Public-Private Partnerships in Infrastructure Days 2008
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Foreword

The third “Public-Private Partnerships in Infrastructure (PPPI) Days” event was held during December 15–18, 2008, in Washington, DC. Against the backdrop of the emerging financial crisis, the thematic content focused on the prevailing financing environment for PPPs and the implications for PPP programs and appropriate policy responses by governments. PPPI Days also brought to the fore some recent significant examples of fast growing national PPP programs for example India, Greece and Korea.

This third event in the series attracted a record attendance from 250 participants from 65 countries, reaffirming the event’s status as the premier global event for public sector PPP practitioners. The meeting reaffirmed the important role of knowledge exchange and capacity building in this area.

For the first time since its inception by WBI, other multilateral partners collaborated in sponsoring and organizing this global forum of PPP practitioners and policy makers. I would like to thank the Asian Development Bank Institute (ADBI) for the excellent cooperation and support in co-financing and jointly producing this year’s event. Special thanks should be addressed to Ms Elaine Glennie, Senior Capacity-Building Specialist at the ADBI and her team. Their contribution has been critical not only in the design but also in the delivery phase of the event. I would also like to acknowledge the vital contribution and support by FOMIN, a member of the Inter-American Development Bank (IADB) Group. Our program would like to thank particularly Mr. David Bloomgarden, PPP Coordinator at the Multilateral Investment Fund (MIF) for his continuous support and assistance. I am pleased to note that collaboration on capacity building and knowledge exchange on PPPs between WBI, IADB and the Asian Development Bank continues to flourish and that PPP Days 2010, to be held March 22–24 at ADB headquarters in Manila, has benefitted greatly from this collaboration.
Financial support was also extended by the International Finance Corporation’s Infrastructure Advisory Services group and the Public-Private Infrastructure Advisory Facility (PPIAF) of the World Bank. Finally, I would like to recognize the excellent work of the WBI’s team working on this, ably lead by Govindan Nair, Lead Economist, and consisting of Filip Drapak, Periklis Saragiotis, Pascal Dooh-Bill, Sung-Hoon Park, Junglim Hahm, Bernardo Weaver Barros, and Patchareporn Talvanna.

Clive Harris
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Introduction

The third “Public-Private Partnerships in Infrastructure (PPPI) Days” event was held during December 15–18, 2008, in Washington, DC. It featured an agenda based on specific topics chosen by the members of the Global PPPI Network. It also reflected an emerging consensus that knowledge sharing and capacity building to support PPPI require greater harmonization, coordination, and alignment of multilateral agencies with focused PPP learning programs.

During the 2008 edition of the PPPI Days, the following new features were added to the structure of the event:

- An optional one-day event on December 15 served as a prelude to the main event. This one-day PPP Workshop served as an introduction to key concepts in public-private partnerships (PPPs) to improve understanding of basic elements of an enabling legislative and fiscal framework for PPPs and as a review of best practices.
- Special focus was placed on the latest issues in the global PPPI market and PPPI policies: leading practitioners and researchers in PPPI presented and discussed findings from current PPPI practice and research.
- Emphasis was placed on the discussion of the future evolution, shape, and role of the existing Global PPPI Network. The discussion enabled the network to examine its role as a more effective factor in knowledge sharing among PPP units or similarly mandated agencies.
- For the first time, the conference dedicated one day to the roles that can be played by multilateral capacity-building agencies and by private sector associations. A roundtable featured practitioners with global perspectives on all elements of private sector involvement in PPPI, including debt and equity financing, advisory services, and rating of PPP projects.
• Finally, throughout the course of the event, practitioners participated in a series of panel discussions focused on the impact of the current global financial crisis on the development of PPPs worldwide.
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This session provided a comparative presentation of three country cases with distinct approaches to institutionalizing PPP processes within the public sector. The Korean, British, and Greek PPP units are three different institutional models that have proved themselves to be efficient in developing and monitoring a robust project pipeline.

Stanford University has conducted a study comparing similarities and differences across various PPP agencies from around the world, mainly from developed countries. This study contains short descriptive profiles of eight agencies and a cross-agency analysis of key agency attributes. It also provides fresh insight into how the global spread of the PPP unit model has led to the creation of what is now quite a large family of more than 45 agencies worldwide.

According to the study, there are two different categories of PPP agencies: review bodies and full service agencies. Review bodies include those agencies primarily responsible for reviewing project business plans and providing recommendations to decision-making authorities. These agencies tend to be housed inside, and funded by, the host government. Full service agencies are those that, in
addition to the responsibilities of review bodies, also provide consulting to service agencies, develop the PPP market in their jurisdiction, and sometimes offer capital or advisory services. These agencies are typically arms-length corporations that receive fees-for-service on top of their government budget allocation. The type of agency implemented depends on the political environment and the structure and objectives of the host government.

The conclusions of the study were summarized as follows:

- **There is no archetypical model for a successful PPP agency.** Although many of the PPP units around the world have been structured according to the PUK model, success and efficiency largely depend on the adaptability of the institutional structure to the government peculiarities of the host government. Ultimately, the formation, function, and structure of the agency should be determined by the needs of the host jurisdiction.

- **The relative positioning of the PPP unit will inevitably change over time.** As PPP programs mature and other sectoral and subnational actors develop competencies, new requirements for advising and monitoring process emerge. PPP agencies are still expected to play a crucial role in developing
and monitoring a robust project pipeline and to be in the center of infrastructure development process. However, the constellation of institutional and policy issues that they will be called to address may change. Consequently, the functions, roles, and responsibilities of PPP agencies are expected to evolve to maintain a high level of effectiveness and responsiveness to the national infrastructure needs.

The Korean PPP program is institutionally managed through the Public-Private Infrastructure Investment Management Center (PIMAC), a think tank established under the umbrella of the Korean Development Institute (KDI) (see figure 2). PIMAC is in charge of the PPP management mandated by Korea’s Ministry of Finance. In fact, both publicly and privately financed Korean projects are managed and reviewed by the same governmental body. To do so, PIMAC encompasses two divisions: the Public Investment Evaluation Division and the Private Participation in Infrastructure Division. The former division is in charge of the public projects and focuses on traditional infrastructure schemes financed by the national budget. The latter division, in charge of the private projects (including PPPs), undertakes the responsibilities and tasks of a modern PPP unit. The PPI division of PIMAC is responsible for the PPP program planning expressed through the establishment of the annual PPP project plan. It also evaluates projects and supports line ministries to excel in PPP project management. Finally, PIMAC is
mandated to conduct economic and policy research studies on PPPs and broader infrastructure development thematic areas.

Apart from being the sole PPP government agency, as well as the main researcher and advisor to line ministries and public entities, PIMAC functions as the government’s PPP market promoter. It consults with local and foreign investors and supports policies for induction of foreign capital into the Korean PPP market. It has also established and promoted a well-structured knowledge economy program on the PPP system that aims to inform and educate the domestic public and private sectors on the mechanics, benefits, and challenges of PPPs.

In the United Kingdom (U.K.), a variety of different institutions are acting in different capacities in managing the national PPP program (see figure 3). These include, among others, Her Majesty’s (HM) Treasury, the National Audit Office, 4ps, Sector Ministries Private Finance Units, and others which are responsible for supporting key functions of the PPP market. These functions include the formulation of the policy framework, the provision of advisory services to the local authorities or the formulation of sectoral investment plans to be financed by private capital or even the independent assessment of policy implementation.

The public sector’s role is critical for the development of the PPP program and policy. The HM Treasury under the Ministry of Finance is responsible for the overall policy formulation and strategy development of the economy, and the infrastructure sectors in particular. The U.K. PPP public system also includes a number of PPP...
teams at the sectoral ministry level. These teams are developed in sectors, with a significant number of projects under preparation and in the pipeline. (Health and education ministries are good examples of ministries that have established specifically dedicated PPP cells.)

Partnerships UK (PUK) complements the U.K. PPP market picture as the institution that focuses on the implementation of the entire PPP project pipeline (see figure 4). It is the result of an evolutionary process that began with the establishment of the Private Finance Panel in 1992, whose objective was to set the right legal and regulatory environment for private finance initiatives (PFIs), and thus setting the rules of the PPP market. In 1997, the Treasury Taskforce replaced the Private Finance Panel and undertook project leadership responsibilities to assist line ministries to structure and deliver PPP projects on the ground. The need for a centrally located entity that focuses on a cross-sectoral level and that will coordinate the market and support the project pipeline led to the establishment of PUK in 2000.

PUK, not being a statutory body of the government, is not responsible for the development of infrastructure policy. Although PUK is being consulted to provide input regarding the strategy direction in respect to PFIs, the ultimate responsibility for policy formulation lies within the HM Treasury. However, PUK assists the government on the implementation of the strategy. Since 2001, Partnerships UK is a public-private partnership itself: the private sector owns a 51 percent majority shareholding, and the Treasury and the Scottish Executive share a 49 percent shareholding. Today, PUK has developed a substantial international business line and supports several countries worldwide through train-
ing and technical assistance programs focusing upon institutional and project quality assurance issues.

The Greek PPP taskforce has been created as a result of inefficient regulatory and legal processes experienced during the procurement of large transport infrastructure projects. In particular, the Attiki Odos Highway, the Spata International Airport, and the Rio-Antirio Bridge projects had to be ratified by Parliament as distinct laws, thus delaying the entire process and increasing the nervousness of the market. In 2005, a new law (Law 3389/2005) introduced the first regulation on PPPs in Greece and opened the market to this new type of public procurement.

The law sets the legal framework for the establishment of the Ministerial Committee and the Special Secretariat for PPPs as the governing institutional entities. The Ministerial Committee comprises three ministers (under the chairmanship of the Minister of Finance), and the Greek PPP Taskforce, a special secretariat within the Ministry of Finance, undertakes the responsibilities of a modern PPP unit.

Overall, the Greek PPP Taskforce has the typical structure of a publicly owned and operated PPP unit placed under the Ministry of Finance. Within a relatively short period of time, it has been recognized as a valuable partner of the Greek public and private sectors. Throughout its three years of operations, it has successfully:

- Assisted line ministries in the identification of feasible projects;
- Provided technical assistance to public authorities;
- Proceeded to the standardization of tender documents;
- Engaged with the private sector and responded to the domestic market’s needs; and
- Developed an ambitious extroverted policy, advising and sharing its experience with other PPP units worldwide.

The key messages derived from this session are the following:

- Comparative results, before and after the establishment of a dedicated PPP agency, confirm that the adoption of a clearly mandated institutional structure is one of the prerequisites for the development of a robust and sustainable PPP program.
- A mosaic of different structural solutions has been adopted by various countries worldwide to institutionally administer their programs. Most of them have followed the U.K. model and established dedicated taskforces with strong links to the Ministry of Finance and the Treasury. However, all countries have accordingly adjusted their organizations to better fit the uniqueness of the governmental and regulatory framework and respond faster to the market needs.
• PPP units have to be equipped with top-of-the-line legal, technical, and financial professionals who, with their experience and skills, will enable the unit to advise procurement authorities on how to better design, develop, and monitor PPP projects. Incentive mechanisms must be in place to provide the motives to capable professionals to develop long-term public sector careers, thus preserving the expertise and knowledge in-house.
This session reviewed the following key operational issues of PPP programs from a public sector viewpoint:

- The structuring of a PPP project pipeline
- The PPP project selection process
- The prioritization of PPPs within the budgetary planning process
- The overall public management process of the PPP program

Partnerships Victoria (PV) in Australia has a very detailed project planning and selection process that supports the decision for project delivery as a PPP. It comprises the following elements:

- Asset management framework, which provides the support for the strategic control of the public sector asset base
- Investment life-cycle guidance, which provides guidance throughout agencies on the policies and the processes that are applied to delivering government investments, including infrastructure projects
- Investment management standard, which is a set of tools that defines the problem that PV seeks to cure by investing in infrastructure, the potential set
of solutions that can be applied, and the expected benefits of each possible solution to the public

• Gateway review (a process adopted by PUK), which is a key quality assurance tool in relation to infrastructure delivery

PV considers market engagement an important tool for the overall management of its PPP pipeline. Market engagement commences informally at the options analysis stage, it provides an important input to the procurement strategy, and it occurs formally though a tender process. Its importance is paramount because on one hand, the market needs to understand the potential future project pipeline, and on the other hand, the government needs to sense the market’s capability when evaluating options and developing procurement strategies.

Current challenges that PV faces in terms of PPP program management can be summarized in three key areas:

• Lack of capability is found in both the public and the private sectors because of the complexity and atypical nature of these project structures. On the public sector side, the government often looks for the right balance between developing internal expertise and outsourcing services to outside experts. In this context, pathfinder projects play an important role in the capability-building process, especially when entering new sectors.
• Capacity issues arise for both government and the private sector, mainly referring to skills shortages on the individual and the organizational levels. Capacity issues can come into play, especially when the PPP program expands in value or number of projects. In Australia, the limited capacity of the private sector, operating in a federal system of competing state-level PPP markets, limits its scope of work and leads to the selection of a specific market. In addition, in many cases the private sector dedicates human and budgetary resources to other economic sectors, thus further limiting its capacity to develop PPP projects. Nevertheless, lack of public and private sector capacity increases significantly the chances of project failures.

• For a central PPP unit such as Partnerships Victoria, coordination across various governmental agencies is another key issue in managing the pipeline. The unit has to balance the specific needs for project development of individual ministries against the need for consistency across the PPP program. This approach assists the better management of transaction costs, the delivery of standardized process, and the allocation of resources across government by reference based on risk.

In Spain, to ensure that PPPs are to provide value added compared with traditional public procurement, they have to prove that the efficiencies provided via the involvement of the private sector cannot be met by the government. This concept has led the Spanish government to the establishment of a flexible procurement procedure that identifies the right private sector company willing to provide the best quality at the least cost and within an accepted time frame. The Spanish legal framework is based on continental Napoleonic law and consists of general and sectoral legislative pieces. The sectoral ones refer mainly to the transportation sector, with separate laws for superhighways, ports, airports, and railroads. These laws are applied as procedure manuals that support the project development of the respective sectors.

