

Diagnosis of Enabling Environment for PPP

Before defining a PPP strategy, policy makers should assess the degree to which their country or state is already compliant with the requirements of the enabling environment for PPP. The following diagnosis may help to indicate the extent of compliance with the components of the enabling environment.



Public and Private Sector Roles in the Supply of Transport Infrastructure and Services, Operational Guidance for World Bank Staff, Paul Amos, 2004.

Public sector commitment

Whilst public sector commitment may be one of the most critical components of an enabling environment for PPP, it is also one of the most difficult to quantify and evaluate and, arguably, to maintain.

PPP projects are often announced and prepared by public institutions and some may be eventually abandoned during design or procurement phase. Private firms are thus very cautious and try to assess the real commitment of the public sector toward the project, given the significant costs incurred by the private sector in bid preparation and contract award. The private sector also needs to be confident of the commitment of the public sector toward the long-term management of the PPP process.

For larger PPP projects, this commitment would be sought at cabinet-level in order to provide required inter-ministerial support measures, counteract possible public opposition to tolling policies and to uphold budget-based financing and support.

Public sector commitment may be affected by the following factors whose relevance should be assessed by policy makers along with methods to limit their impact on the implementation of PPP projects:

- Political mandates are typically far shorter than the duration of a PPP project or of the period required to assess long-term benefits to the road sector.
- Introduction or restructuring of user charges is sensitive. If not well designed and justified to road users and other stakeholders, it could result in loss of political support, complaints or even legal challenges. Tolling is often not popular with road users and can lead to marked changes in behavior.
- PPP policy may accompany a wider restructuring of the road agency with a reduction in the number of civil servants and / or transfer to the private sector. If not carefully planned and conducted in conjunction with social measures, these programs can lead to de-motivation and opposition from road agency personnel.
- Constraints can be imposed by the international context. Countries participating (or planning to participate) in international communities (e.g. free trade agreements, economic communities) have to develop national policies in line and coherence with the common strategies and regulations

The driver of this enabler is political will for which it is useful to ask the following:

- Has strong political commitment been demonstrated by manifesto or statement or PPP policy from the government?
- Have public champions been secured or can they be identified at several levels of government and within the public authority? (Module 5 -> Advisors and Organization -> Organization)

Favorable investor climate

Private actors cannot be forced to join a PPP. They will enter into partnership with the public entities only if they consider that the project has a good chance of success and that their interests will be preserved throughout their participation.

Criteria used by private firms to evaluate a PPP project within a given country highly depend on the characteristics of the project and on the firm’s individual perception and requirements. Some criteria however are general enough to apply to any private firm entering into partnership with the public sector in a given country.

The potential participants in PPP projects will focus on the country parameters that will have direct or indirect influence on:

- the chances of the project actually being implemented and the risk of major delays before implementation. PPP Projects are often announced and prepared by public institutions and finally abandoned during the design or procurement phase. To avoid the loss of preparation cost, private firms are taking more and more care to assess the real commitment of the public sector toward the project.
- their chances to be selected to implement the project
- there being a fair and transparent tendering process
- the initial conditions under which they will be able to deliver the services
- the potential changes in the project environment and in particular those with potential adverse effect on their revenue flows (both in volumes and schedule).

Below is a tentative list of key areas typically assessed by private firms before embarking in a PPP in relation with the above categories (1 to 4 in column 2) and the typical source of information used by the private sector.

AREA	CAT.	PARTICULARLY AFFECTING	TYPICAL SOURCE OF INFORMATION
Political and institutional framework:			
Decision making process (national/regional/ local level - Technical Ministries / Ministry of Finance)	1 & 2	Duration of preparation phase and decisions process	Government organization
Status of the contracting authority	1 & 3	Enforcement of decisions	
Raise of private finance (BOT)	Status		
Political stability (political mandates and stability of key actors, public support)	1 & 4	Project stability	

