Policy brief

43012 | March 2013

Taz Chaponda

International Growth Centre

Key Institutional Decisions in Public Private Partnerships

In brief

- The main building blocks of any sound public-private partnership are: enabling insitutions, supporting institutions, a regulatory framework that facilitates proper planning and good fiscal accounting and reporting framework.
- For a PPP programme to be succesful, the legislative framework needs to provide a clear, fair, predictable and stable legal environment. A clear definition of the scope of the application of the framework and what is meant by PPP should be provided.
- Strong institutions are essential for every stage of the project cycle. Such institutions should: manage and assess risk from proposed PPs, help government to build its reputation as an investment partner, lower risk for the private partner and increase value for money by ensuring contractural commitments are fulfilled.
- A central PPP unit to regulate and oversee PPP procurement is a key reform.
- Main tool of PPP unit is a set of regulations governing the planning of projects. These regulations should state that a PPP should: be affordable to the fiscus, provide appropriate risk transfer to the parties best suited to manage the identifed risks and provide value for money to the public authority issuing the contract.
- Good fiscal accounting and reporting is crucial to the success of a PPP programme.
- PPP reform should follow six distinct stages: set out a PPP policy statement, define the roles and responsibilites of actors, establish a legal and financial framework, create a central PPP unit, develop rules for operational matters and establish a project pipeline of high potential projects for which there is government consensus.

DIRECTED BY LSE UNIVERSITY OF OXFORD

FUNDED BY UKaid from the British people

"Although there is no prescribed sequence to these reforms, a sound legal framework provides a good basis for the entire PPP programme"

Introduction

The purpose of this note is to highlight the main issues that a government should address at the outset of its PPP reform programme. These can be viewed as the essential building blocks of a sound PPP reform agenda:

- Enabling legislation
- Supporting Institutions
- Regulatory framework that facilitates proper planning
- Good fiscal accounting and reporting framework

Although there is no prescribed sequence to these reforms, a sound legal framework provides a good basis for the entire PPP programme. It is the natural starting point for building market confidence as it reinforces the government's commitment to the rule of law.

Key Reforms for PPP

Legislation

At the heart of any PPP project is a contract between the public authority and the private party. This contract, known as the concession agreement or PPP contract governs the relationship between the parties over the project term. The ability to enforce this contract (by either party) is central to the partnership model.

A successful PPP programme needs a sound legislative foundation that provides easy access to a clear, fair, predictable, and stable legal environment for projects that involve private sector participation. The new legislation should also provide reassurance to the private sector that contracts signed with the Government will be honored, even when things go wrong.

It is possible for a PPP project to be governed by a stand-alone contract. Although PPP projects have been concluded without an enabling legal framework, PPPs are less likely to be renegotiated when the regulatory framework is embedded in the law. An alternative arrangement is to establish the regulatory framework through government decree. This too is not as ideal as embedding the regulations in Law, which is itself based on a clear policy.

"The law should ensure that PPPs are integrated with the budget cycle so that PPPs are planned within the budget framework"

To ensure clarity and consistency in interpretation, the PPP law should provide clear definitions of the scope of application of the legal framework as well as providing clear definitions of what is meant by a PPP in that country.

In addition, the law should ensure that PPPs are integrated with the budget cycle so that PPPs are planned within the budget framework. They should not be used as a means to circumvent budget approvals. Instead, the approvals of PPP should help to strengthen accountability.

Given the centrality of the budget process for PPP approvals, the Ministry of Finance will usually have a strong mandate to approve and oversee PPPs. In some countries, another central ministry is given the mandate to enforce PPP regulations. For instance, the Presidency or Cabinet Office could potentially play the same role as long as such arrangements do not create loopholes in the bureaucracy. In Uganda, draft PPP legislation has been prepared and is currently under review. Ideally, the legislation should be passed before the end of 2013.