Figure 6. Legal framework of the concessional regime in Spain

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<td>Sheet of General Clauses in Motorways in Regime of Concession (Decree 215/1973)</td>
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<td>Real Decrees of Awarding</td>
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Author: Antonio M. López
During the tendering preparation process, every PPP project has to meet the same conditions of maturity as those of any other route of financing. In addition, it is required to develop a feasibility study that indicates that there will be sufficient income to support self-financing of the project. The tendering process commences upon the approval of the feasibility study by the government.

The tendering process of a PPP/concession in Spain is usually based on open or restricted competition. The format of the contract is known with a few opened clauses, most of economic content. The process assures the continuation of competitive dynamics throughout the course of procurement, even after the contract has been awarded. The awarding criteria are transparent and set toward the objective of selecting the project that will offer standard quality of service under certain financial and economic conditions.

The Infrastructure and Law Web site was presented by Victoria Delmon and Mark Moseley, from the Finance, Private Sector, and Infrastructure Practice Group of the Legal Vice Presidency (LEGPS) of the World Bank. The Infrastructure and Law Web site is designed as a knowledge management tool with the goal of providing practical guidance on planning, design, and legal structuring of infrastructure projects.

The Web site has the following objectives:

- Guide users through the project development process through the provision of
  - Tips on appointing advisors and sample terms of reference (TORs);
  - Tools and checklists for reviewing legal enabling environments, as well as sample laws and regulatory instruments; and
Summaries and key elements of each category of PPP, including sample contracts, clauses, risk matrices, checklists, and so forth.

- Institutionalize World Bank Group knowledge on the specific thematic subject by
  - Drawing on the experience of the World Bank Group projects in infrastructure projects’ utilities sector reform and
  - Providing links to other relevant Public-Private Infrastructure Advisory Facility (PPIAF)—and World Bank Group–funded analytic work and knowledge products, such as sectoral and thematic toolkits.

- Create links to other useful resources, such as standardized bidding documents produced by several government agencies and PPP units.
- Encourage knowledge sharing and publication of PPP documentation.

The Infrastructure and Law Web site can be found at www.worldbank.org/inflaw.

The main messages of this session are summarized as follows:

- A robust process for prioritizing and selecting appropriate projects for PPP delivery is vital for a sustainable PPP program.
- Both informal and formal market engagements are important for the smooth running of a PPP program.
- Government must have the capability and capacity to manage its PPP program, and there must be coordination across government.

A transparent and clear tendering and award process operating under a tested legal and regulatory framework is critical for the success of the PPP program.
This session reviewed the structure and the models of the PPP program performance management. Who should monitor which results? How to benchmark performance of PPP projects compared with that of traditional non-PPP investments? These questions should focus on monitoring output and measuring financial impact; employing tools to keep track of project performance; considering the role of performance management in renegotiations of procured contracts; and determining how the specific type of PPP influences its performance and the way it is monitored.

Korea is one of the leaders in the development of PPP projects. So far, the PPP program encompasses a mix of nationally and locally developed projects applied in the transportation, environment, water and sanitation, military, education, and other sectors. Two types of structure have been used: Build Transfer Operate (BTO) and Build Transfer Lease (BTL). Around 170 projects worth 59.9 trillion Korean won (KRW) have been developed as BTOs, while 270 projects worth KRW16.6 trillion had been developed by December 2007.

The number of challenges that Korea faces in the management of the BTO projects grows exponentially as the program develops. Within a few years after the signing of the contract, the great number of projects, which reaches 80 percent of BTO projects awarded, is being formally put under supervision and review. Initiation of the process is equally shared by the government and by the concesionaire. The rationale for changes has been one of the design change, refinancing, or act change.
Today, the completion ratio of the clauses is kept at a low level (55 percent) because of the very low completion rate of the refinancing completion ratio (just 11 percent).

In the case of BTL projects, their overall performance has been impressive. According to a performance analysis of Build Operate Transfer (BOT) projects conducted by KDI, considerable progress is demonstrated in the following areas:

- **Budget reduction**, where the ex post value for money (VFM) was significantly higher than the one estimated before the construction.
- **Cost overruns** have been significantly reduced in concession agreements of projects under progress, as well as in already developed military housing and school facilities projects. Cost overruns are calculated as the difference between the amounts announced in the request for proposals (RFP) and the actual agreed amount.
- **Time overruns** have been reduced significantly, as all projects included in the analysis proved to have reduced time for construction compared with the estimated period of construction on the RFP.

A number of challenges in the Korean PPP program need to be addressed to achieve better management of contracts. These could be summarized as follows:

- **Upgrade procurement schemes.**
  A combination of deficient design, rushed process, and questionable advice has resulted in a set of weaknesses in the concession agreement. The importance of regulation with the strongest possible legal grounding has been
recognized. KDI is currently working on the upgrade of the PPP selection criteria, the provision of detailed guidelines for initial concession design, and the evaluation of optimal government support.

• **Keep a safeguard ceiling.**
  A safeguard ceiling was introduced in 2007 to limit the annual expenditure size of the PPP program to 2 percent of the total government expenditure. KDI currently struggles with the implementation process and the frequency of the safeguard ceiling. Next steps that might address these concerns include the (a) reporting of PPP projects to the National Assembly with the Five-Year National Fiscal Management Plan; (b) withdrawing support for PPPs if government annual expenditure fails to comply with the safeguard ceiling; and (c) developing detailed guidelines for the implementation of the ceiling.

• **Strengthen ex post monitoring and supervision.**
  After the construction period, each supervising agency (that is, central or local government line ministry) manages the project independently. However, experience has shown that during the operation and maintenance period, the supervising agency pays less attention, thus making it more difficult to monitor its performance. KDI is currently developing a centralized information and management system that, among other things, will support the provision of standard guidelines for ex post operation and management and will operate a full-time PPP projects portfolio management body within the government.

• **Develop clear guidelines for refinancing.**
  Guidelines for refinancing are not clearly defined from the early stages. There is a need to provide a clear guideline for financing and refinancing that will define the timing of the concession contract, financing and refinancing, the minimum equity ratio, and the profit-sharing percentage between the government and the concessionaire.

• **Refine rules for renegotiation and termination.**
  In Korea, renegotiation of a contract is often requested by the concessionaire to make up for too aggressive bidding, to adjust to macroeconomic shocks, or to compensate for losses from changes in government priorities or from competing government projects. The government is thinking of revising the standard concession contract, including the details of renegotiation determinants, such as the regulatory framework, macroeconomic shocks, government priorities, and so forth. At the same time, it needs to define more clearly the terms “inevitable circumstances” and “public interest,” which are used as a
basis for the commencement of the renegotiation or termination process, and to consider changing the standard rule for calculating termination payment.

- Risk management of BTL projects.
  A more comprehensive risk management structure is needed to administer the BTL program and to better manage and review the burden of a long-term (more than 20 years) contract management. The government is currently establishing a fiscal rule that sets up a ceiling considering future government burden from PPP projects. At the same time, the need for expertise and capacity of competent authority to manage the total Design Build Finance Operate (DBFO) process has been recognized and is expected to be one of the major challenges to address in the near future.

  Patricio Mansilla outlined the incentives theory behind the application of PPPs and presented specific examples of road PPPs’ levels of service and airport PPPs’ productivity factors. He referred to the quality and level of service as indicators to determine the performance of infrastructure projects under monopolistic, contestable, or competitive markets.

  International experience shows that the relationship between price paid and quality of service received is maximized under PPPs. Guaranteed value for money and the transparency of the procurement and monitoring process ensure that consumers will enjoy high levels of service. Lessons learned from infrastructure projects worldwide can be summarized as follows:

  - Adequate application of incentives theory is crucial to reach high levels of service quality.
It is important to have a good diagnostic for existing infrastructure to reduce costs and also to increase the probability of fulfilling the levels of service established in the PPP contract.

Productivity factors can have an important impact on the performance of the PPP contract because it can trigger higher or lower tariff adjustments and it can bring incentives to increase or decrease levels of service.

Richard Foster from Partnerships Victoria presented the big picture of PPP performance and outlined the goals of monitoring and managing performance of projects. Ultimately, PPP performance has to be linked to an overarching government economic policy. The performance framework in Australia is viewed at three levels:

- **The strategic level**
  A strategy links a particular project to the policy and provides the connection between the project's outcomes and the policy objectives. Performance in this level is measured in terms of the expected benefits of the investment.
• The contractual level
  The contract itself has its own obligations and defines a specific set of obligations for the concessionaire measured by key performance indicators (KPIs).

• The operational level
  At the operational level, tools and processes are developed for day-to-day performance management. Government usually has a contract management administration process to support monitoring at this stage.

Managing Performance in Infrastructure Delivery

The PPP “no payment until services are delivered” rule provides a strong driver for concessionaire performance during the construction phase of the project. The concessionaire knows that to get paid, it has to deliver what it has agreed to in the contract. But government also needs to monitor the concessionaire to ensure that what was contracted is delivered. In this context, the government must carefully manage scope creep, both intentional and unintentional.

For projects reliant upon user charges, the transfer of demand risk provides a strong driver for early completion. The combination of an output specification and user charging protects government and end users against cost increases if scope is well managed.

For projects reliant upon government payments, the incentive is to deliver “on time” rather than early. In fact, social infrastructure PPPs in Australia are typically completed close to the scheduled date. From the government side, shortening of the operational phase is a better protection against late delivery than liquidated damages.

Performance management in the service delivery phase requires enforcement of the risk transfer through the following:

• Use of the payment mechanism
  For projects reliant upon user charges, the transfer of demand risk provides a strong driver for performance during the operational phase of the project, just as it does during the construction phase. However, this depends on the level of competition, especially in the case of toll road projects. In addition, sharing of demand risk (for example, if government shares in revenue above specified levels) creates a need for additional government monitoring. Similarly, for projects reliant upon government payments, a well-calibrated
payment mechanism, linked to the output specification, is also important to drive the desired outcomes.

- **Management of disputes**

  Disputes do occur in PPPs because of the contractual complexity of the projects. They are found in two forms: (a) disputes of fact (that is, failure to meet a performance indicator) and (b) disputes of legal interpretation (that is, the contract is ambiguous as to whether the agreed factual situation entitles the concessionaire to an extension of time to meet the performance indicator). The contractual dispute resolution mechanism is often not the only option, and other alternatives must be explored to minimize the impact on the project and the relationship between the partners. In this context, disputes can—and should—be separated from the longer-term relationship and should be dealt with promptly.

  Disputes sometimes—but not always—lead to defaults. Defaults also occur quite often in PPPs, but they do not necessarily result in the project coming to an end. It is important that default processes must be appropriately graduated and should not be easily triggered.

In summary:

- PPP performance is not just a question of contractual compliance by the concessionaire.
- We need to understand and monitor the broader context because all PPPs ultimately aim at fulfilling a government policy.
- The appropriate tools and levers to drive and enforce performance depend upon the specific type of PPP and the particular stage of the project.
- Using the contractual levers requires fortitude and planning.

The main messages of this session are summarized as follows:

- PPP performance is not only a question of how concessionaires will manage PPP contracts. Governments also need to understand the broader context of a PPP program. Therefore, knowing and choosing the appropriate tools to establish a positive performance depend upon the specific type of PPP project.
- PPP programs should set up levels of service (quality/performance), monitor procedures to reach quality levels established in PPP contracts, and consider prizes and penalties while establishing new PPP projects, because regulation and enforcement of PPPs are based on the quality of construction.
This session looked at fiscal issues—at both national and subnational levels—arising from PPP projects and use of various instruments in PPP finance. It evolved around the manner in which fiscal risk of PPPs should be accounted for and contingent liabilities of government should be managed. Presenters only touched upon the mode in which financing of subnational PPP projects affects government liabilities and how these risks are appropriately managed from the public and the investor perspectives.

Bob Finlayson of ADB pointed out that international experience has shown that the use of PPP procurement in infrastructure projects creates long-term fiscal obligations for governments that need to be managed. The degree of public sector responsiveness varies among countries, and fiscal obligations act as a significant constraint to the use of PPPs, particularly in developing economies with limited fiscal flexibility, in which the availability of tax revenue is often a critical constraint.

Being in the center of the discussion, annuity payments have helped develop infrastructure, but they create long-term fiscal obligations. From the public sector side, the government needs to ensure that PPP commitments are affordable and to minimize credit risks for the PPP financiers. It also requires the advancement to
several institutional adjustments to the existing planning, budgeting, financing, and reporting processes.

The management of a PPP investment program requires its inclusion in the national public investment planning and finance framework. This will ensure that

- There is a clear allocation of responsibilities among governmental agencies involved in the process;
- PPP projects are integrated within government’s investment strategy, medium-term fiscal framework, and the budget cycle; and
- PPPs are pursued only if they create VFM when compared with standard public procurement methods.

The management of fiscal risks associated with PPP investments requires the establishment of a dedicated PPP institutional framework. This should support the government not only to manage and assess risks from PPP liabilities but also to build and maintain capacity to address more complex issues in the long run. In this context, the Ministry of Finance should have a central role in managing PPPs. The PPP process should also be supported by safeguards empowering the Ministry to stop or suspend a PPP project that does not satisfy VFM or affordability conditions.

In conclusion:

- PPPs can leverage governments’ ability to develop necessary infrastructure, but they create long-term fiscal commitments.
Hybrid PPPs help resolve fiscal constraints, but contingent risks can be difficult to quantify.

PPPs need to be embedded in the budget framework to manage investments and related risks.

There is a need for a clearly defined risk management strategy.

The Ministry of Finance should have an overall control of risk taking and risk monitoring.

Naoyuki Yoshino, Professor of Economics at the Keio University in Japan, presented the Asian experience fiscal issues in revenue bond issuance and PPPI, as recorded in a paper published in cooperation with the Japan Bank for International Cooperation (JBIC).

In Asia, considerable attention has been paid to private participation in infrastructure (PPI) as an alternative approach to infrastructure development to minimize government fiscal burdens and to maximize efficiency gains through the use of private sector know-how. Growing financing gaps in infrastructure development have called for an urgent resolution. The paper proves that local bond markets should play an important role in supplementing infrastructure financing and for avoiding double-mismatch problems. Several cases of infrastructure financing with private participation in Japan, the United States, and some of the emerging economies suggest that the use of revenue bonds with appropriate risk sharing and properly designed government support could help fill the gap without causing moral hazard problems. The paper tentatively proposes a few conceivable variations of revenue bonds for infrastructure financing with private participation based on appropriate risk-sharing concepts.

