VIABILITY OF PPP IS INCREASING IN EMERGING COUNTRIES

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PPP HAS CONTINUED TO EVOLVE

PPP (Public-Private Partnership) is recognized as the comprehensive concept of public-private collaboration where public organizations, including the central government and municipalities, offer the public services such as construction and operation of infrastructure in cooperation with private companies, and also as a general term referring to the mechanism to achieve public service provision by public-private cooperation. The history of provision of public services through the method of PPP dates back to water utility projects in the middle of the 19th century in France. In the beginning, the term “PPP” originated in the UK in the late 1990s. In the early 1990s, a system called PFI (Private Finance Initiative), which focuses on utilization of private capital, was introduced in the UK. Thereafter, the basic concept of PPP was established as a general term referring to various kinds of public-private partnerships, including PFI. PPP thereby spread from Europe to countries all over the world.

In the 1990s, PPP projects mainly adopted a purely self-contained method, which means that user fee revenues recover invested capital and operating costs, and thereby generate profits. In those projects, where fare revenue could be expected in infrastructure projects such as transportation, water utilities, and electric power facilities, private-sector operators handled all activities, from funding to construction and operation. With this method, the government can improve infrastructure without incurring the cost of facility investment and maintenance. That is to say, it is an ideal method for the government. On the other hand, private-sector operators can obtain the right to operate public infrastructure exclusively over a certain period of time, but they become subject to the transfer of various risks such as fluctuations in the volume of infrastructure usage. Because of this, such projects around the world have started to reach an impasse in terms of management, due to the occurrence of risk events, which are mainly caused by the following factors: 1) gaps between bullish demand forecasts by private-sector operators and the actual amount of usage; 2) unreasonable funding, such as high loan ratios, and borrowing at high interest rates. Under such circumstances, the development and introduction of the scheme supporting the reduction of demand risks and funding by the government has been implemented.

When it comes to road projects in the UK, citizens have a strong resistance to toll roads. Due to such a situation, since the middle of the 1990s schemes such as Shadow Toll, Availability Payment, and Active Management Payment have been developed and introduced to diversify the invested capital recovery methods of private-sector operators. In those schemes, the government pays for the operating cost to private-sector operators, which cannot be found in the self-contained method. In regard to demand risks, in the Shadow Toll scheme, private-sector operators incur them, while in other schemes, the government incurs them. Specifically, Availability Payment allows the government to incur demand risks as well as to guarantee a payment of a certain amount of money to private-sector operators. This has come to contribute to its prevalence on a global scale mainly in the West as an effective means to further expand the scope of the business where PPP can be applied even to projects with little or no user fee revenues. Moreover, in India, a similar method called Annuity Payment was introduced in the middle of the 2000s, and thereafter, in 2005, a scheme called Viability Gap Funding (VGF) was developed. VGF is the mechanism which provides a government subsidy for part of the construction costs in PPP projects (green-field projects), including infrastructure construction, to private-sector operators. This plays a role in securing participants in bidding, and thus promoting the feasibility of PPP projects. That is to say, this is an effective scheme in emerging nations who have many green-field projects difficulty in fundraising due to the immaturity of their financial markets. Recently, not only India, but also Indonesia and Vietnam have introduced this method. (Table 1)

Table 1 PPP Scheme Development until the Middle of the 2000s

Scheme (System,Method)	Contents	Major Countries Adopting the Scheme
Shadow Toll	Introduced in the U.K. in 1994. The government pays virtual usage fees to operators in accordance with infrastructure usage volume.	U.K., Spain, Portugal, Canada
Availability Payment / Annuity Payment	Introduced in the beginning of the 2000s. The government pays a certain amount of money to operators regardless of infrastructure usage volumes, as long as the infrastructure is available in an appropriate condition. If the service level is higher than the standard required, a bonus is paid. Conversely, it is lower than that, payment is reduced.	U.K., Spain, Portugal, Ireland, Astralia, U.S.,Canada, India
Active Management Payment	Introduced in the U.K. in the middle of the 2000s. Multiple indicators are set to service standards, and a payment amount is decided based on the combination of those evaluations.	U.K.
VGF（Viability Gap Funding）	Introduced in 2005 in India. The government provides operators with subsidies as the part of construction cost. The amount of VGF is targeted for the evaluation of bidding.	India, Indonesia, Viernam

