

PPP-Newsletter



A Bi-monthly Publication from the PPP-Secretariat of the Ministry of Economic Development, Financial Services and Corporate Affairs, Mauritius

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PPP: AN UPDATE

PPP has been launched a few months ago and is well positioned to deliver positive results. A lot has been done already: the institutional environment has been set-up and a lot of effort has been put in capacity building. Now more than 30 civil servants have undertaken a 2-day seminar covering all aspects of PPP, from concept to implementation. The policy statement and legislation are both under preparation and will be ready soon, giving the necessary legal and policy guidance for the development of projects. The first 3 pilot projects have been identified and the pre-feasibility studies are currently prepared by the PPP-Secretariat.

However, such an initiative will succeed only if more projects are identified and implemented. PPP is a new way of delivering quality services to the public at a more affordable cost. It is neither limited to traditional

sectors such as transportation or public utilities, nor should it be restricted to under-funded projects. What remains important is the quality and cost of providing these services and the best way to achieve our social objectives. This means that many infrastructure projects can be potential good PPP candidates, regardless of their priority or expectation of public funding.

As all Ministries will soon start preparing for the next budget exercise, it is essential to identify as early as possible projects for which private participation can result in higher value-for-money. The PPP-Secretariat is available to provide all the necessary support to identify, prepare and implement PPP projects and all Ministries are encouraged to contact us.

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Do you want to contribute to the next edition of the PPP Newsletter?

Please contact the PPP-Secretariat at pppsecretariat@mail.gov.mu

WHAT MAKES A GOOD PPP PROJECT

One interesting question is whether all government projects are suitable for implementation as Public Private Partnerships (PPP). Not all projects are good candidates for PPP. This article outlines some of the factors which need to be considered before selecting PPP as an option for implementing a project.

Is the project in line with Government's policy?

Government normally gives priority to the implementation of projects which are in line with its policy. The present capital budget (2002/2003) has made provision for huge investments in various key sectors, namely, information and communication technology (ICT), health, education, public infrastructure and transport.

It is expected that PPP projects will be in priority in these sectors. However, it should not prevent Ministries from considering projects that can meet the other criteria.

Does this project fit into a clear strategy?

Any project must fit into a well-thought sector strategy. This is even more important for a PPP project, as other projects can have an important impact on the demand risk, which is an essential element influencing the cost paid by Government. For example, if the revenues from the operation of a train come from user charging, anything influencing the number of people taking the train (change in bus or parking fare, restriction at the entrance of Port-Louis etc...) will impact the project profitability and its attractiveness to the private sector.

Moreover, the role of the private sector must be clearly defined before undertaking a PPP project. What services are we going to allow it to run (just cleaning and maintenance or provision of more strategic services)? The role of the private sector is a matter of Government policy but has also an important impact on the value-for-money delivered by private participation.

What are the incentives for Private Participation?

A PPP project must be attractive to the private

sector, which needs to recover its costs and make a reasonable profit. Revenues can be generated by charging directly the users of the service (ex. toll roads) or Government may pay directly the private partner (ex. Government accommodation). There is also the possibility of combining the user charges and Government subvention, in order to make the cost affordable to the public.

A project which does not have any profitability potential should therefore not be considered if the Ministry does not have the needed funding to compensate the private sector and if user charging is not an option.

What is the possibility of Risk Sharing?

Risk management means transferring risks to the partner who is best able to manage it. If a risk is better managed, the cost linked to its occurrence will decrease, lowering the total cost and thus generating value-for-money. The objective is not to transfer all risk to the private sector, as it will either not take it or charge a premium for something it cannot control.

A project without clearly identified risks that the private sector will be willing to take should not be considered as a suitable candidate.

What is the project timeframe?

The actual work on site for a PPP project starts later than with traditional procurement. The main reason for the late start is the requirement for conducting a detailed feasibility study and a longer procurement period. These tasks are essential for the success of any PPP project and should not be avoided or shortened.

