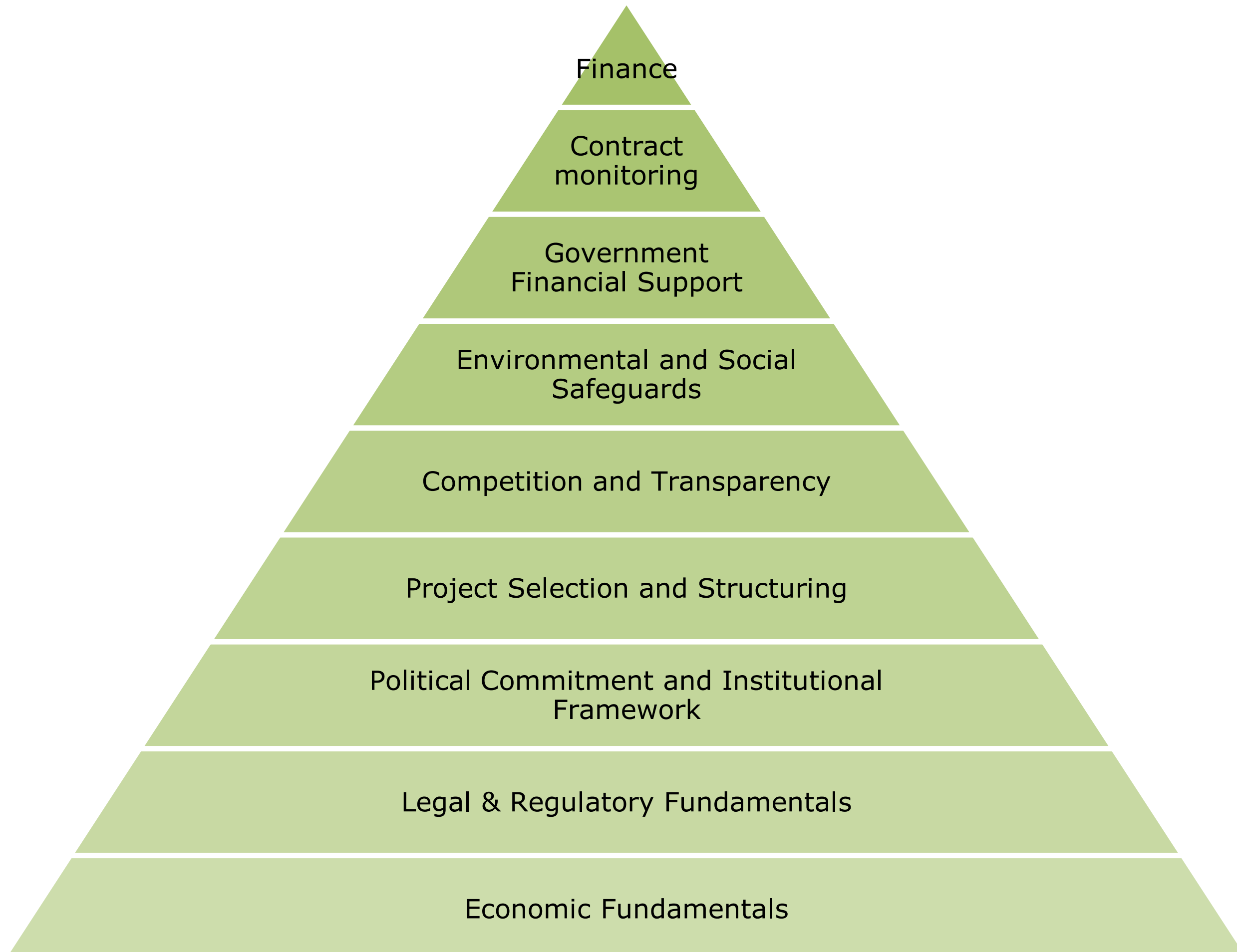
20. The other two regions most affected by cancellations have been East Asia and Latin America. In both regions, water and transport were the sectors with the most cancellations. In EAP and LAC, around 6% and 11%, respectively, of the PPI projects in water, involving 29% and 38% of the committed investment in the sector, were cancelled by 2009. While in transport, 6% of the projects in both regions, involving 12% and 8%, respectively, of the committed investment in the sector were cancelled. Unlike water, where there are no plans to reengage the private sector in the cancelled water concessions, the private sector is reengaging in many of the cancelled transport projects under new concession or PPP programs (e.g. road projects in Mexico).