Source: Created by MGSSI

From the viewpoint of allocation of risks between the public and private sectors, public works projects for which the government incurs all the risks for their implementation are considered to be positioned in opposition to early PPP projects, which are adopting the self-contained method where most risks are transferred to private-sector operators. Therefore, the development and introduction of the above-mentioned schemes situated in between public works projects and early PPP projects enable the allocation of risks to be set in flexible and various ways, as well as to expand the applicable scope of PPPs and their feasibility. That can be called evolution of PPP.

PPP EVOLUTION IN EMERGING COUNTRIES

Since the 1990s, mainly in Western countries, various schemes for PPPs have been developed and introduced. In that sense, PPPs have continued to evolve. Recently, in particular, PPP evolution is noticeable in emerging countries which have more pressing needs to utilize PPPs. Infrastructure development is positioned as a key issue in domestic policies among many emerging countries. That is why each country is trying to attract private investment by utilizing PPPs due to constraints on government financial resources. Among them, India, Indonesia, Argentina, and the Philippines have developed schemes and revamped their legal systems in the light of their respective past experiences and circumstances to satisfy their pressing needs, such as increasing the number of projects, speeding up project delivery, and introducing foreign capital. These efforts have resulted in improving the feasibility of PPP projects, and attention is now being paid to the application of those schemes to future projects. (Table 2)

Table 2 Infrastructure Development Policy in India, Indonesia, Argentina, Philippines and Evolution of PPP

Country	Prime Minister, President (Inauguration Date)	Positioning of Infrastructure Development Policy and Private Investment	Evolution of PPP: Procedure	Evolution of PPP: Overview
India	Prime Minister Modi (May 2014)	Private investment including PPP is expected to be allocated for 48 % of total infrastructure investment amount to be expected in the 12th Five-Year Plan (April 2012 -- March 2017), about 1 trillion USD.	Introduction of Hybrid Annuity Methods (2016)	· Combination of VGF and Annuity Payment
Indonesia	President Joko (October 2014)	In the Five -Year Infrastructure Development Plan compiled in January 2015, financial requirement for infrastructure development until 2019 is estimated as about 355 billion USD. Financial sources are supposed as follows: budget of nation and municipalities (a little over 40%); state-owned companies (a little over 20%); private sector (a little below 40%).	Enactment of new PPP regulations (2015)	· Introduction of Availability Payment · Enabling development of commercial facilities attached to the infrastructure · Expansion of target fields for PPP (education, tourism, health, public housing, etc.) · Enabling projects across multiple fields to be integrated into one PPP project
Argenzina	President Macri (December 2015)	The government announced the investment plan for transportation infrastructure development with a total amount of 95 billion USD from both public and private sector. This plan is Argentina's largest scale one ever in its history. Private investment of 20 billion USD out of the above total is expected for road developments.	Enacment of new PPP law (2016)	· Governmental Limit and elimination of privileges such as unilateral changes to contract terms and suspension of contracts · Provision of sufficient governmental compensation for suspension of contract · Application of consumer price indexation for payments. Enabling payments in foreign currencies · Enabling dispute resolution by arbitration within and outside the country
Philippines	President Duterte (June 2016)	Infrastructure investment in 2017-2022 is planed with the total budged of 168 billion USD ("Build,Build,Build") . Financial sources: National budget (66%), PPP (18%), ODA from Japan and China (15%)	Introduction of Hybrid PPP to be planned	· As for construction of facilities, the government uses fiscal budget and ODA to implement projects, and then immediately sells the operational right of completed facilities to private operators.

