

Panel: PPPs – Lessons Learned

1. David Hawes

Lessons from emerging south-east Asia

I've been asked to talk today about lessons from emerging south-east Asia's experiences with public-private partnerships (PPPs). Several south-east Asian nations, including Indonesia and the Philippines, committed to private provision of infrastructure some two decades before the G20 adopted its Multi-Year Action Plan on Development in 2010. On the demand side, this decision reflected their recognition that the infrastructure investments needed to sustain rapid economic growth would exceed the current financing and delivery capacities of government agencies and state-owned enterprises (SOEs). Additionally, on the supply side, there was tremendous interest on the part of international developers, particularly in the power sector, to find new markets offering higher returns.

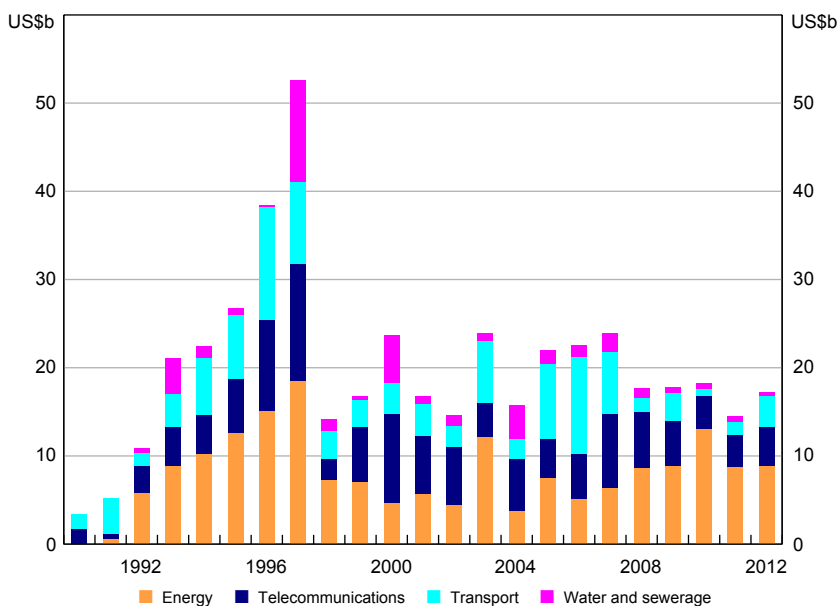
In addition to promoting PPPs, governments also sought to deregulate sectors that were closed to private participation and to corporatise, restructure and, in some instances, partially privatise SOEs. The World Bank played a key role during this period by advocating private participation in infrastructure (PPI), providing support for policy, regulatory, institutional and structural reforms, and by positioning conventional infrastructure lending as a 'sunset' business. Against the backdrop of worsening power shortages, transport congestion and inadequate urban water services, PPPs quickly came to be seen as a fast-track solution. However, governments focused on securing financing for 'big-ticket' greenfield projects, such as power generators and toll roads, and generally gave little attention to harnessing private sector efficiency or investing in social infrastructure, such as hospitals and gaols. At the same time, issues of policy and regulation were put on the backburner, and little consideration was given to user tariffs; the focus was more on how to get the project financed in the first place rather than on who was going to pay for the ongoing provision of services once it was built. In just four years from 1994, Indonesia awarded 27 independent power producer (IPP) projects and more than 40 toll road concessions, while the Philippines signed a similar number of IPP contracts between 1991 and 1998.

Capturing the benefits of private sector efficiency for the public good is best accomplished through competition in the market. The most obvious example is mobile telecoms, where technological advances coupled with light regulation have permitted head-to-head competition among several operators, which has resulted in lower tariffs and improved service quality. Multi-buyer–multi-seller bulk power markets offer another example, although experience over the past decade has highlighted the importance – and difficulty – of effective regulation. PPPs have been employed in situations where effective competition in the market is not feasible. Indeed, the current PPPs in Indonesia and the Philippines have been shaped by the 1990s experience, where the majority of projects resulted from unsolicited bids or direct negotiations and there was, therefore, no

mechanism for capturing private sector efficiency. As a result, tariffs turned out to be high. This experience reinforced the World Bank’s exhortations that, when the infrastructure is being provided in an uncompetitive sector of the economy, it is best to award PPP contracts through transparent competitive solicitation processes designed to attract the most capable investors.

The fallout from the Asian financial crisis has also served to highlight the need not only for sound project preparation and transparent transaction processes but also for credible investment-enabling environments and capable contracting institutions. While governments’ appetite for private infrastructure investment has remained strong, data from the World Bank PPI database indicate that investors and lenders have remained wary. Annual project finance commitments (in constant US dollar prices) for the east Asia-Pacific region have yet to reach 50 per cent of their 1997 peak, while 2012 commitments were equivalent to only around 0.2 per cent of regional GDP (Figure 1).