21. Finally, a last phenomenon completing the global PPI picture concerns the change in the nature of investors. In the 1990s, PPI investors were mainly from developed countries, entering into the developing countries' infrastructure sectors. However, the past decade has seen more South-South engagement and the emergence of new financiers from countries like China, India, Brazil, and the Gulf, increasingly offering loans and other financing arrangements.. In the Africa region alone, financing from such sources has increased from US$1billion in 2004 to US $8 billion in 2008.[13]

Challenges to Expanding PPPs

22. Developing a successful PPP program is a complex undertaking and involves a number of key challenges for developing countries. In order to establish an environment conducive to PPPs, governments are required to take a number of steps which are illustrated in the pyramid figure below. All steps are important building blocks to the establishment of a credible PPP program, whereby failure to implement one step may delay the entire program and even cause possible break-downs of existing projects.

[13] PPIAF (2008) Building Bridges.



23. The following sections will describe each of these steps in detail and use global experience, with salient country examples for illustration.

Economic Fundamentals

24. At the very basic level, investments designated for PPP arrangements need to be scrutinized in terms of their fit with a country's growth and development strategy. Moreover, they need to meet essential economic requirements (such as demand for services). PPP projects that are anchored in a fully-fledged, public national investment program provide greater assurances to investors of political buy-in and that economic fundamentals have been prioritized. PPPs must also include sound fiscal management and public finance practices. An example of rigorous assessment of projects is India's national highway program, part of the national investment program and rooted in the country's growth and development strategy. South Africa adopted the United Kingdom's approach to programmatic development of PPP with a considered program for managing Government fiscal risks arising out of PPP. A clear regime for assessing proposed fiscal risk, using Government support for PPP, and managing fiscal risks during project implementation protects the Government from the potential impact of these risks.

Legal & Regulatory Fundamentals

25. Legal and regulatory frameworks for PPP must provide adequate protection and obligations for all parties involved in a PPP arrangement--government, investors and lenders alike--in particular in light of the long-term nature of infrastructure projects and the need to adapt to changes throughout the lifecycle of a PPP project. Necessary elements of a PPP program include: the existence of a clear framework for approval processes, procurement rules, government financial support, and general investment issues (like dispute resolution, contract rights, tax, etc.) associated with PPP. However, many developing countries lack an adequate legal framework, and in many cases, reforms and specific laws may be required to allow for the public sector to contract with private bodies for the delivery of the services previously provided exclusively by the state. For example, in the case of Gabon, considerable preparation was necessary to adopt important reforms to allow private participation in the provision of water and electricity services. According to a report commissioned by the World Bank and PPIAF, this concession was a relative success thanks to sustained political commitment and the undertaking of essential reforms prior to the transaction, such as legal and tariff reforms.[14] Moreover, the implementation of such reforms can have spill-over effects for future investors in the sector or region.

26. A legal and regulatory framework propitious for PPP need not involve a bespoke PPP law. In the United Kingdom, Australia and Canada, where vibrant PPP programs flourish, the Common Law tradition does not necessitate a PPP law, but rather the legal framework provides the protections for investors, the security and insolvency regimes sought by lenders and the clear public contracting rules needed by public stakeholders to support a strong PPP program. In other countries, such as Spain and Poland, a dedicated PPP law has been passed. Still other countries implement PPP through regulations under other legislation – Kenya and Nigeria use the Public Procurement law. This last option is often only a temporary solution until fully-fledged PPP legislation can be passed.

27. Furthermore, processes designed for public procurement are generally incompatible with PPP arrangements and will reduce the likelihood of success of a PPP program. Thus this is another area where reforms or new laws may be required, in particular the need to improve the transparency of the procurement process.