Source: Created by MGSSI

（1） Scheme Development

India has conventionally been making active use of PPP mainly in transportation and electricity infrastructure. That is why India adopted a policy of implementing national highways development in principle by utilizing PPP in 2005. India has also introduced the Availability Payment (Annuity Payment) scheme, while it independently developed the VGF scheme, as stated above. Until 2011, the number of PPP projects in India was steadily increasing, but this resulted in a sharp decline from 2012 onwards. Behind this decline is the fact that excessive competition among operators, delays in business activities due to delays in land acquisition, and other factors caused a rise in the debt ratios of operators and non-performing loans of financial institutions that provided loans, resulting in the growing reluctance of financial institutions to offer loans. Aiming to revitalize sluggish PPP projects, the Indian government (which has been under the control of the Modi administration since 2014) developed a scheme called Hybrid Annuity, which was introduced and adopted for 16 projects in 2016. This is a combination of VGF and Annuity Payment, contributing to a further decrease in risk-bearing by private-sector operators. Such a decrease is to be achieved by the government incurring a part of the construction costs and demand risks after the start of a project's operation.

With a long history, PPPs in the Philippines have been utilized in the development of infrastructure for transportation and electricity since the 1990s. However, in the procedure executed by the government from the drawing up of plans for PPP projects until the start of the project, contract negotiations between the government and bidders require too much time, which is recognized as a problem. Under such a circumstance, the Duterte administration (which started in 2016) has now set out a policy to accelerate infrastructure development. This policy is one of ten items making up the government's socio-economic policy. Moreover, the Duterte administration is making efforts to invent and introduce an approach called Hybrid PPP to speed up PPP projects. In this newly invented method, the government implements the construction of facilities with the utilization of government budgets and ODA, like with other general construction projects, and immediately after completion of construction, sells the right to operate those facilities to private sector operators. This is an unprecedented approach anywhere else in the world. Although local companies have shown their concerns that this method will contribute to expanding government debt, the Philippine government is trying to make creditable achievements through implementing projects such as the development of local airports.

（2）Reform of Legal Systems

In the process which involves coming up with the idea for a PPP project until its implementation, execution of complicated procedures and agreements on detailed contracts are needed between the government and private sector operators. In order to implement them, a special legal system is not necessarily needed. However, many countries develop legal systems specific to PPPs with the aim of showing the nation's intention to utilize PPPs as well as encouraging business development by unifying complex procedures and rules, and, thereby, improving the environment so that domestic and foreign private companies can easily join in. Moreover, development of the legal system allows the various PPP schemes which have evolved in foreign countries to be incorporated into the system of a nation's own system. For example, Indonesia and Argentina have conventionally possessed a legal system for PPPs, and recently have revamped that by incorporating new contents with reference to the excellent cases and lessons to be learned from the experiences of foreign countries.

In Indonesia, after the advent of the Joko administration in October 2014, the new PPP regulations (Presidential Regulation No.38/2015) were enacted in March 2015, by revising the existing PPP regulations which were enacted in 2005. Under the new PPP regulations, the provision to decrease the risk burden on private sector operators and give incentives for participating in PPP projects is added for the purpose of increasing the number of projects. The most notable point is the diversification in invested capital recovery methods. Although the self-contained method alone is authorized under the existing regulations, the adoption of Availability Payment was made possible under the new regulations. In fact, this scheme was applied to the three projects aimed at developing telecommunication infrastructure on which agreements were concluded in 2016. In addition, the development of commercial facilities associated with infrastructure was allowed, and thus, private sector operators have become able to gain revenues from them.

Considering the introduction of foreign capital, Argentina, which returned to the international financial markets with the advent of the Macri administration in December 2015, has been seeking technical support from international organizations such as the World Bank and the Inter-American Development Bank. Based on various experiences and know-how obtained through such support, the Argentine Government newly enacted the PPP Contracts Law (Law No.27,328) in November 2016. Prior to this, PPPs had been implemented based on the Concession of Public Works law enacted in 1967. Under this law, many governmental privileges such as unilateral changes to contract terms and suspension of contracts were authorized. As a result, there were many unpredictable risks imposed on private sector operators under this legal system. On the other hand, the new PPP Contracts Law clearly limits or eliminates these government privileges. Also, dispute resolution by arbitration outside the country became possible. As for project revenues, revisions of fee settings in accordance with price fluctuations, and payment with foreign currencies are stipulated in that revised law, though those were previously prohibited.