Figure 1: East Asia-Pacific Region – PPI
By sector



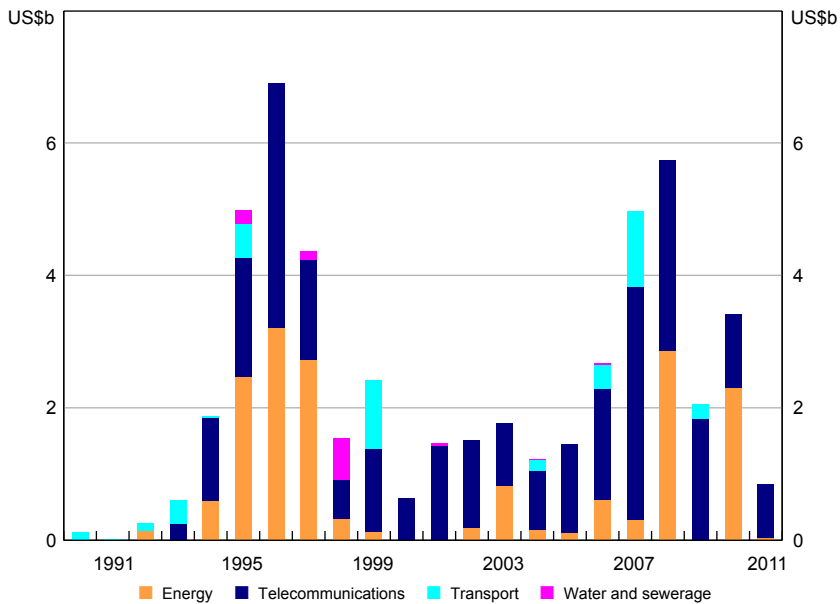
Note: 2012 prices, adjusted using the US CPI
Sources: PPI Project Database; Public-Private Infrastructure Advisory Facility; World Bank

The need for wideranging reforms to enable a positive investment environment has been recognised. By way of example, since 2004 Indonesia has enacted new laws for key infrastructure sectors, which, among other changes, have eliminated the special status previously accorded to SOEs. It has also issued cross-sector regulations for PPPs, which define project selection, preparation and solicitation processes, and expressly permit direct and contingent government support. A guarantee institution and a viability gap-funding policy have since been established under the auspices of the Ministry of Finance, and preparations are now underway to establish a

PPP centre designed to centralise expertise, encourage capacity building and provide transaction advisory assistance.

But these initiatives have yet to translate into the anticipated substantial increase in PPP investment. While Indonesia has seen gross fixed capital investment bounce back strongly after 1998, private infrastructure investment has languished. Moreover, during the past decade, around two-thirds of total PPI flows have gone to the telecoms sector, which generally does not use PPPs, while only a relatively small proportion has gone to the transport and water sectors (Figure 2). The Philippines, with its revitalised PPP centre and recently established Project Development and Monitoring Facility, has arguably progressed more rapidly over the past three years due in part to its ability to offer relatively small projects in sectors such as health and education, which are well suited to private finance, and to engage international transaction advisors through simplified procurement processes.

Figure 2: Indonesia – PPI
By sector



Sources: PPI Project Database; Public-Private Infrastructure Advisory Facility; World Bank

Although Indonesia’s reform initiatives have yet to translate into the anticipated PPP deal flow, they have, in the interim, served to stimulate significant improvements in the performance of key infrastructure SOEs. Some – such as the toll road corporation, Jasa Marga – are now partially privatised and are raising capital through bond issues. They are also empowered to pay competitive salaries and hire top-tier consultants and advisers. This is necessarily blurring the boundary between public and private provision and complicating the definition of public sector comparators.

International cooperation has played an important role in assisting governments in the region to pursue their PPI aspirations. The Asia-Pacific Economic Cooperation (APEC), the Association of Southeast Asian Nations (ASEAN) and, more recently, the G20 provide forums in which members can share their experiences, while the World Bank Group and the Asian Development Bank – along with specialised donor-funded institutions such as the Public-Private Infrastructure Advisory Facility – continue to channel technical assistance for strengthening the underlying investment environment and preparing pilot PPP projects to best-practice standards. Bilateral assistance has also been provided by many individual G20 members, including Australia, Canada, Japan and Korea.

Several valuable lessons can be distilled from south-east Asia's experiences with PPPs over the past quarter century. First, and perhaps most important, well-prepared PPP projects offered through transparent processes can – and do – secure financing. Deal volumes, however, remain well below the levels of 1995–1997, and prospective investors may still need to contend with a 'noodle dish' of regulations and permit requirements, potential delays due to land and right-of-way acquisition, and issues around legal certainty. Additionally, the issue of user tariffs and subsidies has still not been addressed. For example, in Indonesia, only around 60 per cent of the cost of power supply is paid by the user. This is constraining the provision of new infrastructure, as a large funding burden falls on the taxpayer. These concerns will need to be addressed if PPP flows to sectors in need of infrastructure investment, including transport, water and sanitation, are to increase significantly.

