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Recommendation of the Council on Principles for

Public Governance of Public-Private Partnerships

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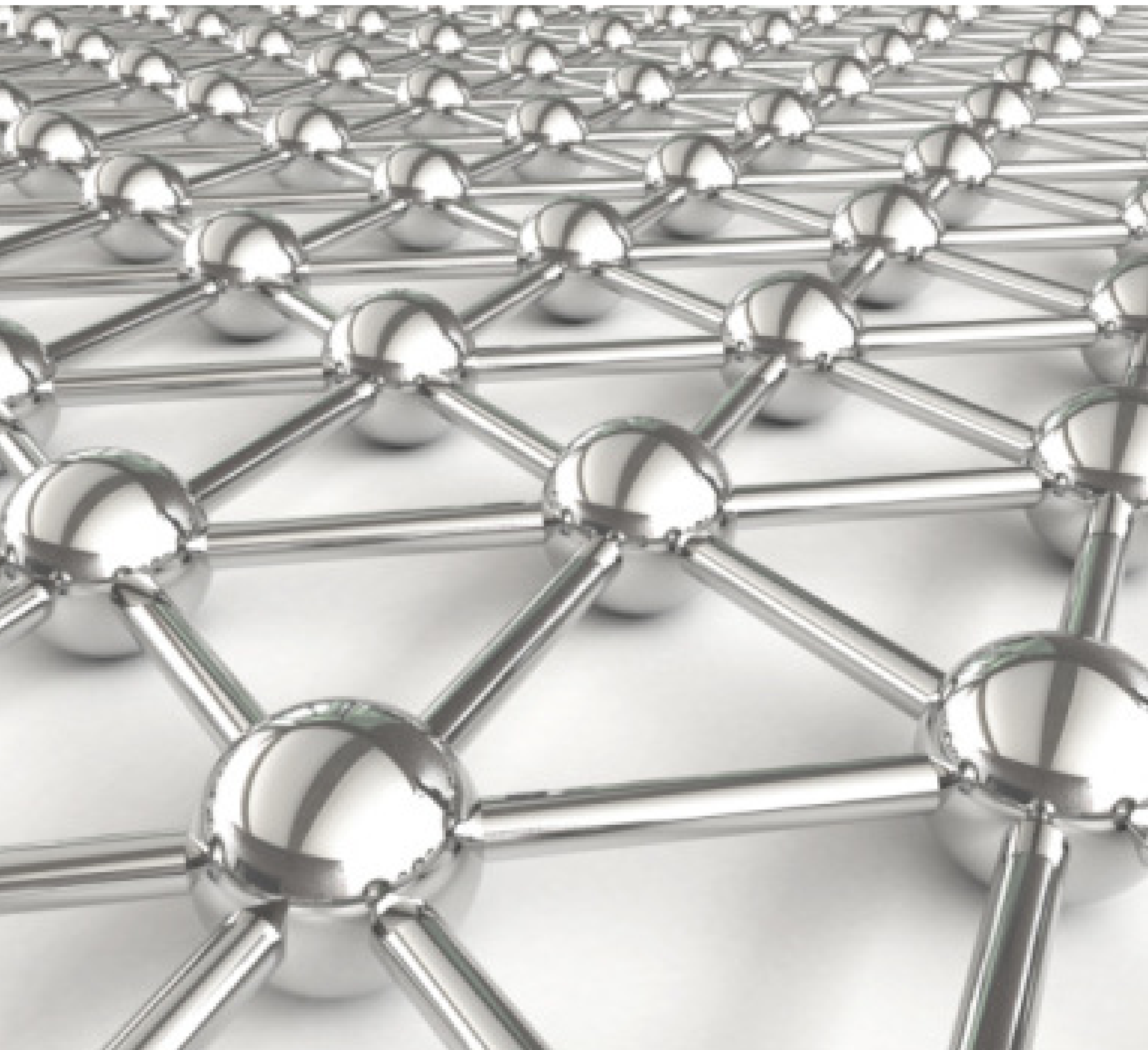

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Draft Recommendation of the Council on Principles for Public Governance of Public-Private Partnerships

The Council,

Having regard Articles 1, 2 a), 3 and 5 b) of the Convention on the Organisation for Economic Co-operation and Development of 14 December 1960;

Having regard to the Recommendation of the Council for Improving the Quality of Government Regulation [C(95)21/FINAL], the subsequent Guiding Principles for Regulatory Quality and Performance [C(2005)52 and CORR1] and the Recommendation of the Council on regulatory policy and governance [C(2012)37], Policy Framework for Investment [Annex 2 to C(2006)68], Recommendation of the Council regarding the Principles for Private Sector Participation in Infrastructure [C(2007)23/FINAL], Recommendation of the Council on Enhancing Integrity in Public Procurement [C(2008)105];

Noting the focus and progress made by Members and non-Members to improve the framework for public governance of Public-Private Partnerships;

Noting that the challenges facing governments today and in the foreseeable future, in ensuring that Public-Private Partnerships are met by strong public institutions, are affordable, represent value for money and are transparently treated in the national budget process, have not been addressed systematically in previous OECD recommendations and principles;

Recognising that democracy and the rule of law depend upon and require sound regulatory frameworks, notably relating to fiscal sustainability;

Recognising that Public-Private Partnerships are increasingly becoming a prominent method for delivering key public services, can deliver value for money transparently and prudently in so far as the right institutional capacities and processes are in place;

Noting that the public governance framework for Public-Private Partnerships should be set and monitored at the highest political level, so that a whole of government approach ensures affordability, transparency and value for money;

Recognising that the current financial crisis makes transparent and prudent management of contingent fiscal liabilities, as well as government long-term commitments derived from Public-Private Partnership contracts particularly necessary.

Recognising that the OECD has played a leading role in the international community to promote fruitful interaction between the public and private sector, prudent budgetary practices and procedures and sound regulatory practices on a whole of government approach;

On the proposal of the Public Governance Committee:

I. Recommends that Members take due account of the Principles for public governance of Public-Private Partnerships set out below:

A. Establish a clear, predictable and legitimate institutional framework supported by competent and well-resourced authorities

1. The political leadership should ensure public awareness of the relative costs, benefits and risks of Public-Private Partnerships and conventional procurement. Popular understanding of Public-Private Partnerships requires active consultation and engagement with stakeholders as well as involving end-users in defining the project and subsequently in monitoring service quality.