In Portugal, fiscal risks are being viewed as potential adverse impacts on the financial position of the government as a result of PPP performance factors. PPP projects transfer construction and maintenance risks to the private sector, thus resulting in lower risk to the public sector, compared with the risk it assumes under traditional public procurement models. However, not all project risks can be transferred to the private sector through PPP contracts; in addition, PPP contracts may create new fiscal risks.

The perception that prevails in the market views PPPs as long-term contracts that can be developed with zero cost for the public budget. This perception reduces the public sector motivation to identify and manage fiscal risks. A fiscally responsible approach leads to the fiscal risk identification and management in a project, as well as at a programmatic level. Many governments have put in place a set of mechanisms and tools to compute fiscal risk exposure of the entire program of PPP projects.

Portugal faced several concerns over fiscal risks that induced government to approve a new PPP legal framework in 2003, which established the following:
A gateway process that allows the sponsoring line ministry to be responsible for the policy design, but under a certain degree of filtering by the Finance Minister (Ultimately, it empowers the Finance Minister to stop or suspend a PPP project or program if certain conditions are not met.)

- The quasi-appropriation of PPPs with a PPP memo—referring to contracted payments or public sector comparator (PSC) forecasts—attached to the budget
- The PPP unit under the Ministry of Finance

Sumter Lee Travers of the Subnational Finance Group, presented the impact of PPP projects on the subnational level from the financier’s point of view. In a subnational environment, the success of a PPP project depends heavily upon a high-quality contract design. However, subnational governments differ from sovereign governments in the way they treat fiscal risks generated by their PPP transactions. One set of risks that they face is the so-called “surprise risk” created by a policy shift at a sovereign level that affects the ability of the local government to meet its contractual obligations. These shifts may have an impact on the service pricing or on the allocations of public funds to fulfill availability payments.

Quite important also is the relationship between the sovereign and the subnational governments as it is being evaluated by financiers and reflected at the project rating. PPP projects developed by municipalities have been assessed and rated positively on the basis of the strong support they receive from the central government. In this context, subnational governments do not properly identify

Figure 12. Sub-Sovereign Finance in PPP Projects and Their Fiscal Impact

Author: Lee Travers
and manage fiscal risks because they assume that if they commit to more than they can afford, the central government will come to the rescue with some sort of financial compensation.

Research has shown that most of the canceled infrastructure projects since the late 1990s have been developed at the subnational level. The risks that a local government faces are greater than those the central government faces, given their financial capacity and their ability to mitigate those risks. Projects developed on the basis of availability payments are very often met, during the last 15 years, in the subnational environment. This has a direct implication on the pace and manner that fiscal risks are being developed and mitigated by local governments or municipalities.

The main messages of this session are summarized as follows:

- To achieve optimum management of PPP projects on behalf of the public sector, there must be a clear allocation of responsibilities within governmental agencies and line ministries for dealing with PPPs.
- PPPs need to be integrated within the government investment strategy as a potential financial structure that, under certain circumstances, may substitute successfully for the traditional public procurement schemes. In this context, PPPs should be part of a regular cycle of investment projects in the medium-term fiscal framework to ensure fiscal capacity in the budget.
- Knowing how to manage PPP fiscal risks means that the Ministry of Finance should have a central role in managing PPPs. Regardless of the size of the program, there is a need for the establishment of a framework to manage long-term PPP liabilities. In addition, the government needs to develop capacity to manage and assess risks related to these liabilities.
- The empowerment of the Ministry of Finance to stop or suspend a PPP project that does not satisfy affordability conditions is used internationally as a risk reduction mechanism that ensures the quality of the entire PPP program. Overall, PPPs need to be embedded in the budget framework to manage investments and risks. A PPP needs a clearly defined risk management strategy.
This session focused on the significance of PPPs for emerging markets in their attempt to develop and maintain infrastructure assets. Participants discussed the latest trends and the key drivers of PPPs in 2007–08 and how these fit into the overall infrastructure finance picture. Extensive discussion occurred on the role that emerging economies played both as destinations and as sources of PPPI investment funds and on the future outlook of the PPP market, given the global financial crisis.

Jyoti Shukla, program manager of Public-Private Infrastructure Advisory Facility (PPIAF), presented the latest trends in private participation in infrastructure based on data derived from the private participation in infrastructure (PPI) database of the World Bank.

In 2007, PPI finally surpassed 1997 peak levels after four consecutive years of growth and reached US$1,475 billion in more than 1,000 projects worldwide. Investment volumes grew in virtually all regions and in all country income groups, including the low-income countries. Brazil, Russia, India, and China—known as the
BRIC countries—plus Mexico emerged as the top five PPI recipients in 2007. These countries received 47 percent of all investments, while the top 10 saw 62 percent. At the same time, more than 45 percent of all new projects were in China and India.

In terms of sectoral breakdown, all economic infrastructure sectors have increased their investment values in absolute terms, except for the water and sewerage sector (which faced a decline compared with its performance of the previous year). Within the sectors that experienced growth, transport and energy expanded their share of the total investment volume, while telecom experienced a significant decline in its share (50 percent).

At the same time, investors have become more risk averse, concentrating more on greenfield projects. These account for the largest share compared with other types of private participation. Concessions have accounted for only 11 percent of investment in 2007 versus 25 percent in 1997. Divestitures were significantly fewer compared with past years—33 percent of investment in 2007—and they mainly reflect partial share sales in the telecom and energy sectors. Management and lease contracts continue to grow, but they involve little investment in terms of value.

Besides, the list of PPI projects’ sponsors became more diverse. Out of the 10 top investors in 1990–2000, only three (America Movil, France Telecom, and Telefonica SA) remained in 2001–2007, while the number of emerging market firms went up to four in 2001–2007, compared with two in 1990–2000. Non-OECD (Organisation for Economic Co-operation and Development) flows to Africa grew significantly. In
2006, emerging financiers—including China, India, and Arab donors—committed more than US$8 billion to infrastructure in Africa. Particularly, the Chinese investment in Africa was at least US$7 billion in 2006 and was estimated to reach US$4.5 billion in 2007.

However, the current financial crisis has greatly affected PPI projects. A series of observations derived from the international infrastructure PPI market confirms the above statement:

- Hedge funds are rapidly being scaled back.
- Private equity funds are holding back capital.
- Currency devaluation is making foreign debt more expensive.
- Investors are demanding higher returns.

In the short to medium terms, more significant impacts will emerge as the financial crisis triggers an economic slowdown, which will cause the overall scaling back of government expenditures in infrastructure, with operational and maintenance expenditures particularly expected to be hit first and hard. The financial assumptions on PPP projects come into question, putting contracts in distress and the infrastructure pipeline on hold—probably for more than the duration of the crisis.

The impact so far (from August to November 2008) can be counted in the decline of the overall number of projects that reached financial closure. In this period of time, 31 projects (US$17 billion) reached financial closure. This number corre-
sponds to about a 30 percent decline from the similar level in 2007. In addition, 29 projects (US$23 billion) were delayed by November 2008, and another 70 projects (US$60 billion) will be potentially delayed if reduced financing continues in the near future. These signals from the market possibly mean a return to the basics, with particular emphasis on the improvement of the contract quality; cautious project risk assessment; and the need for the development of robust legal, regulatory, and institutional frameworks, as well as the public and private sectors’ capacity to develop and monitor PPP projects.

The role of the international finance institutions (IFIs), including the World Bank Group, is critical for the countries in their attempt to overcome the consequences of the crisis. The manner and the nature of their response will have a great impact for the future of PPIs worldwide. It is expected that the IFI-generated funding will provide support for private partners to refinance, recapitalize, and temporarily substitute IFI debt for commercial debt, as well as for public partners to blend higher levels of public financing for PPI projects and meet offtake obligations.

IFIs are also expected to expand their technical assistance portfolios to governments to assist them to assess contingent liabilities on existing projects; to support renegotiations or restructuring of existing projects; and ultimately to maintain project development pipelines and to redesign new projects with less investment or more public debt.
Along these lines, Dr. Barbara C. Samuels, the vice-chair of the UN Financing for Development, Business Sector Steering Committee, presented the challenges that multilateral development banks (MDBs) face in the shifting environment of international development finance. MDBs should optimize their counter-cyclical role and take the opportunity to act toward immediate increase of aid effectiveness to developing countries. The current status of the global financial markets undermines virtually all assumptions about market disruptions and the ability to have access to a steady supply of credit. It is characterized by international banks retreating to preserve capital and transactions facing a substantial “repricing of risk.”

However, many view the financial crisis as a challenge that will enable more effective partnerships between MDBs and the private sector as each looks to the other to complete complex financings. Nevertheless, MDBs should act rapidly to resume their “enabling” functions and increase their roles in attracting private sector capital to infrastructure. There are several ways—roadmaps—in which this could be achieved:

- **Roadmap 1: Reorient Culture, Capital, and Skills of MDBs**
  MDBs align their “development mission” with the private sector culture and shift resources towards risk mitigation and capacity building while realigning incentives and performance metrics with goals.

- **Roadmap 2: Expand Risk Mitigation Activities as “Aid Multipliers” of Official Sector Resources**
  This includes the scale-up of official sector risk mitigation activities (that is, partial guarantees, targeted guarantees of regulatory and currency risks, or output-based aid) to mitigate specific impediments restricting developing country access to private sector capital. It also assumes the development and scale-up of modern financial structures with successful track records in providing long-term affordable finance from capital markets, as well as reinforcing the development impact assessment via the development of “aid effectiveness” measurements and new MDB risk mitigation performance measurement indicators. Finally, it should include expanded risk mitigation support for local currency financing.

- **Roadmap 3: Establish Investment Climate Capacity Building as a Central MDB Priority**
  The goal of the capacity-building roadmap will be to create a step change in MDBs’ funding to strengthen the enabling environment. This will be facilitated by the gradual integration of the private sector expertise on a more systematic basis in expertise development within the public sector via the development
of customized country training programs (with local institutions and business organizations) and learn-by-doing transaction programs.

- **Roadmap 4: Strengthen Investment Project Pipelines with Project Development Support**
  MDBs need to pool and scale up project development funds, making them easier to access, utilizing appropriate experts from across the public and private sectors to identify quality projects, and developing acceptable risk-mitigating financial structures. Possible ways to achieve this objective include the following: (a) set up funds with simplified access (subsovereign, national, regional, and global), using technical assistance or revolving funds; (b) create partnerships for project development with experienced private sector or research entities; (c) create and strengthen regional and local development financial institutions; (d) create “Steering Committees” of experts to oversee the project development process and the development of appropriate policy, legislative, and regulatory frameworks; and (e) establish “SWAT teams” of experts who can, among others, help government officials determine how to approach the private sector and structure bankable deals.

In the context of the global financial crisis, the Asian Development Bank (ADB) has seen its portfolio of infrastructure projects increased within 2008, and it expects similar market behavior in 2009. Demand for assistance, similarly expressed in other regional and multilateral development banks, is translated not only in monetary (lending) terms but mainly in provision of risk mitigation instruments.

The volume of infrastructure deals in Asia in which ADB will be involved in 2009 may double or triple the volume of transactions financed in 2008. However, the confidence level that these deals have high probability to reach financial closure within 2009 is not very high. Therefore, ADB has been very careful in reassessing its infrastructure finance program components and has been very reluctant in financing or even co-financing all requests it receives.

As the crisis deepens, international investors in Asia are narrowing their focus on the area’s two giants: India and China. The challenge for ADB and the rest of the MDBs is to widen the investors’ radar screen and include more countries as target destinations for private capital investments. This could be achieved by the broader participation of the MDBs’ private sector branches in infrastructure transactions, as well as the provision of technical assistance targeted at the institutional framework of PPPs (that is, the establishment of PPP units or PPP cells in the line ministries capable of bringing well-structured projects into the market).

Arvind Mayaram presented the current picture of the Indian PPP market and the steps taken by the government to support the development of PPP projects.
The Indian government supports the use of PPPs in infrastructure because they are seen as an excellent way to develop new, world-class-quality assets and to improve the maintenance and management of existing ones. The key challenges that it faces evolve around two major areas:

- **The establishment of a regulatory and policy framework that will attract long-term financing with regard to equity and debt**

In this direction, the government has enacted Infrastructure Acts in many states to create a clear and stable regulatory framework for PPP project development. In addition, it has streamlined the approval process, thereby improving the speed of project appraisal via uniformity in appraisal mechanisms and guidelines. Moreover, it has prepared sector-specific model concession agreements and model RFP and RFQ documents, ensuring transparency in procurement. Also, to attract additional private funding and meet the gap for making a PPP project commercially viable, it has established a viability-gap funding scheme. The viability-gap funding can reach up to 20 percent of a project’s total costs, and the additional 20 percent should be given by the sponsoring authority.
Capacity building of the public sector to (a) develop credible, bankable infrastructure projects for the market and (b) manage the PPP process

The government places much emphasis on building the capacity of the individuals and institutions responsible for developing and taking PPP projects into the market. Currently, PPP cells in state governments and central infrastructure ministries lack the capacity to understand the structure and the rationale behind the use of PPPs. As a result, good PPP projects are not being selected, the project development is being slowed down, and the ability to enforce contracts remains weak.

The recent PPP global market trends were presented by Edward Farquharson. In recent years, the broad trends that have developed in the global PPP market have been characterized by a shift from “what” to “how” since more and more countries got educated on the fundamentals of PPPs. They are now becoming interested in learning how to put well-structured projects into the market. PPPs are now viewed more broadly not only as financial structures for infrastructure development but also as procurement tools and means for a broader reform of a specific sector and to restructure the way the public sector is organized.

In addition, there is a shift from the development of pure infrastructure assets to services as the mentality of developers has shifted from an input to an output focus. Also, PPPs have been seen as a key tool in developing social infrastructure mainly via the availability payments model, although transport remains the domi-
nant mode in most PPP programs both in numbers and in values. Nevertheless, as countries have benefited from the use of PPPs, they have moved from the development of one-off projects to holistic programs for better management and results run by dedicated PPP units.

The market responded accordingly, to adapt to the rapidly changing infrastructure environment. Within the last decade, private sector partners have evolved from mere builders to project developers to service providers and now to program delivery partners. At the investors’ front, we have experienced a significant rise of infrastructure equity funds at the global level to reflect the respective growth in project finance (at least until recently).

