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Operational Note

Implementing a Framework for Managing Fiscal Commitments from Public Private Partnerships



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The Financial and Private Sector Development (FPD) Network—
Investment Climate Global Practice Private Participation in
Infrastructure and Social Sector Service Line
and The World Bank Institute (WBI).

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1. Introduction

This note, “Implementing a Framework for Managing Fiscal Commitments from Public-Private Partnerships,” provides guidance on managing fiscal risks from Public-Private Partnerships (PPPs) during approval and implementation. The note provides practical advice on how to: consistently identify and assess fiscal commitments arising from PPPs during project preparation and implementation; incorporate these into the project approval process, including budgeting for these appropriately; and strengthen the monitoring and reporting of fiscal commitments over the lifetime of the project. The note explains the fiscal commitments that can arise from PPP projects; why governments may find it difficult to assess and manage these fiscal commitments and incorporate them into project selection; and the key components of an institutional framework to manage fiscal commitments at both the development and implementation stages of a project, including the roles, responsibilities, and processes for managing PPP fiscal commitments. Finally, the note summarizes the key messages for Task Team Leaders when tackling this agenda, and it provides a subset of main readings on the topic. The framework is largely based on the *World Bank Study (January 2013): An Operational Framework for Managing Fiscal Commitments from Public-Private Partnerships: The*

Case of Ghana.¹ In outlining the concepts and providing more detailed references, the note also draws on the *PPP Reference Guide* (World Bank Institute and Public-Private Infrastructure Advisory Facility)². There is already a relatively well-developed body of literature describing PPP project identification and approval and institutional structures within government such as specialized PPP agencies. This note expands on this literature by outlining an operational framework that will integrate PPPs in the wider assessment and management of fiscal commitments.

It is critical to manage PPP fiscal commitments if governments are to make good choices about which projects to do as PPPs. Although there is no universal definition of a PPP, it is defined here as a long-term contract between a private party and a government agency for providing a public asset or service, in which the private party bears significant risk and management responsibility. Governments should undertake PPPs where this route offers “value-for-money,” for example, through efficiency gains and better project governance achieved by bundling the financing, design, construction, operation, and maintenance of infrastructure (a key cost-saving in PPPs) and by following fair, competitive, and transparent procurement processes.

¹ <http://elibrary.worldbank.org/content/book/9780821398685>.

² <http://wbi.worldbank.org/wbi/document/public-private-partnerships-reference-guide-version-10>.

Improper assessment of fiscal commitments can bias project selection and project prioritization and can produce fiscally and operationally unsustainable PPPs that lead to contract renegotiation—to settle disputes, resolve unforeseen problems, or compensate the concessionaire for changes in project specifications—jeopardizing expected benefits from the PPPs.

The primary audiences for this paper are Task Team Leaders/Project Leaders/Transaction Leaders in the World Bank Group working on PPP projects and transactions. Team Leaders need to ensure that the project due diligence

and structuring work incorporates the analysis needed to assess the project fiscal commitments, and that on the basis of this analysis, input from the Ministry of Finance (or equivalent) is sought on the fiscal affordability of the project. Additionally, it is important to advise on structures that need to be put in place to monitor the project's fiscal obligations over the duration of the contract. While this note outlines a general and generic framework for managing fiscal commitments from PPPs, each government will need to adapt the concepts in this note to its own systems and institutional structure in developing its own PPP fiscal commitment framework.

2. What are PPP Fiscal Commitments?

Governments' contributions to the "partnership" of PPPs always create different types of fiscal commitments. PPP contracts have financial implications and always pose fiscal risks for governments that need to be monitored and managed effectively.³ In the case of direct liabilities, the need for payment commitments is known, even though there may be some uncertainty about the exact value of the payments. Examples of direct liabilities include *upfront "viability gap" payments*, in which the government makes a capital contribution to ensure a project that is economically desirable but not commercially viable can proceed; *availability payments* in which a regular payment over the life of the project is conditional on the availability of the service or asset; and *output-based payments* or payments made per unit of service. For contingent liabilities, payment depends on some uncertain future event outside the control of the government—so the occurrence, value, and timing of a payment may all be unknown. Contingent liabilities

include guarantees on particular risk variables such as exchange rate, inflation, prices, and traffic, force majeure, termination payments, and credit guarantees, among others.

The nature and extent of fiscal commitments that governments bear depend on the actual PPP projects they are supporting, as well as broader market conditions.

In the 2008 global financial crisis, governments found that new forms of support may be needed—under which the government bears more risk—to enable PPP deals to close. A recent note on the European Union's PPP market outlines two main avenues being explored by several countries after the crisis: sovereign guarantees applied to project debt or project bonds, and co-lending by the government. Examples of recent developments include: sharing interest rate risk in the Republic of Korea; loan guarantee facilities in France and Portugal; facilities for direct loans to PPPs in France and the United Kingdom; and re-financing risk in Australia.⁴ Providing

³ For instance, Chile's financial obligations to concessionaires in future years have an estimated present value of \$3.4 billion. Most of the future payment obligations relate to subsidies and agreements to purchase services in concessions with no user fees. The estimated present value of revenue guarantees is lower, at \$0.3 billion; see World Bank (2007), "Improving the Management of Concessions: Better Reporting and a New Process for Decision When to Use a Concession."

⁴ Philippe Burger, Justin Tyson, Izabela Karpowicz, and Maria Delgado Coelho (2009), "The Effect of the Financial Crisis on PPPs," IMF Working Paper, WP/09/144; European PPP Expertise Centre–EPEC (2011), "Risk Distribution and Balance Sheet Treatment: Practical Guide"; EPEC (2011), "State Guarantees in PPPs: A Guide to Better Evaluation, Design, Implementation and Management"; and Richard Foster (2010), "Preserving the Integrity of the PPP Model in Victoria, Australia, during the Global Financial Crisis," World Bank Institute *PPP Solutions Note*.

government guarantees as PPP support instruments is not a new phenomenon and has been used since the 1980s in Latin America and East Asia.

In addition to the explicit fiscal commitments that governments bear under PPPs and that are defined in contracts, these projects also give rise to implicit liabilities.

Non-contractual obligations that arise from moral obligations or public expectations are considered implicit liabilities. For example, governments may take on a payment obligation despite the absence of a legal commitment to do so when a project is considered too politically and socially sensitive to fail (and lead to service interruptions). A “Comfort Letter” from a minister or other high-level public official to support a PPP project proposal is often seen by some creditors and investors as equivalent to a sovereign or sub-sovereign guarantee (even if it is in reality an implicit contingent liability of the central government). Another form of implicit liability arises from the long duration of PPP contracts (20 to 30 years or more): over this period unexpected issues almost always arise that can lead to contract adjustments or even renegotiations, which can create additional fiscal costs. Contract termination (normal or early termination) usually creates implicit liabilities—besides compensating the project company (or lenders) according to contractual rules, public authorities will need to safeguard the continuous provision of public service, or to decommission facilities (that is, terminating public service and using the facilities for other purposes, or demolishing them). Governments should recognize that PPP contracts

always embed implicit fiscal commitments; even when government decides not to rescue the project company, public authorities are expected to rescue the project. The extent of implicit risks embedded in a PPP structure, the incentives they generate on the operational behavior of the PPP project, and the government’s ability to manage these risks, are criteria that should be taken into account when deciding to develop a project as a PPP and design its contractual arrangements accordingly. As a long term project, a PPP will be (positively and negatively) impacted by exogenous change—technological, demographic, and commercial— but also by government action or inaction, for example, by changes in public policy and poor execution of government obligations. The government needs to manage the risks that it imposes on PPP projects.

The “upstream” due diligence on PPP selection and design are some of the most important determinants of a PPP’s fiscal implications.

