

PPP Governance Risk Assessment

PPP Days 2012

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Governance and PPPs

Governance: the manner in which public sector power is exercised in the management of a country's economic and social resources for development.

- The growing body of experience with PPPs demonstrates the contribution of good governance to successful PPP outcomes. At the individual project level, good governance can enhance project identification and selection, increase competition, encourage innovation and efficiency, and improve project sustainability.
- The Economist Intelligence Unit recognized the pivotal role of PPP governance in its 2011 PPP Readiness Index for the Asia-Pacific region.
- Despite this widespread recognition, there has been little work in the field of PPP governance risk assessment.



ADB Risk Assessment Guides

ADB has been leading in the development of risk assessment guides for infrastructure, including:

- Electricity Sector Risk Assessment (2009)
- Urban Water Supply Risk Assessment (2009)
- Education Sector Risk Assessment (2010)
- Road Transport Subsector Risk Assessment (2010)



ADB Governance Risk Assessment Guide

- Starting in late 2011 ADB undertook the development of a Governance Risk Assessment Guide.
- Internal focus to assist ADB staff in assessing governance risks and mitigation techniques in PPP projects across multiple sectors.
- External focus to assist public sector decision-makers understand, identify, and mitigate governance risks.
- Robust use of case studies (Asian PPP projects, with globally relevant features).



Outline of PPP Risk Assessment

1. Introduction
2. Governance in Project Delivery
3. Governance Risks
4. Need for Governance Skills and Management
5. Knowledge Management and Transfer
6. Widening and Mainstreaming Good Governance in PPP Projects
7. Case Studies

Methodology

- Initial Research and Inception Report
- Interviews with more than 20 ADB Stakeholders
- Identification of Case Studies
- Further Research and Draft Report
- Additional Interviews with ADB Stakeholders
- Stakeholder Review and Comment
- Finalize Report (February 2012)



Case Studies

Multi-sectoral and Pan-regional

<u>Project</u>	<u>Sector</u>	<u>Location</u>
Nam Theun 2	Power	Lao PDR
Meghnaghat 2	Power	Bangladesh
Chengdu	Water	China
West Jakarta	Water	Indonesia
North Luzon Xpress	Transport	Philippines

Nam Theun II Hydropower Project (NT2)



The Nam Theun II Hydropower Project, a 1070 MW facility on the Mekong River, Laos.

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Risks Discussed Include:

- Political
- Regulatory
- Technological
- Macroeconomic
- Demand
- Change in Requirements
- Institutional
- Contractual
- Construction
- Operational
- Environmental
- Other

Examples from Risk Table

<p>1.1 Policy</p>	<p>The lack of clear policy guidance can result in inconsistent decision processes being used to determine whether or not to use the PPP model.</p> <p>The lack of clear policy guidance can allow vested political and economic interests to influence the prioritization of PPP projects, resulting in suboptimal, or even unnecessary, investments.</p> <p>The lack of transparency in policy formulation and execution can allow influential persons to lobby government officials for favorable treatment (such as approval of unsolicited proposals or generous lease terms) or policy exemptions or reversals.</p> <p>The lack of a mechanism to ensure policy compliance can enable poor project selection or rent-seeking behavior.</p>
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Examples from Risk Table

<p>1.2 Legal Framework</p>	<p>Lack of clarity in the PPP law(s) can create ambiguity and may result in unsustainable, unenforceable, or even illegal contracts.</p> <p>Lack of integration between the PPP law(s) and other pertinent statutes (property rights, foreign investment, etc.) can create in conflicts and may result in unsustainable, unenforceable, or even illegal contracts.</p> <p>The lack of a reliably independent judiciary can reduce the enforceability of contracts.</p>
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Mitigating Governance Risks

Perhaps the most important conclusion of this report is that typical governance risks can be mitigated through careful planning.

- For example, in certain PPP projects, in sectors such as water and power, the private party's revenue stream may be based on user fees, with the fee structure determined by a government regulatory body. A frequently encountered challenge in PPPs is developing and maintaining a set of tariffs which will allow the private party full cost recovery, since there is political pressure to keep the rates as low as possible.
- Sometimes the gap between politically acceptable rates and actual costs is covered by a government subsidy, but if no mechanism exists to keep the project costs and revenues in equilibrium, it can affect the viability of the PPP.
- The potential for political influence on rates constitutes a governance risk.

Mitigating Cost Recovery Risk: The Chengdu Example

- Like other governance risks, the risk of incomplete cost recovery can be identified and mitigated during the project planning process.
- In the case of the Chengdu water PPP, the contract specified that if the City did not allow a tariff increase necessary to keep revenues in line with costs, the City would be obligated to pay the difference, thus holding the City accountable for ensuring that full cost recovery would occur.
- In the early years of project operation, when the city initially balked at approving the contractually-required rate increases, this provision proved crucial to keeping the project financially viable. Today the project has been operating successfully for a decade, providing high quality drinking water for the citizens of the city.

Need for Governance Skills & Knowledge Management Strategy

- Skills relating to legal, procurement, risk distribution, stakeholder communication and project management are critically needed for optimal project outcomes.
- Setting up a formal mechanism for knowledge transfer needs to be an integral part of the project planning process. This could include contracting for knowledge transfer as a specific contract output (both in technical assistance contracts and the PPP contract itself) and training and professional development programs.
- Such a mechanism should take into account government's ongoing and future role, the type of skills required for this role, developing and implementing an action plan to acquire those skills; retaining the skilled government officials and tapping the tacit knowledge that is not documented during the entire PPP project cycle.

For Further Information

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