In 2008, the financial crisis has resulted in a decline in project finance volumes. It is expected that this trend will persist in 2009, given the macroeconomic instability of the global economy and the inability or reluctance of many banking institutions to provide long-term financing in infrastructure projects. At the same time, the governments are rethinking possible ways to intervene in, and regulate the inefficiencies of, the national financial systems. Governments in general support the recapitalization of the banking system, while in many countries the central bank’s policy supports direct injection of additional liquidity into the banking system. In the medium term, banks are already adjusting their funding structures while rethinking the establishing of safeguards against systemic risks.

The impact of the crisis on the PPP market has been primarily expressed by a change in the cost of debt. Underlying rates have gone down while margins have
gone up; as a result, the impact on the total cost of projects is minimal. At the same time, the amount of liquidity in the market has been hugely reduced, and the market also has moved from syndicated arrangements toward club deals in which a small number of banks are pre-identified as potential participants. In addition, the evaporation of the bond market as an alternative source of long-term funding of PPP projects has been observed long before the commencement of the financial crisis and was done mainly because of the inability of monolines to insure risk.

Because there is no one-size-fits-all answer to this problem, governments are currently exploring these possible short-term solutions:

- Increased reliance on support from MDBs and IFIs
- Increase of the loans’ share provided by the public sector authorities until the market recovers and these loans can be refinanced in the private sector market
- Increased capital contributions from the public sector and subsequent reduction of the private sector share
- Increased reliance on debt-underpinning arrangements in which the governments guarantee part of the long-term-debt funding of the project

Looking further ahead, it is more than evident that although bank recapitalization will take time, the PPP model is fundamentally a robust one because of the attractiveness of the long-term contracts to the market. Therefore, no major changes are expected in the fundamentals; PPPs are expected to be used as primary tools for the utilization of the stimulus packages in the area infrastructure. However, predictions are that bank pricing is unlikely to revert to 2007 levels and that the medium-term tenors may be shorter than the average 25–30 years that they are now.

The issues that the emerging markets face are quite similar to those confronting the developed world; however, the following characteristic makes their market more interesting to observe. Many local banks are better capitalized than international banks in the developed world, thus reducing the overall impact on the national economy. In addition, the retreat of overseas lenders and a move back their national markets leaves room for the domestic lenders to develop their business. The IFIs are being pressured to assist developing countries with loans and technical assistance, and this may assist them to develop more than anticipated. However, there is stress on existing contracts caused by reduced demand and supplier liquidity problems; as a result, refinancing becomes an issue in many energizing markets. Lack of mechanisms to accommodate change and gain sharing between private and public partners and re-sharing of risk under the new financial circumstances still needs to be addressed. Ultimately, the impact is that long-term-debt withdrawal from PP projects will result in delay in the development of PP projects in the developing countries.
The main messages of this session are summarized as follows:

- The financial crisis is extensively affecting infrastructure projects through the rapid scaling back of hedge funds and private equity funds and through investors’ shift of focus on large markets.
- Although the forecast of future projects shows a negative impact, as evident from preliminary figures from Q4 2008, it is clear that demand for infrastructure remains high and an attractive investment and that PPP remains in its core a robust financial and procurement model.
- The climate remains optimistic, especially upon the willingness of the multilateral banks to provide risk mitigation products (partial guarantees, output-based aid) and financial structures (insurance, securitization) to make projects more bankable.
This session focused on the role of equity financing in PPP project development. It described the actual and potential size of globally available equity funds for PPP investments and the patterns underlying the emergence of infrastructure funds. The roles, risk preferences, incentive structures, and impact of infrastructure funds have also been described in comparison with those of the funds from strategic investors. Finally, presenters explained how multilateral agencies, private equity funds, and strategic investors approach these issues.

Asian markets have moved away from complex financial products after the financial crisis in 1997; as a result, today’s PPP projects are being funded by straightforward equity and debt financing providing standard leverage under average-length tenors (10–15 years). Also, the multilaterals have been providing a significant portion of financing. However, after the financial crisis of 1997, the market has shifted toward the localization of equity financing. Before the Asian financial crisis, most projects would be funded in U.S. dollars. In 2007, regional and domestic sponsors outnumbered international ones with regard to equal share of funding.
The current attitude of the Asian financial markets is characterized by the slow evaporation of syndicated loans over the last dozen years in Asia: most of the loans are being done on a club-deal basis. Banks are also revising projects close to financial closure by gearing their structures and returns. Their focus is on reassessing the risk composition—specifically, the political risk appetite.

Currently, infrastructure funds have become the greatest repository of funds available for infrastructure investments in Asia. This attitude has been basically driven by supply; because there is a lot of demand for equity for infrastructure PPP projects, infrastructure funds have responded accordingly. But there is also much available cash from pension/wealth funds and insurance companies looking for secure long-term, stable, inflation-proof projects to invest in. Because the role of mezzanine funding has been limited and the secondary markets have not been active at all, equity is expected to be generated by the MDBs or the sponsors or directly from the governments.

On a regional level, the African Development Bank (AfDB) recognizes the pivotal role that equity investment plays to catalyze private sector operations. With equity operations averaging around 10–20 percent of new approvals, it still remains the Bank’s second instrument behind debt. However, in 2008, the board approved a new strategy and business plan for private sector development that puts renewed emphasis on equity operations.

AfDB’s experience in equity funds has showed that although direct investing requires a very resource-intensive structure, in the end it can provide high finan-
cial returns. The current strategy calls for at least 20 percent of new equity to be invested directly and to convert advisory work into "blue-sky" investments by using upstream advisory work to attract small equity plays.

However, so far, AfDB has used equity funds to invest indirectly, mobilizing resources from other IFIs and institutional and private investors and using instruments such as equity, preferred shares, and subloans. This strategic direction is envisioned to continue: about 80 percent of new equity investments will be done through indirect investments that support a wide range of funds with broad geographic and sector diversification and very strong incentives to perform. Experience gained from the equity funds can be summarized in the following lessons learned:

- Cost-effective: broad reach with a single investment
- Lower risk than direct investments if properly diversified
• Reasonable returns of 5–30 percent annualized
• Unlike direct investments, “windfalls” highly unlikely

Despite the interest in equity funds on a global level, Africa still lags as an investment destination. In this context, AfDB’s goal is to favor investments that yield additional development benefits for the region:

• Development of the African capacity
• Increase in the project information network
• Acquiring knowledge in areas of interest such as climate change and Islamic finance

The Rising Africa Infrastructure Fund (RAIF) is a Sharia-compliant PPP infrastructure fund active in investing in greenfield projects and the areas of economic and social infrastructure. RAIF has invested in PPP projects in North, West, and Central Africa, as well as in Mauritius and Madagascar. Many of these projects have been developed in partnerships with major development finance institutions (DFIs) and with AfDB as lead investor.

Because DFIs are committed to finance economic and social infrastructure in Africa via PPPs, PFI structures, in particular, become an innovative way of developing for social infrastructures because they entail a number of advantages. These include the provision of specific guarantees to the rents paid by the public body to the special purpose vehicle (SPV), co-financing via the provision of debt or equity, financing to the local private sector, support of the legal and institutional framework, building the capacity of the public and private sectors, and initiating communication with social stakeholders.

The role of the investment fund in the PPP market is to do the following:

• Initiate a dialogue with the public body via the initiation of a constructive dialogue with the state and regional organizations at a very early stage to identify those infrastructures in the economic and social sectors that could be financed by PPP structures.
• Acting as a strategic partner for the public body, it finances a significant share of the SPV equity, and structures a consortium with international but also local partners. Funds usually keep the infrastructure portfolio for the entire construction phase plus the two first years of the operating phase, thus covering all major risks.
• Focus on greenfield projects, especially in social infrastructures and in projects with strong development (spillover) effects.
• **Bring innovative financing solutions** via the development of innovative financing modes for social infrastructure (specifically through “PFI-style” structuring).

The main messages of this session are summarized as follows:

• Despite the distressed financial environment, infrastructure funds are still willing to support well-structured PPP projects, declaring that they are here to stay. However, nobody knows how these investment vehicles will evolve upon the global economic recovery and adapt more easily in similar future situations.

• The fact that there are endless opportunities to invest in PPP projects globally means great profit prospects for infrastructure investors. However, nowadays they become more and more selective in the provision of equity.

• Creative equity and funding have almost disappeared, but at the same time there is an increase in localization of financing. High turnover is expected in brownfield projects; investors are cautious in greenfield ones because they are considered to contain high risk. Leveraging equity is a problem because secondary markets have disappeared, and the focus has been placed on the provision of primary equity by the sponsors.
DAY 2
SESSION THREE: THE SPATIAL DIMENSIONS OF PPPS: TRENDS AND CAPACITY ISSUES FOR PPPS AT THE SUBNATIONAL LEVEL

CHAIR
- CLIVE HARRIS, Infrastructure Policy Advisor, East Asia and Pacific Operations and Policy, World Bank

PRESENTERS
- WILLIAM STREETER, Managing Director and Head of Global Infrastructure and Project Finance Asia Pacific, Fitch Singapore, Fitch Ratings
- MIGUEL A. ALMEYDA CASILLAS, Specialist, Multilateral Investment Fund, Inter-American Development Bank
- CHRIS WILSON, Executive Director, 4ps, United Kingdom

This session provided the platform to explain how decentralization and the global shift to local governance contributed to the emergence of PPPs at the subnational level (that is, municipal, provincial, and so forth). It also referred to the respective roles of national and subnational governments in the structuring and development of subnational PPP projects. This session featured examples of successful PPP units at subnational levels, as well as the focus on subnational PPPs at the national level (examples from Brazil, India, South Africa, and the United Kingdom) in the absence of a dedicated entity at the municipal or local level.

William Streeter of Fitch Ratings presented the results of an assessment that Fitch conducted regarding the rating of Indian new infrastructure project loans. These projects cover a wide range of sectors, such as toll roads, desalination, airports, and railways. The lessons learned can be summarized as follows:

- The pricing of project risks has varied over time and depends more on the availability of capital and the nature of sponsor-bank relationships than on a broader and more rigorous evaluation of project fundamentals.
- Many of the rated projects have a favorable economic profile, which means
that they also have some debt-carrying capacity. Surprisingly enough, project selection for political value was much less than expected.

- Project cash flows are highly susceptible to construction delays, economic cycles, and interest rate risk (the latter resulting from the frequent interest reset periods of the loans). This multiplicity of risks, when modeled in stress tests, demonstrates a low-to-moderate probability of technical default for many projects.
- Loan maturities are lengthening, but amortization periods are still fairly aggressive compared with expected project cash flows.
- A fair amount of loan restructuring is expected to take place over the next few years, as a wave of projects exit the construction phase and enter operations. The assigned project bank loan ratings consider the ability to restructure project debt within the remaining concession tail.

Given that debt loads are relatively high, it is surprising to see that few projects (only 2 out of the 10 included in this study) have any subordinated debt. Even when subordinated debt is present, it represents a small proportion of overall debt and ranges from 6 to 8 percent of debt outstanding. The aggressiveness of payout schedules and the relative absence of subordinate debt are considered to have negative impact on credit.

In terms of loan duration, Indian infrastructure project loans have been getting longer, but are still considered as medium term by international standards. Most of the rated projects have 9–14 years of operations over which to amortize their project loans, which is aggressive relative to projected cash flow volatility. Similarly, very few have a principal-free grace period for usage and revenue to ramp up; instead, they begin debt amortization in the first year of operations.

Up-front negative grants for greenfield projects deter the credit quality. Other countries have more organic ways to share in project revenue upside, including assessing a windfall tax or dividend rate for stronger-than-expected project cash flows or for the sharing of cash flow benefits of lower-than-expected interest rates after a debt refinancing. These forms of public returns occur as actual project cash flows permit and do not generally detract from credit quality, although they can detract from equity returns.

Fitch foresees that some migration will take place from commercial banks to the bond markets through the bundling, restructuring, and securitization of multiple project loans. Although these prospective portfolios could include some projects under construction, the higher-rated securitizations will be dominated by cash flows from operating projects. In this context, securitization will be an important form of bank recapitalization in the future, freeing up lending capacity for new projects.
Chris Wilson of 4ps presented the latest trends and capacity issues that public institutions face at the subnational level in the United Kingdom. The emergence of PPPs at a local level has been focused on schools, housing, transport, and waste management. It is clearly demonstrated by:

- The exponential growth in local demand for services;
- The legacy of underinvestment in local infrastructure;
- The lack of capacity in local government (funding, skills, and range of authorities); and
- The shared vision across public, business, voluntary, and community sectors.

Factors of success for locally generated PPP projects are similar to those of the centrally developed projects:

- Involvement of the right advisors with skills on funding issues
- Close liaison with the PPP unit
- Development of risk mitigation strategies
- Regular review of bank terms
- Compliance with standard contractual terms, including refinancing

Mexico’s PPP implementation process at the national and subnational level was presented by Miguel A. Almeyda Casillas of the Inter-American Development Bank (IADB). PPP development in Mexico faces similar problems at the federal and state levels:

- Lack of adequate legal frameworks (constitution, law, and rules) allowing for the implementation of PPP
- Lack of institutional and technical capacity to use the laws in place so as to structure executive projects and tender them to the private sector
- Lack of a portfolio of projects suitable to be addressed under PPP, resulting from insufficient resources for pre-investment studies to accurately determine scale or demand

The Multilateral Investment Fund of the Inter-American Development Bank established the Programa para el Impulso de Asociaciones Público-Privadas en Estados Mexicanos (the Program to Promote Public-Private Partnerships in Mexican States; PIAPPEM), an initiative that provides non-reimbursable technical assistance to Mexican states. Its objective is to strengthen the legal, institutional, and technical capacity of Mexican states to develop PPP projects, thereby enabling an increase in the provision of infrastructure and public services through private participation. This is expected to allow state governments to implement PPP models, set up approval mechanisms by competent governmental authorities, to establish
methodologies for the elaboration of cost-benefit analysis and to implement a clear and transparent tendering process. Ultimately, it will lead to the optimization of public resources, reduction of the infrastructure deficit that affects the states, improvement of the quality and quantity of infrastructure and public services, and reduction of short-term budgetary pressures implied by the development of mega-projects financed by the budget.