Raise of private finance (BOT)	Political risk rating		
Commitment of key actors to PPP	1	Decision process	Comfort letter at high Government level
General acceptance of PPP by the public (in transport and other sectors)	4	Stability of the project	
Project revenues (BOT)	Local press		
Legal framework			
Procurement law and procedures	1 & 2	Competition	Legislation
Legislation directly related to PPP such as concession laws, tolling, private ownership etc. (for BOT)	1 & 3	Feasibility of the project	
Duration of preparation phase (change in law)	Legislation		
Dispute resolution (e.g. international arbitration)	4	Settlement of disputes	Legislation and contracts
Labor law	3	Conditions of work	Legislation
Tax system	3	Project revenues and costs	Legislation, experience
Unexpected events (Force majeure, hardship, Materially Adverse Government Action)	4	Project stability Project revenues	Project records
Macro-economic and financial environment:			
Inflation (past records, trend)	3 & 4	Project revenues and costs	Statistics
GDP and evolution	3 & 4	Feasibility Trend in revenues	Statistics
Currency convertibility and exchange rates fluctuations	3 & 4	Project revenues	Legislation, statistics
Motorization rate and evolution	1, 3 & 4	Project feasibility Project stability	Statistics
Experience of public sector in PPPs	1 & 3	Project feasibility Decision process	Safeway ITT Industries
Stability of the flow of public resources (public financed projects)	4	Project records	Status of the road agency

Objective and quantifiable indicators

Various well-established public and private institutions doing business in developing and emerging economies have developed methodologies and indicators to assess risks incurred by a project due to the country environment. The main institutions proposing country-related risk assessment are:

- the International Monetary Fund
- the OECD
- Export Credit Agencies who provide insurance to mitigate political risk

- the three main credit rating agencies namely Moodys, FITCH IBCA (Duff & Phelps) and Standards and Poors.



The Country Ranking developed by Nord-Sud Export (NSE), adviser to the French ECA COFACE



FITCH IBCA methodology on sovereigns rating.

For the Administration in charge of transport policy, identifying the main features characterizing the country with respect to the above criteria will allow it to assess whether the right signals are being sent to potential private actors. All the components need to be addressed: their absence will discourage involvement, no matter how financially attractive the projects may be.

The Doing Business Report, 2008 of the International Finance Corporation (IFC), a member of the World Bank Group, provides objective measures of business regulations and their enforcement across 178 countries and selected cities at the subnational and regional level. Cited obstacles to business were: price control, corruption, policy instability, tax regulations, foreign currency regulations. More information on this matter is found in:



Doing Business 2008, World Bank <http://www.doingbusiness.org/>

Effective Risk Management

Risks are not created under PPP procurement but rather are intrinsic to the nature of highway construction and operation and under public procurement risks are mainly borne by the public sector.

However, risks are openly identified and managed under PPP procurement, as opposed to being managed almost implicitly by the public authority under conventional procurement methods, who remains liable in the event of the risk occurring (the government “insures” itself against the results of its own actions). Examples include:

Insufficient project preparation and design result in contractor claims during works. Either such costs may be partially or fully recovered from the design consultant (who will mitigate through a professional insurance policy) or the public authority will have to assume itself the additional costs of works and/or redesign.

Delays in works completion on conventional works contracts may be partly assumed by contractors through liquidated damages but would in any case be at least partly assumed by the public authority through its own costs related to extended project administration and finance. Moreover, the economic loss to the government of delayed construction and ensuing benefits would be supported entirely by government.

The introduction of performance based maintenance transfers performance risks to the private sector; the private sector is not entitled to higher compensation if more maintenance is required to keep the road at a given standard. Previously, under contract maintenance or force-account units, the public authority would have assumed this risk intrinsically. However, if the risk materialized, the result would likely have been insufficient maintenance, as a result of constraints of public budget rather than cost overruns for the maintenance activities concerned. The government would then support the economic loss from insufficient maintenance.

Risk plays a central role in PPP due to the identification and assessment of risks inherent in highway construction and maintenance and the transfer of certain risks to the private sector. Moreover, the use of private financing imposes a much higher degree of analysis and quantification of the risks involved than that which would occur for public funding.

The principles and methods for risk assessment and management are described in Module 2 -> Risk.

In order to prepare effective risk management under PPP, public authorities can ask themselves the following;

- Has PPP procurement been applied in the highway sector? In other infrastructure sectors (energy, telecoms, water, transport) ?
- What risks can be identified under existing “conventional” contractual arrangements? How are they managed, even if intrinsically?
- What data sources exist for risk management, including the frequency of occurrence and their effect (eg cost overruns on construction projects)?
- What public sector skills exist in risk management?
- What private sector skills exist in risk management?