2. Key institutional roles and responsibilities should be maintained. This requires that procuring authorities, Public-Private Partnerships Units, the Central Budget Authority, the Supreme Audit Institution and sector regulators are entrusted with clear mandates and sufficient resources to ensure a prudent procurement process and clear lines of accountability.

3. Ensure that all significant regulation affecting the operation of Public-Private Partnerships is clear, transparent and enforced. Red tape should be minimised and new and existing regulations should be carefully evaluated.

B. Ground the selection of Public-Private Partnerships in Value for Money

4. All investment projects should be prioritised at senior political level. As there are many competing investment priorities, it is the responsibility of government to define and pursue strategic goals. The decision to invest should be based on a whole of government perspective and be separate from how to procure and finance the project. There should be no institutional, procedural or accounting bias either in favour of or against Public-Private Partnerships.

5. Carefully investigate which investment method is likely to yield most value for money. Key risk factors and characteristics of specific projects should be evaluated by conducting a procurement option pre-test. A procurement option pre-test should enable the government to decide on whether it is prudent to investigate a Public-Private Partnerships option further.

6. Transfer the risks to those that manage them best. Risk should be defined, identified and measured and carried by the party for whom it costs the least to prevent the risk from realising or for whom realised risk costs the least.

7. The procuring authorities should be prepared for the operational phase of the Public-Private Partnerships. Securing value for money requires vigilance and effort of the same intensity as that necessary during the pre-operational phase. Particular care should be taken when switching to the operational phase of the Public-Private Partnerships, as the actors on the public side are liable to change.

8. Value for money should be maintained when renegotiating. Only if conditions change due to discretionary public policy actions should the government consider compensating the private sector. Any re-negotiation should be made transparently and subject to the ordinary procedures of Public-Private Partnership approval. Clear, predictable and transparent rules for dispute resolution should be in place

9. Government should ensure there is sufficient competition in the market by a competitive tender process and by possibly structuring the Public-Private Partnerships program so that there is an ongoing functional market. Where market operators are few, governments should ensure a level playing field in the tendering process so that non-incumbent operators can enter the market.

C. Use the budgetary process transparently to minimise fiscal risks and ensure the integrity of the procurement process

10. In line with the government's fiscal policy, the Central Budget Authority should ensure that the project is affordable and the overall investment envelope is sustainable.

11. The project should be treated transparently in the budget process. The budget documentation should disclose all costs and contingent liabilities. Special care should be taken to ensure that budget transparency of Public-Private Partnerships covers the whole public sector.

12. Government should guard against waste and corruption by ensuring the integrity of the procurement process. The necessary procurement skills and powers should be made available to the relevant authorities.

II. Recommends that Members take appropriate steps to ensure that Public-Private Partnerships are affordable, represent value for money and are transparently treated in the budget process, in accordance with the principles expressed in this Recommendation, which are recalled and further developed in the Annex to this Recommendation of which it forms an integral part.

III. Invites Members and the Secretary-General to disseminate this Recommendation.

IV. Invites non-Members to take account of and adhere to this Recommendation.

V. Instructs the Public Governance Committee to monitor the implementation of this Recommendation and to report thereon to the Council no later than three years following its adoption and regularly thereafter, in consultation with other relevant OECD Committees, including the Investment Committee.

OECD Principles for

Public Governance of Public-Private Partnerships

A. A. Establish a clear, predictable and legitimate institutional framework supported by competent and well-resourced authorities

1. The political leadership should ensure public awareness of the relative costs, benefits and risks of Public-Private Partnerships and conventional procurement. Popular understanding of Public-Private Partnerships requires active consultation and engagement with stakeholders as well as involving end-users in defining the project and subsequently in monitoring service quality.

Only if the political level is aware of and accepts the costs and benefits of using PPPs can the issues around PPPs be tackled and balanced appropriately with stability and predictability. The Ministry of Finance, line Ministries and executive agencies should ensure that a coherent approach to PPP is rolled out in the public sector and is joined up with other initiatives in adjacent fields. Given their complexity and long-term scope engagement with civil society is a prerequisite for the successful use of PPPs. This is especially the case when PPPs provide key public services. PPPs should, ideally, form part of an integrated public-sector infrastructure investment and procurement framework.

Active consultation and engagement with stakeholders should be an integral element of the process. PPPs may be used to introduce a more private-sector approach to service delivery in sectors that have previously been a part of the government. This can have effect on both working conditions, the culture of the work place and opportunities for advancement. Labour unions consequently represent a key stakeholder group that can be substantially affected by the usage of PPPs. For PPPs to work and to be legitimate, labour should be actively involved. The same can be said for NGOs and other civil society groups which often have concerns that PPPs may have social and environmental consequences and impact the rights of minority groups. Active involvement of NGOs can create transparency about problematic issues that might otherwise be overlooked and become serious problems if not tackled at an early stage.

Defining outputs in the PPP contract is essential. It should involve end-users in defining the project and its output specification and subsequently in monitoring service quality once the project is operational. Defining outputs can be instrumental in achieving better alignment of service specification with user expectations and exert pressure on service providers to meet service standards. In addition, involving end-users in design and monitoring increases the likelihood of the effort being perceived as legitimate, fair and understandable. Independent public oversight of PPP implementation can also promote public sector innovation and better outcomes for the society as a whole through greater accountability and social control.

2. Key institutional roles and responsibilities should be maintained. This requires that procuring authorities, Public-Private Partnerships Units, the Central Budget Authority, the Supreme Audit Institution and sector regulators are entrusted with clear mandates and sufficient resources to ensure a prudent procurement process and clear lines of accountability.

A number of institutional roles should be competently pursued to secure and maintain value for money: a sound procurement process; implementing the specific PPP; fiscal and budgeting issues; auditing of the PPP; rule monitoring and enforcement. These roles can be maintained in a number of institutional set-ups, but it is important that they are kept separate so as not to confuse the key tasks of each actor and to secure lines of accountability.