The main messages of this session are summarized as follows:

• Growth for PPPs at the local level has demonstrated exponential demand during the last decade. There is an ambience of optimism in the local financial markets, given the history of low infrastructure-investment flow at a local level.

• Infrastructure plans in India show that local financing needs exceed the local borrowing capacity and that much needs to be financed through the PPP/ PFI model. This requires a loan restructuring for municipalities to attract competitive financing (especially having a short or no history of debt-servicing capability).

• PIAPPEM is a Mexican central organization designed to provide capacity to states, in the context of an IADB-supported program. Despite having experience in developing PPP projects in airports and toll roads, Mexican states still face several systemic problems, such as the absence of an adequate legal framework and the lack of technical capability.
Presenters in this session shared the most recent experiences in reaching financial close in PPP projects. They have also investigated the key bankability issues and the reasons of projects failure to reach financial close. Finally they discussed how a PPP Unit can support successful financial close and how project risks can affect the bankability of a PPP project.

Chee Mee Hu of Moody’s project and infrastructure finance ratings group presented the perspective of a rating agency to PPPI projects. The growth in project finance ratings has been steadily strong: its volume has grown significantly since Moody’s first rating in 1991. Today, many infrastructure sectors worldwide have proven suitable for project finance, including power and energy, transportation, water treatment, health care and education facilities, and government facilities in general.

Moody’s recognizes that project finance spans a range of transactions from those typically characterized as structured finance to traditional infrastructure projects. Most transactions fall between these two extremes. In this context, the rating approach will vary with jurisdiction, transaction type, and intended financing structure. Demand-based PPPs have an entirely different structure from that of PFI models, which has an impact on the rating methodology.
However, they both encompass risks that have to be timely identified and mitigated. The construction period—completing projects to specifications, on time, and within budget—is often the riskiest part of a project. In PFI projects, if the project is not delivered on time and within specifications, the government offtaker can walk away or terminate the PFI agreement. Similarly, in demand-risk models, if the project is not completed on budget and on time, no operating revenues will be generated. Especially, for demand-risk PPP projects, structural enhancements such as concession “tails,” liquidity reserves, protective covenants, and restricted payments, are key elements for minimizing the overall risk of the project.

In addition, clear and demonstrated political support for the program or project is essential for mitigating political and regulatory risks. In general, the major characteristics of creditworthy PPPI projects embrace the following elements:

- Strategic importance of the asset for the public sector
- Credit quality of the parties to the transaction
- High degree of revenue predictability and stability under all scenarios, including stress scenarios
- Clear risk sharing between government and private sector partners
- Relatively manageable construction risk
- Mature legal and political framework
- Appropriate capitalization, tenor, debt size, and repayment profile
- Liquidity and reserves to support full and timely repayment of debt service

In the context of the current financial crisis, the long-term bankability of PPP projects and the management of the financial close become of imperative importance. Robert Sheppard of the UN explained that the current crisis is more severe than the savings and loan crisis of the early 1990s, the Asian crisis of 1997–98, or the more widespread emerging markets crisis of 2001–02. Although a possible effect of a crisis may be to stop all project finance transactions from closing during its most extreme period, transactions that are in the pipeline and near closing at the inception of the crisis will usually close, while many transactions in the pipeline may have to add additional support to achieve closing. Based on past experience, the volume of infrastructure transactions over a one-year period may decline, but the remaining volume will still be significant. However, for a significant period after the commencement of the crisis, credit standards will tighten, requiring stronger project structures (for example, higher debt-service coverage ratios, more stringent covenants, and cash traps), higher credit standards, and greater requirements for mitigation of country risk.

Recent trends in the project finance market underline the importance of local capital in the development of infrastructure projects:
A significant amount of transactions were underwritten by banks that do not have their headquarters in Europe, Japan, or the United States.

More transactions were developed by local sponsors, rather than by companies headquartered in Europe, Japan, or the United States.

Although local financing markets have been developed to a great extent, international capital markets have remained active for developing-country transactions.

Therefore, despite the development of local-currency financing markets, foreign-currency financing will continue to be important.

Major impediments to financial closing include two main types of risks:

- **The regulatory risk.** This risk could be triggered by macroeconomic crisis (devaluation of the host country’s currency), but it mainly refers to the host government’s normal exercise of police power affecting all sector participants equally.

- **The foreign exchange risk.** This risk is not usually addressed unless there is a host-government guarantee of a foreign exchange (FX)–indexed PPA. The use of FX-indexed contracts is a failed attempt to shift this risk to the public as a result of macroeconomic stress. Nowadays, many countries use the FX liquidity facilities as the only mechanism that provides effective mitigation to this type of risk.

In the same manner, PPP bankability in developing countries still remains a challenge, but is also being greatly affected by the currently financial environment of stress. According to David Ssebabi of the Ugandan Ministry of Finance, Planning, and Economic Development, the key tenets for bankability of PPP projects include the following:

- **A PPP enabling environment.** A robust economic environment includes policies that foster macroeconomic stability, encourage investment, and inspire political consensus. Failure to address the above will lead to a significant deterrent to the development of an attractive PPP program and will also lead to reduced foreign investment in infrastructure.

- **A pipeline of economically viable projects** that have been conceived out of a proven economic and social need, have an optimal investment size, and that embrace a significant amount of sustainable technology solutions. However, there is an optimum balance between the socioeconomic rates of return that accrue to the government and the projected financial return of the investor.

- **A smart financing structure** that assumes the use of financial instruments to adequately manage risk, as well as the provision of guarantees and escrow ar-
rangements. The latter are necessary at the structuring of the project, particu-
larly in countries that lack country credit ratings.
DAY 3
SESSION TWO: RISK MITIGATION AND USE OF GUARANTEE INSTRUMENTS IN PPP TRANSACTIONS

CHAIR
• MARILOU JANE D. UY, Sector Director, Financial and Private Sector Department, Africa Region, World Bank

PRESENTERS
• FRANÇOIS BERGÈRE, Secretary General, PPP Taskforce, Ministry of Finance, France
• JAY-HYUNG KIM, Director, PIMAC, Korea Development Institute (KDI), Republic of Korea
• ROBERT SCHLOTTERER, Financial Analyst, Africa Energy Unit (AFTEG), Finance, Economics, and Urban Department (FEU), World Bank, and ELENA PALEI, Senior Underwriter, Multilateral Investment Guarantee Agency (MIGA)

This session demonstrated the role that guarantee instruments play alongside equity and debt finance in the area of PPP in infrastructure. It explained how specific risks could be mitigated using various guarantee instruments and the potential role of government and other actors in providing guarantees. Finally, examples of risk mitigation and guarantees, innovative approaches in both the developing and developed worlds, and case studies were presented.

François Bergère of the French Ministry of Finance presented the French framework for the provision of public guarantees in infrastructure projects. Although they may seem contrary to the spirit and principles of PPPs, guarantees could potentially be beneficial in the sense that they can mitigate some of the risks borne by the project company and hence decrease the corresponding cost of financing.

France has been using a specific type of guarantee, initiated by the public sector at large (including the PPP unit or the procuring authority), that could cover the technical risks associated with the design, construction, and operations and
maintenance (O&M) stages of the project. This type of guarantee is applied on the PFI type of projects, where there is no demand risk assumed by the private sector, and is being activated after the construction period is over. The risk profile of PPP projects differentiates based on the stages of the project life cycle to which it belongs. The risk for the private sector reaches high levels during the design and construction stages, while it is reduced significantly during the operations and maintenance stage.

The cession de créances acceptée is based on the idea of transferring by the borrower (SPV) to the financial institution (lender) of its right to receive specific cash flows from the customer (public authority) in such a way that they became isolated from performance risk following completion of work. The use of this financial structuring technique essentially derisks the projects to the funders and leads to a cheaper cost of financing and an overall cheaper cost for the public sector. The public authority may be called to transfer directly to the lender up to 80 percent of the payments (initially aimed at the SPV), which correspond to the initial investment, including cost of financing. The remaining 20 percent of the payments, which correspond to O&M payments, are still transferred to the SPV to maintain the element of risk necessary to incentivize the private sector to perform.

The main benefit of this type of guarantee is that lenders justify a credit analysis and risk-weighting approach on the underlying public debtor risk and hence attract greatly reduced margins and spreads compared with those of the construction stage. Potential gains may range from 50 to 100 base points.

Figure 24. Mitigating PPP Risk with Government Guarantees: The French Experience

1) Normal scheme

2) After assignment of receivables

Author: François Bergere
The Korean array of instruments provided to reduce the private sector’s risk were presented by Jay-Hyung Kim, Director of PIMAC at the Korea Development Institute. These include construction subsidies, minimum revenue guarantees, an infrastructure revenue guarantee fund, and compensation for proposal costs.

Construction subsidies have been provided by the government in the past to the concessionaire in case the project company was unable to maintain user fees at the appropriate level. The level of subsidies is determined in the individual concession agreement.

The minimum revenue guarantee (MRG) in Korea applies only to solicited proposals. It applies to a certain fraction of projected annual revenues that may be guaranteed when the actual operating revenue falls considerably short of the projected revenue prescribed in the contract. MRGs are not applicable to projects that earn less than 50 percent of the projected revenue. This guarantee instrument has received a significant amount of criticism in mainly two areas:

- Government took most of the risks, but provided unreasonably high returns to private participants.
• The project company may show moral hazard behavior by not trying its best to increase the revenue.

Nevertheless, the Korean PPP market is currently quite competitive even with limited use of MRGs. Only 37 out of 145 signed contracts included minimum revenue guarantee clauses at the end of 2007.

The Korea Infrastructure Credit Guarantee Fund (KICGF) is a fully government-invested credit enhancement vehicle for PPP projects. KICGF has provided guarantees for US$5.9 billion since 1994. This covers 9.5 percent of the total investment for PPP projects implemented in Korea during the same period of time, and the demand for the KICGF guarantee is rising. KICGF is an independent legal entity wholly invested and owned by the government and managed by KODIT, a government-owned credit guarantee fund targeting small and medium enterprises (SMEs).

Its assets comprise investments by the government, revenue from the guarantee, and revenue from other management of the fund. Total assets as of 2007 were KRW304.4 million, including KRW230 million investment from the government and KRW74.4 million net income. The capital investment from the government has been made in seven installments, and the amount is decided considering the amount of guarantee outstanding, the remaining funds available, and the demand for guarantee. The law requires the contingent liability of KICGF to be capped at 20 times the value of the assets. KICGF receives an annual audit by the Board of Audit and Inspection of Korea.

Compensation for proposal costs is provided to unsuccessful bidders for a portion of the project proposal cost. The goal is to promote competition in projects and to avoid the discouragement to bid resulting from the financial costs of proposal development. The amounts of the compensation vary from 25 to 30 percent, based on the number of unsuccessful bidders. The competent authority is responsible to provide details in the RFP regarding whether the compensation is available, the size of the compensation, the criteria and procedures of compensation, and the due period of compensation.

Robert Schlotterer from the World Bank and Elena Palei from MIGA presented the Uganda Power Distribution PPP project and the variety of risk mitigation instruments put in place to provide comfort to the private sector.

The Uganda Power Distribution PPP project was the first power distribution PPP signed in Sub-Saharan Africa. The Government of Uganda (GOU) opted for a concession structure because of its objective of retaining ownership in the power distribution assets. The project was critical to the sector viability and upstream generation investments and followed the setting up of an independent regulatory body and a new regulatory framework (as part of broader energy sector reforms).
The support of the World Bank Group was provided in three forms:

- An International Development Association (IDA) credit of US$11 million for additional network investments, mainly for the financing of equipment for the distribution company. The ultimate objective was to upgrade the production process, reduce costs, and eventually keep the tariffs competitive.
- An IDA Partial Risk Guarantee aimed at the backstop of the ongoing regulatory and governmental payment risks, including the support of termination risk as “first loss.” In particular:
  1. Regarding the regulatory framework, PRG covers
     - Noncompliance by the regulator with the pre-agreed tariff framework relating to the distribution tariff,
     - A full pass-through of the bulk electricity supply from the Uganda Electricity Transmission Company (UETCL), and
     - Timely adjustments of tariffs (45 days after tariff submission).
2. Related to government payment arrears, the Partial Risk Guarantee (PRG) covers nonpayment of GOU agencies’ electricity bills up to 60 days.
3. Regarding termination payments, PRG covers the buyout of the amount for undepreciated investments resulting from early termination of the concession resulting from a breach of concession agreements by GOU and its entities.

• MIGA insurance that covered these four risks:
  1. Transfer restrictions related to the inability to convert local currency into FX for transfer outside the host country, as well as the inability to transfer in acquired FX
  2. War and civil disturbance, which includes damage/disappearance of tangible assets resulting from war or civil disturbance (including revolution, insurrection, coups d’état, sabotage, and terrorism) or prolonged business interruption
  3. Breach or repudiation of the contract with the investor and non-enforcement of an arbitration award by the government
  4. Buyout clauses in the support agreement that allow the investor the right to exit the project and receive termination payments from the government if
     – Supply of electricity is insufficient (subject to thresholds) and/or
     – There are no offsets received to compensate for losses caused by lower supply.
This session focused on the costs of PPP project development and how the procurement method influences these costs. Discussion revolved around the benchmarking of project delivery cost and government tools to make project delivery affordable. According to Rui Sousa Monteiro of Parpública, the design, procurement, and management of PPP contracts revolve around these four elements:

1. **Efficiency and Innovation**

The efficiency factor of a PPP contract largely depends on the effective transfer of substantial risks to the private partner. These risks should be large enough to imply large future financial gains, yet manageable to draw the attention of private companies. These risks have to be clearly allocated to the private partner contractually. In the opposite case, the private partner could realize that it is more profitable trying to shift risks to the public sector than managing those risks.

Efficiency is also linked to a certain minimum degree of flexibility in the tender rules and in the draft contract, allowing the bidders to present innovative designs and processes and allowing the private partner to adapt to changes (technological, commercial, demographic, legal, and so forth) in a resourceful and cost-efficient manner.
manner. This flexibility requires an output- and outcome-focused procurement approach, significantly different from the traditional one.