On the other hand, the work on site takes less time than with the conventional method since the private partner gets paid only when the service is being delivered.

Before considering a project as PPP, it is thus important to consider when the construction is expected to start, while understanding at the same time that the overall time remains the same.

D.Khoodeeram



FROM ASSETS TO OUTPUT

Procuring a public-private partnership (PPP) agreement is quite different from typical government procurement of a service or commodity. The key difference between the PPP and conventional procurement is the use of an output specification by the State to describe the outputs the private sector must provide as part of the complete service.

Conventional procurement typically involves the procurement of distinct elements of a particular project through an input-based specification, for example the construction of a school. The State then becomes the owner and operator of the school, and only discrete elements of risks such as design risks and portions of construction risks are passed on to the private sector. In a PPP, the emphasis falls on the procurement of a complete service. The State may remain the sponsor of the project but very often the private sector provides the finance for the project. Substantial risks, such as project management, design and implementation responsibilities are passed to the private sector; ideally, the State retains the risks that it is best able to manage.

For example, under a PPP contract for a school the private sector will provide accommodation and related services, while teachers still employed by the public sector provide the core education services. In certain circumstances, outcome specification may be used where certain results are required to flow from the PPP, for instance educational attainment. Payment is only made to the private sector upon delivery of certain outputs and penalties are applied whenever the contractor fails to meet output requirements. For instance, if a space was not available for use, no payment relating to that space would be made. Deductions could also be made if rooms were available but the performance standards had not been met.

A PPP approach has certain advantages over an input-based approach. Often the input-based approach leads to delays in construction,

significant cost overruns and maintenance costs that become steadily less affordable. An output-based approach which focuses on what is required rather than how it is to be delivered, transfers the risks of cost and time overruns from the State to the private sector contractor, who is paid only when the output is delivered. Box 1 highlights the key features of the output-based approach.

Under the PPP approach, the contract goes beyond the provision of the asset, for example the school building. By transferring responsibility and risk for the ongoing management, maintenance and operation of the asset to the private sector contractor, it gives the contractor the incentive to develop design solutions that take into account the costs of managing the asset over its entire life. This ensures that the contractor does not design an asset that is cheap to build but unaffordably expensive to manage and maintain over the rest of its life - as has often been the case in the past.

This approach offers important advantages to Government, not only more efficient risk allocation and access to private sector expertise but also the delivery of new assets without pressure on Government resources.

R. Boodhoo

Box 1 - Key features of the output-based approach:

1. Specification of the outputs required, not the method of delivery
2. Procurement of a service, not the underlying asset
3. Allocation of risks to the party best able to manage them
4. Value for money as the overriding objective
5. Value for money assessed over the whole life of the asset
6. Payment for service as received, not as asset delivered.

CASE STUDY IN THE WATER/WASTEWATER SECTOR (ARGENTINA)

Private sector participation in the water and wastewater sector in Argentina is part of a program intended to help stabilize the economy after the crisis of the 1980s. Service provided by the public company Obras Sanitarias de la Nacion (OSN) in the capital, Buenos Aires, was deficient. In 1993 the government following an international bidding process, awarded a thirty-year concession contract to Aguas Argentinas, a consortium led by the French firm Lyonnaise des Eaux-Dumez. The concessionaire is responsible for providing all water supply and sewerage services for the federal capital itself and fourteen districts of the province of Buenos Aires. Its responsibilities include commercial and technical operations, maintenance, and provision of all investment financing necessary to achieve certain performance targets designated in the contract.

The contract specifies quality standards and performance targets for each of the six consecutive five year periods. At the end of the concession period all fixed assets are to be transferred to the government in good working order.

When Aguas Argentinas took over operations in Buenos Aires in May 1993, 6 million people had connections to piped water and 5 million to sewerage. By January 1996 the homes of an additional 570,000 of the city's inhabitants had been connected to the water system (a 9% increase), and those of an additional 340,000

inhabitants had been connected to the sewerage system (a 6.4% increase).

