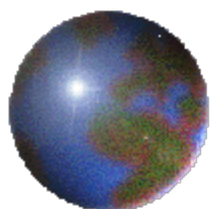
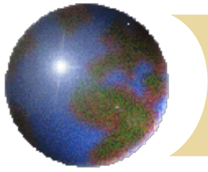


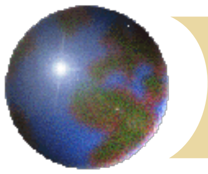
Public-Private Partnerships and Fiscal Risks

Anton Marcinčin
Country economist
World Bank

Bratislava, September 27, 2005

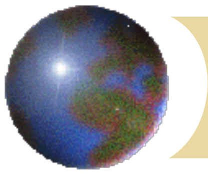


PPS are popular around the world, in part because they allow governments to secure much-needed investment in public services without immediately having to raise taxes or borrow



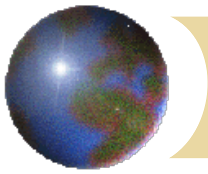
Needs and constraints in EU8

- Infrastructure needs: €100 billion for transport, €500 total in next 15 years (EU8, Romania and Bulgaria)
- Environmental needs: €47- €69 billion
- Maastricht criteria on GG budget deficit (CR, H, PL, SR above); on public debt (all countries below)

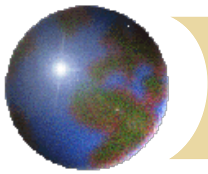


Are PPPs the only solution?

- Consider portfolio rebalancing of existing public investment projects: keep the state only in projects where public involvement is helpful
- Structural reforms can generate fiscal savings and stimulate (private) infrastructure investment, leading to improvements in the quantity and the quality of public services, while lowering their cost.
  - For example: increased competition in infrastructure (e.g. electricity), tariff increases toward cost recovery (e.g. water and transport), and hard budget constraints on public utilities benefit the public and generates fiscal savings

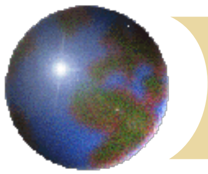


Although PPPs may generate fiscal savings, they entail fiscal obligations that are often not captured in the fiscal accounts. Thus their fiscal effects are often obscure.



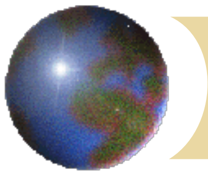
Costs and benefits

- No up-front payment: no change in deficit and debt
- But creates direct or contingent liability
  - Private finance initiative: the government commits itself to purchase the output of the private partner (regular payments)
  - Government guarantee on investors' returns (toll roads)
  - Implicit guarantee (Railtrack in GB)
  - Long-term purchase agreements of public enterprises (in some countries guaranteed by the government)
- Private partner may be better than government at coordinating construction, operations, and maintenance; may be more successful in achieving cost-covering user fees



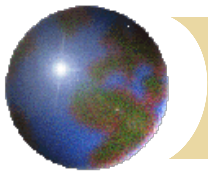
Conventional fiscal institutions tend to promote incentives to:

- ***Favor PPPs even when public investment would deliver equal results at a lower cost in the long term***
- ***Accept risks (for example, offer explicit and implicit guarantees) rather than providing cash subsidies under PPPs***
- ***In the design of PPPs, let the public sector accept risks that the private sector is more suited to bear.***



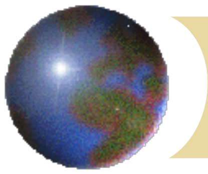
Various types of guarantees, provided under PPPs, are not easily captured by ESA95, nor other accounting standards

- EUROSTAT (2004): a PPP remains off a government's balance sheet if the private partner bears construction and availability risks
  - (that is, risks related to construction costs and delays and whether the private partner has constructed, operated, and maintained the asset to ensure that it can provide the required service).
- In a typical PPP where the government is the sole purchaser of the output, however, the private partner bears these two types of risk.
- Hence, under such conditions, governments accumulate debt-like liabilities without affecting their fiscal deficit and debt figures (at best, mentioning the liabilities only in a note to financial statements). No up-front payment: no change in deficit and debt



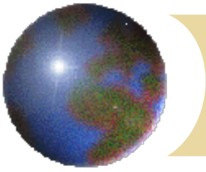
Weak accountability structures

- Accountability structures in EU8 countries as well as in a number of other EU countries, although improving, fall short of ensuring fiscal prudence in the use and design of PPPs.
- EU8 countries have been also strengthening their audit mechanisms (namely internal audit by the ministry of finance and external audit by supreme audit institution) so as to promote accountability of policy makers for fiscal performance.
- The existing accountability frameworks in EU8 countries (as well as most other EU countries) are, however, still incomplete with respect to government risk taking and risk management.
- With respect to PPPs, policy makers do not seem accountable for the long-term fiscal risk arising from take-or-pay contracts and various types of guarantees offered by local and central governments. Similarly, there is no clear accountability for the adequacy of risk analysis that supports government decisions about fiscal support to infrastructure. Limited also is government accountability for managing government risk exposures under PPPs.



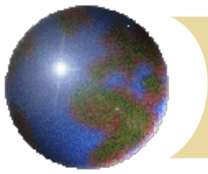
Information

- Good information on and understanding of the long-term fiscal cost of PPPs is important for promoting risk awareness (that is, an open discussion and acknowledgement of risks and government risk exposures).
- EU8 countries, however, have only limited information on the risks involved in PPPs and limited understanding of the long-term fiscal cost of PPPs. Moreover, these countries make very little of such information publicly available.
- PPP contracts and their content are considered confidential. This makes it difficult for policy analysts to assess the long-term fiscal cost of PPPs—and for the public to exercise appropriate pressure on policy makers for fiscal prudence.



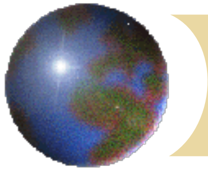
Capacity

- Weaknesses in government capacity to evaluate and manage risk may surface in the form of inefficient risk allocation and excessive government risk exposure under PPPs.
- Promoting PPPs without having such capacity has proven costly in a number of countries.



Enhancing fiscal institutions for PPPs

- Better fiscal institutions can increase the chance that PPPs will be well designed and appropriately used.
  - First, governments can take steps to improve the awareness of risks among officials and politicians.
  - Second, they can impose upon themselves and lower tiers of government stronger requirements to disclose information about PPP contracts and the fiscal obligations that they create.
  - Third, governments can continue to improve their fiscal planning, budgeting, and accounting in ways that help them choose their expenditure and investment plans rationally.
  - Fourth, they can improve their ability to manage risks—by allocating responsibility for taking on risk, developing quantitative monitoring of exposure, and so forth.



Source: Hana Polackova Brixi, Nina Budina, and Timothy Irwin (2005). Public-Private Partnerships, Fiscal Risks, and Fiscal Institutions in the EU8. The World Bank, mimeo.