If the underlying project does not make sense in terms of national policy, socio-economic cost-benefit analysis, or the improved public service delivery it aims to achieve on the basis of minimum acceptable service standards, or if the PPP is not structured in a way that will achieve value-for-money, then a PPP cannot be fiscally responsible even if its cost is well understood and managed. The primary consideration for embarking on a PPP should be improved public service delivery rather than financial cost minimization. It has been suggested that the post-Asian crisis realization of PPP-related contingent liabilities largely

resulted from inadequate project design and poor investment decisions.⁵

Lack of proper economic analysis of PPP projects may create fiscal shocks. PPP projects should be subjected to a sound evaluation of costs and benefits incurred by all agents in the society, including risks. Even after considering risk, the benefits should outweigh the costs. Without such evaluation, the sustainability and credibility of a PPP program risks being affected by *fiscal surprises*, particularly by ones that should have been identified *ex-ante* as relevant project risks.

These decisions—choosing a particular project, deciding to do that project as a PPP, and deciding how that PPP is structured (including allocating risks and responsibilities and defining payment mechanisms)—are also central elements of the PPP development process. For the purposes of this note, the structure of a proposed PPP is assumed to have been developed following these upstream analyses. *This note focuses primarily on the “downstream” assessment and management of the fiscal implications of a PPP, once these key decisions have been made.*

⁵ Hana Polackova Brixi (1998), “Government Contingent Liabilities: A Hidden Risk to Fiscal Stability,” Policy Research Working Paper, World Bank; Hana Polackova Brixi and Allen Schick (2002), *Government at Risk: Contingent Liabilities and Fiscal Risk*, World Bank and Oxford University Press, Washington, DC and New York.

3. Why Does Managing Fiscal Commitments from PPPs Matter?

Managing fiscal commitments under PPPs poses several challenges. Fiscal commitments which are long term—extending over the lifetime of the PPP contract—often do not start until several years after contract signing. Payments for contingent liabilities are by definition uncertain, and they can arise suddenly and unexpectedly when a trigger event transpires. By contrast, most government budgets are cash based, with a relatively short planning horizon (for example, a -three- or four-year Medium Term Expenditure Framework) and follow a process designed to be relatively inflexible to “in-year” changes.⁶

Because of these challenges, governments can be tempted to undertake PPPs for the “wrong” reasons. If fiscal commitments are not clearly acknowledged and managed, PPPs may be pursued simply to postpone the budget impact of public investment, and to move the associated debt off the government balance sheet in a way that does not take into account the longer-term implications for public finances. This approach can undermine the possible advantages of PPPs and increase

the risk of accumulating significant fiscal exposure in the future.

PPPs may help identify but also may hide true costs of infrastructure projects. Assessing PPP fiscal commitments is critical for good project selection and prioritization. Contrary to traditional procurement—in which a government agency can start implementing a project based on an undervalued budget, creating significant sunk costs before the real cost of the project emerges—PPP procurement requires bidders to do a whole-life costing of the project before committing to the project’s implementation. Thus, governments can use PPP procurement to help uncover real project costs before contract close. But PPPs may also be used as a convenient way to hide costs, presenting them as contingent liabilities (explicit or implicit). Such hidden costs can bias project selection and project prioritization, and they can also jeopardize long-term fiscal sustainability. PPPs should instead be undertaken in cases that can be expected to lead to better value-for-money compared to the public project.

⁶ For more on medium-term fiscal frameworks, see Jim Brumby et al (2013 forthcoming), “Medium-term Budgeting in the Public Sector,” World Bank.

Proper assessment of PPP fiscal risks is also relevant to ensure effective competitive procurement practices.

When fiscal risks are not clearly identified and addressed by the government, bidders may expect to obtain rents from the government during the construction or operational phases through anticipated renegotiation after being awarded the contract (with no competitive pressure by then). Therefore, bidding behavior may be influenced, with some firms betting on their ability to influence future government decisions—bidders with poor ethical standards will benefit from formal competitive procedures, not necessarily the most efficient firms. In that case, the utmost competitive and transparent procurement process will not solve the issue; formal competitive rules will not translate into effective competition (in the sense of survival of the best), but rather into gaming behavior.

Budgeting appropriately for PPP fiscal commitments is important for the reputation of a PPP program.

Providing a clear budgeting mechanism to ensure timely payment of both direct and contingent commitments to PPPs improves the credibility of the government's commitments in the eyes of its private partners. If this is not the case and the private party perceives a risk that payments will not be made when due, the cost of this risk will be priced into the PPP contract accordingly and the advantages of a well-designed risk allocation undermined. Systematic budgeting and payment are best done as part of the overall framework in government for managing all PPPs rather than only on a project-by-project basis.

In the absence of a proper assessment of traditional (non-PPP) procurement projects, several anti-PPP biases may dominate.

Adequate assessment of and reporting on PPP fiscal commitments help eliminate a few pro-PPP biases, reducing the incentive for shifting costs to future generations and mitigating the potential threat to fiscal sustainability. However, a poor assessment of traditionally procured projects can create a bias against choosing the PPP route, reducing the effectiveness and efficiency of projects. Indeed, traditional procurement is a major source of cost overruns. In traditional procurement, the absence of concerns with long-term maintenance and operational costs can result in non-optimization of the cost of the project over its life and allows for easier strategic misrepresentation of projects through undervaluation of costs and over-estimation of revenue. Therefore, a framework for proper assessment of PPP projects should not disregard the assessment of traditional procurement projects. Ideally, the assessment of traditional procurement should be part of a public investment management framework that establishes a level-playing field for the decision on using PPP or traditional procurement. (As previously noted, this note will only address the specific case of PPPs fiscal commitments and their management.)

Historic and recent experiences have demonstrated the importance of managing government fiscal support to PPPs and avoiding biased decision making between PPP and public procurement routes.

In the midst of the 1997 Asian crisis, several Asian countries suffered exacerbated impacts due to PPP contingent liabilities

that transformed into immediate obligations. While the banking sector was the major source of fiscal liabilities in Korea, infrastructure projects added to the fiscal stress. In Indonesia, concerns have been raised regarding the role of the Ministry of Finance, which had the chance to intervene in the development of a concession only when it was too late to propose major changes without serious disruption to the investment program. Such problems may have been more effectively addressed if the Ministry of Finance had assessed the fiscal obligations of these deals at approval.⁷ More recently and under the current financial and economic crisis, a number of European countries have faced the reality of the fiscal implications of their PPP projects. Portugal and Hungary have placed a moratorium on new PPPs and are reviewing existing ones. Portugal's recent crisis has been exacerbated by the fact that the government had to make large payments to PPP companies as a result of PPP contracts developed in the years before the crisis without adequate consideration of their fiscal implications. Spain is facing a sequence of PPP toll road operators going bankrupt.⁸

The above examples reflect instances of macroeconomic crisis which are closely correlated to the performances of PPP projects. For instance, all PPP road projects in countries affected by macroeconomic crisis (Greece, Portugal, and Spain recently, and previously Malaysia and Mexico) simultaneously suffered demand challenges (and faced bankruptcy risk) creating a systemic risk. The predictability of these events and the extent to which their impact could be mitigated through a fiscal commitment framework can be significantly different from project specific and idiosyncratic risks. A careful examination of these examples shows that several projects already suffered from microeconomic issues—low demand (including projects for which effective demand, after the ramp-up phase, stabilized at 10 percent of expected demand) or high cost (for example, cost overruns arising out of *ex-ante* cost under-evaluation due to strategic misrepresentation of projects in order to maximize the chances of approval). In some cases, those issues induced governments to cancel PPP projects and even PPP programs.

⁷ Tim Irwin and Tanya Mokdad (2009), "Managing Contingent Liabilities in PPPs: Practice in Australia, Chile, and South Africa," World Bank and PPIAF Publication; Louis Wells and Rafiq Ahmed (2006), *Making Foreign Investment Safe: Property Rights and National Sovereignty*, Oxford: Oxford University Press.

⁸ <http://bankwatch.org/public-private-partnerships/background-on-ppps/build-now-pay-heavily-later>; Mariana Abrantes de Sousa (2011), "Managing PPPs for budget sustainability: The case of PPPs in Portugal, from problems to solutions," PPP Lusofonia network; and <http://www.claretconsult.com/spaintollroads.html>

4. Components of a PPP Fiscal Commitment Management Framework

The public financial management framework for PPPs is discussed in the World Bank Institute's *PPP Reference Guide*, particularly in section 2.4, dealing with fiscal exposure, budgeting, and reporting.