Political Commitment and Institutional Framework

28. A strong, sustained political commitment at the highest levels is required to attract private finance and provide the necessary assurances to build investor confidence. Institutional

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[14] The World Bank and PPIAF, 2011, *How to Engage with the Private Sector in Public-Private Partnerships in Emerging Markets, pg. 17*

frameworks must provide the support and incentives for proper PPP implementation, with coordination between the different parts of government involved, without adding excessive complexity and red tape. For example \an independent Inter-Ministerial Council can serve to prioritize projects, resolve coordination or conflicts amongst ministries, and approve policies and risk allocation for projects. Moreover, mechanisms for the assessment and management of contingent liabilities and fiscal risks linking back to the Ministry of Finance need to be considered. The institutional framework needs to drive proactive PPP development, while providing sufficient time to prepare PPP projects. It should also seek to provide transparency and clarity to PPP arrangements, e.g.: standardized contracts can simplify negotiation, compliance, and monitoring. South Korea's clear PPP policy framework is illustrative of the Government's commitment to PPP: its policy is reviewed and revised every year, as needed, to adjust to changing market contexts for Korean PPPs. The strength of the commitment to the policy framework, combined with its adaptive flexibility has resulted in a robust PPP framework.

29. One option for inter-ministerial coordination is the establishment of a dedicated PPP unit, serving as the single point of contact for all PPP-related issues for the government and investors for coordination of all PPP activities across sectors, so as to enhance transparency and consistency[15]. A recent study has shown that for PPP units to increase their likelihood of success, governments need to provide them with, not only a clear and specific mandate, but also grant them decision-making power beyond that of an advisory role. In addition, the location of the PPP unit within government is a key design feature, due to the importance of interagency coordination and political support for a PPP unit's objective. [16]

30. Equally important to the success of a PPP unit is the need for highly qualified staff able to work across government agencies. Experience shows that even highly skilled external advisors cannot replace the need for a strong public sector to lead and manage PPP projects. Chile and India provide examples for successful allocation of significant public resources to the PPP agenda and investment in institutional strengthening.

31. At the sector level, reforms addressing needed commercial viability for PPP projects are a vital component for attracting private investors. Often line ministries have less incentive to implement projects using PPP, as they often do not have the expert staff or funding needed to prepare projects well or even understand the PPP dynamic; where central PPP Units are created, mechanisms to provide support at sector level can be instituted and dedicated staff trained to overcome these challenges.

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[15] Jeffrey Delmon, The World Bank, PPIAF, & Wolters Kluwer, 2009, *Private Sector Investment in Infrastructure, pg. 23*

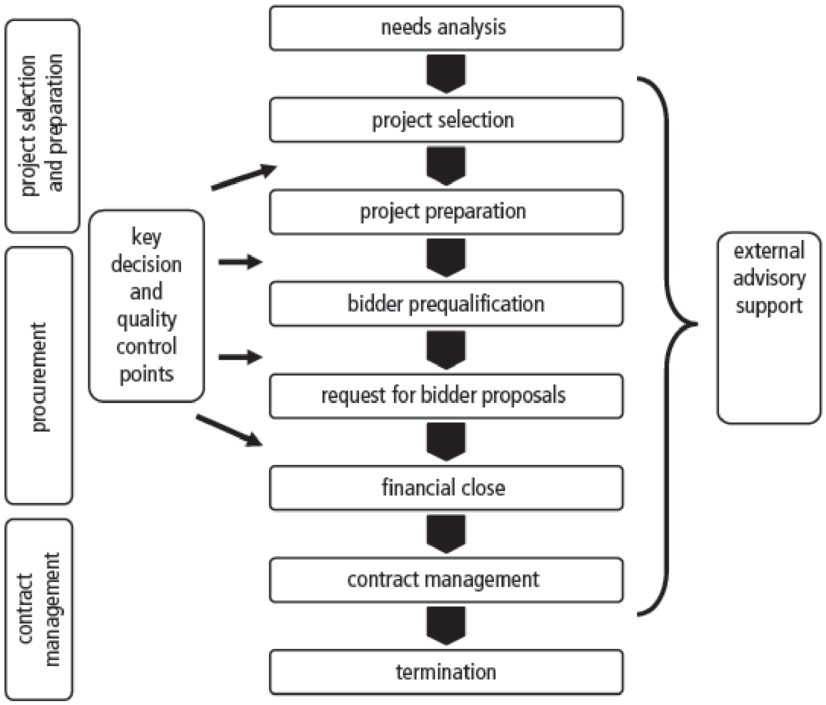
[16] The World Bank and PPIAF, 2011, *How to Engage with the Private Sector in Public-Private Partnerships in Emerging Markets, pg. 24*

Project Selection and Structuring

32. Getting project selection right includes imposing criteria on selected projects, such as value for money, financial viability, affordability and sustainability; but it also means giving incentives to line ministries and other contracting authorities to propose good, well developed projects for PPP, which in turn may require capacity building and appropriate staffing to foster acceptance of a change in approach.