Second, policy, regulatory and institutional reforms aimed at enabling PPP investments have brought broader benefits, including by creating pressures for improved SOE performance. SOEs will continue to play a crucial role in infrastructure provision in countries such as Indonesia, and can also contribute to expanded private participation, including through business-to-business schemes.

Third, international cooperation has been invaluable but fragmented and sometimes overlapping, meaning that a large number of entities are involved and the sequencing of individual initiatives is often sub-optimal. This suggests a possible role for the G20 in promoting better coordination among the main actors.

2. Maria Monica Wihardja

The agenda during this year's G20 presidency has a clear goal of stronger and more resilient growth, supported by a vigorous and robust private sector contribution and necessary structural reforms. Earlier this year, the G20 Finance Ministers and Central Bank Governors reached a consensus to boost global growth by 2 per cent over the next five years, and each G20 member will submit their commitments to support this in November 2014, to be encapsulated in a 'Brisbane Action Plan'. One strategy to stimulate growth has stood out and been consistently and concertedly championed: infrastructure investment. The Australian presidency has put a lot of focus on private sector participation in infrastructure financing through PPPs and institutional investor support. These comments will draw together some lessons learned on PPP development in Indonesia.

History of PPPs in Indonesia

Indonesia has a long history of PPPs, which has evolved significantly in regard to the number of projects, the types of projects and how they are implemented. From the 1950s to the early 1990s, infrastructure projects were undertaken through a series of five-year national development plans by the public sector. From the early 1990s through to 1997 – a period of high growth and export-oriented industrial policy – the private sector was invited to invest in infrastructure development as partners with the government. By 1997, Indonesia had invested over US\$20 billion in PPP projects, including electricity (US\$10.2 billion), telecommunications (US\$8.4 billion) and transport (US\$2.1 billion) (Wibisono, Delmon and Hahm 2011). However, over this 1990s period, projects were awarded and selected based on patronage in an ad hoc manner. The Asian financial crisis (AFC) hit Indonesia in 1997–1998, and a lot of projects, especially those in highly subsidised high-tech industries, were stopped or renegotiated. For example, there were lengthy renegotiations between the central government and the country's 27 independent power producers (Wibisono *et al* 2011).

During the Reformasi era (1999–present), after the collapse of the Soeharto regime, there have been many reforms in the regulatory framework, institutions and project preparation for PPPs, but very little has been achieved in terms of actual project implementation (Table 1). Additionally, at present, private sector investment in Indonesia has not recovered to its pre-AFC peak in 1996 of US\$6.9 billion. It averaged US\$5.5 billion per annum between 1995 and 1997, around US\$1.6 billion between 1998 and 2006, and then recovered to an average of US\$4.0 billion between 2007 and 2010 (World Bank 2011). Despite Indonesia's robust growth and a relatively low (risk-unadjusted) cost of financing in the past decade (especially before the global financial crisis), PPPs have not taken off.

Table 1: The Realisation of PPP Projects
2005–2011

Date/event	Number of planned projects			Realised/ contract awarded
	Potential	Priority	Ready-to-offer	
2005 Infra Summit 1	91	na	na	na
2006 Infra Summit 2	101	10	na	na
2010 Infra Summit 3	72	27	1	na
August 2010	na	5	na	na
April 2011 Infra Summit	11	5	na	na
May 2011 MP3EI ^(a)	na	na	32	na
June 2011 PPP Book	45	21	13	1

Notes: Projects over years are not necessarily the same projects

(a) Masterplan for Acceleration and Expansion of Indonesia's Economic Development

Source: Wibisono *et al* (2011)

The first ‘P’ for ‘public’

In most countries, the government funds the majority of infrastructure needs. Hence, the first ‘P’ in PPP remains critical. In Indonesia, total infrastructure investment has remained at only 3–4 per cent of GDP over the past decade compared with 10 and 7.5 per cent for China and India, respectively (World Bank 2014). Infrastructure development rests on improving the quality of central and sub-national governments’ public spending; however, in recent years, central government spending on fuel subsidies reached 2.6 per cent of GDP, ‘crowding out’ spending on infrastructure (World Bank 2014). Phasing out fuel subsidies alone could allow central government spending on infrastructure to more than double from its current level of 1 per cent of GDP (World Bank 2011). In addition, about 90 per cent of sub-national government budgets come from the central government, without any strings attached. If these transfers were earmarked for more infrastructure projects, infrastructure development at the sub-national level might also be improved from its current level of 1.5 per cent of GDP. A potential risk is that with more and more officials, including high-ranked officials and people in the President’s inner circle, being caught by Indonesia’s Corruption Eradication Commission, remaining officials may become more risk averse, which could deter the start of new infrastructure projects.