The authority that is procuring the PPP is the institution ultimately responsible for the project, subject to approval, monitoring and advice from the other actors at various stages. The authority is responsible for preparation, negotiation and administration of the contract and for monitoring and evaluating contract performance during the construction and operation phases of the project. This is crucial to ensure government retains value for money during the whole life of the contract. This authority is, therefore, ultimately responsible for the PPP contract and its operation. By value for money is meant the optimal combination of quality, features and price, calculated over the whole of the project's life.

Given the complexity of PPPs and their somewhat infrequent use, critical skills to ensure value for money may need to be concentrated in a PPP Unit that is made available to the relevant authorities. A PPP Unit's function can be pursued by a number of complementary units. The PPP Unit can fill gaps in terms of specific skills, a lack of coordination or high transaction costs. Institutional shortcomings should be addressed taking the country's needs and current institutional context into account. The PPP Unit should enable authorities (e.g. line ministries) to create, manage and evaluate a PPP efficiently and effectively.

This role requires that the PPP Unit has the requisite in-depth financial, legal, economic and project management skills. This capacity should be used to assess the specific PPP compared to the traditional public investment route. The PPP Unit should support the authority in its endeavor to secure value for money both in the procurement and in the implementation phases. This Unit should also make sure that procedural steps (gateways) are followed throughout. It is important that the role of the PPP Unit is clear and without conflicts of interest. While responsible authorities should draw on expertise from the PPP unit where necessary, it should be emphasised that they remain ultimately responsible for the project. Importantly, although the PPP Unit should help the relevant authorities prepare and negotiate the PPP contract, it should not decide on whether the PPP should move forward. This green-lighting process should be anchored in the Central Budget Authority.

To secure affordability and project quality the Central Budget Authority should scrutinise each PPP. The Central Budget Authority should check and monitor the PPP through each key phase: Planning; Feasibility, Design and Tender Preparation; Bidding and Contract Signing; and Construction and Operation. The Central Budget Authority should scrutinise the project for value for money, affordability, procedural steps and that the projects remain in line with political agreements. While the Central Budget Authority need not possess deep and specific knowledge of the PPP project's technical design, it needs sufficient capacity to evaluate the documentation presented to it. The Central Budget Authority should assure that capital investments are aligned with the government's short and medium term macroeconomic stability targets.

The Supreme Audit Institution (SAI) has an important role in examining whether the risks involved in PPPs are managed effectively. The SAI's reports to Parliament can keep the public informed about the services that they receive and also disseminate best practice. The SAI should audit and assess the PPP ex post with regards to performance, finance and compliance. It should maintain sufficient capacity to give a clear verdict on whether or not the project ultimately represented value for money, suggest possible improvements to the regulatory PPP framework, the procurement processes and make available overall lessons regarding the use of PPPs and investments. All relevant information should be made available to the SAI.

Sound regulatory policy promotes the efficient functioning of regulatory agencies by ensuring that they operate under an appropriate and clear mandate, with the necessary independence from political influence and regulated subjects, that they are appropriately resourced and equipped, and that their decision-making is fully transparent and accountable. Where PPPs are employed in the delivery of infrastructure facilities with natural monopoly characteristics, the role, design and organisation of regulators is important to secure value for money for the public sector and protect users and consumers. This role should be clear to all (staff, regulated entities and the community). The appropriate sector regulator should consequently be consulted in the project design and subsequently monitor compliance with regulated service standards. This role is important not only in shaping the markets, but also with concrete issues such as service quality, profitability, tariffs and prices. Of particular interest in monopoly-like situations is the degree of profitability compared to the sector average using various benchmarks.

The above roles should be institutionally maintained at sub-national level.

3. Ensure that all significant regulation affecting the operation of Public-Private Partnerships is clear, transparent and enforced. Red tape should be minimised and new and existing regulations should be carefully evaluated.

A regulatory environment which meets the key principles of good regulation, as set out in the OECD Recommendation on Regulatory Policy and Governance, reduces the costs to business and enhances the chances that PPP projects bring value for money.

While the contract is the main basis for a PPP, it is necessary to have a clear and transparent regulatory framework that all parties can trust, is enforced and that does not create barriers to entry. Such a framework fosters competition and helps minimising the risk of conflicts of interest, regulatory capture, corruption, and unethical behaviour. To that end, governments should adhere to principles of open government. Access to information and the decision-making process should be open and equitable.

Private investment will be facilitated if unnecessary red tape is removed and delays to approval processes are reduced. An effective regulatory framework implies careful evaluation of new regulations and systematic review of the stock of significant regulations to ensure that they are up to date, cost effective and consistent and deliver the intended policy objectives. This may require the coordination of approval processes in specific circumstances to remove regulatory obstacles to the delivery of PPPs, such as coordinating and streamlining multiple layers of regulation that may affect projects – either across one or different levels of government (central/federal, sub-national/state and local). The rule of law and the protection of property rights and contractual rights are a key condition as also highlighted in the Principles for Private Sector Participation in Infrastructure.

B. Ground the selection of Public-Private Partnerships in Value for Money

4. All investment projects should be prioritised at senior political level. As there are many competing investment priorities, it is the responsibility of government to define and pursue strategic goals. The decision to invest should be based on a whole of government perspective and be separate from how to procure and finance the project. There should be no institutional, procedural or accounting bias either in favour of or against Public-Private Partnerships.

It is important that the projects that go ahead have been prioritised at the political level. The basis for the decision should include an initial cost assessment and evaluation of the opportunity cost that should feed into the affordability decision. The decision to invest should include a holistic cost-benefit analysis addressing the project's interaction with other government policy tools (such as spatial planning, regulation of traffic, utilities, and development plans) and objectives. Line ministries and other actors should not be allowed to develop their investment programs without aligning them with the government's overall political priorities.

On the basis of the initial cost assessment, the holistic cost benefit analysis and the political judgment, an initial affordability decision can be made and projects can be prioritised against each other. The cost-benefit evaluations and the ranking of different projects should be made available to the public to encourage debate about what large infrastructure projects are the most important. The investment decision should be separate from the decision as to how to procure and finance the specific project. To strengthen prioritisation between PPPs and traditional infrastructure procurement within the budget envelope decisions should be based on a whole of life, present value, approach for both.

