



Public-Private Partnerships

The National PPP Framework

In December 2008, the PNG Government endorsed a National Public-Private Partnership (PPP) Policy to facilitate private investment in the delivery of infrastructure and infrastructure-related services. An interdepartmental task force has since developed draft legislation to complement existing and planned PPP arrangements. This legislation will lead to additional expertise in government via the creation of a PPP Centre that will report to the Treasurer. This additional PPP transaction expertise, combined with legislative requirements for transparent processes to be followed in executing PPP arrangements, should provide the private sector enhanced confidence to invest in PNG PPPs. A PPP Task Force, chaired by the DNPM, will submit the draft PPP Bill to NEC in early 2012.

What are PPPs?

Public-private partnerships (PPPs) are agreements between the public and private sectors for the provision of assets and/or services. PPPs can be used in most infrastructure and social sectors, including power, water, transportation, telecommunications, education, and health.

Unlike contracts issued under traditional procurement, PPPs often combine construction with operation of the assets for a set period of time. For example, a PPP for a port may combine construction of new wharves, storage areas, and facilities to load and unload freight, with their operation for a number of years. PPPs often require the private operator to also finance construction and operation, rather than the government.

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Government subsidies paid to deliver services are not PPPs - they are government grants. Similarly, Government tax exemptions provided to private firms in exchange for the provision of health and other social services in rural PNG are not PPPs, they are service contracts agreed directly with the service provider without a competitive process, as the service provider is the only firm available to provide the service.

Under a PPP, the public sector first identifies what service it needs (for example, port services, or operation and maintenance of a water supply system). It then organizes a competitive tender to procure the service. The private partner will receive payments from users, or from the government, or from a combination of both, in exchange for the services provided.

PPPs provide strong performance incentives for the private partner, as payments are only made in exchange for services provided. PPPs also provide strong incentives to maintain the assets, as they must be in operational order so the services can be provided reliably and to a high standard.

Good PPPs are based on the five principles of (i) certainty, (ii) fairness, (iii) transparency, (iv) accountability, and (v) competition.

Why are PPPs attractive?

Governments throughout the world have been using PPPs for more than 20 years, for three key reasons:

- (i) PPPs provide extra capacity and know-how from the private sector, helping overcome capacity constraints within government;
- (ii) by shifting the burden of capital spending to the private sector, PPPs can help governments provide more services, with less up-front costs to the government;
- (iii) PPPs contribute to enhanced efficiency in delivering services. A feature of a good PPP is that it shares project risks with the private sector provider, reducing the risk borne by governments.

The end result is that PPPs help governments overcome bottlenecks in supplying services that can constrain development.

What are the different forms of PPP?

PPPs can take different forms depending on the nature of the service to be provided. PPP contracts fall into four broad categories:

Service contracts are the simplest form of PPP. The private partner does not operate any public assets, but simply contracts with the public sector to provide a specified level of service. These contracts are typically 2–3 years in duration, and are common for such services as road maintenance.

Management/Operation & Maintenance (O&M) contracts typically involve the operation of public assets by a private partner. The private partner receives a management fee based on performance and, in some cases, a profit-sharing incentive. The Eda Ranu contract for water supply in Port Moresby is an example of a management contract.

Design/Build-Operate-Transfer (DBOT/BOT) involves significant investment by the private partner, which constructs and operates the infrastructure required to provide the service. The assets are returned to public ownership at the end of the PPP. Contract periods are often 20–30 years, allowing sufficient time for the private operator to earn a fair return on their investment. Many power plants, airports and ports around the world have been built using this PPP structure. In PNG, there may be opportunities to develop future power generation plants, ports and the Jackson's airport under BOT structures.

Concessions involve the rehabilitation and expansion of an existing asset and its operation over time under an exclusive license. As is the case with BOTs, substantial

concessions involve substantial investment from the private sector partner. Concessions are the most complex form of PPPs; they require careful structuring and monitoring if the public is to be protected (e.g. from monopolies) and the PPP is to provide good value for money. Contract duration is typically 20–30 years.