The second ‘P’ for ‘private’

Because of the big funding gap between infrastructure needs and available public funds, the Indonesian Government has probably relied too much on private sector investment in its medium- and long-term development plans. Indonesia’s National Medium-term Development Plan (RPJMN) 2010–2014 assumes 70 per cent of its US\$150 billion funding needs will come from the private sector, and Indonesia’s Master Plan for the Acceleration and Expansion of Indonesia’s Economic Development 2011–2025 expects 51 per cent of its US\$468 billion funding needs to come from the private sector. The National Development Planning Agency identified a funding gap for infrastructure development of 2 741 trillion rupiah (or about US\$274 billion) between 2015 and 2019, with an additional 1 183 trillion rupiah expected to come from PPPs (Priatna 2014).

In terms of financing, the banking sector does not yet have sufficient capacity to finance long-term infrastructure projects. Indonesia is a bank-dominated economy, with the banking sector’s assets making up about 78 per cent of the total financial sector’s assets (World Bank 2014). Although banks do have the capacity and capital to lend, they cannot provide long-term credit, mainly because the tenor of financing infrastructure projects (up to 20–30 years) does not match the largely short-term tenor of banking liabilities. The majority of bank credit has a maturity of less than one year. Although bank loans can be used during the construction phase of a project, longer-term financial instruments, such as infrastructure bonds, are more suitable during the operational phase.

The capital market also does not yet provide financial instruments that can be used to finance long-term infrastructure projects. The bond market is still very thin and about 30 per cent of sovereign bonds are held by foreign investors, making it more vulnerable to foreign capital flight. The shallow financial market in Indonesia partly reflects the risk-averse behaviour of both investors and savers following the AFC (World Bank 2014). Some Indonesian state-owned companies in the infrastructure sector do issue bonds but they are merely a fungible part of these companies’ portfolios rather than project-specific bonds intended to finance an infrastructure

project. Insurance, pension funds and investment fund assets have also grown in recent years but they have not contributed to the pool of domestic long-term savings and investments because they are often invested in short-term equities (so called 'unit-linked') for high immediate returns (World Bank 2014). The goal of the newly established Financial Services Authority is to link the banking sector and the capital market to help with financial deepening. Indonesia's Social Security Administrative Bodies are also potential sources of financing through their pension program, which is due to start by July 2015. In summary, one of the main financing constraints for the private sector is finding financial instruments for the longer-term operational phases of a project's lifetime.

The third 'P' for 'partnership'

The most difficult 'P' out of the three 'P's is probably 'partnership'. It involves changing the mindset of high-level politicians from 'project owners' to 'project sellers'. Private investors are often seen only as sources of capital that can help fill the investment financing gap, rather than as partners who can help improve efficiency in the allocation of risk and reward, accountability, asset delivery and service performance over the lifetime of a project.

Improving the capacity to 'sell projects' is also a critical key of 'partnership'. Project selection is often based on political imperatives and not a 'value-for-money' mindset. Currently, there are around 80 projects in the pipeline, worth more than US\$50 billion, but only a few of these projects are viable. Project selection also often focuses on 'strategic' projects and different government agencies hold different 'PPP lists' (Wibisono *et al* 2011). Moreover, changes in political imperatives or government policy priorities create uncertainties for investors.

Project preparation is also poor: many PPP projects are prepared without any feasibility study; there is no appropriate process for dealing with unsolicited proposals; and the modelling and allocation of risk are also still very weak (Wibisono *et al* 2011). Until 2011, there had been no support for project preparation within the government, except for one project that was prepared by a state-owned electricity company with help from the International Finance Corporation (Wibisono *et al* 2011). Furthermore, the Ministry of Finance is often not involved from the beginning, so time can be wasted on projects that ultimately cannot be financed.

Project implementation capacity in terms of structuring, procuring and managing PPP contracts is limited (Wibisono *et al* 2011). Land acquisition is a major issue in Indonesia, which may take many years to resolve, and this poses serious challenges to private investors. In fact, more than 80 per cent of infrastructure issues in Indonesia are land-related, including land acquisition problems and land conflicts. Having said that, in 2012, the government issued a new land law (National Law No 2 of 2012 on Land Procurement for Development in the Public Interest) to speed up land acquisition for public goods, including infrastructure. Moreover, there have been changes to the legal framework, which might support involvement of private sector participants (see Wibisono *et al* (2011)).

Indonesia's international role in infrastructure financing

In 2011, Indonesia proposed infrastructure investment as a new focus for the G20's Framework for Strong, Sustainable and Balanced Growth. The goal is to help lift growth, reduce global imbalances and promote development by redirecting excess savings, especially in Asia, to finance

infrastructure investment in both developing and advanced economies as an alternative to the current portfolio investments that focus on advanced economy debt. It also proposed a framework to develop a pipeline of projects focused on the assessment of country-level capacities to deliver and implement bankable projects. Lastly, Indonesia proposed that the G20 develop a global infrastructure financing arrangement to explore innovative ways to channel global savings into productive economic infrastructure, and to find new sources of financing and new mechanisms to diversify investment risks.