This note sets out three key components of a Fiscal Commitment Management Framework, which are described in turn in the sections below:

- a. Defining clear *roles and responsibilities* within government for managing the fiscal commitments of PPPs throughout the project cycle;
- b. Building the requirement to *assess and approve fiscal commitments into the PPP development and approval process* (PPP development stage);
- c. Ensuring *fiscal commitments are adequately managed during PPP project implementation*—by monitoring fiscal commitments at a project and portfolio level, reporting on and disclosing them as part of regular government financial reporting, and budgeting for them as needed (PPP implementation stage).

This Fiscal Commitment Management Framework should be part of a broader PPP governance regime.

Effective and efficient PPP implementation requires also institutions and capacity for assessing PPP projects, procuring them, and managing PPP contracts during their long life. Without institutions and effective capacity for assessing projects, PPP fiscal costs (direct and contingent, explicit and implicit) will not be well identified, and so project selection and prioritization may be jeopardized. Without proper procurement, those costs cannot be minimized through competitive pressure. And without adequate contract management, fiscal costs tend to rise by force of exogenous change (technological, demographic, and commercial), policy action or inaction, and moral hazard or strategic behavior by the private partner.

PPP Units have a key role to play in managing fiscal commitments.

PPPs require a design and procurement approach that significantly differs from the usual approach for four main reasons. They require complex financing arrangements, a broad identification and analysis of risks, an output- and performance-based definition of project requirements, and a long-term assessment of the projects. The natural scarcity of government staff with the required knowledge typically invites governments to move scarce “PPP resource people” into central teams, known as PPP Units. PPP Units are usually given responsibility

for fostering the PPP agenda—advising on policy, adapting the legal framework, preparing a pipeline of projects, structuring them, procuring them, even managing contracts on behalf of line ministries. Too much centralization risks weakening the governance regime for PPPs. The inevitable centralization of government PPP expertise should not imply the full centralization of PPP-related decision making. International experience shows that some checks and balances are needed, particularly when large infrastructure investments are at stake. Good decision processes require an informed debate between several government agencies. For example, some agencies will propose projects, others will select and prioritize them; some will prepare projects, others will review them.

4.1 Roles and Responsibilities for Managing Fiscal Commitments from PPPs

A number of key fiscal commitment management functions need to be undertaken when developing, awarding, and implementing a PPP project. During project development, these functions include identifying and estimating the cost of all fiscal commitments under a proposed project (which, if the contracting authority is a state-owned enterprise (SOE), may include reviewing overall SOE financial health and ability to cover the proposed PPP commitments). Another key function at project development is to consider the affordability of the fiscal commitments, in light of budget priorities and constraints as well as from an overall liability and macro management viewpoint.

At project implementation stage, key functions are project monitoring and information gathering for regular fiscal commitment tracking over the life of the project, fiscal commitment reporting and disclosure, budget management and timely release of funds called for any fiscal commitment.

Defining institutional responsibilities for managing PPP fiscal commitments can be complicated, since it typically requires input from a range of government entities. The primary motivation of a contracting authority, and any internal advisory function such as a PPP unit (depending on the latter’s mandate), is to develop a PPP project and get the deal done. Ensuring the fiscal discipline of a project might not be their primary objective or mandate. Thus, other government entities have an important role in managing the fiscal exposure and budgetary implications of PPP projects. Due diligence of fiscal commitments needs to be led by the entities with prime responsibility for safeguarding the public purse.

Table 1 shows examples of government institutions that can be involved in undertaking these functions. Although the contracting authority and its transaction advisors cannot be primarily responsible for fiscal commitment management, they nonetheless have important roles to play, as highlighted in the table. The table also highlights the roles of “fiscal commitment oversight entities”; in practice, these functions may be combined in a single entity or a team (typically within the Ministry of Finance), or they may involve input from several different

departments and agencies. Ultimately, the PPP decision maker, or approving body, is responsible for ensuring that the inputs from these oversight entities are taken into account when deciding to approve a PPP. *The table is meant to be illustrative of the various functions and does not prescribe any specific institutional set-up.* The structures can vary considerably from one country to another, and in practice many countries do not perform some of these functions. Ultimately one will need to adjust the proposed functions to the local environment and capacities. For instance, after the recent financial crisis and following advice from the IMF, the European Commission, and the European Central Bank, the central bank in Portugal has become involved in assessing PPP projects' fiscal health, and the Ministry of Finance was put in charge of leading PPP procurement (instead of line ministries).⁹ In Chile, the decisions about guarantees and other financial commitments to concessionaires are made jointly by the Ministry of Public Works and Hacienda (the Ministry of Finance).¹⁰

Recommendations on a project's fiscal commitments need to be coordinated; also, the entities undertaking the gatekeeping functions will need to provide feedback at various stages of project development. Depending on the institutional structure in a particular country—for example, if debt

management and budgeting are responsibilities of different entities—some mechanism may be needed to manage and synchronize the various recommendations on the fiscal commitment that are communicated to the PPP approving body (such as the Minister of Finance, a PPP approval committee, Parliament, and so on). Options could include designating one entity as the lead fiscal appraiser responsible for gathering inputs from the others, or establishing a committee composed of the different key entities. The cited World Bank (2007) report on Chile highlights the challenge of coordination between the concessions department and the Ministry of Finance; sometimes the latter's involvement in reviewing the concession's bidding documents might be too late in the process to constitute an effective intervention. The status quo institutional setup is believed to create a bias towards the use of concessions.

Estimates of the required government support for a PPP project are commonly developed during the transaction due diligence stage and should be reviewed at different stages of project preparation.

The actual level of fiscal commitment will often not be known until the tender process has been carried out and the winning bidder selected—particularly when a fiscal commitment such as a level of subsidy—is among the bid criteria. Thus a subsequent review

⁹ Government of Portugal, the European Commission, the European Central Bank, and the International Monetary Fund (2011), "Portugal: Memorandum of Understanding on Specific Economic Policy Conditionality," Section 3.21.

¹⁰ World Bank (2007), "Improving the Management of Concessions: Better Reporting and a New Process for Decision When to Use a Concession."

Table 1: Related Roles and Responsibilities of Various Government Entities for Managing Fiscal Commitments from PPPs

| Government department or agency | Role | Role during PPP preparation/ approval | Role during PPP implementation |
|---|---|---|---|
| Project Management Functions | | | |
| 1 Contracting Authority (may be supported by internal and/or external advisors) | <ul style="list-style-type: none"> Contracting authorities may be government departments, agencies, local government, or state-owned enterprises.. It is the signatory to PPP contract from the government side. Sometimes line ministries delegate procurement responsibilities to a central procurement agency, but typically they keep responsibility for policy. | <ul style="list-style-type: none"> Prepares the initial economic appraisal of each project. Presents the rationale for procuring the project as a PPP. Develops the outline business case/feasibility studies for the PPP. Submits a draft contract and tender rules for each project. Identifies and estimates the cost of fiscal commitments as part of the project preparation (with support from transaction advisors). Leads the procurement process, or cooperates with a central procurement agency. | <ul style="list-style-type: none"> Monitors the project. Regularly obtains information needed from the PPP sponsor for fiscal commitment tracking over the life of the project. Monitors and responds to fiscal commitment-related project risks. Includes fiscal commitment payments in budget requests submitted to government. |
| 2 PPP Project Advisory Function | <ul style="list-style-type: none"> The entity/unit responsible for PPP policy formulation and coordination; technical assistance for PPP projects; standardization and dissemination of contracts; and PPP promotion and marketing. (commonly known as a PPP Unit) This function can be in the Ministry of Finance/ Treasury (as is the case in France, Ghana, Kenya, Portugal, South Africa, the United Kingdom), the office of the Prime-Minister (Italy), a non-sectoral ministry (the Ministry of Planning in Brazil, the Public Works Ministry in Chile), or a standalone unit (Indonesia, Korea, Rep.). | <ul style="list-style-type: none"> Supports and quality assures the above process (such as review of tender documents). Helps develop standard contractual clauses and other guidance material, namely on fiscal commitments. | <ul style="list-style-type: none"> Monitor PPP programs and project implementation in order to improve standard contractual clauses and other guidance materials. |