Capable Public Sector

Launching a PPP strategy requires public authorities to adopt a new role and thus acquire specific expertise at several levels for both the project development phase and contract management. These skills will need to cover such key areas as planning and economic analysis, environmental assessment, contract management and supervision, and prioritization of works.

It is also important to involve personnel that clearly understand the objectives and regulations of the public sector but also private business and contracting conventions. Some PPPs also involve special financial issues (where finance is part of the procurement) and the need to assess financial capabilities. Furthermore, non-standard procurement methods themselves also require special legal and contracting expertise. A public authority with limited experience may find it advantageous to capitalize on the background of other state or local authorities or indeed those outside of the country.

Whilst private contractors may play a greater role in road maintenance, they may require support and training in estimating and understanding specifications and in output measures.

The adoption of the required skills by the public authority should strengthen its deal-making capacity and promote a basis for a strategic orientation of infrastructure development.

The following questions can help to determine the capacity of the public sector to implement PPP projects.

- To what extent are the required skills for PPP present at the different levels of the public sector organization?
- What is the process for implementing PPP projects? How is inter-ministerial coordination achieved?
- Is there a PPP unit? Where is it housed within the public sector organization? How long has it existed? What is its mandate? What projects has it helped to implement?
- Can international expertise be funded and readily mobilized for technical assistance and training?

Module 3 -> PPP Policy Framework -> Capacity Building and Training provides an indication of training needs for the development of public sector capacity.

One aspect in which the public sector frequently needs strengthening is strategic and structural planning, most particularly when increased private participation is being considered or is undergoing its running-in period. Government has an irreplaceable planning role in transport. This is partly because of the need for active consensus building among the different modes to maintain an effective integrated system. But it is also due to the importance of transport infrastructure, and especially the road and rail networks, in structuring land use and regional development more generally. Multimodal strategic planning is particularly crucial at the national and metropolitan levels of government.

In parts of Asia and Africa where the study team inquired into reasons for the absence of reforms that have proved productive elsewhere, the main obstacle to progress appears to be local fears among labor, but also among concerned bureaucrats and less dynamic enterprises, of losing their acquired positions. This problem is often exacerbated by laws and regulations, often dating back several decades, which may never have been sound but have built up over time an array of supporting interests. Bringing about changes in public-private balance requires multiple scarce political skills, particularly of communication to generate wider understanding of the opportunities being missed; of alliance building, to gather political support; of negotiation, to win the tolerance of those who expect to suffer; and of effective implementation, including respect for the rights of all concerned.

Considering distributional as well as environmental aspects of projects, there would seem to be a need for more combinations of larger-scale public and private financing than is so far generally undertaken in developing countries, more along the lines of some recent projects in continental Europe. This can bring the advantages of private management into areas that have high economic priority but cannot be expected to become financially viable rapidly.



A Decade of Action in Transport, World Bank, 2005 (pg 76)



Public-Private Partnership Units: Lessons for their Design and Use in Infrastructure, EASSD, World Bank / PPIAF, 2007

Capable Private Sector

The private sector can only bring added value to the road system if it is sufficiently developed and entrusted with services in adequacy with its competence and the environment. At project level, the number and nature of the private actors involved depend highly on the characteristics of the PPP.

The contracting of local or international firms or a combination of both is to be considered. Local actors have a superior knowledge of their country and regional environment (legal and tax system, local standards, cultural and social issues) while international firms can bring added value by a better capacity to handle larger projects, experience in new forms of contractual arrangements, new technologies and stability for long-term relationship. Bringing in qualified international firms is more a matter of setting up a suitable and attractive environment than screening the entire international market.

However, market sounding shall be an important step in working with the private sector and obtaining knowledge and participation in investment opportunities (Module 5 -> Dialogue Process). The diagnosis on the private sector should rather focus on the local industry (locally established firms).

Policy makers should have thorough knowledge of the capacity of the private actors in their country and region in all their potential fields of intervention.