Indonesia is currently co-chairing the G20 Investment and Infrastructure Working Group (Germany and Mexico are the other co-chairs), which has a mandate to: create a supportive investment climate for long-term financing of infrastructure investment; promote intermediation of global savings into infrastructure investment; optimise multilateral development banks' resources as a catalyst for private sector involvement; and improve processes and transparency in the project planning, prioritisation and funding of infrastructure investments.

ASEAN, of which Indonesia is a member, is also working to facilitate infrastructure financing, including through the ASEAN Infrastructure Fund. In 2013, under Indonesia's chairmanship, APEC leaders also committed to creating a comprehensively connected Asia-Pacific region that will lead to significant investment in the software and hardware needed to enhance physical, institutional and people-to-people connectivity.

Indonesia has also welcomed and stated its intention to participate in the proposed Asian Infrastructure Investment Bank. This is a potential game changer initiated by China. The Asian Infrastructure Investment Bank can make a contribution to lending, on a commercial basis, to infrastructure projects with acceptable rates of return.

Leading by example

The outcomes of the Indonesian Presidential election in July 2014 may lead to democratic consolidation in Indonesia, which will hopefully be accompanied by pragmatic reforms, including for infrastructure development and PPPs. Pressures from outside, through Indonesia's involvement with the G20, APEC and ASEAN, should also help to accelerate domestic reforms on approaches to infrastructure financing. Upgrading Indonesia's ports and airports is one priority, as are pilot projects designed to improve Indonesia's domestic supply chain and connectivity, which have weighed on Indonesia's competitiveness.

Indonesia's newly revised Negative Investment List will create more opportunities for the private sector to participate in PPP arrangements, which should be welcome. For example, in the sea transportation industry, which includes docks, buildings, terminals and/or container ships, foreign investors will be allowed to hold up to 95 per cent ownership within a PPP and 49 per cent within a non-PPP during the concession period. Likewise in the energy sector, foreign ownership will be allowed to be up to 100 per cent for PPPs and 95 per cent for non-PPPs in the transmission and distribution sector and for power plants producing more than 10 megawatts during the concession period.

The way forward for Indonesia

The first step is to deepen capital markets to facilitate long-term financing. This includes regulatory reforms to increase the domestic institutional investor base. Second, to attract private financing, it is important to improve the quality of project selection, preparation and implementation. Reforms include: more effective implementation of the new Land Law; establishment of an infrastructure prioritisation agency (similar to Infrastructure Australia and Infrastructure UK); and coordination within broad institutional settings of infrastructure projects by ensuring that the responsibilities of relevant government institutions are clear. Indonesia currently has three PPP centres – one under the State Ministry of National Development Planning, one under the Ministry of Finance and another under the Investment Coordinating Board. There are also ‘PPP umbrellas’ such as the Committee for the Acceleration of Priority Infrastructure Development. All these have to be coordinated so that there is only one ‘lead agency’ and one ‘PPP priority list’. Third, it is necessary to create a success story by finding small viable projects that work. Finally, it is necessary to find a ‘project champion’ for each priority PPP project equipped with convening power to move the project forward through the bureaucracy.

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3. Peter Regan

I am going to talk about recent developments in the infrastructure finance space in the state of New South Wales (NSW), with a particular focus on the use of PPPs. NSW is currently in the midst of a substantial infrastructure procurement phase, with around A\$25 billion in big-ticket infrastructure projects being procured. While we believe that PPPs are a good mechanism to achieve the right balance of risk transfer, we are very much employing a ‘horses-for-courses’ approach to transferring risk, with the exact nature of risk transfer differing from project to project. I will describe the primary challenges that we have faced in procuring infrastructure, as well as the infrastructure procurement program that we have been running over the last three years. I will also talk specifically about some of the features of the PPPs that have been used in this procurement.

There a number of challenges that the NSW Government faces in procuring infrastructure. Like a lot of governments, both in Australia and around the world, our number one challenge is that we cannot afford to finance all the infrastructure that is required. This constraint arises both from our own balance sheet considerations and from credit rating constraints. Another challenge arises from the relatively shallow market for the construction and delivery of major projects; activity is highly

concentrated in only a handful of players and costs are high, particularly in the area of greenfield development. Furthermore, government and industry have perhaps not worked closely enough historically, resulting in negative outcomes that have weighed on the private sector's interest in subsequent projects. On the government side, there has possibly been an over-engineering of financial structures in an attempt to pass risks to the private sector that probably should have been retained by the government. At the same time, industry has sometimes taken risks that were probably imprudent. Finally, international experience has shown that slightly different accounting treatment of PPPs can drive their adoption. We certainly view this as a challenge that needs to be managed, as it is important that PPPs are being used for the right reasons.