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Table 1: Related Roles and Responsibilities of Various Government Entities for Managing Fiscal Commitments from PPPs

| Government department or agency | Role | Role during PPP preparation/ approval | Role during PPP implementation |
|--|---|--|--|
| Fiscal Commitment Oversight and Gatekeeping Functions | | | |
| 3 Debt Management Department | <ul style="list-style-type: none"> Commonly in the Ministry of Finance | <ul style="list-style-type: none"> Assesses and advises on fiscal commitment liabilities from a <i>long term liability management</i> point of view. | <ul style="list-style-type: none"> Monitors the impact of PPP fiscal commitments (particularly contingent) on fiscal risks. Incorporates updated fiscal commitment estimates into debt and fiscal sustainability analyses, and discloses in reports. Undertakes scenario analyses and stress tests. |
| 4 Budget Department | <ul style="list-style-type: none"> Commonly in the Ministry of Finance | <ul style="list-style-type: none"> Assesses and advises on fiscal commitment affordability from a <i>budget priorities/constraints</i> point of view. | <ul style="list-style-type: none"> Incorporates fiscal commitment as needed into relevant reports. Allocates and releases budget for direct payments and realized contingent liabilities. Creates provisions for PPP contingencies (explicit and implicit) and fiscal rules on the use of any resources that are set aside to respond to these contingencies. Undertakes scenario analyses and stress tests. |

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Table 1: Related Roles and Responsibilities of Various Government Entities for Managing Fiscal Commitments from PPPs

| Government department or agency | Role | Role during PPP preparation/ approval | Role during PPP implementation |
|--|---|---|--|
| 5 Macroeco- nomic Fore- cast Entity | <ul style="list-style-type: none"> Commonly in the Ministry of Finance | <ul style="list-style-type: none"> Assesses and advises on the PPP projects' fiscal commitments from an <i>overall liability and macro management</i> viewpoint. Including assessment on possible adverse impact of excessive subnational exposure to PPP fiscal commitments. | <ul style="list-style-type: none"> If relevant, incorporates updated PPP liabilities in macro/fiscal projections. Undertakes scenario analyses and stress tests. |
| 6 Entity Overseeing State-Owned Enterprises | <ul style="list-style-type: none"> It is sometimes in the Ministry of Finance or can be a standalone entity/ commission. It oversees SOEs' performance and financial health. | <ul style="list-style-type: none"> Assesses and advises on SOE health and exposure to PPP commitments. | <ul style="list-style-type: none"> Monitors SOE performance, including for PPP contracts. Reviews implications for government expenditure and the need for any budget transfers. |
| 7 PPP Approving Body | <ul style="list-style-type: none"> It can be Finance Minister, Cabinet, Parliament, and so on. May be supported by a unit playing some kind of secretariat function to the gatekeeper, responsible for checking that all procedures have been followed. The Finance Minister should have veto power in this process. | <ul style="list-style-type: none"> Takes above assessments and recommendations into account when approving a proposed PPP project at the project development stage. Approves draft contract and tender rules. | <ul style="list-style-type: none"> Approves any (formal or informal) renegotiation of a PPP contract. |

of the project fiscal commitment will be required. Fiscal commitments may change after selection of the winning bidder and before the “finalized execution copy of the contract” (although the bid process should aim to minimize negotiation at this stage). A final review of the fiscal commitments may

be needed at this final stage, bearing in mind that small changes in contractual wording may imply significant changes in fiscal commitments.

The next sections discuss in more detail the various steps and considerations during the PPP project preparation

and implementation phases to identify, assess, monitor, report on, and budget fiscal commitments.

4.2 Managing Fiscal Commitments—PPP Development Stage

4.2.1 *Identifying and Evaluating Fiscal Commitments to PPPs*

The first step in assessing the fiscal implications of a proposed PPP is to identify and evaluate the cost of the fiscal commitments implied by the project structure. The process of “identifying” fiscal commitments stems from the process of structuring the PPP. Identifying and evaluating fiscal commitments involves: allocating risks (and hence, identifying which risks are borne by the government, creating a fiscal commitment); defining payment mechanisms, including payments for services required by government; and defining responsibilities, which may include contractual commitments to provide inputs or carry out associated works. As previously noted, the initial assessment of fiscal implications should be reviewed during the procurement process, at each of its stages, considering changes introduced by bidders’ proposals or the procurement agency. The PPP contract should require the private partner to regularly provide adequate information on project evolution and performance, allowing for effective and dynamic fiscal risk monitoring and management.

Table 2 provides a sample of the required fiscal commitment analysis during project preparation. During

this due diligence phase, the entity responsible for project development should ensure that the relevant information on the project fiscal commitment and analysis are specified in the terms of reference for the transaction advisors who will be supporting the government (the same considerations hold in the event that the transaction studies and due diligence are undertaken by in-house specialists).

Efforts towards containing the government’s fiscal commitments should not translate into biased risk allocation. Contractual risk allocation is critical for project success. The risks that can be contractually allocated should be clearly assigned to one party or the other—“shared risks” may be a relevant source of contingent liabilities. In general, insufficient transfer of risk to the private partners results in low incentives for project performance, creating rents for private parties. But excessive transfer of risk to private partners (in contract provisions) may act in a counterintuitive way by creating large implicit contingency costs for government. Additionally, excessive risk transfer induces adverse selection of PPP operators, creating a breeding ground for rent-seeking firms rather than efficient operators. For instance, allocating to private partners some degree of demand risk creates sound incentives for service provision, but the excessive transfer of demand risk will simply force renegotiation (without competitive pressure and under threat of service disruption) or termination.

Several possible measures can express the cost of fiscal commitments under PPP projects. In the case of direct fiscal

Table 2: Key Analysis on Fiscal Commitments in Due Diligence of PPP Transactions
(can be used as input in the Terms of Reference of Transaction Advisors for PPP projects)

| 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"> • Annual cost over the project life (both upfront and ongoing commitments) • Present value of the payment stream for long-term commitments 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 guarantees) | At a minimum, a scenario analysis approach should include: <ul style="list-style-type: none"> • Estimated annual cost under different scenarios for each guaranteed risk variable (base case and downside scenarios) • “Trigger points” for relevant risk variables—that is, the change from the base case at which contingent liabilities become payable (for example, percent drop in demand from base case at which a demand guarantee is payable), and qualitative analysis of the likelihood of reaching these values Over time, and for variables for which the government is building up significant exposure, could move toward probabilistic approach (to determine “expected” value and range). |
| Payment guarantees (guarantee on payment by SOE or local/subnational government) | Value of underlying payment requirements (“face value” of guarantee), in terms of: <ul style="list-style-type: none"> • Annual cost over the project life • Present value of the payment stream Analysis of transfers likely to be required to meet payments under different scenarios for key variables (for example, sector tariffs) and a qualitative estimate of likelihood for each scenario. |
| Termination payment commitments (payments in case of contract termination by either party) | <ul style="list-style-type: none"> • Maximum value of the termination payment, under base case assumptions (Value will vary over the project lifetime; maximum typically at project commissioning, when debt has been drawn down and repayments have yet not started.) • For any termination payments triggered by concessionaire default, trigger points for relevant key assumptions at which default might occur (for example, percent drop in demand that would mean insufficient cash for debt service), and a qualitative analysis of the risk of default. |

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Table 2: Key Analysis on Fiscal Commitments in Due Diligence of PPP Transactions*(can be used as input in the Terms of Reference of Transaction Advisors for PPP projects) (continued)*

| Type of Fiscal Commitment | Suggested Analysis |
|---|--|
| Cost of related investments and associated works (such as dredging for a port concession; building distribution networks, power connections, and waste management for a bulk water PPP) | <ul style="list-style-type: none"> • Total cost to government of the contractual commitments to provide inputs, or requirements to carry out associated works. |

commitments, suitable measures typically include both the estimated annual value and the present value of the stream of payment commitments over the project lifetime. Evaluating the cost of contingent liabilities is more complex and can be handled through two approaches:

- a. **Scenario analysis**, which involves making assumptions regarding the outcome of any events or variables that affect the value of the contingent liabilities and calculating the cost given those assumptions. For example, this analysis can include “upside,” “downside,” and “worst case” scenarios for any given risk variable, or for a combination of risk variables;
- b. **Probabilistic analysis**, which is an alternative approach that uses a formula to define how the variables that affect the value of the contingent liabilities will behave. Probabilistic analysis treats all input parameters as variables that change according to an assigned probability distribution function, and then calculates

the resultant distribution of possible costs.