Supporting Institutions

The legislation setting up the PPP framework should be complemented by a strong set of supporting institutions to both interpret and implement the regulations. These institutions will need to fulfill a number of functions including:

"One of the most important institutional reforms is the establishment of a central PPP Unit to regulate and oversee PPP procurement"

- Managing and assessing risk from the proposed PPPs
- Helping government to build its reputation as a good investment partner
- Lowering political and regulatory risk for the private partner
- Increasing value for money by ensuring that parties deliver on their contractual commitments

Strong institutions are therefore essential for every stage of the project cycle, beginning with project appraisal and design, project execution and monitoring and evaluation. At each stage of the project, there should be a clear allocation of responsibilities amongst the different players. In addition, the institutions should be staffed with appropriately skilled and dedicated staff. This can often be a challenge when the required technical expertise are difficult to find in the country. It might be necessary to employ consultants or external experts while building up local capacity.

One of the most important institutional reforms is the establishment of a central PPP Unit to regulate and oversee PPP procurement. Most advanced PPP markets have seen it fit to establish a central body that will ensure that projects are properly appraised and are awarded in such a way as to ensure value for money for the public authority.

The typical functions of a PPP unit are illustrated below. The Government of Uganda has recognized the need to establish such a unit as one of the key reforms.

The location of the PPP unit is usually a matter of debate. The majority of countries have located it in it the Ministry of Finance. In brief, the main functions of the PPP unit include:

- To provide a forum to acquire, develop, and share knowledge and expertise with other government agencies
- To provide centralized oversight for PPPs by playing the role of "gatekeeper"
- To provide a single contact point for various operators involved in PPPs, thus contributing to lower transaction costs over time

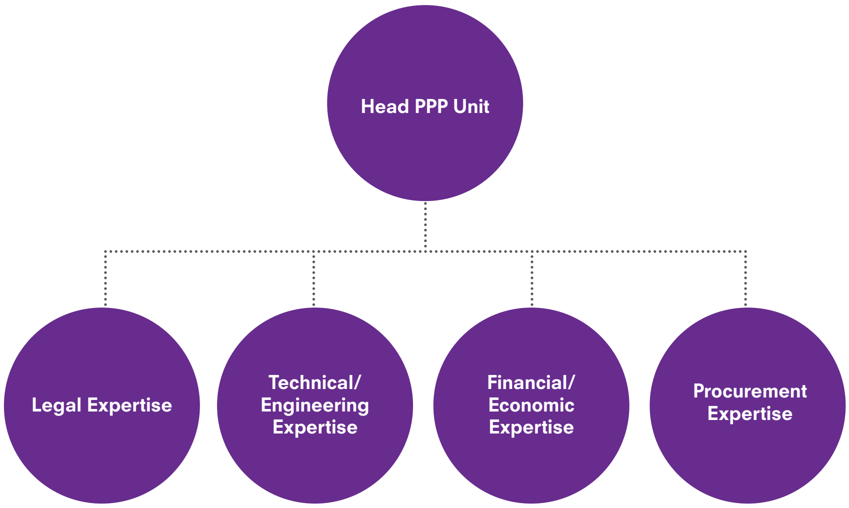
Regulatory framework for planning

The main tool of the PPP unit will be a set of regulations to govern the planning of projects. The PPP regulations may be issued under the legislation, once adopted by parliament. The regulations establish an appropriate "gateway" that empowers the Ministry of Finance to stop a PPP if it does not adhere to the fundamental rules for PPP design. These basic rules are accepted internationally as best practice. They state that a PPP:

- Should be affordable to the fiscus throughout the project/ concession term.
- Should provide appropriate risk transfer to the parties best suited to manage the identified risks.
- Should provide value for money to the public authority issuing the contract.

In addition to the above, the commitment incurred under a PPP should not threaten the country's macroeconomic framework in any way. This recognizes that PPPs may generate complex contingent liabilities. These should be carefully monitored in relation to the country's debt ceiling ratios and other macro sustainability measures.

"The commitment incurred under a PPP should not threaten the country's macroeconomic framework in any way. This recognizes that PPPs may generate complex contingent liabilities."



The PPP gateway consists of a set of approvals at specific stages of the planning process (eg. project preparation, negotiation, and renegotiation). A "no objection" should be obtained from the Finance ministry at each crucial stage and before the final contract is signed. Such a gateway process ensures that the key steps and decisions are systematically communicated to the Ministry of Finance.