In NSW, we have a very specific policy of 'capital recycling' as part of our framework for infrastructure provision. While there have certainly been many examples of governments around the world selling assets to finance the provision of infrastructure, we are operating a fairly unique program where proceeds from asset sales, long-term leases of assets and certain prescribed upside revenues are, by legislation, ring-fenced. These proceeds (net of debt) are placed in a ring-fenced fund within the government and are earmarked for infrastructure provision. The practice is somewhat removed from the political process through the involvement of Infrastructure NSW, which is a semi-independent government body. A part of their task is to make recommendations for the use of recycled funds, a process that also allows the government to make a stronger case for reinvesting the proceeds of capital recycling. Additionally, it is unnecessary to select new projects before existing assets are privatised, as the fund retains the proceeds of privatisation until appropriate projects present themselves. To date, a range of projects has been funded through this mechanism.

In addition to having a source of funds from capital recycling, the NSW Government has been focused on developing appropriate financing structures across different projects. There are six major projects currently being procured: two rail projects (the Sydney Light Rail Program and the North West Rail Link); the Darling Harbour Live project, which is a redevelopment of the exhibition and conference facilities in the Darling Harbour area of Sydney; the Northern Beaches Hospital in Sydney; and two large toll motorways (WestConnex and NorthConnex).

These six projects nicely illustrate the different financing approaches being employed. The rail projects are being procured using availability-based PPP contracts, with no transfer of demand risk. There is probably little value in transferring demand risk on an integrated public transport project, so we are employing service-based concessions with a full transfer of construction and operating risk to the private sector. In both cases there is also a form of government contribution either at completion of construction or after two years of operation. In particular, provided that certain delivery and performance standards have been satisfied (i.e. construction risk is extinguished), we are looking to reduce the amount of private sector capital by refinancing directly into (lower-cost) state borrowing. The Darling Harbour Live project and the Northern Beaches Hospital are both forms of social infrastructure that are being procured through models that combine a high degree of output specification with construction finance and other commercial opportunities. The hospital is somewhat unique in that it is the first time in Australia that a PPP structure has been used for the full outsourcing of clinical services.

I would like to focus a little more on the toll roads, as they have a number of interesting features. These roads are predominately tunnels within the Sydney urban area, which provide bypasses of free but very congested routes. These two projects are similar to four other motorway projects in Australia that have had financial problems, in that they are all bypasses of free routes and require high capital expenditures. This kind of scenario poses a complex problem for traffic forecasting, and certainly there have been large forecast errors in these types of projects historically. In both of these projects we are looking to use models that share demand risk in different ways. For example, the NorthConnex project is linked to three adjoining motorways that are already operated by the private sector, and there is a large degree of blending of traffic risk across these concessions. On WestConnex, we are setting up a ring-fenced investment vehicle with initial state ownership to hold the equity in that project. As each segment of the road is completed, tolls will be imposed with a view to selling the state's interest in these segments to the private sector. The approach is designed to capture the value uplift that the state can achieve by selling stakes in the post-project delivery when there is known traffic demand, compared with selling beforehand when traffic is unknown. This is a very deliberate retention of risk on our part.

Associated with the large pipeline of major projects, we have been grappling with some key issues related to Australian markets' limited capacities for financing and contracting. We have had to stagger our projects to ensure that we have the most appropriate interests bidding on them, as well as to ensure that the government has enough capacity. We are also seeing a limitation around the tenor of bank debt, which has tended to cap out at around seven years. While there is no real volume constraint in the bank market, the tenor is unmatched to the asset life that is being procured. We have less liquid capital markets in Australia to make up for this, and no project bond market. As a consequence, governments in Australia have been looking to expand capital markets in the infrastructure space to relieve some of these constraints. To some extent, these issues have been improving with greater international joint venturing on the construction side and further internationalisation of capital markets.

On the other hand, we have noticed some benefits from procuring multiple large pieces of infrastructure simultaneously. The depth of the infrastructure pipeline, both in NSW and in other states, and the relatively low political risk around the delivery of major projects has encouraged a lot more international contractors and financiers to enter the Australian market. International parties may also have been attracted by the NSW Government's decision to provide a capped amount of reimbursement to consortiums that are unsuccessful in the bidding process, provided they have submitted compliant bids with a transfer of intellectual property to the state.

One of the key requirements for a government to be effective in procuring PPPs is the often overlooked necessity that governments develop and retain a skilled staff that are, in the long term, accountable for the outcomes of procuring infrastructure. Development of a skilled staff should also reduce the reliance on consultants in decision-making processes. For these reasons, we have been building our internal capabilities in both the financing and project delivery areas. For example, we are trying to address the shortage of long-term government-side project directors, who are essential during the bid and delivery phases. Most state governments and the Australian Government have created central infrastructure units in some form, where they can house this kind of specialised expertise.

In conclusion, the overall framework for the use of PPPs in NSW is evolving, but it still needs development. The existence of good legal structures – something that I think we have – is one important factor, but a consistent political will and well-developed markets are also important. It is also imperative to have a well-refined and relatively efficient government procurement framework.