As the simpler, more intuitive approach, scenario analysis is almost always the best option for assessing PPP fiscal commitments. Probabilistic analysis requires a lot of information 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.

4.2.2 Assessing Affordability of PPP Fiscal Commitments as an Input to Approval

Having estimated the cost of PPP fiscal commitments, the government needs to decide whether those commitments are affordable and fiscally responsible. Generally, this can be achieved by: (i) comparing annual cost estimates against the projected budget of the contracting authority; (ii) considering

the impact on debt sustainability; and/or (iii) introducing specific limits on different types of PPP commitments.

Assessing the affordability of proposed PPP fiscal commitments in light of budget constraints and priorities is the responsibility of the budget department. At a minimum, this assessment should compare the estimated annual cost of the fiscal commitments (whether direct or contingent) with the annual budget of the relevant sector. Most countries have a medium-term expenditure planning horizon of three to four years. In the absence of a long-term expenditure plan, this assessment may involve projecting forward sector spending over the lifetime of the PPP contract. The simplest approach is to assume growth in sector spending beyond the end of the Medium Term Expenditure Framework (or any other equivalent medium-term framework) equal to GDP growth.

Assessing the affordability of fiscal commitments under a PPP project in terms of the government's overall liability and fiscal risk management can be the responsibility of the Ministry of Finance or debt department. The debt department should consider whether the PPP debt will need to be recognized as a public liability and included in debt measures, and thus it will determine the project's impact on overall debt sustainability. The debt department should also consider the size of the government's commitments under the PPP contract—both

direct payments and contingent liabilities—and how these compare and contribute to the government's existing liability portfolio. (In countries where the debt department is responsible for only debt management, as opposed to debt sustainability, this function will be undertaken by an alternative entity. However, Cebotari (2008)¹¹ makes the argument for the debt department undertaking these proposed functions. (See also World Bank-IMF "Guidelines for Sound Practices in Sovereign Debt Management.")

The impact of all PPP projects on the overall government fiscal position and an assessment of systemic risk need to be addressed. The entity or body responsible for macroeconomic forecasting should also consider whether and how the government's liabilities under the PPP may affect fiscal projections and analysis. This entity, in collaboration with the debt department and budget department, will need to analyze PPP projects on a portfolio level, and assess if the nature and sectoral concentration of PPP projects constitute systemic risk. As previously noted, all PPP road projects in countries affected by 2008 macroeconomic crisis (for example, Greece, Portugal and Spain currently, and previously Mexico) simultaneously suffered demand challenges (and faced bankruptcy risk) creating a systemic risk. The entity responsible for macroeconomic forecasting can also assess the national level fiscal risk associated with subnational PPPs.

¹¹ Aliona Cebotari (2008), "Contingent Liabilities: Issues and Practice," IMF Working Paper WP/08/245.

Box 1: Country Examples of Limits on Fiscal Commitments to PPPs

Some countries have introduced explicit limits on PPP fiscal commitments. The United Kingdom, for example, has specified individual departmental spending limits for each department, ranging from 6 to 7 percent of total annual spending. Brazil's current PPP law prohibits undertaking new PPPs if the projected stream of payments under the overall PPP program exceeds 5 percent of government revenue in any future year. In Greece, current payments of approved PPP projects account for 6–7 percent of its public investments program are expected to reach 10–12 percent in five years, and are ultimately capped at a limit of 15 percent.

In India, 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 particular grant or scheme of any department for the next five years should not exceed 25 percent of the department's current five-year plan outlay of such grant or scheme. However, no cap is set for guarantees issued to PPPs.^a

Note: for other examples of ceilings for PPPs in El Salvador, Hungary, and Peru, see Funke, Irwin and Rial (2013), "Budgeting and Reporting for PPPs," OECD/ITF Joint Transport Research Centre Discussion Paper 2013/07.

^a India Planning Commission (2010), "Report of the Task-Force on Ceilings for Annuity Commitments."

Some governments introduce specific limits on direct fiscal commitments to PPPs, either as part of the spending commitments of the specific department or in aggregate for the PPP program (such as in the United Kingdom, Greece, Brazil, and India—see Box 1). The rationale for such limits is to avoid tying up too much of the budget (whether at the sector or aggregate level) in long-term payment commitments. Such a limit is not typically necessary in the very early stages of a PPP program and can be later developed as the potential of the PPP program becomes clearer (further analysis will need to be undertaken to determine the basis of setting such limits for each country). Among the reasons

that the IMF lists for the review of the *Manual on Fiscal Transparency (2007)* is the need for better fiscal management of PPPs and to capture a broader range of direct and contingent liabilities¹² (a revised version is planned for late 2013).

Table 3 summarizes some key indicators and ratios that can be used to assess the affordability of a proposed PPP. These indicators are from both the budget and liability management perspectives and also can be used during the monitoring of the PPP contract.

If a PPP project is undertaken by a SOE or subnational government, the fiscal impact assessment needs to

¹² International Monetary Fund (2012), "Fiscal Transparency, Accountability, and Risk," August, IMF's Policy Paper; see the Fiscal Transparency webpage, <http://www.imf.org/external/np/exr/consult/2012/FAD/>.

| Table 3: Examples of Key Indicators and Ratios on Affordability Assessment and Risk Exposure from PPPs | | |
|--|---|--|
| Fiscal commitment type | Relevant measure | Relevant comparator for considering affordability |
| Budget implications | | |
| Long-term direct fiscal commitments (such as availability payments) | Annual payment (Executed from the budget) | <ul style="list-style-type: none"> The relevant measure as a percentage of sector ministry or agency total and capital annual budgets <i>(projected forward for the duration of the PPP contract—beyond the Medium Term Expenditure Framework (MTEF) horizon)</i> |
| Guarantees (for example, on particular risk variables such as demand; or for payment guarantees) | Estimated annual payment— “base” and “downside” cases; and associated stress tests. (Contingency budget required for this value.) | <ul style="list-style-type: none"> The relevant measure as a percentage of sector ministry or agency budget <i>(projected forward for the duration of the PPP contract—beyond the Medium Term Expenditure Framework (MTEF) horizon)</i> The relevant measure as a percentage of the “contingency” line The relevant measure as a percentage of total and capital annual budgets. <i>(to consider impact of having to make sudden payment)</i> |
| Termination payments | <p>Estimated “worst case” payment; (Contingency budget required for this value.)</p> <p>Early termination should be considered—typically, termination payments differ according to the timing and cause of termination. A good PPP contract should include specific rules for computing compensation for early termination, according to the several reasons for termination.</p> | <ul style="list-style-type: none"> The relevant measure as a percentage of “Contingency” line The relevant measure as a percentage of total and capital annual budgets. <i>(to consider impact of having to make sudden payment)</i> |