Besides these achievements, the quality of potable water has been upgraded in Buenos Aires. A new water quality laboratory and equipment for quality control of drinking water and sewerage effluents were commissioned. Water pressures have been optimised and physical leakage has diminished. Average repair time was reduced from two weeks before the new arrangement to forty-eight hours in 1995. Aguas Argentinas has also improved customer service: new payment systems were introduced allowing customers to pay bills at nearly 900 payment counters, including the company's own customer service centres, commercial banks, and financial institutions.

Tariff increases generally depends on the state of the infrastructure when the contract is awarded but eventually decreases. In the case of Buenos Aires, despite an increase of 13% in the second year of the concession, current water and sewerage rates are now 17% below what they were before the private sector entered the picture. The main lesson to draw is that private sector participation in this particular case has led to substantial benefits to consumers in terms of expanded coverage and quality of services as well as significant improvements in productive efficiency.

S.Appadoo
Source: World Bank

WORLD BANK LEAD ADVISER ON PPP

The Private Sector Advisory Services of the World Bank is acting as Lead Adviser on PPP for Government.

Mr Michael Schur, Private Sector Specialist and former Head of the South African PPP unit is working closely with the PPP-Secretariat and PPP Task Force to ensure the initiative will deliver the expected results.

A first mission in November gave the opportunity to assess the situation in Mauritius and to make a few recommendations regarding the strategy in place.

Mr. Schur will also provide support in the preparation of the legislation, sector reviews and evaluation of PPP projects.

PPP-Secretariat



PRICEWATERHOUSECOOPERS TRAINING ON PPP

PricewaterhouseCoopers organised a 2-day seminar on PPP entitled “PPP in Practice: a step-by-step training course to getting started”. Two sessions (19-20 November and 21-22 November), adapted to the Mauritian context, were conducted by two PPP-experts from PricewaterhouseCoopers Ireland.

The course covered various topics such as the procurement process, forms of PPP, consortia structures and targeted managers of private companies and government officials directly involved in the preparation, evaluation and implementation of PPP projects.

More than 30 officials of Government received a complimentary invitation and attended the training. Representatives of the private sector included consultants, lawyers and executives of

local firms. The mix of different sectors and partners in this initiative enriched the discussions which took place during the training.

In his speech, Minister Khushiram insisted on the importance of building capacity in Government and private sector. He encouraged other companies to follow the lead of PWC in building PPP expertise in the country and understanding better the long-term objectives of Government.

The PPP-Secretariat worked with PWC to adapt the training to the local context. Policy recommendations of the Task Force, such as the procurement process used for PPP projects, were included in the training manuals.

PPP-Secretariat

10 KEY MISCONCEPTIONS ABOUT PPP

The value comes essentially from the injection of private funds

In fact, the value does not come from the financing as the private operator must recover its costs and make a reasonable profit. The value-for-money generated by the private sector comes from several sources: output specification (payments are based on quality and quantity of services and not assets), optimal risk management, higher efficiency, 3rd party revenues (user charging or rent from commercial activities).

PPP just transforms capital expenditure into recurrent expenditure

As Government pays for the services and not the assets, payments are often scheduled over the life of the contract (15-30 years). A PPP option is chosen based on the value-for-money generated, which means more services at a lower cost. This is where most of the value comes from and not from the rescheduling of expenditures.

However, Government will smoothen

expenditures but this can have a significant impact on long-term financing as payments are committed for a long period of time. The project affordability (impact on budget) is done to ensure that a Ministry/Agency undertakes a project only if the long-term financial commitment can be sustained.

PPP is more expensive than traditional procurement

A PPP project is implemented only if it is less expensive than traditional procurement.