4. Gerassimos Thomas

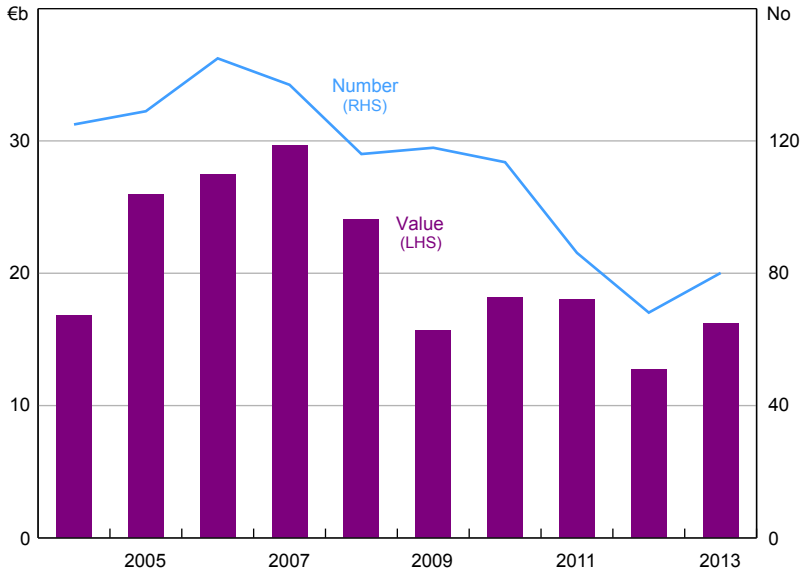
Lessons learned from Europe

I've been asked to speak about the European experience of using PPPs. The support of PPPs at the European level has its origins in the promotion of the single market, the need to attract private financing to complement constrained public financing and the push to improve infrastructure procurement. Performance so far has been mixed. In terms of efficiency, European PPPs have often performed better than purely public-financed projects at various levels of government, but they have often proved expensive. Even in the areas where public administration is relatively efficient, very rarely is it good at both building and maintaining infrastructure. If we look over the total life of the project we find that there is a lot of benefit in continuing to learn from and improve our PPP model.

PPPs currently only account for a small subset of total infrastructure investment in Europe, at around €16 billion in 2013, and PPP volumes are substantially lower than before the crisis (Figure 1). However, the huge investment needs linked to our energy, climate change, information and communications technology, and transport policies have been driving a renewed interest in PPPs. There are various constraints that oblige us to find solutions together with the private sector. One comes from the government side. The public sector accounts for about one-third of total infrastructure investment in the European Union (EU). But, for fiscal policy reasons, future government investment in infrastructure will necessarily be constrained. Another constraint is bank financing. We estimate that bank financing will be insufficient to meet Europe's long-term infrastructure investment needs. This is why we are trying to promote infrastructure as an asset class and develop capital market solutions to complement bank financing.

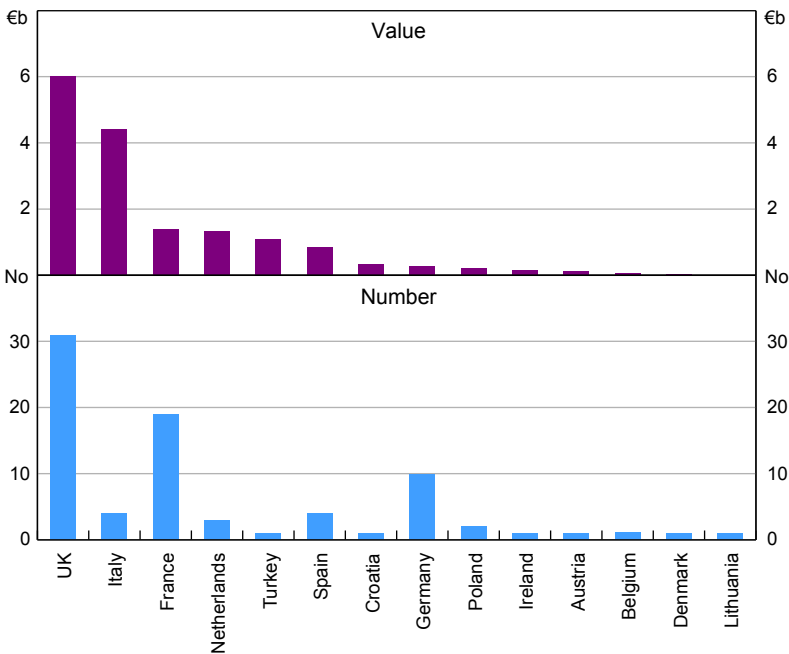
PPP volumes in Europe have been dominated by projects in the United Kingdom, but there are an increasing number of countries using the PPP model (Figure 2). For example, PPP projects have recently been undertaken in Austria, Poland and Lithuania, among others. This may partly reflect the fact that we have had a consistent policy of trying to promote PPPs in Europe for several years now. In 2008, we created the European PPP Expertise Centre (EPEC) with the purpose of sharing existing PPP-related expertise among different EPEC members. EPEC was useful in diffusing knowledge, although it did not have a mandate to help develop a pipeline of projects; in retrospect, this mandate was needed.