There should be no institutional, procedural or accounting bias either in favour of or against PPPs. Value for money should be the only test as to whether a particular project is procured by way of a PPP or through conventional procurement routes.

5. Carefully investigate which investment method is likely to yield most value for money. Key risk factors and characteristics of specific projects should be evaluated by conducting a procurement option pre-test. A procurement option pre-test should enable the government to decide on whether it is prudent to investigate a Public-Private Partnerships option further.

Once the government has decided to move forward with the investment, a project should be subjected to a procurement option pre-test. This should guide government in selecting which mode of procurement is likely to deliver the most value for money.

The following elements should be included in such an examination and thereby indicate to the policy maker whether it is worthwhile to investigate the PPP procurement option.

- What are the comparative costs of (a) finance (b) construction (c) operation, as calculated over the whole lifetime of the project, in each alternative mode of procurement?
- Can the risks of the project be clearly defined, identified and measured?
- Can the right types of risk be transferred to the private partner to ensure value for money?
- Does the project involve any transfer of risks onto other stakeholders, including workers and local communities?
- Is the risk appetite of potential private-sector partners sufficiently robust to explore a PPP?
- Do potential private-sector partners have a track record of good service delivery, responsible business conduct and PPP experience?
- What is the potential level of competition in the market? If competition is lacking, is the market contestable?
- Is there sufficient market interest in the project to generate a robust competition that will ensure a value for money outcome?

- How large are the whole of life benefits from combining the construction and the operating phases of a project in one contract?
- What are the risks of project failure associated with similar PPPs? What are the costs to the public authority associated with such failures?
- What contingent liabilities are associated with the project?
- Can the risks, cost and quality trade-offs be quantified and managed by the public sector?
- Can the desired project output be specified clearly ex ante? Is the planned project operating in a rapidly changing policy or demand environment? Are the underlying assets to be used to deliver the output in an area subject to rapid technological change?
- Is the potential PPP project of a size sufficiently large to justify the transaction costs?
- Who will make the contractual payments to the private-sector partner? Can some or all of the payments come from end-user charges?
- If end-user charges are levied will demand be sufficient over the lifetime of the project to ensure that the private partner generates the revenue required for it to maximise its profit? Might the potential private-sector partners accept demand risk in addition to availability risk?

If relevant, further analysis regarding using a PPP should be based on input from a prudent public sector comparator, or an equivalent to compare value for money across options, especially when operation is an important component of the project. There are different methods used to assess the relative value for money of the different delivery models. In principle, a public sector comparator compares the net present cost of bids for the PPP project against the most efficient form of delivery according to the output specification by conventional public sector means (the so-called reference project). The public sector comparator serves as a hypothetical risk-adjusted cost of public delivery of the output specification of a PPP project. The methodology for preparing the public sector comparator should be published.

6. Transfer the risks to those that manage them best. Risk should be defined, identified and measured and carried by the party for whom it costs the least to prevent the risk from realising or for whom realised risk costs the least.

After the fundamental assessment of specific issues and comparative costs, the key element in the decision to use PPPs is the transfer of risk from the government to the private partner. Risk is defined, identified and measured, and either retained by the public sector or transferred to the private partner through specific contract terms and an appropriate payment mechanism. Risk should be allocated where it can be best managed. By 'best' managed is meant the party for whom it costs the least to prevent the risk from realising, or for whom it costs the least to deal with the consequence of realised risk.

Risk should not be transferred to the private partner at any price for the sake of transferring risk alone or to achieve a desirable accounting treatment. Governments and public authorities cannot transfer to the private sector the risks associated with statutory responsibilities to maintain services.

An essential question is whether the risks of the project can be defined, identified and measured. The less this is the case, the more room there is for conflict over the contract, particularly when the risk realises. Potential private partners might also be unwilling, for an acceptable price, to take on risks that are not clearly defined, identified and measured. There should be clear methods in the contract by which risks can be apportioned when they materialise. This is particularly important in cases where risk is difficult to measure.

7. The procuring authorities should be prepared for the operational phase of the Public-Private Partnerships. Securing value for money requires vigilance and effort of the same intensity as that necessary during the pre-operational phase. Particular care should be taken when switching to the operational phase of the Public-Private Partnerships, as the actors on the public side are liable to change.

There is a danger that after the financial close of the PPP the attention from public sector decision-makers and key actors is substantially reduced. Should such a reduction of attention result in a concomitant reduction of capacity on the public side value for money can be threatened. Monitoring the performance of the PPP in the construction phase and the operational phase requires skill and dedication, especially as targets may shift and unforeseen, but legitimate, obstacles may arise. It is also the responsibility of the procuring agency to ensure that the private partner acts according to the norms of responsible business conduct as mentioned in the OECD Guidelines for Multinational Enterprises.

For the operational phase to be successful all relevant actors should remain involved. The responsibility for the operational phase of the project primarily rests with the procuring line ministry/ agency. Potential problems should be identified at this level and dealt with to the extent of these institutions' mandate. However, the PPP Unit, Central Budget Authority, Supreme Audit Institution and Regulatory Authorities should play their part and retain the appropriate level of ownership regarding the project. Particular attention should be paid to contractual arrangements and monitoring capacity at later stages of a project so as to ensure that incentives do not deteriorate as the cost of non-compliance falls.

8. Value for money should be maintained when renegotiating. Only if conditions change due to discretionary public policy actions should the government consider compensating the private sector. Any re-negotiation should be made transparently and subject to the ordinary procedures of Public-Private Partnership approval. Clear, predictable and transparent rules for dispute resolution should be in place.

   By monitoring and liaising with the private contractor, the public sector should maintain a project's value for money throughout its operation. The original risk transfer and contract terms should be maintained and care should be taken to make sure that the standards to which the private-sector contractor operates are not eroded without compensation to the public-sector authority. Clear rules stipulating the criteria, procedures and compensation for government expropriating the asset should be in place as prescribed in the Guidelines for Multinational Enterprises.

   Nonetheless, in some cases the assumptions underlying the project may turn out to be flawed and in extreme cases this can lead the project towards failure. As the public sector has an interest, sometimes a statutory responsibility, in making sure the asset keeps operating smoothly; a re-negotiation should take place to investigate possible solutions. However, even if the current project outcome differs from what the private partner expected, it may just be a realisation of the risk that it carried.