When are PPPs appropriate?

In principle, PPPs should be used whenever they offer greater efficiency than traditional public procurement.

PPPs can generally be ruled out when direct government control is essential to the service, however, such as the operation of defense infrastructure and court systems.

PPPs are not, however, the answer to all infrastructure or public service shortcomings. While some countries, such as Korea, procure a substantial portion of their infrastructure via PPPs, in most other mature markets, such as the United Kingdom, PPPs represent less than 20% of the total value of infrastructure investment.

What makes a PPP different to traditional procurement?

Successful PPPs require careful risk allocation and contract structuring. A PPP contract must have detailed specifications regarding outputs, payments and roles and responsibilities of each partner. It is not just a simple contract where a private supplier is paid upon delivery of an asset or service, the normal situation under traditional public procurement.

A PPP is a multi-year agreement, in which both the private and public partners have obligations. In order to be successfully implemented, both the public and private sector must have the capacity to honour their obligations.

Are PPPs more costly than traditional procurement?

No. Critics of PPPs argue that they are more costly than public procurement because the private sector (generally) has a higher cost of borrowing than the public sector. This does not mean that the public sector can provide infrastructure at a lower total cost than the private sector. The international experience is that good PPPs are more likely to deliver assets and service on-time and on-budget than if they were delivered through traditional public procurement.

Why? Because, under a good PPP the private sector has very strong incentives to deliver on time and on budget. Moreover, good PPP contracts include maintenance, which prolongs the life of the assets. Over time, maintenance costs can total as much (if not more) than the initial construction cost. In traditional public procurement, infrastructure is built, but often no budget is allocated for maintenance, so the assets quickly fall into disrepair. High replacement costs then need to be incurred. These are more likely to be avoided with PPPs.

Do PPPs result in higher costs to users?

No. properly structured PPPs generally result in lower costs of service delivery than public provision, and these savings can be passed on to users. When prices do increase, it is usually because: service quality improves, service coverage increases, or government subsidies are discontinued.

In Latin America, for example, in the 1990s many water PPPs resulted in price increases for users. This was because, under the public service providers, large volumes of water had been distributed for free. When private companies took over the distribution, they discontinued the free water allocations, because the government refused to subsidize them. In such cases, the burden on poorer users could be avoided by including a subsidized service component to the PPP. Many PPPs now have a 'lifeline service' or community service obligation component to protect poor users.

Where have PPPs been successful?

Successful PPP transactions far outnumber failures. Some of the most successful PPP programs have been run in Chile, India, Korea, Australia and the United Kingdom. Brazil and Portugal have also completed many successful PPP transactions:

In Chile, the private sector now provides most of the new investment in power, gas, telecom, airports, major highways, rail freight services and water and sanitation;

- In S. Korea, 145 PPP transactions were completed between 1994–2007 with an average private investment per year of \$1.5 billion;
- In India, more than 450 PPP projects have been negotiated successfully representing close to \$40 billion in investment;
- In the United Kingdom, one of the first countries to adopt PPPs, over 700 PPP projects have been implemented in various sectors;
- In Brazil, which adopted a PPP law in 2004, more than 67% of power distribution and 20% of power generation assets are operated by the private sector under PPP arrangements; and
- Portugal, which was one of the first mainland European countries to adopt PPPs, has built its National Motorway System using PPPs. In doing so, it has kept pace with the traffic demands of its country, vastly improved highway safety and travel times, and leveraged private investment.

PPPs have thus a long, and (largely) successful history.

Why do some PPPs fail?

Some PPPs do, nonetheless, fail. Most PPP failures arise from poor contract preparation, inadequate risk allocation, the absence of competitive and transparent tendering procedures, and/or poor contract monitoring and enforcement. For example:

- In the United Kingdom, the failure of the Metronet PPP for the operation of 9 of London's 12 Underground lines was owing largely to poor contract structuring, where the costs of operations were not adequately forecasted;
- In Sydney, Australia, the Cross City Tunnel PPP encountered similar difficulties;
- In Bulgaria, the direct allocation of toll-road concessions to private operators, undertaken without competitive tender, led to high costs and a weak bargaining position for the government; and
- In Indonesia, poor contract preparation has led to several failed PPP tenders, as the proposed contracts were unattractive to the private sector.