One essential step in the preparation of a project is the feasibility study which contains an assessment of the cost incurred by Government in providing the services. Procurement will start only after that study and if it is believed that the private sector can provide the same services at a cheaper cost. Finally, a proposal from the private sector will be selected only if the price asked is less than Government costs of providing those services. However, it is important to compare apples with apples: the amount paid should be



10 KEY MISCONCEPTIONS ABOUT PPP (CONT.)

compared to the risk-adjusted total cost of the project. This includes capital cost but also maintenance and operation as well as the cost associated with all risks, which are usually not budgeted but which Government has to pay if for example major works have to be done.

PPP is another word for privatisation

PPP, like privatisation, involves private participation in public delivery of services. However, whereas privatisation is a transfer of assets from Government to the private sector, PPP by focusing on the output, allows Government to better retain control on the social objectives. Moreover, depending on the structure of the PPP arrangement, the assets can be just managed by the private sector and remains under the ownership of Government.

PPP did not work in UK

UK has tried different versions of private participation and the early projects were not always successes. PPP has started in the UK only 10 years ago and an Andersen report evaluated the cost savings to be around 17% during the first few years of the initiative. The infamous example of the British Railway is in fact an example of privatisation which was not done properly. The issue came with the transfer of assets and constraints imposed to the private partner, resulting in reduced maintenance and deterioration of services. This cannot happen with PPP as the focus is indeed on the quality of services and not the assets.

PPP is interesting only for big projects such as the LRT

PPP is often used in major infrastructure projects in transport, public utilities or waste management. However, the UK experience suggests that PPP can be applied in other sectors such as health or education and for smaller projects. If a small project is correctly structured, it will generate interest from the local private sector. Moreover, smaller projects can be bundled

to increase their attractiveness to foreign firms.

PPP projects take much more time than traditional projects

The total cycle for a PPP project does not take more time. While it is true that a more extensive feasibility study and longer procurement is needed, the time saved in the construction usually compensates it. The procurement takes more time, as private partners need to come with a detailed technical solution to achieve Government objectives, stated in terms of output. However, the private sector is paid only for the services and not the assets, so it has the incentive to complete the construction as soon as possible.

PPP bidding is too expensive for private firms

There are high costs associated with the preparation of PPP proposals as the firm needs to submit a detailed technical proposal based on the desired level of services. Cases in which the costs are reimbursed are rare and, when it happens, only a fixed sum is reimbursed to short-listed companies. A reduction of the bidding cost is considered the best way to encourage private sector proposals, rather than reimbursement. Asking detailed proposals only after the short-listing of companies, putting emphasis on the quality of the feasibility study by Government before procurement, competitive bidding with reduced recourse to lengthy negotiations can significantly reduce the length and cost of the procurement.

Private initiative is the norm with PPP

In fact, private initiative or unsolicited proposal is the exception rather than the norm everywhere. The reason is that a PPP project needs to fit into Government strategy and deliver more value than Government traditional way service delivery. Competitive bidding is also becoming the norm and direct negotiations are used only in very specific cases such as in defence and when proprietary knowledge is involved. Competition is the best way to ensure value-for-money and this often can happen only during the



10 KEY MISCONCEPTIONS ABOUT PPP (CONT.)

procurement. Competitive bidding also ensures transparency and fair treatment, which is in the advantage of the private partners.

The private sector will not make unsolicited proposals if only competitive bidding is allowed

The PPP Task Force has not yet made recommendations regarding the way to deal with unsolicited proposals. However, the

decision will take into consideration the need to financially reward a truly innovative project and ensure at the same time value-for-money for Government. Other countries such as South Africa have options combining competitive bidding and financial reward and this does not deter their private sector to make proposals.