2. Trade-Offs between Swift and Efficient Procurement
The design and development of PPP projects imply a trade-off between rapid and efficient procurement. In general, PPP procurement tends to be slow compared with the traditional procurement of public projects. This is the result of the embedded contractual complexity of several public and private entities and the implied need to inject the private sector’s financial and technical innovative solutions.

However, PPP projects, if structured rightly, will lead to significant efficiency gains. For instance, negotiating with bidders under competitive pressure allows for cost reduction and quality improvements. Too much pressure for signing contracts may jeopardize PPP efficiency, delivering suboptimal contracts and increasing fiscal risks for the public sector. However, the trade-off between speed and efficiency is rather illusionary because there many well-structured projects worldwide are done in a speedy manner. The genuine trade-off is rather the one between cheap project development and efficiency.

3. Institutional Capacity of the Public Sector
Public authorities that are willing to procure PPP projects need to create in-house capacity to design, deliver, and manage these projects. Unless there is a link between the PPP scheme (and the PPP contract) and the actual (or expected) capacity of the public sector for contract management, significant fiscal risks will arise in the long term.

Procuring authorities need to be accountable for the project, and they should procure contracts that are compatible with their capacity to manage them over time. Otherwise, the contract managers will not feel fully responsible for the resulting outcomes and will not be motivated to ensure the quality of the service. In practice, public authorities buy project leadership from the private sector. However, they cannot buy accountability or a sense of public interest because these qualities are found only within the institutional context of the public sector. Therefore, public authorities need a strong (not necessarily large) public sector team to lead the project, assume responsibility for it, and align the different external consultants with the public interest.

PPP efficiency gains require project management skills in planning, budgeting, hiring, training, and motivating people, as well as linking project management to future contract management. PPP expertise is typically scarce on the public administration side, so there is a role for a central PPP entity to provide public authorities with adequate advice subject to a strong sense of public interest and consequent awareness related to fiscal risks.
In conclusion, public authorities need to create their own teams, responsible for project delivery and able to move in a seamless way from procurement to contract management. The ex post efficiency of a PPP contract will depend on the future ability of the public sector to manage the contract and the competitiveness of procurement will depend largely upon the expectations regarding that ability.

4. The Need for Hiring and Managing External Consultants

Because public administration lacks some expertise and is too much used to traditional procurement, external consultants are always needed for the delivery of PPP projects. So typically, PPP projects that are led by external consultants tend to present more fiscal risks when compared with those of projects with high-capacity public sector leadership, but they tend to present less fiscal risks when compared with those of projects with poor-capacity public sector leadership.

However, the hiring of external consultants may lead to lengthy procurement and PPP inefficiency, if not carefully managed and aligned with the public interest. Consultancy contracts need to be carefully designed, especially in the area of compensation (for example, considering flat fees, success fees, and so forth).

In conclusion, the design and delivery of a PPP project are costly. The contract should be drafted in a way to provide enough advantages to compensate for procurement costs. Although pricey, good project management delivers long-term benefits, such as swift procurement and better contract management. Relying

Figure 27. Transaction Costs As a Percentage of Capital Costs in Victoria, Australia

![Graph showing transaction costs as a percentage of capital costs in Victoria, Australia.](image)
solely on external consultants is costly and does not prevent future problems; however, creating a strong public sector team is harder, but it saves consultancy costs and provides added accountability and efficiency from within.

In the state of Victoria in Australia, the consistent use of value for money (VFM) is considered the most important policy driver to achieve efficiency in infrastructure delivery. The VFM approach is perceived differently in governments that focus on cost and time savings compared with the ones focusing on quality and risk. In addition, government’s flexibility regarding the scope of the project influences greatly the future benefits of the project for the public. Finally, it is important for the public sector to have the necessary tools and processes in place to better control and manage all factors that influence cost, time, and the quality of outcomes.

According to Richard Foster of Partnerships Victoria, the implicit drivers of VFM in Australia include the whole of life planning and costing, output specification and scope for innovation, efficient risk allocation, asset utilization and third party revenues, and the existence of a rigorous procurement process.

At a project level, emphasis is placed on this secondary—yet important—set of drivers:

- Novelty of project (that is, costs might be higher for a scientific research building than for a hospital if there have been similar hospital projects undertaken, but no similar research buildings)
- Complexity of the public-private interface (that is, costs might be significantly higher for a hospital with a complex public-private interface than for the development of a simple wastewater treatment plant)
- Extent of public sector change management accompanying the project
- The project site (that is, costs differ for greenfield, brownfield, or linear projects; for instance, they might be higher for a project enabling a new mode of public sector service than for a direct replacement of an existing asset)

Infrastructure Partnerships Australia (IPA) engaged the Allen Consulting Group, in conjunction with the University of Melbourne, to undertake a study of the efficiency of PPPs relative to traditional procurement approaches in the provision of public infrastructure. This study tested the commonly held notion that more competition and greater alignment of incentives and constraints result in PPPs providing infrastructure with reduced cost overruns compared with those of traditional procurement. The sample included 21 PPPs and 33 traditional procurement projects. Here are two findings of the study:

- PPPs demonstrate clearly superior cost efficiency over traditional procurement, which can range from 11.4 to 30.8 percent.
In absolute terms, the PPP cost advantage was found to be economically and statistically significant. On a contracted US$4.9 billion of PPP projects, the net cost overrun was only US$58 million, not statistically different from zero. For US$4.5 billion of traditional procurement projects, the net cost overrun amounted to US$673 million.

Comparing international practices, there is a close correlation between VFM and bid and transaction costs. However, governments apply VFM principles, focusing either on a combination of price and time savings or on a combination of quality and risk management. Spain and the United Kingdom reflect different procurement systems that influence the overall transaction costs. Spain has a time/price focus as it runs very efficient bidding and relatively low-cost procurement processes, which keeps the transaction costs at a low level. On the contrary, the United Kingdom applies lengthy negotiations with the preferred bidder, thus increasing the overall transaction cost of the project, yet improving significantly project quality and risk management.

In Egypt, the public sector costs of PPP projects include (among others) expenses for procurement and monitoring, contingent liabilities, long-term purchase obligations, guarantees, and in-kind support. Project development costs usually reflect 2–3 percent of the entire project cost and are significantly larger than the development costs of a public infrastructure project.

The budget for project development usually should include (among other things) an estimate of surveys and investigation expenses, consultant fees for stud-
ies and project documentation, out-of-pocket expenses for procurement process documentation, advertising, marketing road shows, investor meetings, and so forth. However, it should not include expenses incurred by the sponsoring authority on its own staff.

Rania Zayed of the Egyptian Finance Ministry mentioned that in Egypt the procurement costs reflect up to an average of 5 percent of the total project costs. However, this percentage becomes larger for smaller projects, thus reducing its attractiveness for the private sector. Many governments have promoted the use of a “project bundling” approach to increase the total value of the project(s) and reduce the ratio of procurement costs to the overall value of the project.

Transaction advisors with wide experience in similar deals are very commonly used. Advisors supplement the project team’s technical strengths, provide access to international best practices, and protect against mistakes. Eventually, it boosts bidders’ and investors’ confidence for the market.

Egypt is in the process of establishing a PPP project preparation facility with the primary objective to improve the quality and quantity of proposed projects. Concurrently, this initiative will support the project management and technical capacity of public authorities to undertake PPP projects. It will also be used to further develop the Egyptian PPP advisory services market and to provide a vehicle to the multilateral and donor organizations to contribute their funds and leverage their sector objectives.

Patricio Mansilla of Chemonics International presented the experience of Chile and Peru in the context of PPP cost management and efficiency:

- Adequate project definition is necessary to reduce the cost of design of proposals and also to reduce the time frame to adjudicate the PPP. It can mitigate potential negotiation of the contract.
- Competition is not able to solve the incomplete contract problems. Every risk must be carefully studied. Technical studies are needed to estimate the official investment cost of the PPP project.
- Multilateral agencies’ and donors’ support is very important to reduce the gap of funds to design adequate PPP projects.
- Regulation strategy must be included in early stages of the project cycle. Economic variables should define the bidding winner.
- Transport and financial models must be considered in the regulatory studies to have a consistent PPP model.
- Incomplete contracts must include the potential conflict resolution issues like an easy buyout or way out, negotiation mechanisms, and treatment of new investments.
The main messages of this session are summarized as follows:

- PPP expertise is typically scarce in the public administration, so there is a role for some kind of central PPP entity to provide public authorities with adequate advice subject to a clear sense of public interest. Public authorities need a strong public sector team to lead the project, assume responsibility for it, and align the different external consultants with the public interest. The creation of such a team is difficult, but in the long term it saves consultancy costs and provides added accountability and efficiency.

- Efficiency in PPPs depends largely on good project development before calling for tender. It is also linked to a certain minimum degree of flexibility in the tender rules and in the draft contract in an efficient way. Too much pressure for reaching contract close may jeopardize PPP efficiency, delivering suboptimal contracts and increasing fiscal risks for the public sector.
DAY 3
SESSION FOUR: PPPI DAYS AND PPPI GLOBAL NETWORK:
ROUNDTABLE DISCUSSION ABOUT FUTURE DEVELOPMENT

CHAIR

• GOVINDAN NAIR, Lead Economist and Leader, PPPI Program, World Bank Institute

PANELISTS

• ZERE SEIDIMBEK, Deputy Chairman, Kazakhstan PPP Center, Ministry of Economy and Budget Planning, Kazakhstan

• EVA KARINA CALLEJAS SIERRA, Dirección General Comisión Presidencial de Modernización del Estado, Honduras

• AHMAD WALI SHAHRZAY, Deputy Minister, Ministry of Energy and Water, Afghanistan

• MIGUEL A. ALMEYDA CASILLAS, Specialist, Multilateral Investment Fund, Inter-American Development Bank

• GODWIN BROCKE, Member, PPP Unit, and Director, Research, Statistics, and Information Management, Ministry of Transportation, Ghana

• HAROON KHAWAJA, Chairman, Chief Minister’s Secretariat, Pakistan

• BAMBANG SUSANTONO, Deputy Minister, Infrastructure and Regional Development, Coordinating Ministry of Economic Affairs, Indonesia

• JIM VIanne MUGUNa, Senior Public Relations Officer, Privatization and Utility Sector Reform Project, Ministry of Finance, Planning, and Economic Development, Uganda

• OTGONBAT SEDBAZaR, Advisor to the Minister, Ministry of Mineral Resources and Energy, Mongolia

• ROGERIO PRINCHAK, Executive Secretary, Public-Private Partnership Program, Secretariat of Finance of State of Bahia, Brazil

This roundtable discussion focused on the possible expansion of the PPP Network to benefit the knowledge-sharing and capacity-building needs of PPP units world-
It also addressed the specific performance requirements of PPP units that should be met through such knowledge-sharing and capacity-building programs and the overall value of face-to-face workshops, global video dialogues, e-learning, and other learning instruments. A number of country delegations were asked to kick off this discussion by expressing their views regarding the role of the multilateral agencies, private PPP associations, and other players in the knowledge and learning arena.
This session reviewed how various multilateral agencies contribute to helping developing-country governments fill gaps in institutional capacities, organizational competencies, and individual skills.

The PPPI program of WBI presented in detail its new core-learning program on PPPs. The Multilateral Public-Private Partnerships for Infrastructure Capacity-Building Program (MP3IC) includes a graduated series of problem-oriented and interactive multimedia training modules that can eventually be integrated within relevant certificate and/or degree programs offered by national, regional, and international academic institutions with globally validated quality assurance mechanisms.

MP3IC is viewed as complementary to the national training program’s attempt to build capacity of the public sector. In this context, national systems of training are strong candidates for becoming partners and sustaining this initiative over time. Many representatives of local governments and municipalities identified the great importance of the program for the development of their respective pipelines.
Participants confirmed the important role of capacity building in the development of infrastructure PPPs. Several PPP units expressed their commitment to share information and lessons learned by national experience to support WBI’s initiative.
DAY 4
SESSION TWO: CLOSING KNOWLEDGE AND CAPACITY GAPS:
THE ROLE OF REGIONAL CENTERS OF PPP EXPERTISE

CHAIR
• RICHARD CABELLO, Principal Investment Officer, International Finance Corporation (IFC)

COPRESENTERS/DISCUSSIANTS
• NICHOLAS JENNETT, European PPP Expertise Center, European Investment Bank (EIB), Luxembourg
• GEOFFREY HAMILTON, Chief, Cooperation and Partnerships Section, United Nations Economic Commission for Europe (UNECE)
• SERGIO HINOJOSA, Partner, IKONS ATN, Mexico

The European PPP market has developed rapidly since 1990, and more than 1,000 projects of almost US$275 billion in total value have been delivered to this point. In many countries—France, Germany, Poland, Turkey, and the United Kingdom—PPP share has reached almost 10–15 percent of the total public capital expenditure. Project development has been accompanied by significant political commitment and concurrent legislative development in the Czech Republic, France, Germany, Greece, Italy, and Poland. Most of the European deals have been recorded in Portugal, Spain, and the United Kingdom (75 percent of deal value); France, Germany, Greece, and Italy reflect a lower share (15 percent); and the Czech Republic, Hungary, Latvia, Poland, Romania, the Slovak Republic, and Slovenia account for much of the remaining value (4 percent).

Although PPPs have played a key role in modernizing Europe’s infrastructure through the provision of efficiency and private sector innovative resources, the weakness of the public sector in building organizational capacity still hinders further growth. Low levels of public sector experience, knowledge, and organizational resources have created barriers to the development and implementation of PPP programs. Although capacity issues appear to have commonalities across different
national programs, PPP expertise is not shared effectively between authorities. As a result, public authorities tend to make the same mistakes, or (at best) they “reinvent the wheel.” This leads to poor value of PPP projects or even to failure of programs.

The European PPP Expertise Center (EPEC) aims at making the public sector a better-informed client for PPP transactions by sharing experience, expertise, and information among public sector organizations and agencies in distant European countries. As a result, EPEC promotes PPP deal flow in infrastructure by assisting exclusively the public sector in the European Union (EU), candidate, and certain other countries. This is mainly done via the full participation in networking activities with all principal PPP taskforces in Europe, which provide access to information and analysis. EPEC also provides potential for policy and program support through direct technical assistance provision or even the ability to second staff.