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Table 3: Examples of Key Indicators and Ratios on Affordability Assessment and Risk Exposure from PPPs *(continued)*

| Fiscal commitment type | Relevant measure | Relevant comparator for considering affordability |
|--|--|---|
| Risks contractually allocated to the public partner (such as force majeure, major environmental problems, costs of expropriating land) | Estimated “worst case” payment, with tentative assessment of the probability of occurrence and possible mitigation. (Some of these risks may be harder to estimate, for example, force majeure.) | <ul style="list-style-type: none"> • The relevant measure as a percentage of “contingency” line • The relevant measure as a percentage of total and capital annual budgets. • <i>(to consider impact of having to make sudden payment)</i> |
| Renegotiation | Estimated “worst case” payment, for each relevant scenario of technological, demographic, or commercial change, as well as for relevant changes in public policy. | <ul style="list-style-type: none"> • The relevant measure as a percentage of “contingency” line • The relevant measure as a percentage of total and capital annual budgets. • <i>(to consider impact of having to make sudden payment)</i> |
| Cost of PPP project related investments and associated works | Estimated annual payment— “base” and “downside” cases (Executed from the budget) | <ul style="list-style-type: none"> • The relevant measure as a percentage of sector ministry or agency total and capital annual budgets |
| Liability Management Implications <i>(to consider the impact of adding the proposed commitments – on the debt sustainability and liability position)</i> | | |
| All PPPs | Value of PPP debt | |
| Long-term direct fiscal commitments (such as availability payments) | Present value of government payments | |
| Guarantees on particular risk variables | Present value of annual payments— “base” and “downside” cases | <ul style="list-style-type: none"> • The relevant measure as a percentage of total public debt exposure • The relevant measure as a percentage of GDP |
| “Payment” guarantees (covering SOEs or local/subnational government) | <ul style="list-style-type: none"> • Present value of underlying payment stream (“face value” of guarantee); • Present value of payments under different scenarios. | |
| Termination payments | Maximum payment required (typically = debt + equity) | |
| Cost of PPP project-related investments and associated works | Present value of payments that might be beyond the budget time horizon— “base” and “downside” cases | <ul style="list-style-type: none"> • The relevant measure as a percentage of total public debt exposure • The relevant measure as a percentage of GDP |

take into consideration the broader financial position of the SOE or sub-national government. In the case of SOEs, their PPPs create contingent liabilities for the government. The likelihood and cost of the government needing to make payments will depend on the financial obligations of the SOE under the PPP contract, and also on the overall financial position of the SOE. This type of assessment also applies to PPPs undertaken by subnational governments, considering the constitutional arrangement of each country and political realities. Subnational governments need to manage their own fiscal commitments, but national governments should not disregard monitoring the aggregate fiscal commitments of the country. Regardless of the degree of solidarity between different levels of government (and of the direct cost of possible rescue efforts), excessive direct commitments and excessive risk exposure by subnational governments will have macroeconomic impacts, and they will have fiscal consequences. Careful monitoring of subnational expenditure and risk will be critical in preventing “free-riding” behavior that may jeopardize national fiscal sustainability. (The role of a macroeconomic forecasting entity is outlined in Table 1.)

4.3 Managing Fiscal Commitments—Project Implementation Stage

4.3.1 Monitoring PPP Fiscal Commitments

Monitoring entails managing, reporting on, and budgeting for the fiscal commitments arising from PPP

projects, at both the project and portfolio levels. Monitoring PPP fiscal commitments requires gathering information on project risks and project performance from the concessionaire—as well as other inputs that affect the cost of PPP fiscal commitments, such as updated projections of key economic variables—and ensuring that this information reaches the relevant gatekeeping entities.

Gathering information from the concessionaire is typically the responsibility of the contracting authority, which has the direct contractual relationship with the PPP company or concessionaire. Information requirements should be clearly specified in the PPP contract (including for instance, traffic information and key financial ratios for the PPP company) along with indicators needed to monitor service performance. To back up this requirement, PPP legislation could include a provision giving the contracting authority the right to periodically collect monitoring information from the PPP company; alternatively, monitoring can be covered in the PPP contracts.

4.3.2 Reporting and Disclosing PPP Fiscal Commitments

Each government needs to determine whether and when PPP commitments should be recognized—that is, formally recorded in financial statements as liabilities. As previously noted, one attraction of PPPs is the notion of getting investment financed (by the private sector) without immediately increasing reported government spending and debt. This perception sometimes creates a bias in favor of PPPs and can lead to the selection of projects that may be better candidates

for traditional public procurement. This bias is also closely related to the way governments measure their spending and debt.

Determining whether and when PPP commitments should be recognized is particularly important since it defines whether the liabilities count towards government debt management limits or targets.

There are international standards for public accounting and statistics relating to PPP commitments specifically and contingent liabilities more broadly, namely: International Public Sector Accounting Standards (IPSAS)–Standard 32; the IMF’s *Government Finance Statistics Manual – GFSM* (IMF 2001 and November 2012 draft); the IMF *2011 Guide on Public Sector Debt Statistics (PSDS 2011)*; and Eurostat Rulings (see Table 4 for some of these standards). 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. (For more detail, see Cebotari 2008; Hemming 2006; and Funke et al. 2013¹³). While relevant international accounting standards were recently published, few countries have yet adopted these standards in practice, and country approaches to this question vary widely. Funke et al. (2013) looks in detail at this question, noting that “reported spending and debt in the short run [...] is increasingly done in accrual-based fiscal data, which often treat PPPs as government projects, even though from a legal perspective they are undertaken by a private company. This means that the government treats investment in the PPP project as public investment and records the PPP asset on its own balance sheet, along with a corresponding liability.” Where PPP liabilities

Table 4: Summary of Main Requirements for the Recognition and Disclosure of Contingent Liabilities

| | | Recognition | Disclosure |
|-----------------------|----------|--|---|
| Cash accounting | | Only when the contingency is called and cash payments need to be made. | Encouraged. |
| Accrual accounting | IPSAS 19 | The expected cost of a contingent obligation should be recognized if: (1) it is more likely than not (50%) that the event will occur; and (2) 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. |
| Statistical reporting | GFS 2001 | Only when the contingency is called and cash payments need to be made. | Required as a memorandum item to the balance sheet. |

Source: Aliona Cebotari (2008), “Contingent Liabilities: Issues and Practice,” IMF Working Paper WP/08/245.

¹³ Richard Hemming and staff team (2006), “PPPs Government Guarantees, and Fiscal Risk,” International Monetary Fund; and Katja Funke, Tim Irwin, and Isabel Rial (2013), “Budgeting and Reporting for PPPs,” OECD/ITF Joint Transport Research Centre Discussion Paper 2013/07.

are treated as public debt, they are likely to be subject to checks and limits accordingly. *Nevertheless, the suggestions in this note—and the importance of clearly understanding and carefully managing the fiscal implications of PPPs—apply irrespective of how PPPs are treated in public accounts.*

When PPP fiscal commitments are not recognized as part of a government’s debt, they should nonetheless be reported alongside information and analysis of public debt.

This is important for both internal and external transparency of the government’s liability position. Key questions on PPP reporting are what information should be disclosed and where. 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.

As noted in Tables 5 and 6, the information reported will likely include a mixture of qualitative and quantitative information on the different types of government commitments to PPPs. For illustration purposes, Tables 4 and 5 show a sample of reporting formats to present both direct and

contingent liabilities under PPP projects. These formats suggest providing a description of liabilities under each PPP project and a simple estimate of the value of those liabilities. In the case of long-term payment commitments, such as availability payments, the information reported could include the annual cost and the present value of the payment stream over the contract lifetime. For contingent liabilities, the reported information should include any realized costs, as well as the “maximum” or “worst-case” value, where this can be calculated.

Reporting on PPP fiscal commitments can be included alongside public debt reporting in documentation such as: a Medium-Term Debt Strategy report, budget statement, notes to the national account, special purposes reports, and so on. From a fiscal management viewpoint, PPPs are one item in a government’s “fiscal risks matrix” (see Brixi and Schick 1998). As PPP programs develop, governments may consider publishing a specific report on PPP fiscal commitments (such as in Chile, which started by publishing a report on contingent liabilities from minimum revenue guarantees to PPPs and later broadened its disclosure into a wider report that extends beyond PPP contingent liabilities).¹⁴

A government should also define how it will treat SOE obligations under PPP contracts in its reporting and accounts. SOE payments *guaranteed* by the government create an explicit contingent liability that should

¹⁴ Government of Chile (2011), *Informe de Pasivos Contingentes 2011* (Contingent Liabilities Report, in Spanish), available at http://www.dipres.gob.cl/572/articles-76644_IPC_2011.pdf. This document also includes some disclosure formats for PPP fiscal commitments.