In particular, the following categories of actors should be assessed:

- Consulting firms for technical design, demand analysis, auditing, supervision
- Contractors for construction and maintenance
- Financial markets (banking system, capital markets)
- Potential road operators (for toll roads as well as “free” roads)
- Insurance companies
- Potential corporate and individual investors
- Legal and contract specialists

In each field, the number of actors, their experience record, their size and relative capacity (technical as well as financial) will influence, to a large extent, the possibility of developing PPP options and the level of competition that can be expected.

If the local industry does not have sufficient capacity to commit itself in PPPs, measures can be taken to assist its stakeholders to develop this capacity. Some of these measures are reviewed in Module 3 -> PPP Policy Framework -> Capacity Building and Training -> Enhance private sector capacity. The World Bank website also provides guidance to develop a new road management industry using various techniques such as marketing, revenue control, construction / maintenance / costing life-cycle.



http://www.worldbank.org/html/fpd/transport/roads/toll_rds.htm

At least three conditions are necessary to enable the private sector to efficiently participate in PPP implementation schemes:

- Existence of a favorable business environment (including legal/contracts);
- Sustainability of the demand for works;
- Customized training and assistance programs which suit their capacities and needs of local contractors and consultants.

Typical indicators for assessing the capacity of contractors

The capacity of private actors to become involved in the road management system (construction, maintenance, operation) must be associated with the type of activities for which they are required.

Routine maintenance, labor- and equipment-based periodic maintenance or rehabilitation and medium-size construction works can be opened up to domestic contractors.

The first assessment to be made concerns the complexity of the works (or activities) to be carried out. Once relevant categories have been worked out, the availability of contractors with appropriate capacities in each of these categories can be investigated.



Developing domestic contractors for road maintenance in Africa - Jean-Marie Lantran, World Bank Road Maintenance Initiative, 1990

Assessing the capabilities of contractors

The first issue is to know whether domestic contractors have already carried out comparable activities to the one for which they are approached, and what is their experience record is in this field. Secondly, the contractor’s capacity to undertake this type of activity shall be thoroughly investigated through a preliminary survey. This preliminary survey is essential in the case of companies which have no experience in the proposed activity. In many developing countries, road works are a new activity for most small or medium-size contractors who are more familiar with building construction work.

EXAMPLE OF CATEGORIZATION OF POTENTIAL PRIVATE CONTRACTORS FOR ROAD MAINTENANCE WORKS		
Type of works	Available contractors	Preparation/Training
<i>Equipment-based works</i> Resealing Regrading Regraveling	Medium-size contractors and farmers/foresters with some machines - some experience of civil and road works	Seminars Training works Technical manuals Contract format
<i>Labor-based road works</i> Regrading Regraveling Pothole patching	Small and medium-size contractors with no or few machines - no or little experience of civil or road works	Seminars Training works Technical manuals Contract format

Source: *Developing domestic contractors, Jean-Marie Lantran, op. cit*

Assessing the capacity of the firm means quantifying indicators such as turnover, assets, equipment, labor and financial resources.

The type of indicators and their interpretation (the weight assigned to each of them) may differ depending on the type of private sector involvement envisaged. In the case of works contractors, the quality of the equipment shall be of great importance. As regards engineering companies (for example contracting for making traffic counts), the skills of the staff is a major component.

RANKING OF ROAD MAINTENANCE CONTRACTORS: THE CASE OF BURKINA FASO

In Burkina Faso, where most routine road maintenance works (and some limited periodic maintenance works) are now carried out on a contract basis with small and medium-sized local firms (petites et moyennes entreprises, PME), the companies are sorted into several categories defined by ranges of values attributed to the following criteria:

- Total number of staff,
- Total number of skilled staff (per category),
- % of skilled staff hired in past years,
- Total turnover,
- Share of road activities in the total turnover,
- Equipment (per category) - number of machines, age, etc.,
- Former involvement in works by contract,
- Number of contracts obtained,
- Number of contracts obtained on projects involving an international donor,
- Other activities of the firm (besides road maintenance),
- Participation in training sessions: experience record.

On this basis, the firms are attributed a letter from A to E which will determine the possibility they will be given by the Administration to bid for certain categories of works. This ranking is permanently reviewed and the firms' performance evaluated in order to update the data base ready for any new programs/projects for which a competitive bidding process will be organized.

Source: Technical Assistance to the Road General Directorate in Burkina Faso, BCEOM - Louis Berger Int. - Activity Reports (1995 - 1998).