In PNG, where there is limited PPP experience, the water and power supply PPPs have underscored the importance of careful risk allocation and structuring of performance incentives. Perhaps most importantly, PNG's government has indicated that it recognizes the need to develop a rigorous project preparation process, which facilitates this analysis and allows a transparent, competitive process to take place.

Are PPPs suitable for PNG?

Yes. PNG has a substantial unmet need for infrastructure investment and service delivery. New infrastructure must be built and operated, which will require significant capital and expertise. The government can support development by looking at ways in which the private sector's experience, innovations and efficiencies to provide services can be used to deliver infrastructure.

Examples of possible PPPs in PNG include:

Jackson's Airport: the expansion, modernization and operation of the terminal could be done by a private partner. The airport would still remain under the authority and ownership of the State, but the private partner would upgrade the facilities and operate it for a set number of years. There is substantial commercial land development potential around the airport which could be packaged into the PPP to generate future revenue to offset the infrastructure investment requirements. There are many examples of successful airport upgrades completed using this model around the world;

Lae Port: the new port facilities planned for the Lae Tidal Basin be built in collaboration with the private sector. For example, the public sector could prepare the site and the private sector could build and operate the superstructure required to handle freight;

Hydropower systems: the private sector could build and operate hydropower generation systems such as Naoro-Brown and Yonki under a BOT/BOOT model. The success of these projects would require government support for land acquisition and resettlement, secure power off-take agreements and a transparent, competitive tender for the private partner; and

Road Maintenance: performance-based road maintenance contracts are already under development with increasing levels of risk and operational responsibility transferred to the private sector.

South Pacific Games: the private sector could be engaged to design, build and maintain a range of buildings associated with these upcoming Games.

Who is the Private Partner in a PPP?

The private partner in a PPP arrangement is usually a consortium of companies: often one company provides the financing, another company constructs the asset and a third company operates it. In smaller PPPs, which do not involve construction or finance, such as a service or management contract, the PPP partner can be a single operator.

What can the Government do to support successful PPPs?

Enact a PPP legal framework, signaling government's willingness to engage with the private sector for the delivery of public services and creating a transparent and competitive process for preparing, tendering and implementing PPP contracts. This legal framework would allow the implementation of the PPP Policy. PNG's Interdepartmental PPP Task Force has a draft PPP law ready for final consultation prior to consideration by the Parliament.

Develop the institutional framework for PPPs, which includes clear guidelines for the transparent tendering, evaluation, and award of PPP contracts. A small PPP Centre would provide the support required for the government to identify, assess and prepare PPP contracts, with support from experts as required.

Develop government's risk management and contract monitoring and evaluation capabilities. Risk management is essential to evaluate the magnitude of the risks assumed by government under PPP arrangements. Contract monitoring and enforcement ensures that government pays only for the level of service that the private partners have contracted to deliver. A robust risk-management capability would be developed within Treasury.

Ensure that all PPPs are tendered on a fully transparent and equitable basis. Competition is the only way for the government to make sure that it is not paying too much for the services it is procuring in a PPP. Contracts with the private sector, which have not been the subject of a competitive tender, should not be referred to as PPPs. The draft PPP law outlines a robust process for PPP contract preparation, tender and implementation.

Establishing the right framework and capacity first, and ensuring public confidence from the outset, will be critical to the success of PPPs in PNG

What is the PPP project cycle?

The PPP cycle outlined in the draft PPP law sets out the key stages of a PPP:

- Inception, to assess if the project is suitable for a PPP;
- PPP Pre-feasibility/outline business case;
- PPP Feasibility;
- Identification and procurement of a private sector partner;
- Construction and delivery of a facility;
- Operation of a facility and payments for services;
- Contract management and performance monitoring;
- Auditing and accountability; and
- Exit and transfer to the government.