Table 5: Example of Reporting Format for Direct Commitments

| PPP project | Description of commitment | Total project investment cost | Annual payment value for the 3 budget years | | | | Estimated present value of all future obligations |
|--------------------------|--|-------------------------------|---|-------------|----------|----------|---|
| | | | Current year | Budget year | MTEF Y 2 | MTEF Y 3 | As of current year |
| Toll road A | Shadow toll paid annually; Duration X years; Denominated in [or indexed to] Y currency | | # | # | # | # | # |
| Toll road B | | | | | | | |
| Toll road C | | | | | | | |
| Total (transport) | | | | | | | |
| Prison A | Annual availability payment; Duration X years; Denominated in Y currency | | # | # | # | # | # |
| Hospital A | Annual subsidies; Duration X years; Denominated in Y currency | | # | # | # | # | # |
| Total (other) | | | | | | | |
| Total | | | | | | | |

be reported alongside other contingent liabilities under the PPP program. If no explicit guarantee has been provided, the government may nonetheless have an implicit obligation to support the SOE in case of financial distress and protect the provision of basic services. However, the latter is a general liability that encompasses all financial obligations of the SOE and not just those under the PPP contract. Publicly reporting on these commitments could risk creating moral hazard in cases in which SOEs and the concessionaries perceive this disclosure as explicit government back-up, affecting the private party's due diligence on

the capacity of the SOE to meet its PPP commitments, as but one example. In this case, the clearest approach may be to ensure that governments are aware of the SOEs' PPP commitments and generally strengthen their oversight and visibility of SOE financial performance.

As well as reporting specifically on fiscal commitments under the PPP program, there are wider benefits to disclosing PPP contracts and procurement processes. Disclosure can help PPP programs achieve better value-for-money in several ways. For example, revealing information on the

procurement of PPPs can improve governance; furthermore, disclosing information on the performance of PPPs helps users of services understand the levels of service they should receive. Latin American countries publish their PPP contracts, India has recently published a large number of highways contracts, and Australia and Canada disclose significant information on their contracts and projects.¹⁵

4.3.3 Budgeting for PPP Fiscal Commitments

Budgeting for direct, ongoing commitments, such as availability payments or annuities, is relatively straightforward since the timing and value of payments are known. The most common and simplest approach is to build the payment requirement into the annual budget allocation of the relevant department. As previously described, the budget department is responsible for checking that a contracting authority has built its PPP commitments into its annual budget request. Actual payments to PPP companies may be made through a centrally controlled account to avoid the risk of delay. In some cases, when payment risk is considered high, escrow accounts may be used (or even required in the contract) to provide assurance that resources are available to meet payments when needed.

However, budgeting for long-term PPP commitments is not straightforward. The recent paper by Funke et

al. (2013) discusses three possible solutions: (a) “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”; (b) “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”; and (c) “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 projects deemed affordable in the first stage.”

Budgeting for contingent liabilities is also challenging, as the need for, timing, and amount of payments are often not known until the liability is realized. If payments are needed unexpectedly and savings cannot be found within the existing appropriations, the government may need to go to Parliament to request a supplementary appropriation—often a slow and contentious process. Some countries have found various ways to reduce this risk, such as creating additional budget flexibility by including a contingency reserve in the budget that can be used to meet calls on contingent liabilities, or “insuring” against the need for such payments by creating a fund upfront from which contingent liabilities will be paid (as in Colombia)¹⁶.

¹⁵ World Bank Institute – WBI (2013), “Disclosure of Project and Contract Information in PPPs.” See Table 1 for a summary of country practices on approaches to PPP contract and project disclosure.

¹⁶ Aliona Cebotari (2008), “Contingent Liabilities: Issues and Practice,” IMF Working Paper WP/08/245.

Table 6: Example of Reporting Format for Contingent Commitments

| PPP project | Description of project | Description of contingent liabilities | Actual payments | Estimated payments over MTEF period | | | Estimated present value of all future obligations |
|--------------------------|---|---|-----------------|-------------------------------------|----------|----------|---|
| | | | Current FY | Budget year | MTEF Y 2 | MTEF Y 3 | As of current year |
| Toll road A | 100 km toll road linking A to B; 25 year contract dated 201X; Operational from 201Y | <ul style="list-style-type: none"> Government bears two on-going contingent liabilities: <ul style="list-style-type: none"> Minimum revenue guarantee Exchange rate guarantee In case of contract termination Government has a one off payment commitment of a value between X and Y million, depending on cause of termination. | # | # | # | # | # |
| Toll road B | | | | | | | |
| Toll road C | | | | | | | |
| Total (transport) | | | | | | | |
| Prison A | | | | | | | |
| Hospital A | | | | | | | |
| Total (other) | | | | | | | |
| Total | | | | | | | |

With regards to the latter approach, the credibility of the fund rests on it being capitalized upfront, which can create a high opportunity cost. A critical consideration in this process is the timeliness

and coordination by which the debt department provides the budget department with the estimates on contingent liabilities that are expected to materialize in a particular year.

5. Role of Legislation

Several key requirements of fiscal commitment management may be most effective if included in legislation (such as a PPP law) and in a PPP project contract.

These could include:

a. **Providing regular access to performance information throughout the life of the project:**

Granting the relevant authority (such as the contracting Authority, Ministry of Finance, or PPP unit) the right to periodically request and obtain performance information from the project concessionaire helps ensure that the data for managing fiscal commitments are available in a timely manner and throughout the life of the project. A PPP law can allow this in general, while the particular data to be provided by a concessionaire on a specific project can be elaborated in each PPP project contract.

b. **Assigning the obligation of monitoring PPP fiscal commitments to a particular government entity:**

Responsibility for disclosing all material information should be an important part of the legislation. For example in New Zealand, the legislation requires that the Minister of Finance sign a statement of responsibility to the effect that he or she has

communicated all policy decisions and circumstances with material fiscal implications to the Treasury, and that the Secretary of the Treasury sign a statement that, on the basis of the economic and fiscal information available to it, the Treasury has used its best professional judgment in putting the budget together.¹⁷

c. **Publishing PPP contracts and disclosing information on PPP fiscal commitment:**

As previously mentioned, a PPP law can stipulate that PPP contracts should be published, along with other information on the costs and risks of the financial obligations they impose on government. This enables the public to take an independent view of the extent of government's obligations, over and above the level that the government reports.¹⁸ A study by the World Bank Institute (2013) found that Freedom of Information legislation is the most common legal basis for PPP contract disclosure. However, there are cases in which the PPP law mandates that tender documents and contracts related to PPPs are to be disclosed to the public, such as in the states of Bahia and Minas Gerais in Brazil.

Whether or not a country publishes PPP contracts, there needs to

¹⁷ Aliona Cebotari (2008), "Contingent Liabilities: Issues and Practice," IMF Working Paper WP/08/245.

¹⁸ World Bank Institute — WBI (2013), "Disclosure of Project and Contract Information in PPPs."

be minimum disclosure requirements for PPP contractual information. For instance in Chile, and before disclosing full PPP contracts, the government was publishing its PPP contractual fiscal obligations in a standalone contingent liabilities report. With regards to disclosing contingent liabilities, the legislative requirements in some jurisdictions follow the principle of

materiality: a risk exposure is disclosed if it may have a material effect on the government's financial position. Many countries have institutionalized the requirements to report contingent liabilities in their fiscal responsibility legislation or in the legislation covering public financial management (for more detail, see Cebotari 2008 and WBI 2013).

6. Key Messages for Task Team Leaders

The task of managing fiscal commitments from PPPs is critical for the success of both a PPP transaction and a country's PPP program. As highlighted in the examples discussed from the Asian crisis and more recently the 2008 financial crisis (with examples from Portugal, Spain and the United Kingdom), managing PPP fiscal obligations is critical to the success of a PPP project and the program as a whole. Assessing fiscal commitments during the development stage is not only important from a government point of view, it is also key for a project to achieve financial close. Providing a clear mechanism for managing fiscal commitments improves the credibility of the government in the eyes of its private partners. If this aspect is not addressed and the private party perceives a risk that payments will not be made when due and the cost of this risk is priced into the PPP contract, the advantages of a well-designed risk allocation are undermined accordingly. Additionally, managing these obligations at the implementation stage helps ensure the survival of the project.