   Both parties should distinguish between the realisation of risk and a genuine unforeseen change in circumstances. Only if conditions change due to discretionary public policy actions (i.e., "actions of the Principal") should the government consider compensating the private sector. Any other compensation for changes in commercial conditions should be explicitly negotiated within the contract. Otherwise, the risks to re-negotiations of PPP contracts due to changes in international conditions not foreseen at the moment of the contract award could significantly increase fiscal costs of PPPs for the government.

   Clear, predictable and transparent rules for dispute resolution should be in place to resolve disagreement on the above between the public and private parties. Furthermore, any re-negotiation that substantially alters the original agreement should be made public and be subjected to approval by the authority responsible for approving PPPs. Such an agreement should be as competitively done as possible.

9. Government should ensure there is sufficient competition in the market by a competitive tender process and by possibly structuring the Public-Private Partnerships program so that there is an ongoing functional market. Where market operators are few, governments should ensure a level playing field in the tendering process so that non-incumbent operators can enter the market.

   Competition helps ensure the effective transfer of risk, that optimal solutions are developed by the private sector and that the most competitive bid is tendered. There should be competition for the market when tendering for PPP bids or in the absence of competition, the market should be contestable once the tendering is concluded and the PPP is operational.

Thus, the private partner would know that there is the possibility of other private partners entering the market. To further strengthen competition, it can be beneficial to structure a PPP program to ensure an ongoing functioning market. This can possibly be achieved by unbundling the supply chain, so that different operators can enter various operational segments of the chain, and also by unbundling large-scale national or regional projects into different geographical parts. This is particularly important in cases where the PPP operator subsequently becomes a monopoly in a certain area. The OECD Recommendation Concerning Structural Separation in Regulated Industries can provide guidance in this respect.

It is beneficial to maintain an open and non-discriminatory investment environment and steps should be taken to ensure that domestic and foreign-owned firms can compete on an equal footing. Though private providers can coexist with State owned incumbents, measures to maintain a level playing field may be needed. According to the OECD Guidelines on Corporate Governance of State-Owned Enterprises, these measures include a clear separation between the public sector's ownership function and other factors that may influence companies' position, transparency regarding service obligations, access to finance and transparency concerning financial assistance and guarantees covered by the public purse.

C. Use the budgetary process transparently to minimise fiscal risks and ensure the integrity of the procurement process

10. In line with the government's fiscal policy, the Central Budget Authority should ensure that the project is affordable and the overall investment envelope is sustainable.

PPPs, as well as conventional long-term government borrowing for investment, are more difficult to integrate with the annual budget process than more ordinary variable expenditures that can be modified from year to year. This makes affordability assessments particularly important when the project is being prepared. An investment project is affordable if the expenditure and contingent liabilities it entails for the government can be accommodated within current levels of government expenditure and revenue and if it can also be assumed that such levels will be and can be sustained into the future.

The investment expenditure budget, including an assessment of contingent liabilities, should be based on medium and long term fiscal projections and regularly updated. Limits on stocks and flows of PPP, while not a substitute for medium-term planning, can help contain fiscal costs and limit overall public sector long-term commitments to levels that are fiscally affordable. This applies to the overall public sector, regardless of the level of government from which the fiscal costs originated.

11. The project should be treated transparently in the budget process. The budget documentation should disclose all costs and contingent liabilities. Special care should be taken to ensure that budget transparency of Public-Private Partnerships covers the whole public sector.

Budget documentation should transparently disclose all information possible regarding the costs and contingent liabilities of the PPP. The information should include what and when the government will pay, and full details of guarantees and contingent liabilities. The payment stream from government under the PPP contract should be highlighted, particularly if it is back loaded. Preferably the information should be disclosed at the same time as the results of the long-term fiscal analysis that shows the long-term effects of the stock and new flow of PPP contracts. The treatment of PPPs should conform to The 2002 OECD Best Practices for Budget Transparency.

A particular challenge for the prudent and transparent usage of PPPs is the application of this tool outside of general government but within the public sector, in particular state owned enterprises (SOEs). SOEs can engage in PPP-type of arrangements that often, but not necessarily, require explicit, or implicit, guarantees from the central government. SOEs may have long-term obligations to purchase goods and services from the private sector, such as power and water purchase agreements. As these obligations in general are not included in the definition of public debt they may not be properly monitored by the central government. However, given the political importance of the provided services central government might very well be expected to assume some financial responsibility if needed. This may require that the Central Budget Authority actively monitors and mandates the use of PPP-like arrangements in the Public Sector at large.

Where central government has the relevant constitutional authority it should consider allowing sub-national governments to prudently use PPPs. If there are implicit or explicit central government guarantees to sub-national government levels, PPP activity should be controlled through rules on PPP stocks and flows. The Ministry of Finance should retain an up-to-date overview of all PPP liabilities relevant for central government. Given the fact that sub-national governments are less likely to accumulate a critical mass of projects over time central government should consider ways of leveraging its management capacity regarding PPPs to the benefit of sub-national governments.

12. Government should guard against waste and corruption by ensuring the integrity of the procurement process. The necessary procurement skills and powers should be made available to the relevant authorities.

Enhancing integrity necessitates recognising the risks inherent throughout the entire procurement cycle, developing appropriate management responses to these risks, and monitoring the impact of mitigating actions.

PPP procurement should be a strategic profession, informed by an understanding of relevant commercial principles rather than a simple administrative process within a public organisation. This transformation necessitates developing knowledge and creating tools to support improved procurement management decision making. Enhancing integrity in public procurement should be placed within the broader management goals of the public sector as discussed in the 2008 OECD Principles for Enhancing Integrity in Public Procurement.