33. Once good projects are selected, sound project structuring is needed, including adequate risk allocation, measurable performance indicators, and flexibility to adapt to change. Project structuring requires experienced, sophisticated transaction advisers, which can be expensive. In the UK, arguably the most efficient PPP market in the world, these costs have been estimated to amount to some 2.6% of the capital costs for a given project.[17] The average costs in middle income countries is estimated to run around 2.5 - 4% and 3 – 10% in lower income countries. However, failure to buy in the best advisers is usually far more costly, with failed or overly expensive projects resulting. The UK's PPP Unit has helped contracting agencies to appoint and manage top transaction advisers, often funding some of the cost of for mo1s1c4(me. I(ofte5(6 of a)15(c)-4(ha)-2(n4( )c)T)-f-18)-1)-4(e)p1 RG11(c)6(h)TJETB

Figure 14: Key Phases of the Public-Private Partnership Project Process



How to Engage with the Private Sector in Public-Private Partnerships in Emerging Markets

Competition and Transparency

35. Good governance ensures transparency, equal treatment, and open competition for entrants into a given market. PPP processes provide an opportunity to introduce good governance into every aspect of project implementation, hence reducing the opportunities for corrupt practices. The efficiencies derived from PPP are generally best achieved through competitive tendering and transparent processes. While direct negotiations are still prevalent in PPP transactions across the world, they make it impossible to assess whether either the government or ultimate end-users of the services received true value for money . The long-term management of non-transparent contracts is not only more difficult, but efficient and equitable allocation of responsibilities and profits can be much more difficult for all involved parties to achieve.

36. Transparency can also help manage social and political risk, where nervousness and misunderstandings arise about the nature of PPP and the impact on average citizens. Consultation and communications among public and private parties are key to understanding and managing expectations, to access information on project performance and provide capacity building. Sharing of information can avoid misunderstandings and reduce social and political resistance to needed reforms. India has learned through its extensive PPP program that well developed projects, with robust consultation processes, are far more likely to succeed.

Environmental and Social Safeguards

37. Proper management of environmental and social risks is another important aspect of successful PPP projects. For this reason, the IFC has agreed with many of the key commercial banks lending to PPP transactions a common set of environmental standards - the Equator Principles[18]. The standards applied by most MDBs are designed for public sector projects using input based finance focused on construction; the processes for these can be difficult to fit into the dynamic of PPP. More lenient environmental and social standards are often cited as one of the reasons for the attractiveness of South-South financing the share of which is increasing globally.

Government Financial Support

38. Most PPPs require some form of government financial support (the first "P" in PPP), including grants and guarantees. This support needs to be well designed, to meet project needs without exposing the government to excessive risk. The United Kingdom used, until recently, "PFI credits" to encourage the use of PPP by government authorities that provide identified value for money. India uses its viability gap fund[19] to achieve similar results. The fiscal risks that result from such support must be actively assessed and managed. Chile and South Africa are just two of many countries that face these fiscal risks proactively, looking to identify, monitor and manage those risks to the best benefit of the national budget.

Contract monitoring

39. Once a project is awarded and reaches financial close, regulatory frameworks and processes need to be in place to monitor that all parties honor their contractual obligations, that their rights are preserved, and that there are clearly defined penalties for noncompliance. Contract monitoring during implementation of often long-term contracts is an essential function for the government and needs to be undertaken either in coordination with, or entirely by, sector regulators. Whatever regulatory unit is in charge of contract monitoring, it requires a team with the appropriate skills and resources to ensure robust performance and contract compliance monitoring, address conflicts as they arise, and follow clear rules when arbitration between parties becomes necessary.

40. Figure 15 (below) shows the number of key contract management functions that the government is expected to implement when supporting PPP projects. Aspects of the government's role in contract management for a given project can also be achieved by hiring advisers, who would work on the basis of a project manual, including: deadlines, risk matrices, and management plans for addressing each significant risk.