The evolution of capacity building in the area of PPPs is a relatively new phenomenon evolved in the last 10 years. Until then, in the absence of any structured PPP training, governments expected to learn by doing from one or two “pathfinder” PPP projects. Today, there is a huge interest and demand for training, especially among transition economies developed in the context of a more comprehensive and integrated PPP capacity-building framework.

Geoffrey Hamilton presented how the United Nations Economic Commission for Europe (UNECE) plans to spread PPP knowledge throughout Eastern European transition economies. Its mandate is to undertake PPP capacity building, using the UNECE Guidebook on Promoting Good Governance in Public-Private Partnerships as a basis for the elaboration of training modules. In February 2008, a challenging program of work for capacity building with a focus on the Russian Federation and the Commonwealth of Independent States, Central Asia, and Southeastern Europe was approved under the leadership of the UN.

Working in the transition economies environment is challenging because of the nature of training needs in this set of economies. While they possess good local training facilities and trainers, strong technical and engineering skills, and a strong commitment to the free market philosophy, they contain a number of training issues that require special attention. In most of them, there is no living memory of private participation in infrastructure and PPPs. There is also a wide dispersal of power and authority (lack of internal procedures and weak enforcement and implementation of laws). In most of these countries, there is a focus on transport (mainly on roads and railways) and social infrastructure and services (health and education). Being industrialized, highly pollutant economies, there is a special interest in PPPs for sustainable development.

The reality is that while there is little expertise within the public sector entities to prepare bankable projects, there is very little actual PPP training of government officials in a structured or even ad hoc manner. Existing training is not directly
linked to the development, preparation, management, and delivery of a specific project or program, but is rather done in a vacuum.

A comprehensive, integrated PPP capacity-building program that combines training people, promoting project proposals, and fostering policy reforms (three Ps) should be established in-house and within the context of the public sector.

Establishing a PPP unity exchange is paramount in building people capacity. Training through modules is a necessary condition for developing individual skills to do PPP projects, but often not enough. A PPP unity exchange allows for the sharing of PPP experiences, practical and operational guidance between PPP units from countries with a track record of PPPs with those countries from transition economies whose PPP programs are just starting.

Because training results are difficult to measure, doubts emerge as to the value of actual training, regardless of the quality of materials and trainers. National PPP implementation campaigns aim at linking training with project delivery. This approach was initiated in the Netherlands when it started its PPP program.

It includes a relay “road show” involving different regions, one after another, that showcase project proposals to be discussed by experts as to their bankability. Bottlenecks are identified and recommendations are made in the context of reforming the legal and regulatory framework. Eventually, this will lead to a number of similar, relatively small projects coming forward that could be “bundled” together to attract financing.

Finally, the third P refers to structured consultations with top-level policy makers. The UN has established the UNECE PPP Business Advisory Board, which is an independent board of key PPP experts under Sir Adrian Montague (former Head of the U.K. Treasury Taskforce) to advise policy makers on PPP policy matters and financial support for projects and to offer advice on pilot projects. Upcoming consultation meetings are planned in Kazakhstan, Russia, and Southeastern Europe.

Sergio Hinojosa of IKONS ATN explained how the PPP knowledge gap can be filled through the use of a methodology that aims at the clarification and improvement of the widely used for project appraisal concept of cost-benefit analysis. The new model refers to the cost “and” benefit analysis methodology for decision making in PPP projects. The methodology is based on pseudo-“action research,” in-depth interviews, conceptual analysis based on a literature review for cost-benefit analysis, real options, and a public sector comparator (PSC).

The main messages of this session are summarized as follows:

- Regional and global capacity-building programs are of paramount importance for the development of national PPP programs. Emphasis was placed on the various models of cooperation between these regional training centers and the PPP units and their impact on the capacity level of the national public sector.
• Regional PPP centers should find ways of establishing a platform for exchanging experiences and expertise with each, thus transforming regional into global knowledge.

• There is an increasing need to expand their scope of capacity building and include, apart from training programs focusing on the public sector, similar programs for the private sector companies (contractors, sponsors, and so forth) and information sessions for the civil society.
DAY 4
SESSION THREE: PPP ASSOCIATIONS: KNOWLEDGE IN ACTION AT THE INTERFACE OF THE PUBLIC AND PRIVATE SECTORS

CHAIR
- ART SMITH, Chairman, National Council for Public-Private Partnerships, United States

PRESENTERS
- RICHARD B. NORMENT, Executive Director, National Council for Public-Private Partnerships, United States
- JANE PEATCH, Executive Director, Canadian Council for Public-Private Partnerships
- RICHARD NORMINGTON, Senior Manager, International Financial Services London, United Kingdom
- STEPHEN HARRIS, Turkish PPP Platform; Chairman of the U.K. Trade & Investment (UKTI) PPP Export Advisory Group; and International Development Director, Tribal Group plc
- GERALDINE KOUZAN, Vice Chairman, PPP Club, France

PPP associations (comprising private sector operators in PPP and sometimes also public sector institutions) from several countries, including Canada, the United Kingdom, and the United States, described their roles and experience in PPP programs. Discussion focused what further roles that associations might play as sources of knowledge and capacity building for PPPI programs worldwide.

Richard Norment of the National Council for Public-Private Partnerships (NCPPP) presented the profile of the institution. NCPPP is nationally and internationally recognized as a pioneer in building consensus among public entities and private sector parties interested in the PPP industry. It places emphasis on the U.S. domestic arena, but also works with several international financial institutions, such as the Inter-American Development Bank, the United Nations, and the World Bank.
Its mission is to promote public-private partnerships and provide the floor for knowledge exchange and promotion of best practices. It focuses on a wide range of sectors, including transportation, water and sanitation, urban development, energy, financial management, and education. Since its establishment in 1985, NCPPP has taken the lead in several initiatives within the United States:

- Organization of workshops and conferences
- Production of white papers and other resource documents
- Establishment and maintenance of a comprehensive Web site
- Provision of advisory services to legislative bodies at federal, state, and local levels

In the international arena, NCPPP supports the Web site of the United Nations and the Inter-American Development Bank, provides speakers at international conferences, and organizes multiday training programs and tours of PPP projects.

The promotion of the use of PPPs at the federal, provincial, and municipal levels of government within Canada is being undertaken by the Canadian Council for Public-Private Partnerships (CCPPP). Several entities from the public and the private sectors have become members since its establishment. Currently, around 25 percent of the members belong to the public domain, while the rest are investment banks, investment companies, law firms, advisors, and other private entities active in the Canadian PPP arena.

The role of CCPPP is dynamic and shifts as PPP progresses domestically. Its preliminary role was to introduce the concept to the market and engage the public and private sectors in a series of meaningful and fruitful dialogues. As the PPP program in Canada has expanded, its role has evolved to the provision of opportunities to apply global and domestic PPP experience. CCPPP treats PPP development as a matter of public policy and recognizes that the engagement of the senior civil service in the discussion is critical. Its mission is to study failures and successes to understand critical factors and improve the development of future projects.

Its annual activities range from research to meetings and to projects and people recognition. Each year, CCPPP undertakes three or four research activities that culminate in a published document for the use of the public. The focus of research can be a case study, an in-depth review of a PPP topic (for example, finance or labor relations), or a sector exploration (for example, schools, hospitals, water, wastewater, or transportation). CCPPP hosts the annual national PPP conference; in 2008, it attracted 1,000 people to two days of sessions and special events. It also occasionally organizes focused PPP meetings to provide input into a specific topic area (for example, feedback to a government initiative). Finally, with regard to projects and people recognition, it has established the “National CCPPP Awards for
Innovation and Excellence,” aimed at praising the projects with innovative structure or excellent performance. In addition, it has established the “Champion Award” for professionals who made a difference in the area of PPP project management.

Each year, more provinces engage in PPPs and establish specialized divisions or offices. In the meanwhile, federal support continues, regardless of which of the two major parties lead the government, thus providing political assurance and comfort to the private sector. Overall, there is an optimistic outlook for the Canadian PPP market, reinforced by the latest modifications made to deal with new financial market realities. In this context, CPPP has an important role and currently works with its member organizations and companies to identify remedies to ease the domestic market anxiety.

In Turkey, there was a feeling that much government and private sector debate on PPP was ill informed. The idea of establishing a PPP association was suggested in the form that exists in other countries internationally, such as Canada, the Czech Republic, France, Japan, Latvia, Poland, the Slovak Republic, and the United States. Support was gained from a number of government and private sector organizations at the end of 2007. However, the ability of the Turkish government to engage with a broad group of private sector players at both policy and project development stages is a key factor for the (so far) success of the project.

Currently, the Turkish PPP Platform counts more than 100 members, the bulk of them corporate (around 80 percent) and the rest governmental (15 percent), academic, and others. The governmental members include the Privatization Administration, Treasury, Police Academy, State Development Bank, Ministry of Energy, Foreign Investment Association, Public Procurement Authority, and Health Ministry.

The Turkish PPP association provides a number of capabilities aimed at the creation of a forum for private sector and government organizations for the development and promotion of PPP models in Turkey. One of its main objectives is the capacity building of all the involved players of the Turkish PPP market. More specifically, its goal is to

- Build capacity and understanding in the private sector of PPP so as to encourage the building of a domestic PPP market to service government projects;
- Educate all sectors of society as to the benefits and issues surrounding PPP and to encourage an informed debate within the country; and
- Assist and support the public sector in building capacity within all levels of government through participation in seminars or events, briefing material, and the sharing of practical experience and knowledge.

In the U.K. financial market, International Financial Services London (IFSL) is an independent, not-for-profit membership organization with 40 years of experience
in promoting the U.K.-based financial services industry throughout the world. Its members are drawn from companies that span the entire financial services sector, including banking, insurance, trading exchanges, regulatory bodies, and professional services. One of the most vital components of its work is PPPs.

IFSL has extensive links with business and government that provide a unique platform for promoting U.K. financial services to the world. In the area of PPPs, IFSL is the designated private sector partner of U.K. Trade & Investment (UKTI) and the Corporation of the City of London for international promotion of U.K. financial services. At the same time, it works closely with the worldwide network of U.K. embassies, consulates, and high commissions and with all of the government departments and regional bodies supporting financial services, especially with the HM Treasury; the Foreign and Commonwealth Office; and the Department of Business, Enterprise, and Regulatory Reform.

In France, the launching of the PPP program in June 2004 was followed by the establishment of the French PPP Club in late 2005. The objective of the club is to provide PPP actors a common ground to meet and exchange ideas, thus to better understand the concept of PPP as it is developed domestically and internationally.

The French PPP Club intends to become an observatory of good practices and projects. It aims at the promotion of this new tool for the public procurement in France via a better understanding of PPP by public decision makers (MPs and local government officials). Over time, enhanced knowledge on the subject and exchange of experiences (in the form of feedback collection) from public and private partners will enable the simplification and ease of administrative decisions and will lead to the further development of quality projects.

Similar to the French Club PPP in terms of structure and objectives, the Club PPP MedAfrique aims at the development of infrastructures in Africa through the introduction of PPP. Because this development requires well-educated and convinced public and private actors, in the core of MedAfrique operations is the promotion of knowledge exchange and development of synergies between the private and the public sectors in the geographic area of Mediterranean and French-speaking Africa. The ultimate objective is to

- Support the evolution of public procurement financing possibilities,
- Investigate the PPP opportunities,
- Ensure the maintenance and upgrading of the public infrastructure (beyond the construction phase), and
- Favor subcontracting for local companies and ensure capacity building over the long term.
Currently, Club PPP MedAfrique has created two working groups focusing on the two sub-regions:

1. **PPP “Union for the Mediterranean”**
The first working group has focused on the role that public investment—and PPPs, in particular—will play in the process of building the Mediterranean Union projects (schools, hospitals, roads, public transport, water networks, desalination, and so forth). In this context, the group will focus on the development of common guidelines, applicable on both sides of the Mediterranean, to foster private financing infrastructures through PPP development.

2. **PPP “Africa”**
The second working group supports the enabling conditions for the development of PPP as a new tool, ensuring the durability of public infrastructures in the Mediterranean region and West and Central Africa. It functions as a platform for information exchange about the legal and financial framework encouraging the PPPs, the setting up of PPP units, and the main factors of success in developing PPPs.

**Figure 30. Club PPP MedAfrique Action Plan**

- Organization of meetings
- Participation in meetings in Europe, Africa, etc.
- Study visits/reception of foreign delegations
- Website
- Political interviews
- Signature of a PPP «Charter»

**Actions in 2008**
- March: Official visit to Egypt, Tunisia, and Libya with the Minister of Trade
- May: Participation in a meeting in Dakar (Senegal)
- July: A journal special: «Union for the Mediterranean»
- October: First working session about «Union for the Mediterranean and PPPs»
- October: Egypt is guest of honor at the International Meetings in Paris

Author: Geraldine Kouzan
The main messages of this session are summarized as follows:

- PPP associations are of paramount importance for the progression of the knowledge and capacity-building agenda of the country.
- PPP associations are growing very fast in many countries around the world, and their objectives include the promotion of PPPs; the provision of objective and timely information; the facilitation of communications between the public and private sectors; and the delivery of educational, training, and other activities on PPPs.
- A new role for PPP associations has emerged: in many countries, they have been used as a tool by the private sector for the establishment of a supporting legal and institutional PPP environment.
DAY 4
SESSION FOUR: EMERGING MARKET PPP IN THE CONTEXT OF THE GLOBAL FINANCIAL CRISIS

CHAIR
- LAURENCE CARTER, Director, Infrastructure Advisory Services, International Finance Corporation

PRESENTERS
- ROBERT COLLINS, Executive Director, Morgan Stanley, United States
- SE-IL KONG, Director of the Project Finance Department, Investment Banking Division, Korea Development Bank (videotaped presentation)

PANEL DISCUSSANTS
- ROBERT BESTANI, former Director General, Private Sector Operations Department, Asian Development Bank
- SHUILIN WANG, Managing Director and Head, Public Relations and International Cooperation Department, China Investment Corporation
- CHERIAN GEORGE, Managing Director, Fitch Ratings, New York, United States
- ROBERT COLLINS, Executive Director, Morgan Stanley, United States
- EDWARD R. NEAHER, JR., Partner, White and Case LLP, Washington, DC, United States
- BRIAN MILLER, Executive Vice President, AES Corporation, Virginia, United States

Recent developments in global capital markets and how they are reshaping market perceptions of PPP projects in emerging economies were discussed. Emphasis was on the new challenges raised for infrastructure funding via infrastructure bonds, infrastructure funds, and structured finance and how they might shape the future of PPP projects in emerging markets. Attention was also given to lessons from previous financial crises (for example, Korea 1997–98) for sustaining the PPP market under challenging market conditions. The dialogue explored options for restoring
debt and equity market financing for infrastructure projects, both under implementation and planned, and restoring willingness and ability of financial markets to consistently fund planned infrastructure projects.