Background Note on the Draft Recommendation of the Council on Public Governance of Public-Private Partnerships

Defining PPPs and the reasons for undertaking them

Public-Private Partnerships (PPPs) are long term contractual arrangements between the government and a private partner whereby the latter delivers and funds public services using a capital asset, sharing the associated risks (see Box 1). In a PPP agreement the service delivery objectives of the government are intended to be aligned with the profit objectives of the private partner. The effectiveness of the alignment depends on a sufficient and appropriate transfer of risk to the private partners. In a PPP contract, the government specifies the quality and quantity of the service it requires from the private partner. The private partner may be tasked with the design, construction, financing, operation and management of a capital asset required for service delivery as well as the delivery of a service to the government, or to the public, using that asset. A key element is the bundling of the construction and operation and maintenance of the underlying asset over the life of the contract. The private partner will receive either a stream of payments from the government for services provided or at least made available, user charges levied directly on the end users, or a combination of both.

This definition excludes a wider array of arrangements where non-governmental organisations such as non-profit civil society groups, trusts, church groups etc. are involved in the development and delivery of public or semi-public services. It includes concession type arrangements where the concession is designed to deliver a public service but excludes concessions such as licenses to use government assets such as mining which are another way for government to raise revenue. It also excludes traditional public works contracts.

If the government is responsible for a stream of payments to the private partner for services delivered, their actual payment will likely depend on the private partner's delivery of service and compliance with the contractually set quality and quantity specifications. The government may also establish service standards as a representative of the public interest when PPPs are financed from tolls or user charges. Public-private partnerships are often undertaken by a special purpose vehicle acting as the government's private sector counterparty. A special-purpose vehicle is often (but not always) a consortium of companies responsible for the main activities of the public-private partnership[1].

PPPs are sometimes recorded on-budget and sometimes off-budget. When PPPs are undertaken by a special purpose vehicle acting as the government's private sector counterparty, the impact on the government's accounts will depend on whether the Special Purpose Vehicle (SPV) itself is classified as a public or a private entity. In many countries, most of these SPVs are created and organised in a way that allows them to be classified outside the central, general, or even the public sector as a whole, jeopardising fiscal monitoring and control.

Through harnessing the private sector's expertise in combining the design and operation of an asset a PPP can provide the service in a more efficient manner compared to traditional forms of procurement. There are a number of conditions that should be in place for a PPP to be successful. The most important generic issues are set out on the next page.

1 Within the category of public-private partnerships a number of different models exist – which can also give rise to different definitions. These are influenced not only by the responsibilities of the private partner but also the ownership and conceptualisation of the asset.

Box 1. Different country definitions of public-private partnerships

There is no widely recognised definition of PPPs and related accounting framework. Eurostat, IASB, IMF, IFRS and others work with different definitions. As illustrated below there is variation between countries.

Korea defines a public-private partnership project as a project to build and operate infrastructure such as road, port, railway, school and environmental facilities – which have traditionally been constructed and run by government funding – with private capital, thus tapping the creativity and efficiency of private sector.

South Africa defines a public-private partnership as a commercial transaction between a government institution and a private partner in which the private party either performs an institutional function on behalf of the institution for a specified or indefinite period, or acquires the use of state property for its own commercial purposes for a specified or indefinite period. The private party receives a benefit for performing the function or by utilising state property, either by way of compensation from a revenue fund, charges or fees collected by the private party from users or customers of a service provided to them, or a combination of such compensation and such charges or fees.

The **United Kingdom** defines a public-private partnership as "…arrangements typified by joint working between the public and private sectors. In their broadest sense, they can cover all types of collaboration across the private-public sector interface involving collaborative working together and risk sharing to deliver policies, services and infrastructure." (HMT, Infrastructure Procurement: Delivering Long-Term Value, March 2008). The most common type of PPP in the United Kingdom is the Private Finance Initiative. A Private Finance Initiative is an arrangement whereby the public sector contracts to purchase services, usually derived from an investment in assets, from the private sector on a long-term basis, often between 15 to 30 years.

The **State of Victoria (Australia)** defines a public-private partnership as relating to the provision of infrastructure and any related ancillary service which involve private investment or financing, with a present value of payments for a service to be made by the government (and/or by consumers) of more than AUD 10 million during the period of a partnership that do not relate to the general procurement of services.

Particular challenges around PPPs

The complexity of PPPs requires a number of capacities in government both in terms of skills, institutional structures and legal framework. There should be a robust system of assessing value for money using a prudent public sector comparator and transparent and consistent guidelines regarding non-quantifiable elements in the value for money judgement. It also involves being able to classify, measure and contractually allocate risk to the party best able to manage it and the ability to monitor the PPP contract through its life. It requires sound accounting and budgeting practises.

Value for Money and the public sector comparator

Governments should assess whether or not a project represents value for money. Indeed, the drive to use PPPs is increasingly premised on the pursuit of value for money (OECD, 2008). Value for money is a relative measure or concept. The starting point for such a calculation is the public sector comparator. A public sector comparator compares the net present cost of bids for the PPP project against the most efficient form of delivery according to a traditionally procured public-sector reference project. The comparator takes into account both the risks that are transferable to a probable private party and those risks that will be retained by government. Thus, the public sector comparator serves as a hypothetical risk-adjusted cost of public delivery of the project. However, ensuring the robustness of a public sector comparator can be difficult and it may be open to manipulation with the purpose of either strengthening or weakening the case for public-private partnerships (e.g. much depends on the discount rate chosen or on the value attributed to a risk transferred).

In addition to the quantitative aspects typically included in a hard public sector comparator, value for money includes qualitative aspects and typically involves an element of judgement on the part of government. Value for money can be defined as what government judges to be an optimal combination of quantity, quality, features and price (i.e. cost), expected (sometimes, but not always, calculated) over the whole of the project's lifetime. What makes value for money hard to assess at the beginning of a project is that it ultimately depends on a combination of factors working together such as risk transfer, output-based specifications, performance measurement and incentives, competition in and for the market, private sector management expertise and the benefits for end users and society as a whole.

Appropriate Risk Transfer

To ensure that the private partner operates efficiently and delivers value for money, a sufficient, but also appropriate, amount of risk needs to be transferred. In principle, risk should be carried by the party best able to manage it. This may mean the party best able to prevent a risk from realising (ex ante risk management) or the party best able to deal with the results of realised risk (ex post risk management). Some risks can be managed, and are hence called endogenous risks. However, not all risks can be managed and cases may exist where one or more parties to a contract are unable to manage a risk. To those parties such unmanageable risks are exogenous risks (an example is uninsurable force majeure risk that affects all parties, while political and taxation risk is exogenous to the private party and endogenous to government). It should be noted, however, that statutory and political obligations can mean that ultimately the activities of a PPP that fails have to be taken over by government.