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[18] www.equator-principles.com

[19] www.pppinindia.com

Figure 15: Contract Management Framework

Finance

41. As long-term contracts, PPPs are best funded through long-term financing. Since PPP revenue streams are often denominated in local currency, financing should be in local currency to avoid foreign exchange risk. However, in many countries, where access to long-term local currency financing from lenders familiar with PPP can be found at all, it is limited. In many middle income countries, the local financial markets are liquid enough to support PPP, but the market intermediaries that can move that liquidity to PPP may not have the skills or the appetite for this type of exposure. For this reason, India has created a number of specialized intermediaries, e.g.: IL&FS, IDFC, IIFCL, to mobilize local long-term financing for PPP. Indonesia, Nigeria, Ghana, and the Philippines are example of countries that considering similar approaches. Box 1 provides a more detailed discussion of local finance aspects and country examples.

Box 1: Mobilizing Local Capital for PPP

Infrastructure is a long term investment, with high up-front capital commitment to create an asset with a long life cycle. The financing for infrastructure (in particular PPP) should reflect this long-term nature of the underlying assets, with tenors of debt in most cases in the 12-18 year range, ideally longer. Sources of long-tenor debt (or mechanisms to replicate long tenor debt such as take-out financing and credit guarantees), include global banks, global capital markets, national governments, bilateral agencies, multi-lateral development banks, multilateral agencies, local banks and local capital markets. This box discussion focuses on mobilizing long-term finance for PPP from different local sources ("local finance"). Local finance has a number of benefits: it is generally in local currency which mitigates foreign exchange risk; provides opportunities for reform and enhancement of local financial markets; creates additional opportunities for local banks and investors; and unlocks long-term liquidity in local financial markets.

There are three key functions that may need to be strengthened in local finance: origination, liquidity and refinancing. MDBs or Government may be able to provide support to resolve gaps.

- **Origination**: Financiers originating PPP finance will assess a project, influence its design and structure, then build a book of debt either alone, with a club of other lenders, and/or through syndication. This requires significant expertise both amongst the financiers' origination staff and in their credit committee and treasury functions. In many cases local lenders do not have these skills, and therefore efforts are made to reinforce this capacity in one or more of those financiers or by creating a new specialized financial institution (for example the Infrastructure Development Financing Company Limited (IDFC) of India or the Indonesia Infrastructure Finance facility (IIFF) of Indonesia).
- **Liquidity**: Local financiers may have limited liquidity, or their liquidity may be short-term, creating a fundamental liability mismatch where long tenor loans are required. Long tenor funds can be made available to those financiers by MDB, Government, pension funds and other sources of local currency(for example the Investment Promotion Finance Facility (IPFF) of Bangladesh) or as co-financing (senior or subordinated) to provide additional debt to the project and therefore reduce the amount of debt needed from local financiers (for example the Indian Infrastructure Finance Company Limited (IIFCL) of India). Also, take-out guarantees can be used to extend tenors on debt, where local financiers have only short term debt available. MDBs, Government or other institutions can guarantee a bullet repayment or that refinancing will be available.
- **Refinancing**: Liquidity constraints, risk ratios, single borrower limits and other prudential requirements can constrain the amount of support that local financiers can provide to PPP markets. Refinancing involves the pre-payment of part or all of a project's debt by borrowing from a new lender (possibly at a lower interest rate, longer tenor or on easier terms). When the original lender is repaid (often with a pre-payment penalty), it is able to use this liquidity to invest in a new project. Refinancing does not require the same level of sophistication in the areas of project assessment and design that a new project does. Therefore, lenders with less PPP expertise can refinance a project, releasing liquidity to more experienced PPP lenders to undertake new projects. MDBs, Government or a financial institution can offer refinancing of PPP debt.

The source of capital needed for long-term local finance must be mapped in advance. For example, will it be generated by the Government through sovereign debt and MDB loans, or will it be mobilized from private sources like local banks, pension funds and retail bond issues. Some local finance initiatives are based on on-lending of Government sourced capital (like the Tamil Nadu Urban Development Fund (TNUDF) in India or the Investment Promotion Finance Facility (IPFF) in

Bangladesh), whereby MDB loans are disbursed into an intermediary that lends to financiers and/or projects. Others (like National Infrastructure Fund (Fonadin) of Mexico) are given access to their own sources of capital like public assets, infrastructure revenues or tax receipts. And a final group of local finance initiatives are given sufficient credit enhancement in the form of guarantees, stand-by capital or

(Box 1 continued)

deeply subordinated debt to mobilize local finance from local financial markets (bond issues or bank debt, like Infrastructure Development Financing Company Limited (IDFC) of India).