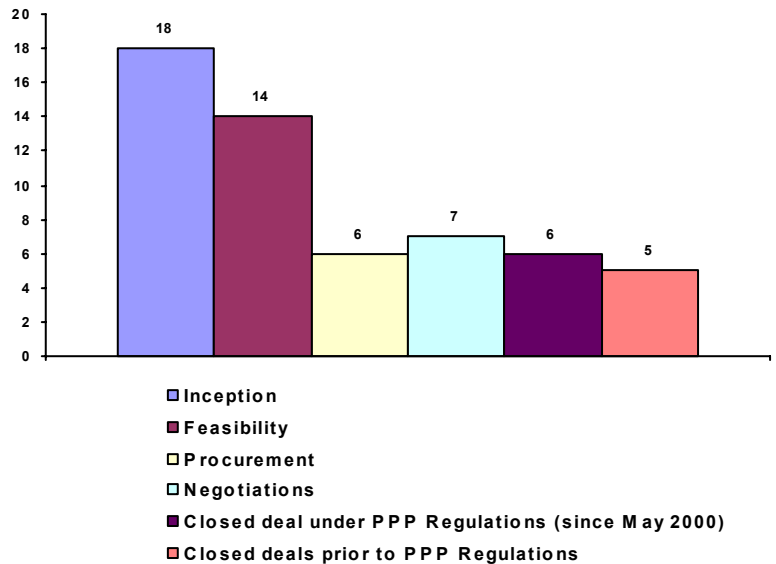
V. Cuttaree

PPP IN SOUTH AFRICA

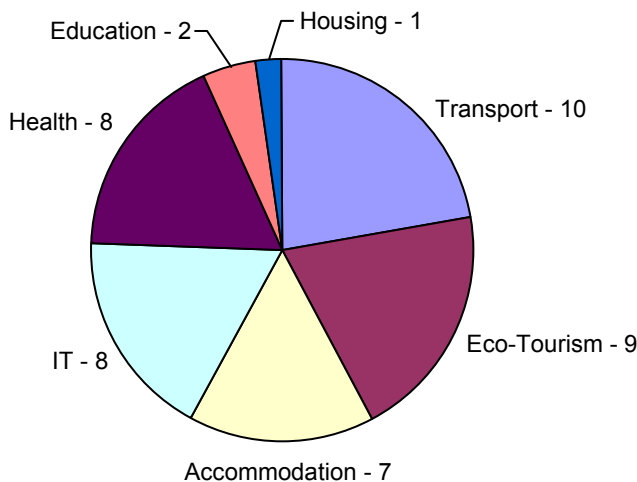
Prior to the promulgation of PPP Regulations in May 2000, five pioneering PPP projects had been rolled out at national government level: The N3 and N4 toll roads, the Bloemfontein and Louis Trichardt prisons, and SA National Parks tourism concessions.

Since May 2000, the number of PPP projects-in-making has grown exponentially. The list published in PPP Quarterly (SA publication on PPP) shows a wide variety of PPP types and scale, in a range of sectors, being developed across the country.

Number of Projects per Project Life-Cycle Phase



Projects in Progress - Dec 2002



The PPP Unit updates its list of Active PPP Projects monthly. These have been formally registered with the Unit by the relevant department or public entity, in terms of Treasury Regulation 16, and are being driven proactively through the PPP Project life-cycle by their principals.

From PPP Quarterly December 2002



PPP PROJECTS LIFE-CYCLE

All PPP projects initiated by Government will follow the project life cycle described next page. This cycle was approved by the PPP Task Force and is being used in the drafting of the new PPP legislation.

In this process, Ministries remain the project initiators and owners during the whole cycle. The PPP-Secretariat acts as a advisory and quality control entity, providing technical guidance and ensuring the feasibility studies and process meet the requirements of value-for-money, risk transfer and affordability (impact on budget).

In order to ensure transparency and generate value-for-money, the projects will follow a competitive bidding cycle under the supervision of the Central Tender Board. Cabinet approval will be required for all PPP projects before the tendering process and the signature of the contract.

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PPP PROJECTS LIFE-CYCLE (APPROVED BY THE PPP TASK FORCE)