The regulations would need to cover a number of important parameters that relate to the quality of projects as well as to their potential impact on the fiscus. Typical parameters include:

- A ceiling on the project size to guide the affordability assessment. Mega projects result in a huge drain on resources and a small economy may only be able to afford to procure one or two such projects at a time.
- A floor on the size to avoid overburdening the PPP process. Due to the high transaction costs associated with PPPs, small capital projects of below USD100 million may not be suitable for this form of procurement.
- The minimum percentage of "value for money" that can be quantified, or stated differently, the minimum net cost saving that the public sector can expect to achieve from allowing the private sector to implement the project. If the expected VfM is too small, then it might be more suitable to follow normal

public procurement.

As part of the regulatory framework, proper accounting and reporting of fiscal implications of PPPs is essential to prevent their misuse, and to make increased efficiency their main motivation. Each ministry or public agency involved in PPP when preparing its annual budget must account for all PPP liabilities, in addition to normal capital and operational requirements.

The importance of good fiscal accounting and reporting cannot be overemphasized to countrys embarking upon a PPP programme. While PPPs allow the private sector to assume some of the financial risks, governments still bear considerable risk, and face potentially large fiscal costs. Thus, proper accounting and reporting of fiscal implications of PPPs is essential to prevent their misuse, and to make increased efficiency their main motivation.

The Way Forward

The main building blocks for PPP reform have been summarized above. The reforms rest on a foundation of sound legislation, supported by strong institutions, and regulations that manage the planning and procurement process.

The reform path should include these aspects, and is broken down into six distinct stages:

"The reforms rest on a foundation of sound legislation, supported by strong institutions, and regulations that manage the planning and procurement process."

PPP Policy Statement

The Government should make a clear statement on its commitment and policies towards private sector participation in the delivery of public infrastructure services. The Government of Uganda issued such a statement in 2010.

Define Roles and Responsibilities

In any given project, there will be numerous actors involved within the public sector. Each institution's role should be made clear, including the entry point for private sector engagement. For some functions, the responsibilities may be shared across institutions.

Establish Legal/Financial Framework

A legal framework for PPPs should be adopted as early as possible. It should be aligned to the public procurement act as well as to the public finance management act.

Central PPP Unit

The PPP Unit should be established, preferably within the Ministry of Finance.

Rules for Operational Matters

Develop a well-articulated PPP process that covers the entire project cycle from project concept to financial close. This process may be codified in a set of guidelines.

Projects

Establish a project pipeline consisting of high potential projects for which there is a consensus across the Government. Begin to implement these as pilot projects.

For Uganda, a number of steps have already been taken along this reform path. The Government of Uganda is now reviewing its legal framework for PPP. Thereafter, it will need to establish a central PPP unit and provide PPP guidelines to the market on how the procurement process will be managed.

About the authors

Taz Chaponda is a Principal at Genesis Analytics, a consulting firm based in South Africa. He leads the Infrastructure and PPP Advisory team.

Taz has been working as an infrastructure and public finance specialist for the past decade. He has served in numerous roles across Africa including as an infrastructure adviser in the National Planning Commission of the South African Presidency and as an adviser to the Development Bank of Southern Africa. Beyond South Africa, he was a Senior PPP Adviser to the Lagos State PPP Office under the Nigeria Infrastructure Advisory Facility (NIAF). He has also served as a PPP Adviser to the Ministry of Finance in Rwanda and as the Head of the PPP Office in the South African Treasury.

At the South African Treasury, Taz served in several capacities including as Head of the Budget Office (DeputyDirector General) in which role he was involved in the planning and funding of mega projects. Before that, Taz was an economist at the World Bank in Malawi where he focused on private sector development and privatization. He also worked as a Management Consultant for Bain & Company across a range of industries including banking, telecommunications, petroleum industry and the airline industry.

Taz holds an MBA from INSEAD Business School, an MSc (Development Economics) from the University of Oxford, and a BA Economics from Harvard University. He is also a graduate of the Queens University Executive Programme on Project Appraisal and Risk Analysis.

The International Growth Centre (IGC) aims to promote sustainable growth in developing countries by providing demand-led policy advice based on frontier research.

Find out more about
our work on our website
www.theigc.org

For media or communications
enquiries, please contact
mail@theigc.org

Follow us on Twitter
@the_igc

International Growth Centre,
London School of Economic
and Political Science,
Houghton Street,
London WC2A 2AE

International
Growth Centre

Designed by soapbox.co.uk