Mobilizing local finance for the benefit of PPP projects can be achieved through different intermediaries, each has its challenges, strengths and weaknesses:

- **Direct Government intervention** (for example National Infrastructure Fund (Fonadin) of Mexico). Using a Government agency or public entity to secure local *long-term* funds can be quick, and there is no need for the creation of new legal entities or structures. It also leverages off of the existing Government credit position, allowing access to lines of credit and capital markets that a private entity might not have. However, public entities are generally subject to public employment rules and may not be able to pay the salaries and provide the benefits needed to attract the best, expert staff that would need to be hired for governments to function as local PPP financiers. They are subject to political influence on which projects are financed and how decisions are made. They are subject to public audit and oversight that can make decision processes cumbersome and complicated, making it difficult to respond to market demand in the time required.

basis with other sources of private financing,

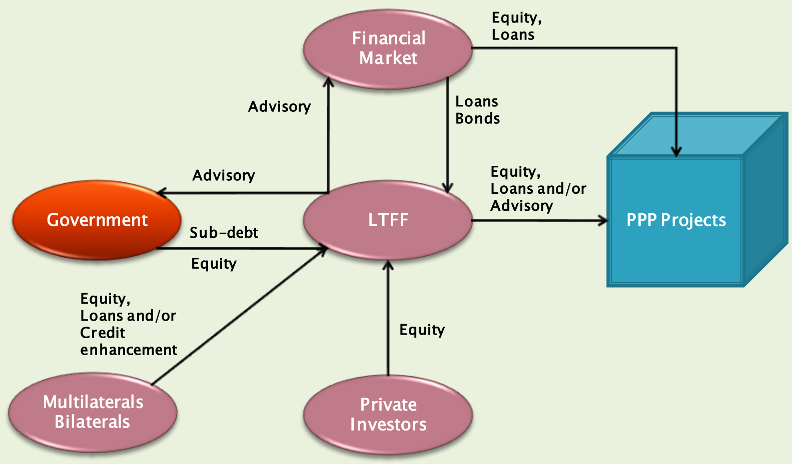
2) by providing financial products to enhancing the credit of individual infrastructure projects and thereby mobilize additional private financing for those projects, and

3) by using its staff of highly experienced infrastructure financiers to provide advisory services, assist in the identification and arranging of bankable infrastructure projects and provide policy support.

(Box 1 continued)

The entity would be capitalized through equity investments and subordinated loans from the Government, the private sector and multilaterals. It will invest in PPP projects, with debt, equity and/or guarantees, and by providing advisory services. The following diagram shows the long term finance facility's (LTFF's) possible relationship with the Government and the financial markets.

LTFF Structure



Opportunities for MLAs and BLAs to assist in expanding PPPs

42. There are numerous opportunities for MLAs (including MDBs) and BLAs to assist partner countries in expanding their access to PPP investment. In what follows, different activities to support PPP are suggested for further discussion.

43. It is suggested at the outset that, given the differences in needs and resources different countries and projects require, no single PPP strategy can be identified for low-income and developing countries. A distinction between the approaches adopted for private investment in small versus large infrastructure projects would seem intuitive, contrasting for example a PPP program designed for the multi-million development of urban transport infrastructure with a program inviting small-scale renewable power producers in urban areas. However, other categorical distinctions, notably along country income levels or country size, are open to discussion. A middle-income country with no experience in PPPs presents a different case from a MIC with earlier, failed experience. A LIC with high population density offers

different opportunities from an island archipelago with a dispersed population. The different framework conditions encountered in each of these cases calls for different approaches, for example: local versus global private investors. The small percentage of private funding versus large, less complex project design versus more, or explicit mechanisms to support customer ability to pay or not are all unique attributes along a continuum for a given project or country.

Data

44. Despite the prominence of the topic and the increasing acknowledgement that private participation in infrastructure has to be an integral part of the development agenda, access to data about PPP, its successes and failures, volumes, regional variations, etc, is still insufficient. The best current source of such data is the PPIAF/World Bank PPI database; which could be reinforced and expanded, in particular on the types of government support to PPPs. However, there is a clear need for other sources of data to be developed and supported. For example, regularly published comparable country information for governments and investors on the legal and regulatory environment for PPPs, such as a 'Doing Business for PPP' information platform, would be a productive next step.