The main messages of the discussion are summarized as follows:

- The current times are very exciting, but also very upsetting for PPPs. On one hand, there is a global momentum for the extensive utilization of PPPs as a great alternative for infrastructure development; on the other hand, the financial crisis has resulted in the revaluation and prioritization of existing PPP projects.
- More PPP projects are expected to be developed in the near future; however, they will be smaller in size and will attract shorter-duration debt.
- Private bidders are also expected in the future to utilize a larger variety of financing sources apart from commercial bank debt and private equity. The financing mix will be enriched by public funds (in the form of guarantees or direct payments) and contributions from multilateral development banks.
- The global financial crisis is an excellent opportunity for governments to dedicate time and resources toward building a more robust PPP framework that can facilitate the development of a project pipeline when the market stabilizes.
Panel Discussion

The Impact of the Financial Crisis on PPPs

Although the demand for infrastructure projects is kept at high levels in many countries, the financial crisis currently affects the supply side of the global PPP market. The magnitude and the nature of the impact vary, depending on the current phase of the projects:

1. Undergoing projects
   In the case of active projects already in progress, the financial crisis doesn’t seem to have much of an effect, except for the fact that in many countries, the private sector has submitted requests for refinancing and renegotiations.

2. Projects in the procurement process
   The crisis seems to have greater impact in projects that have been put in the market, but not yet reached financial closure. Challenges seem to be greater for large-scale projects that experience significant delays in finalizing their financial structure and obtaining long-term funding. In addition, the risk premium increase from the side of the banks raises issues related to the VFM and how it can be measured in
relation to alternative public financing. However, the ultimate impact will be assessed in its full magnitude when the banks finalize the process of risk pricing.

3. New (future) projects
Governments have to carefully prioritize and strategically select the projects to put into the market. They will certainly have to increase the quality of economic and financial assessments and ensure that the PPP route is the best alternative financial option to take. In this context, the absolute number of new PPP projects is expected to decrease; however, the financing structure is expected to change and its quality to improve to attract more private capital. In this context, IFIs will play an integral role in formulating the projects’ financial structure through the provision of long-term funding.

Liquidity injections have been seen by many countries as a necessary measure to boost the financial markets and maintain economic activity. However, it is too early to assess the impact of such policy as to the ability to structure and financially close PPP projects. In this context, many governments take two additional measures to ensure the PPP market functionality:

- Increase their financial contribution in large PPP projects or
- Break large projects into smaller sections, thus converting them into viable and attractive parcels for private financing

Regardless of the measures taken by the governments, the PPP fundamentals should not be disturbed. Practitioners believe that PPPs are here to stay and are confident that the qualities of the model can still be appreciated even in these difficult financial times.
PANEL DISCUSSION
THE IMPACT OF THE GLOBAL FINANCIAL CRISIS ON SUBNATIONAL PPPS

MODERATOR
• ART SMITH, Chairman, National Council for Public-Private Partnerships, United States

PANELISTS
• BOB FINLAYSON, Senior Evaluation Specialist (Private Sector), Operations Evaluation Department, Asia Development Bank (ADB)
• SUMTER LEE TRAVERS, Manager, Subnational Finance Group, World Bank / IFC
• WILLIAM STREETER, Managing Director and Head of Global Infrastructure and Project Finance Asia Pacific, Fitch Singapore, Fitch Ratings
• RICHARD FOSTER, Head of PPP Unit, Partnerships Victoria, Australia
• TOMAS BRUGINSKI DE PAULA, Director, Companhia Paulista de Parcerias (CPP), Brazil

Main Messages
• Municipal and local projects have been very popular in a handful of countries such as Australia, Brazil, and Korea, but have gained momentum in other countries as well (for example, India and Russia). However, the crisis slows down local governments’ PPP activity worldwide and generates serious challenges for the implementation of projects at a subnational level.
• The challenge for the local governments is to remain focused on developing good procurement processes and attracting robust projects to maintain the private sector's interest in local projects.
• In reality, most of the world’s subnational governments are not rated. This affects the willingness of the private sector to enter into long-term agreements and to partner with them in the development of large infrastructure projects. A
long-term strategy for institutional building and fiscal responsibility is necessary to convince the market of their creditworthiness.

• The impact of the global financial crisis on the creditworthiness of subnational governments depends largely on the structure of the revenue sources of each local government. In this context, subnational governments that support their financial streams on robust national transfers base their hopes on central government’s policies to respond to the crisis.

• Local governments with long credit histories and good ratings are not expected to experience great fluctuations in their creditworthiness, despite expected reductions in transfers of federal funds and state tax revenues. However, in many countries, the national government’s response to the financial crisis has distorted the capacity and ability of the financial markets to fund local governments’ PPP projects. The reality is that, worldwide, only a few local governments are rated and even fewer have the fiscal capacity to undertake a PPP program. As a result, the financial crisis has affected the already limited ability of the states to raise debt for infrastructure development.

• The role of the central government still remains important for the development of the local PPP program. The traditional roles of setting the legislative and regulatory framework, putting in place the procurement processes, and general supervising of the pipeline become more important for the overall success of the local PPP program. The central government should assume the role of coordinator among the various subnational programs to achieve the development of a well-balanced and consistent market comprising a national and local mix of projects.

• Local governments will be forced to prioritize their existing pipeline and reevaluate selected projects under the current financial circumstances. Only a few projects will be pushed to the market as PPPs, while governments will have to think carefully how to economically and financially structure new ones to be offered to the investment community.

• Institution building is one of the most important things that local governments can do to be able to make public policy choices that will affect their ability to develop a marketable PPP program.

• Local governments should prove their ability to manage their fiscal affairs effectively and build confidence in the market and in potential private sector counterparts.
PANEL DISCUSSION
IMPACTS OF THE CRISIS ON EQUITY FINANCING OF PPP PROJECTS

MODERATOR
• IAIN MENZIES, Senior Infrastructure Specialist, World Bank

PANELISTS
• MICHAEL BARROW, Director, Private Sector Department, Asian Development Bank
• HELEN CHEIKHROUHOU, Manager, Infrastructure Finance Division, Private Sector Department, African Development Bank
• BOB ASTANI, Stanford University
• NICOLAS BOUDEVILLE, Director, Rising Africa Infrastructure Fund (RAIF), and Deputy Managing Director, Natixis Environment and Infrastructure, France
• GEOFF SEGAL, Senior Manager, Macquarie Capital Advisors

Main Messages

• The importance of equity in the financing of PPP projects increases as equity capital becomes scarce and debt dries up (at least temporarily). Investors will have to be selective in terms of where they put their limited equity, and only the best projects with the strongest government support will survive. The international investors’ community has already started to look for projects with high-return and low-risk profiles.
• New PPP projects face competition in equity attraction from existing PPP projects with established risk profiles.
• Local investors become increasingly important in investing in PPP projects because they understand the market much better and usually have a significantly lower perception of risk.
• Multilaterals will have to be involved in a countercyclical manner and play a more active role in making PPP projects more attractive to equity investors.
PANEL DISCUSSION
THE IMPACT OF THE CRISIS ON DEBT FINANCING OF PPP PROJECTS

Moderator

- Mark M. Moseley, Senior Counsel, Energy, Legal Vice Presidency, World Bank

Panelists

- François Bergère, Secretary General, PPP Taskforce, Ministry of Finance, France
- Sergio Hinojosa, Partner, IKONS ATN, Mexico
- Robert Sheppard, Cochair, Infrastructure Experts Group, UN
- William Streeter, Managing Director and Head of Global Infrastructure and Project Finance Asia Pacific, Fitch Singapore, Fitch Ratings

Main Messages

- The global financial crisis has a great impact on the ability of banks to provide long-term debt financing for the development of PPP projects. This affects both projects already in the pipeline and those planned to be procured shortly. Projects that are already far along in the procurement process may be repriced, but are expected to eventually close because of high costs associated with cancellation. New loans will be provided under shorter tenors—typically 10–12 years—than the ones given in the past (which reached 20–25 years).
- In many countries, the market has experienced a shift from the use of syndicated loans to the formation of club deals in which the project developer is responsible to identify and structure the debt financing.
- The issuance of infrastructure bonds is not expected to be affected significantly because it reflects a small portion of infrastructure finance, especially in developing countries.
- As a result of the banking system’s reluctance to provide long-term finance,
governments should reevaluate the list of infrastructure projects and put into the market only the ones that entail strong cash flows. In addition, they should think of alternative mechanisms to support PPP project development. The introduction of guarantees or the injection of public equity, with the subsequent reduction of the senior debt amount, is expected to restore confidence in the financial system.

- The role of multilaterals in the management of the financial crisis becomes very important, especially via the offering of guarantee instruments.
PANEL DISCUSSION
THE IMPACT OF THE CRISIS ON THE BANKABILITY OF PPP PROJECTS

MODERATOR
• EDWARD FARQUHARSON, Project Director, Partnerships UK (PUK)

PANELISTS
• RICHARD FOSTER, Head of PPP Unit, Partnerships Victoria, Australia
• ALFREDO PASCUAL, Advisor, Public Private Partnerships, Asian Development Bank (ADB)
• ROBERT SHEPPARD, Cochair, Infrastructure Experts Group, UN
• RUI SOUSA MONTEIRO, Senior Economist, PPP Unit, Parpública, Portugal

Main Messages
• The financial crisis will affect not only developing countries but also developed countries with a fairly well structured financial system. Compared with similar situations in the past, the current financial crisis affects systemically the global financial markets, thus making it more difficult for projects to react by altering the terms of the financing deals.
• The impact on the bankability of PPPs will be great for both projects that base their revenues on user charges and those that receive availability payments. The former will be influenced by demand reduction for infrastructure services as they become less affordable by consumers. The latter will be affected by difficulties from the government side to meet their obligation for regular payments or availability payments resulting from reduction to tax revenues.
• Financing for PPP projects becomes easier for small projects based on availability payments; however, as risks have increased, margins have adjusted upward and tenors have become shortened from 20–25 year to 10–12 years (on average).
• New PPPs will have great difficulties in raising financing because they face
intense competition not only from similarly structured local and international projects but also from already developed (low-risk) ones.

- The governments need to understand the limited capacity of the financiers to finance large infrastructure projects and will have to adjust their expectations to the capability of the current market. They should be ready to shorten the existing list of potential PPP projects and prioritize upon criteria of economic importance and financial viability. In addition, the public sector should run the procurement process with more flexibility and may further support and reinforce the operation of project development funds in which the public sector reimburses bidders for all preparation costs if not selected.

- IFIs will have to play a more active role on multiple fronts:

  - Providing complementary funding for the development of viable PP projects
  - Supplying advisory services to governments to reprioritize and restructure selected projects before taking them into the market
  - Offering guarantee products to reduce the overall risk of the projects

Although financial markets are expected to react to the crisis, as they have in past financial crises, governments have the opportunity to spend available resources to better structure and prepare projects to be put in the market when the financial conditions improve.
PANEL DISCUSSION
THE IMPACT OF THE FINANCIAL CRISIS ON RISK ALLOCATION OF PPP PROJECTS

MODERATOR
• EDWARD FARQUHARSON, Project Director, Partnerships UK (PUK)

PANELISTS
• ROBERT SHEPPARD, Co-chair, Infrastructure Experts Group, UN
• FRANÇOIS BERGÈRE, Secretary General, PPP Taskforce, Ministry of Finance, France
• SERGIO HINOJOSA, Partner, IKONS ATN, Mexico
• CHRIS WILSON, Executive Director, 4ps, United Kingdom
• TUMI MOLEKE, Head of the PPP Unit, National Treasury, South Africa
• NICHOLAS BOUDEVILLE, Director, Rising Africa Infrastructure Fund (RAIF, France

Main Messages

• The possible increase of demand risks, in the case of projects based on user charges, will not affect the structure of the risk matrix because the fundamentals of risk allocation will be unchanged.
• The financial crisis has also affected the balance sheets of many sponsors and operators and increased the risk of contractors’ default. Sponsors are being more careful to select the most well-structured projects and to partner with bigger companies with stronger financial bases.
• The refinance risk emerges as a new risk element in many of the PPP deals because there is a misalignment of the contractual horizon (usually 20–25 years) from the length of financing tenors, which now have dropped to 10–12 years (on average).
PANEL DISCUSSION

THE IMPACT OF THE FINANCIAL CRISIS ON RISK ALLOCATION OF PPP PROJECTS

MODERATOR

• BOB ASTANI, Stanford University

PANELISTS

• CLIVE HARRIS, Infrastructure Policy Advisor, East Asia and Pacific Operations and Policy, World Bank
• HEILA CHEIKHROOUHOU, Manager, Infrastructure Finance Division, Private Sector Department, African Development Bank
• MICHAEL BARROW, Director, Private Sector Department, Asian Development Bank
• DENIS J. CLARKE, Chief Investment Officer, International Finance Corporation

Main Messages

• As PPP projects become more complicated and difficult to close, IFIs are expected to play a significant role in assisting governments to overcome the problems imposed on PPPs by the global financial crisis. Most of the IFIs have already scaled up their operations, with a special focus on existing projects in the pipeline, making sure that existing deals will close on good terms for both the public and the private sectors.
• IFIs have undertaken several measures and complement governments’ responses (mainly done via stimulus packages) to assist their client countries and their infrastructure PPP programs to survive the financial crisis.
• The specific measures that multilaterals have taken can be summarized as follows:
  i. Expansion of lending operations with regard to participation in existing PPP projects
ii. Provision of technical assistance resources to assist governments to re-package projects and minimize risks

iii. Attracting other bilateral agencies and other multilateral organizations to work together and invest in PPP projects, thus increasing the viability of the projects
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