FUTURE OUTLOOK OF PPP— EVOLUTION WILL CONTINUE IN THE FUTURE

One of the factors common to the above-mentioned four countries is the existence of an administration with a unifying force. Leaders exercising strong leadership in all four nations have situated infrastructure development as an important challenge in domestic politics. Recognizing that introduction of private investment is essential due to constraints on governmental financial resources, those governments are instigating PPPs, while overcoming difficulties. Furthermore, in line with the world trend, they are implementing the development of schemes and legal systems in a way that increases the allocation of risks imposed on the government.

PPPs have started to be utilized by setting the self-contained method to the basic scheme. However, in the process of PPP evolution, the allocation of risks between the public and private sectors has become affordable for private sector operators. After that, the allocation of excessive risks has gradually started to be imposed on private sector operators, due to rising expectations from governments which have been suffering from financial budget shortfalls, as well as excessive competition among operators. This has caused some projects to end in failure. In some emerging countries, cases of unsuccessful bidding occur frequently, because the allocation of risks is an excessive burden to bear for the private sector. Efforts in India, Indonesia, and Argentina are based on this background, and risk allocations are being set as affordable ones for companies outside the nation concerned.

The above-mentioned efforts in the Philippines as seen with the Hybrid PPP are considered unique, and make the government bear construction risks as well as speed up project implementation by partly simplifying complicated PPP procedures. This initiative separates the construction part from the whole project, and thus makes PPP operators deal with the maintenance part mainly. Therefore, construction-related companies which can take a construction risk might see the Hybrid PPP as less attractive. However, institutional investors in pursuit of projects, where stable profits over the long term can be expected despite lower returns, are likely to get interested in this scheme. Future developments about whether or not the Hybrid PPP can gain support from the private sector and become prevalent in the Philippines as well as other countries are worth paying attention to.

According to the estimates of the World Bank, in emerging countries, the infrastructure gap, which is the difference between the required amount for infrastructure investment and the actual amount for infrastructure investment, amounts to 452 billion USD annually. This shows that the expectation for private sector financing is still enormous in those countries. Even in the future, due to the shift to a pragmatic policy line stemming from a change of administration and other factors, the progress of PPPs might suddenly be accelerated in emerging countries that have not sufficiently attracted private capital so far. Meanwhile, replacement demand for aging infrastructure in developed countries is huge. Moreover, considering the negative effects of excessive competition, as seen with the business failures of companies in some developed countries which are committed to powering their business with PPP, those governments might choose to evolve and review existing PPP schemes.

It is highly likely that PPP schemes will continue to evolve, regardless of whether they are in developed countries or emerging countries, a large nation or a small one. This is because the various components of PPP schemes, such as funding methods, invested capital recovery methods, allocation of risks between the public and private sectors, and technical specifications, have been advancing. In addition, new schemes and legal systems created by inventive approaches for each nation as well as analysis and evaluations of those new schemes and legal systems are passed on to other nations around the world through the Multilateral Development Bank, etc. This also encourages the further improvement of PPPs. Even in the future, government concessions seem to contribute to increasing the number of nations which can enter into the private sector with the appropriate risk allocation. However, sooner or later, the competition for entering into PPPs seems to become intensified in countries which once achieved success in introducing PPPs. Therefore, the entry timing might play a vital role in getting results of PPP projects. In such countries, private sector operators tend to increase their own allocation of risks. They will decrease the cost in funding with financial technologies and the requested amount of government subsidies by raising leverage, enhance the accuracy of demand forecasts by utilizing technology, and allow for a part of the demand fluctuation to decrease government spending. Consequently, acceleration of competition in PPP bidding cannot be avoided. In addition, such competition will be further accelerated by local forces with higher tolerance of risks, as seen in the case of engulfing foreign currency risks. In any case, we should pay close attention to the likelihood that the PPP environment, anywhere in the world, is improved for the short term, under the stimulus of the above-stated infrastructure gap that many are urging must be reduced.

Note: The original Japanese report was written in March 2018.