Transaction support

45. PPP transactions require patience, funding, and expert advice, on both sides, to be developed properly and yield value for the government and ultimate consumers. Specifically, the government must:

- Provide project preparation funding, with the support of a body of experts to help manage the process. Even in the context of limited resources, governments should ensure a strong project team and adequate resources for reputable advisers.

- Provide vehicles for funding for the public part of PPPs for well prepared, competitively procured projects, for example India's viability gap fund, UK PFI credits, etc.

- Adjust MDB processes and practices to match PPP market expectations and rhythm, while maintaining transparency and accountability, in particular in procurement and financial management. Box 2 elaborates on this issue.

Box 2: MDB Reforms to Target PPP

MDB sovereign financing policies and practices are designed to support financing of public projects; these policies and practices are generally ill-suited to financing public contributions to PPP. This box provides a brief discussion of the challenges faced by MDBs endeavoring to adjust to the market realities on PPP.

Before addressing policies, it is important to note that compared to public projects, PPP requires more upfront preparation, coordination, clear processes and attribution of financial and operational responsibilities. In short, PPP projects are more costly, time consuming and risky

than public infrastructure projects, and therefore MDB management needs to be incentivized to pursue PPP projects. Rather than motivating staff and management to maximize lending or focus on instruments, if the overarching agenda of increasing public *and* private finance for infrastructure is pursued, it may be preferable for MDBs to measure results based on maximizing leverage of private finance, use of private innovation and efficiencies.

Fundamental reform is needed, in some cases in the policies themselves, but more often it is a question of practices. The policies are often flexible in nature, written to enable rather than restrict. But staff tasked with implementing those policies are incentivized to be increasingly conservative and cautious (these staff are not rewarded for taking risks, but are penalized and criticized if any risk crystallizes).

The following are examples of changes that MDBs may wish to consider. These changes may involve reform of policy, or more often may be a change in practice that can be implemented through new guidance issued to staff.

- **Standard form procurement documents are rarely directly relevant to PPP.** Ideally, a new set of standard form documents would be created for PPP projects, but the range of different PPP structures (eg management contracts, BoT, leases, concessions, etc) is so broad that standard form documents may be impractical. However, safeguard staff need to understand that efforts to fit PPP into standard form documents is usually unhelpful, costly, time consuming and may be risky.
- **Requirements specific to commercial relationships within the project and with the MDB need to reflect the commercial realities of PPP.** For example, in public financing, the consortium members undertaking construction work are generally required to be held jointly and severally liable. This does not work in PPP, where limited recourse and off balance sheet treatment would be undermined by this approach. Equally, pre-qualification criteria are applied to the key consortium member only (or primarily) in public financing. In PPP, these criteria are often met by some combination of consortium members (for example there will be a construction partner, an operation partner, a finance partner, etc.). Also, while many MDBs do not allow imposing a maximum number of pre-qualified bidders (because this involves rejecting a bidder for reasons not associated with their ability to do the job), this mechanism is very common in PPP, where it is important not to have too many bidders which can demotivate key investors.
- **Public finance is focused on paying for inputs, for materials and equipment; while PPP is about outputs/performance.** Under PPP arrangements (but also under various forms of other results-based schemes, such as output-based aid), disbursements of MDB funds cannot be linked to expenditure/inputs, since the agreement between the investor and Government is focused on outputs/performance. In the global PPP market, the Government often places on the investor the risk that the information about the project provided at bid is inaccurate, but this is often not permitted by MDB procurement practices.

In addition to new rules and guidance, the MDBs may consider creating PPP expert teams within their safeguard departments, to ensure best practice and market responsiveness is adopted across the MDB. Staff tasked with assessing and approving procurement, financial management and other safeguard requirements for public projects will often have little if any experience in PPP. Policies often make reference to project characteristics “acceptable to the Bank” which requires an important subjective assessment. To avoid the natural tendency to revert to the practices specific to public finance, a PPP expert team can help interpret this phrase in a manner more appropriate for PPP.

Program support

46. Moving from transactions to a PPP program requires government engagement across a series of areas. MLAs and BLAs can assist with the following:

- Embedding experienced consultants for extended periods in PPP institutions can help manage transactions and provide capacity building.