Contract Negotiating Skills

The ability to write and negotiate PPP contracts are an important public sector capacity requirement, especially given the long-term nature and the large transaction costs associated with PPPs.

Box 2. Accounting for PPPs in the EU

Originally, the Statistics Office of the European Union (Eurostat) considered that the main issue in classifying a public-private partnership depended on who bears the most risk. The traditional Eurostat view has been that assets involved in a public-private partnership should be classified outside the government sector if both of the following conditions were met: (i) the private partner bears the construction risk; and (ii) the private partner bears either the availability risk or the demand risk.

However, the bearer of risk is not always easy to define, and contract design varies. In cases where it is not possible to classify a public-private partnership as on or off the government books, other contract features can be considered, such as if the asset is supposed to be transferred from the private partner to the government at the end of the contract period and at what price. This event is also an important part of the risk sharing. It should be noted however, that recent guidelines by Eurostat are moving away from the Eurostat decision of 2004.

The Eurostat ESA95 Manual on Government Deficit and Debt (MGDD), in its PPP chapter, discusses the considerations that should be analysed in order to evaluate the distribution of risks between the public and private sector. In particular, if the government provides majority financing, or provides guarantees covering majority financing, it would be an indication of an insufficient risk transfer to the private sector.

Moreover, the recent research of Eurostat, in collaboration with the EPEC and EIB ("New developments in PPPs," Financial Accounts Working Group, Eurostat, 2009) highlights the need for revision of these criteria to conform to recent IPSASB guidance (international public sector accounting standards). Eurostat (2004), - New Decision of Eurostat on Deficit and Debt: Treatment of Public-private Partnerships, News Release No. 18, 11 February 2004, The Statistical Office of the European Communities, Luxembourg.

Affordability

A project is affordable if government expenditure associated with a project, be it a PPP or other mode of delivery, can be accommodated within the intertemporal budget constraint of the government. A public-private partnership can make a project more affordable if it improves the value for money compared to that realised through traditional public procurement, and then only if the increased value for money causes a project that did not fit into an intertemporal budget constraint of the government under public procurement to do so with a PPP. Some countries are tempted to ignore the affordability issue due to the fact that PPPs may be off budget (discussed below). Political considerations may also alter the decisions: due to the political cycle, the policy maker who makes the decision to enter the PPP often does not bear the long-term expenditures involved in the project.

Future Budget Flexibility

A possible difficulty could be that PPPs reduce spending flexibility, and thus potentially allocative efficiency, as spending is locked in for a number of years. Given that capital expenditures in national budgets are often accounted for as an expense when the investment outlay actually occurs, taking the PPP route allows a government to initiate the same amount of investments in one year while recording less expenditure for that same year. On the other hand, the obligation to pay an annual fee will increase expenditures in the future, reducing the scope for new investment in coming years.

However, if the PPP represents more value for money compared to traditional procurement, and this saving is not spent up front, the government will have increased its fiscal space in coming years and thus increased flexibility. Government spending might also be affected if the government provides explicit or implicit guarantees to the PPP project and thus incurs contingent liabilities. In some cases, concessions and PPPs may also provide a revenue stream to government as part of payment for using existing assets.

Fiscal Impact of PPPs

The system of government budgeting and accounting should provide a clear, transparent and true record of all PPP activities in a manner that will ensure that the accounting treatment itself does not create an incentive to take the PPP route. In some cases, budgeting and accounting systems make it possible to avoid normal spending controls and use public-private partnerships to circumvent spending ceilings and fiscal rules.

PPPs should only be undertaken if they represent value for money and are affordable. However, there are those that argue that PPPs should be used to invest in times of fiscal restraint. The fiscal constraint argument for public-private partnerships is driven by pressures for governments to reduce public spending to meet political, legislated and/or treaty-mandated fiscal targets. In parallel with this, many governments face an infrastructure deficit stemming from a variety of factors including a perceived bias against budgeting for capital expenditures in cash-based budgetary systems.

However, when responding to fiscal constraints, governments should not bypass value-for-money and affordability. PPPs may also create future fiscal consequences if they violate the budgetary principle of unity, i.e. that all revenues and expenditures should be included in the budget at the same time. Potential projects should be compared against other competing projects and not considered in isolation to avoid giving priority to the consideration and approval of lower value projects.

Box 3. The transfer of risks in PPPs

As risks should be carried by those that manage them best. The key aspect to PPPs is thus identifying and sharing the risks between private and public partners. Three categories of risks, listed in the table below, can be identified: macroeconomic, commercial and legal/political risks. Risks are events that can be measured and the probability for its occurrence assigned. Risks vary in nature, some of them are endogenous (controllable by a party to a meaningful extent) and some others exogenous, uncontrollable, to at least some of the parties, but measurable.

Risk	Agent	Types of Risk		
		Macroeconomic	Commercial	Legal and Political
External/	Private	Aggregate Demand	Force majeure	Different Investment preferences of alternating governments
		Interest rate risk	Demand risk	Expansionary anti-crises policies raising the cost of financing
		Liquidity risk		Risk of expropiation
		Exchange rate risk		
	Public	Aggregate Demand	Force majeure	
		Interest rate risk		
		Liquidity risk		
		Exchange rate risk		
Project specific/	Private		**Project risk**	
			Design and construction risk	
			Operation	
			Maintenance	
			Input and output quality and quantity risk	
			Residual value risk	
			Contractor failure risk	
			Renegotiation risk	
			Early termination risk	
			Security risk	
			Technology risk	
			Idyosincratic interest rate	
			Idyosincratic liquidity risk	
			Credit risk	
			of the SPV	
			of the constructing and operating	
			of the financial institution	
	Public		sovereign risk	Different Investment preferences of alternating governments
			Demand risk	Expansionary anti-crises policies raising the cost of financing
				Risk of expropiation

As a general rule parties are better at managing those risks which are endogenous to them. However, it is difficult to determine a clear list of which risks should be borne by whom as this will often depend on an assessment of the concrete case. Legal/political risks are typically exogenous to the private partner but endogenous to the public partner and therefore are probably better managed by the public side. Macroeconomic risks are exogenous to both private and public partners, but the former could be expected to carry the normal business cycle movements. Demand risk is a type of risk that can be both exogenous and endogenous for the public sector depending on whether the demand is based on end users' preferences or whether it is based on public sector consumption.