Working on PPP transactions, Task Team Leaders/Project Leaders/Transaction Leaders in the World Bank Group encounter different issues outlined in this note and are advised to actively address them and advocate fiscal commitment management to client countries. Task Team Leaders need to ensure that the PPP project due

diligence and structuring work incorporates the analysis needed to assess the project fiscal commitments, and that on the basis of this analysis, input from the Ministry of Finance is sought on the fiscal affordability of the project. They also need to advise on the necessary structures to monitor the project's fiscal obligations over the duration of the contract. Box 2 below summarizes the concepts discussed in this note, outlining seven key questions a Task Team Leader needs to resolve as he or she undertakes PPPs in client countries.

Capacity-building activities will reinforce institutional measures. It will be important for governments to acquire hands-on support and medium-term technical advice from specialized experts for the various concerned entities. Support and advice are likely the best form of training and knowledge sharing, providing an opportunity for on-the-job training with actual PPP projects. As the PPP project due diligence starts, a fiscal commitment advisor should be hired to advise on the project and to coach the relevant gatekeeping entities through their respective roles in undertaking the relevant fiscal commitment analysis. In another related mode of capacity building, a consultant is hired to review all (or a subset of) existing PPP project contracts and uncover the fiscal commitments in these deals. This exercise can help familiarize the various entities with fiscal commitment analysis. The function

Box 2: Key Questions Addressed in This Note

- a. How can and should public financial management and oversight/gatekeeping agencies—particularly the Ministry of Finance—be involved in the development stage, and later implementation and monitoring, of a PPP project? (Table 1)
- b. Does the PPP transaction due diligence and structuring clearly incorporate the analysis needed to assess and monitor the project's fiscal commitments? (Table 2)
- c. Do the gatekeeping agencies undertake the needed assessment and regular monitoring of PPP contracts? (Table 3)
- d. Does government adequately report on PPP fiscal commitments? (Tables 5 and 6)
- e. Does the legislative framework (and PPP contract) incorporate provisions to enable management of fiscal commitments? (Section 5)
- f. Is the client country aware of the imperative of managing PPP fiscal commitments and does the government have the capacity to do it? (Sections 2 and 6)
- g. Is there an appetite in the country to develop and adopt a holistic framework for managing PPP fiscal commitments?

The answers to these questions, in addition to the concepts within this note, can guide Task Team Leaders in making the diagnosis, recommendations, and the related action plans—tailored to the local environment—for improving management of fiscal commitments under PPP projects and programs.

of assessing fiscal commitments is closely related to the function of managing fiscal commitments (which cannot be outsourced because it requires decision making, not only information-gathering and analysis). Ultimately, assessing fiscal commitments should be conducted in-house as soon as there is enough capacity in government to do so. Involving

government teams in a regional network of PPP practitioners and linking them to public sector managers and experts in other countries may also be an option. Large PPP programs create critical mass for organizing PPP workshops, which can combine training and brainstorming activities for an audience of local PPP practitioners.

Box 3: A Sample of Key Readings on This Topic

- **World Bank Institute – WBI (2012), “PPP Reference Guide” Version 1.0;** (pp. 102–112). This document outlines key concepts with regards to fiscal commitment management and provides a wider set of relevant references on the topic.
- **World Bank Study (Jan 2013), An Operational Framework for Managing Fiscal Commitments from Public-Private Partnerships: The Case of Ghana.** This guidance note is largely based on this Ghana study which provides a wider set of citations and references for the country examples and concepts discussed.
- **Aliona Cebotari (2008), “Contingent Liabilities: Issues and Practice,” IMF Working Paper WP/08/245. Washington, DC.** This study largely focusses on contingent liabilities in general; however, it includes key insights on those from PPPs. It discusses theoretical and practical issues raised by contingent liabilities, including the rationale for taking them on, how to safeguard against the fiscal risks associated with them, how to account and budget for them, and how to disclose them. Country experiences are used to illustrate ways these issues are addressed in practice and the challenges faced.
- **Hana Polackova Brixi and Allen Schick, eds. (2002), “Government at Risk,” Oxford University Press and the World Bank, New York and Washington, DC.** The book provides an analytical framework, operational tools, and cross-country case studies of how countries have managed the fiscal risks from contingent liabilities, including PPPs. It also provides recommendations for an institutional framework in government to monitor and manage fiscal risks from contingent liabilities.
- **International Monetary Fund – IMF (2012), “Fiscal Transparency, Accountability, and Risk.”** This document considers possible revisions to the Fiscal Transparency Code and Manual, addressing several issues, including PPPs. New standards should ensure that published fiscal reports (i) cover a wider range of public sector institutions; (ii) capture a broader range of direct and contingent assets and liabilities; (iii) recognize a wider range of transactions and flows; (iv) are published in a more timely manner; (v) take a more rigorous approach to fiscal forecasting and risk analysis; and (vi) present forecast and actual fiscal data on a consistent basis.
- **Katja Funke, Tim Irwin, and Isabel Rial (2013), “Budgeting and Reporting for PPPs,”** OECD/ITF Joint Transport Research Centre Discussion Paper 2013/07. This study provides a thorough review of practices in budgeting and reporting for PPPs and provides recommendations on these processes.
- **Tim Irwin and Tanya Mokdad (2009), “Managing Contingent Liabilities in PPPs: Practice in Australia, Chile, and South Africa,” World Bank and PPIAF Publication.** Acknowledging the decision of governments on whether to assume PPP contingent liabilities and, if so, determining how to value, monitor, and limit them, this report describes how the governments of Australia, Chile, and South Africa have tackled these problems. The report compares a number of issues across all three countries such as: tiers of government undertaking PPPs; nature of PPPs; major contractual contingent liabilities; main central location of PPP expertise; approval, analysis, and reporting on PPPs.
- **Richard Hemming and staff team (2006), “PPP Government Guarantees, and Fiscal Risk,” IMF Publication** – This is one of the key referenced IMF publications on fiscal commitments from PPPs. Chapter 1 provides an overview of some of the issues raised by PPPs, with a particular focus on their fiscal consequences. It also discusses

(continued on next page)

Box 3: A Sample of Key Readings on This Topic *(continued)*

the transfer of risk to the private sector and the challenges involved in assessing who bears PPP risks and the implications of limited risk transfer. Chapter 2 looks more closely at government guarantees, which are used fairly widely to shield the private sector from risk and are a common feature of PPPs. Public disclosure of information about guarantees is a good fiscal transparency practice, but it is unclear how best to reflect in the fiscal accounts the financial impact of fiscal risk associated with guarantees. Chapter 3 looks at the consequences of PPPs and guarantees for debt sustainability, focusing on the appropriate approach to debt sustainability analysis and addressing the uncertainty created by guarantees. Finally, Chapter 4 summarizes and concludes with a list of measures that can maximize the benefits and minimize the fiscal risks associated with the use of PPPs.



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This report was developed by the Financial and Private Sector Development (FPD) Network – Investment Climate Global Practice Private Participation in Infrastructure and Social Sector Service Line, and the World Bank Institute (WBI). It presents practical advice to Task Team Leaders/Project Leaders/Transaction Leaders in the World Bank Group on how to implement a framework for managing fiscal commitments from Public-Private Partnerships (PPPs) and draws on specific regional operational experience and on WBI's wider thematic engagement with different partners worldwide.

The note explains the kind of fiscal commitments that can arise from PPP projects and why governments may find it difficult to assess and manage them. It provides guidance on how to: consistently identify and assess fiscal commitments during project preparation and implementation; incorporate these into the project approval process—including budgeting appropriately; and strengthen the monitoring and reporting of fiscal commitments over the lifetime of the project. The note further highlights the key components of an institutional framework including the roles, responsibilities, and processes for managing these fiscal obligations.