- Provide advice on:

    - defining appropriate, clear, adaptable PPP policies to match the requirements and risks associated with the location, sector, system complexity, and PPP "space" in question;

    - reforming laws and regulations as needed for PPP, through a gradual process, addressing reforms by phases in order of their criticality;

    - creating an institutional framework to promote PPP, assign roles to different participants—in particular SOEs (to ensure crowding-in of the private sector)--to manage fiscal risk and encourage contracting authorities to comply with government PPP policy;

    - prioritizing the selection of those projects best-suited to PPP as part of the national infrastructure planning process, providing assessment of project pipeline, and identifying solid, implementable, early-mover demonstration projects;

    - managing the PPP pipeline to ensure it is effectively developed and contracting agencies cannot cherry pick PPP pipeline projects to be financed by other means.

- Government funding support (e.g.: grants and guarantees) provided to the best proposed projects to encourage line ministries and local governments to propose viable PPP projects, ensure projects are well-prepared and any, associated fiscal risks are assessed, accounted for, and monitored.

- Ensuring long-term support for:
    - Implementation and performance monitoring, with the necessary funding for building strong teams to conduct thorough monitoring.
    - Assisting with establishing or strengthening regulatory agencies
    - Supporting communication and outreach strategy that ensures public understanding and support for PPP, in particular with respect to politically sensitive sectors such as electricity and water supply.

- Offering built-in incentives/bonuses for countries that are able to meet milestones in improving the legal and regulatory environment critical to PPP implementation

- Coordinating MLA/BLA initiatives to help governments coordinate their programs, improve efficiency, and avoid over-laps.

- Providing regional centers of excellence, staffed with MDB staff expert in PPP frameworks and transactions, with access to expert consultants, to provide real-time support to PPP programs and projects

- Mobilizing long-term, ideally local currency, financing through a broad range of financing instruments, including:
    - sovereign guarantees,
    - commercial bank loans, (e.g.: by on-lending long-term funds provided by DFIs)
    - risk/credit guarantees from MDBs (to guarantee project risk or to wrap bonds issued by a project),
    - DFI financing – improve incentive for DFI financing directly to PPP (for example judging staff performance based on capital mobilized rather than directly committed), and improve ability of DFIs to finance PPP in local currency (eg through hedging or by funding themselves in the local markets)
    - Improve access to hedging instruments for currency and interest rate risks

Capacity building

47. Governments introducing PPP need significant help socializing such projects amongst government staff and the public at large, as well as training people in how to approach PPP. The best training is through learning by doing – through implementing actual projects, but there is also an important role for training courses and partnering with countries that have developed PPP programs.

- Consultation with the public and among constituencies within the government is key to managing social risk and tailoring the PPP program to the needs of the public and the government.

- Learning tools should include training programs for government staff, local private sector, and other key stakeholders. These tools should include general training, legal, access to finance, financial management, fiscal risk management, project management, procurement, and monitoring and regulation. Such programs should be reinforced by technical assistance and training programs provided by transaction advisers and other PPP-related specialists. Support could also be provided for the next generation of PPP experts, for example in universities and through internships and secondments.

- Knowledge needs to be captured from project development and experiences from different sectors and types of project. Feedback loops should be built into reporting lines and documentation of project experiences.

- Efforts should be prioritized on building domestic capacity for PPPs, especially for smaller or "lighter" PPPs, such as water management contracts, road maintenance contracts or performance-based contracts for services, especially as PPP is introduced to a region without a strong PPP track record.

- Establish Peer Learning Networks and regular Roundtable meetings

- Provide assistance to governments must seek to strengthen capacities for both PPP project identification and procurement, as well as contract management and regulation.

Regional efforts

48. Smaller or lower income economies may not be able to afford to develop the necessary expertise within government to develop PPP and manage transaction advisers. Countries with a limited pipeline of projects may not achieve the economies of scale to justify the cost of investing in PPP expertise. In these cases, a more localized solution may be more efficient, pooling PPP expertise in the region to benefit each of the regional economies, and providing access to the expertise needed to develop PPP. Regional efforts can also create a common platform for structuring reforms, standard documents, common legal frameworks, and the other items needed for creating a regional practice that can attract investors and identify risks more effectively.

49. Regionally based resources may also be most effective in supporting regional projects, where political challenges of sharing costs, making project decisions and accessing resources would otherwise make regional projects more difficult to implement.

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