Source: P. Burger et. al. « The Effects of the Financial Crisis on Public-Private Partnerships". IMF Working Paper 144, 2009.

Since the early 1990s, and even more so since the early 2000s there has been a significant increase in the stock of PPPs in OECD countries. Countries such as the United Kingdom, Korea, France, Australia, Portugal and Germany increasingly use PPPs to deliver services that they previously delivered through traditional public procurement. For most of the last decade, PPPs in the United Kingdom constituted approximately 12% of total annual capital expenditure (cf. EIB, 2004:5; KPMG, 2007: 4), with other countries following suit. Although governments increasingly use PPPs, they still constitute a relatively small component of total public sector investment (see Table 2).

Some countries do not foresee PPPs to exceed 15% of total public investment, one reason being the rather cumbersome process to create a PPP (OECD 2008). As noted above, there is a divergence in definitions regarding what constitutes a PPP. This also leads to different figures regarding the number of PPPs in the world. As such, not all the figures are comparable, but they do give an indication of the wide extent to which countries use PPPs. According to Deloitte Ireland (2009), infrastructure projects constitute the largest sector by number of deals internationally, followed by healthcare and education. The United Kingdom is by far the leading country implementing projects, followed by the rest of the EU put together. New PPP contract activity reached a peak during the period 2003-7, before slowing down due to the onset of the international financial crisis and recession.

Table 1 comprises data collected by Public Works Financing International Major Projects Survey (PWF 2009: 2). It includes projects that represent various combinations of public and private sector risk-taking and represents cumulative data since 1985. According to Public Works Financing (PWF) Road PPPs represent almost half of all PPPs in value (USD 307 billion out of USD 645 billion) and a third in number (567 out of 1 747). Second is Rail and third is Water. The PWF database also confirms that Europe represents about half of all PPPs in value (USD 303 billion) and a third in number (642).

Table 1 – Global public-private partnership deals by sector and region 1985-2009

		Roads		Rail		Water		Buildings		Total	
		Number of projects	Cost US$m	Number of projects	Cost US$m	Number of projects	Cost US$m	Number of projects	Cost US$m	Number of projects	Cost US$m
United States	Total planned and funded since 1985	77	61 894	41	58 334	187	20 001	164	10 985	469	151 926
	Funded by 10/09	35	16 913	27	10 950	136	15 024	158	9 421	356	52 308
Canada	Total planned and funded since 1985	31	18 103	7	9 700	29	3 029	91	12 529	158	43 521
	Funded by 10/09	20	11 058	1	2 000	14	457	49	9 572	84	23 114
Latin America	Total planned and funded since 1985	272	101 236	69	51 104	153	17 163	19	1 729	513	171 222
	Funded by 10/09	140	61 652	26	10 355	79	9 865	8	521	253	82 388
Europe	Total planned and funded since 1985	339	320 375	102	157 258	218	34 171	306	90 388	965	602 215
	Funded by 10/09	193	156 492	55	54 579	171	24 657	223	66 975	642	302 968
Africa and Middle East	Total planned and funded since 1985	21	10 886	16	12 479	101	28 165	10	1 185	148	52 717
	Funded by 10/09	13	5 681	4	4 688	45	17 686	4	957	66	29 151
Asia and Far East	Total planned and funded since 1985	295	92 652	93	101 826	180	50 746	37	11 358	605	256 581
	Funded by 10/09	166	54 640	40	55 676	119	37 452	21	7 201	346	154 969
World	Total planned and funded since 1985	1 023	486 186	328	380 886	868	153 282	627	128 157	2 846	1 278 202
	Funded by 10/09	567	386 673	153	138 228	564	165 280	463	94 647	1 747	644 638

Notes:
Cost US$m refers to Nominal dollars, converted to USD at time of financial close.
This database comprises data collected by PWF's International Major Projects Survey. It includes all projects that are being planned, built or are operated in 131 countries. According to PWF (2009, pg. 3): "PWF's survey aims to describe projects where governments are seeking to franchise the delivery of public works infrastructure services to private, for-profit companies outside of a regulated, public-utility structure. That delegation of control can take the form of long-term service contracts, concession arrangements involving finance, construction and long-term operations of facilities under term-limited contracts; private development and ownership of facilities; and divestiture of infrastructure assets."

Source: Public Works Financing (2009), Public Works Financing Newsletter, Vol. 242, October www.PWFinance.net

Table 2 – What percentage of public sector infrastructure invesment takes place through PPPs (2010)

Range	Number	Country/economy
0% - 5%	9	Austria, Germany, Canada, Denmark, France, Netherlands, Hungary, Norway, Spain
>5% - 10%	7	United Kingdom, Czech Republic, Slovak Republic, Greece, Italy, South Africa, Ireland
>10%-15%	2	Korea, New South Wales
>20%	2	Mexico, Chile
Total	20	

Note: No response for the >15% - 20% range.

OECD surveyed Member countries in 2010 concerning what percentage of public sector infrastructure investment takes place through PPPs (Burger & Hawkesworth, 2011). Table 2 indicates the percentage of public sector investment that takes place through PPPs and the number of countries to which each range applies. For instance, in 9 of the 20 countries PPPs constitute between 0% and 5% of public sector investment in infrastructure. Furthermore, in 9 countries PPPs constitute between 5% and 15% of total public sector infrastructure expenditure. The stock of PPPs in countries varies significantly. It ranges from one at the federal level in Canada, three each in Norway, Denmark and Austria, to 670 in the United Kingdom[2]. In between is France with 330, Korea[3] with 252, Mexico with 200, Germany with 144, Chile with 60, New South Wales with 35, the Netherlands and Hungary each with 9 and Ireland with 8.

2 The United Kingdom count includes only PFIs, and not PPPs falling under a wider definition. For Italy number excludes approximately 2000 concessions.

3 Excludes concessions, and includes only those PPPs falling under the authority of the PPP unit.

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