ADB Webinar - Fiscal and Debt Management of PPPs
Presented by Michael Schur
11 November, 10:30 to 12:00

The objective of the training session, "*Fiscal and Debt Management of PPPs",* presented as a webinar, was to provide guidance to ADB staff and other event participants on possible fiscal and debt impacts of public-private partnership (PPP) investment, and how these can most effectively be managed. The session formed part of a program of webinars dealing with the application of the principles of Quality Infrastructure Investment (QII) to PPP transactions.

Asian governments confront significant infrastructure gaps. Financing this investment will require them to take on substantial additional debt, which will be challenging, for two reasons. First, over the last decade their debt has risen by over 50%, from 30% to 46% of GDP.[1] And second, the COVID-19 pandemic will continue to result in an economic downturn on a massive and unprecedented scale, with the International Monetary Fund (IMF) labelling it the "worst economic downturn since the Great Depression".[2] This convergence of infrastructure gaps, high and rising debt levels and the economic impacts of COVID-19 will tempt many Asian governments to turn to PPP as a solution. The training session pointed out that PPPs cannot solve such fiscal constraints. While PPPs can assist governments to improve public services, when well-structured and developed as part of a country's strategic infrastructure planning program, they are not a new source of funding for infrastructure investments.

The illusion that PPPs fill funding gaps typically arises from a combination of factors, including accounting treatment, asset recognition criteria and poor accountabilities for the management of contingent liabilities (CL). Cash accounting, for example, allows governments to increase infrastructure investment without an immediate impact on public-sector deficits or debt. But over the project cycle the impact on government accounts is the same. For availability payment PPPs, the avoided upfront investment is offset by subsequent payments to the private partner covering the costs of construction, finance and the operation of the asset. For user-pay PPPs, short-term budget savings during construction are equal, in net present value, to the user fees foregone during operation. Even under accrual accounting, where revenue or expenses are recorded when a transaction occurs, public infrastructure can be classified as "private"— because for almost all PPPs the legal asset owner is the private sector. Asset recognition criteria can thus tempt governments to exclude PPPs from their fiscal accounts. This presumes, however, that the public sector retains no economic control over the

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[1] Finance & Development, Volume 57. 57, Caught by a Cresting Debt Wave, Kose, M. A., P. Nagle, F. Ohnsorge, and N. Sugawara. 2020. Global Waves of Debt: Causes and Consequences. Washington, DC: World Bank, 2020

[2] "World Economic Outlook", IMF, April 2020

PPPs. This is rarely the case—even an unsolicited proposal for a PPP toll road funded entirely by user charges creates fiscal risks for governments.

The ability of governments to identify, price and manage contingent liabilities (CL), ex ante and throughout the project cycle, is arguably the single most important source of fiscal risk in PPP projects. Based on an analysis of 80 countries, including 46 EMEs over the period 1990 to 2014, the IMF quantified the average fiscal cost of PPP CLs as 1.2% of GDP (with a maximum of 2% of GDP).[3] Considering forecast GDP growth in developing Asia of 6.2% in 2021, average CL realisation would equate to a 20% reduction in such growth. It is also worth noting that external shocks—such as the GFC and most recently the Covid 19 crisis—can have an even more profound impact, since in such circumstances, the shocks are likely to impact all PPPs all at the same, giving rise to substantial crystallization of CLs.

Given the above, the training on fiscal and debt impacts of PPP investment thus argued that strong governance institutions are required to manage risks and avoid unexpected costs from PPPs. The training session described best practice PPP governance models as those in which PPPs development is integrated within the public investment management operational framework and linked to medium term fiscal framework (MTFF) processes, and in which projects derive from a comprehensive medium-term infrastructure planning process linked to strategic economic priorities. Such governance models typically incorporate processes for effective CL management, including a strong, standardized approval process with final approval by a central agency (usually Ministry of Finance / Treasury), as well as setting limits and controlling usage appropriate to the fiscal circumstances. The training noted the innovative approach the Philippines has adopted in setting up a Contingent Liability Fund based on the probability of CL realization.

The training concluded by emphasizing that good project outcomes depend critically on both the design and effectiveness of institutions that govern PPP planning, allocation and implementation. This suggested several key takeaways for multi-lateral development bank support to PPP programs in member countries. These include the need to be careful not to “feed” the fiscal illusion through communication policies and operational practices when it comes to PPPs; and to balance current downstream, transaction level support to PPP Units with focused investment in institutional capacity development targeted at the upstream and mid-stream stages.

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[3] The Fiscal Costs of Contingent Liabilities: A New Dataset, Prepared by Elva Bova, Marta Ruiz-Arranz, Frederik Toscani, and H. Elif Ture, IMF, January 2016