Figure 1: PPPs in Europe



Source: European PPP Expertise Centre

Figure 2: PPPs in Europe – by Country
2013



Source: European PPP Expertise Centre

In 2009, the EU produced an action plan to promote PPPs. We improved procurement policies to better fit the needs of PPPs and allowed cross-border provision of services (e.g. for maintenance of infrastructure) by the private sector. We also clarified the treatment of PPPs in the national accounts – an issue that was highlighted in the paper by Engel, Fischer and Galetovic (in this volume) – as some governments had, in the past, used PPPs to circumvent fiscal limits.

Going forward, I think the main lesson to take from our experience of PPPs is the importance of looking at projects over their entire life cycle. This is in contrast to the procurement methods of the past, which would often consider only the bidding and construction processes. The second lesson is that we need fiscal transparency. The tightening of the statistical rules around PPP reporting has dealt with this issue. The third lesson is the importance of capacity building within the government to procure, regulate and monitor PPPs.

Another key lesson is that we need transparency in pipeline development. Interaction with the private sector through PPPs obliges us to develop this transparency and helps with the better prioritisation of projects in a true partnership spirit. Lastly, we need to connect more effectively with institutional investors and develop capital market instruments. Our economy has traditionally been financed by banks. We are trying to recalibrate this, but it takes effort.

We believe that all of these lessons that we have learned in Europe are relevant in an international context. International cooperation will also contribute to addressing the issues that we have identified, particularly by increasing transparency and improving skills through the sharing of expertise.

5. General Discussion

The discussion began with one participant describing how the equity investor in a PPP is the residual claimant to any efficiency gains made by the PPP. Given that over the typical lifetime of a PPP there are likely to be many potential efficiency gains, the participant questioned whether some of these gains should be shared with taxpayers. Following on from this, another participant noted that a lot of the focus on PPPs is on the management of downside risk, and asked how the public sector can capture more upside risk. One participant likened the sharing of upside risk to the economic regulation of utilities, under which the cost structure of a utility is regularly reviewed and revised to share the benefits of efficiency gains with consumers. The participant went on to suggest that systematic economic regulation of PPPs may reduce the risk of unpredictable regulatory changes, as mature PPPs often become the focal point of political pressure due to a perception that they are making excessive profits. In response, Peter Regan suggested that it is important for governments to think carefully about how many upside risks they try to capture versus how many downside risks they transfer to the private sector. Mr Regan noted that in most cases, particularly concerning social infrastructure, the extreme downside risk unavoidably remains with the government as it is necessary that certain services are always provided. Mr Regan described some ways in which upside risks are shared between public and private partners, including gains from debt refinancing and revenues from greater-than-expected demand. He also noted that media commentary tends to focus on circumstances where the private partner in a PPP either does very well or does very poorly, but that there are many instances of PPPs that

fall between these extremes. Finally, Mr Regan suggested that reset mechanisms – similar to the economic regulation already discussed – are attractive, but are hard to implement in practice.

There was some discussion around the objective of PPPs. One participant noted that other conference participants had identified a number of objectives of PPPs, including risk transfer, efficient procurement, public budget relief, promoting innovation and efficiency, and reducing poverty. The participant argued that it is difficult to develop policy without a clearly defined objective, and questioned whether PPPs have a commonly accepted primary objective. In response, another participant contended that public budget relief cannot be an objective of PPPs based on the arguments put forward in the paper by Engel, Fischer and Galetovic (i.e. that PPPs do not provide public budget relief once intertemporal accounting has been taken into account). The participant also suggested that the objectives of PPPs may differ from country to country based on differences in political economy. Gerassimos Thomas noted that the area of financial regulation often has multiple objectives, such as ensuring financial stability and promoting financial innovation, and argued that having one objective may not necessarily be optimal.

Another topic of discussion was 'capital recycling'. One participant picked up on the notion that capital recycling provides some insulation of the infrastructure investment decision-making process from political forces. The participant questioned whether these capital recycling schemes allow the associated capital to be subjected to the same types of budgetary processes that allocate spending across the broader range of government imperatives, which could yield greater benefits than infrastructure projects. Mr Regan suggested that, to some extent, the proceeds from privatisation were being used as off-budget funding to deliver PPPs. However, this process has also reflected a genuine release of capital, because 50- to 60-year capital is released and invested in projects that deliver their benefits over the next 20 to 30 years. Mr Regan also noted that the sources of this capital release have also tended to be businesses that are elsewhere operated by the private sector, such as ports and desalination plants.

