SECTOR ASSESSMENT (SUMMARY): PUBLIC SECTOR MANAGEMENT (PUBLIC–PRIVATE PARTNERSHIPS IN INFRASTRUCTURE)

Sector Road Map

1. Sector Performance, Problems, and Opportunities

1. **Poor infrastructure quality limiting competitiveness**.[1] The Aquino government has recognized infrastructure to be a critical factor of economic growth. According to the Global Competitiveness Report, 2014–2015, the Philippines' ranking in quality of overall infrastructure has improved to 95th out of 144 countries, against 98th out of 148 countries in the 2013–2014 report. While this is a positive development, the Philippines remains behind Malaysia (29th), Thailand (76th), and Indonesia (72nd). More needs to be done according to international surveys to meet economic growth targets, attract foreign direct investment in services and manufacturing, and support remittance flows to the productive sector. The World Competitiveness Yearbook 2013 of the Institute for Management Development (IMD) indicates that the basic infrastructure in the Philippines (54th out of 60 countries surveyed) is lagging behind that of other members of the Association of Southeast Asian Nations—Malaysia (12th), Thailand (25th), Indonesia (41st). To respond to the demand for urbanization in Metro Manila as well as major provincial hubs, the country's infrastructure investment needs during 2010–2030 are assessed at $700 billion, or $33 billion annually (11% of gross domestic product [GDP] in 2014), implying the need for a more than threefold increase from the current level of infrastructure investments.

2. **Leveraging public resources via private participation**. External shocks and governance challenges have led to a sharp decline in private sector investment in infrastructure, from 12.5% of GDP in 1997 to an annual average of 1.1% between 2000–2012. In 2010, the government took on the infrastructure challenge, while maintaining strict fiscal discipline, by initiating reforms to revive the country's public–private partnership (PPP) program. These reforms have resulted in the award of nine projects (total investment of $3.0 billion). This robust rollout of the PPP program supports the government's intention to raise private investment in infrastructure from 0.4% of GDP in 2013 to 1.1% of GDP in 2015. Spending on infrastructure is expected to grow at about 10% a year in the next decade, reaching an annual $27 billion by 2025, which is close to the average annual investment needs.

3. **Inadequate financing for government's share in projects**. First, it is essential that PPP implementing agencies improve their systems of assessing and budgeting for right-of-way acquisition and resettlement—lack of available funds for these preconstruction activities can delay the implementation of PPP projects, particularly their financial closure. Second, adequate budgetary allocations for contingent liabilities are required to ensure fiscal sustainability and enhance the capacity of the implementing agencies to discharge their obligations under risks allocated to them. The estimation of contingent liabilities needs to be based on the pooling of the contingent costs of the risks allocated to the government under the PPP contracts, and be under the supervision and direction of the Department of Finance (DOF). Third, viability gap funding (VGF), the non-remunerated grant made by the government to a PPP project, must be institutionalized so that the project can charge affordable tariffs to the public while producing a satisfactory financial return for the investor. VGF can meet the objective of making socially viable projects become commercially viable through an efficient and transparent process of public resource allocation.

[1] This summary is based on Sector Assessment: Public Sector Management. Available on request.

4. **Untapped funding options**. The long duration of PPP projects and their varied risk–return characteristics, as well as their complex structures, require facilitation of long-term funding by the capital markets. Infrastructure projects generating a robust revenue stream provide an opportunity for project bond structuring and, with the appropriate rating, represent an attractive asset class for institutional investors, e.g., pension funds and life insurance companies managing long-term asset–liability portfolios. By improving the development of the project bond market, the government could also pool the savings of the broad working-age population in the Philippines (its youth dependency ratio in 2008–2012 was 58.6), and of overseas remittances. Project financing through commercial banks is becoming more restrictive as the new Basel III capital requirements mandate banks to hold additional capital against long-term finance typical in PPPs. The large size of investments also affects the single-borrower limits of banks. Increasingly, international banks with experience in takeout financing and securitization are needed to develop the PPP portfolio in the country.

5. **Incomplete legal and regulatory framework**. Since the revival of the PPP program in 2011, several key policy and regulatory reforms were introduced but now need to be institutionalized through amendments to the build–operate–transfer (BOT) law. The law defines a narrow legal framework for PPPs that lacks different implementation modalities. In addition, the institutional framework designed for PPP program implementation is not yet incorporated into the legal framework, casting a risk over the sustainability of reforms.

6. **Lack of infrastructure master plans**. The county's transport infrastructure woes are rooted in a lack of long-term planning. While sector master plans exist, no integrated infrastructure master plans for regions, or regional infrastructure development plans, are in place. The sector plans themselves are marked by insufficient integration of land-use planning and physical framework plans across administrative jurisdictions, which may be regarded as the root causes of the infrastructure deficit.

7. **Need to strengthen implementation**. Experience from countries with a decentralized PPP framework highlights the critical importance of dedicated PPP units at the implementing agencies. These units need to be set up, staffed, and budgeted properly to take on the responsibility of implementing the agencies' PPP programs. In the Philippines, some agencies such as the Department of Transportation and Communications (DOTC) and the Department of Public Works and Highways (DPWH) have functioning PPP units, but these still need strengthening to fulfill their role effectively, especially in contract management over the operating period of the project.

2. Government's Sector Strategy

8. **Amendments to the build–operate–transfer law**. The proposed amendments to the BOT law, now discussed in Congress, are critical in sustaining the PPP program in the Philippines. They cover a wide range of improvements to the enabling environment and PPP institutions, such as providing further incentives. Specifically, it is proposed to (i) exempt PPP projects of national significance from real property taxes and other local business fees or licenses; (ii) streamline PPP project approvals within government by raising the cost thresholds to the accountable hierarchy; (iii) strengthen the PPP institutions; (iv) tighten the terms of unsolicited proposal challenge bids and prohibit court-issued temporary restraining orders (which delay contract awards to successful bidders). Particularly important is the need to institutionalize the transaction advisor mechanism of the project development and monitoring facility (PDMF) in the BOT law. It is appropriate for the PPP Center to submit proposals to the PPP Governing Board on how to sustain the PDMF transaction advisor mechanism. Capacity development

technical assistance support (Strengthening Public–Private Partnerships in the Philippines)[2] from ADB is limited and the Philippines' public procurement system is silent on independent contract reviews by an international panel of transaction advisors.

9. **Strengthening interaction**. The core PPP institutions are the PPP Governing Board as the overall policy-making body, the PPP Center as the anchor body for PPPs, the PDMF as the revolving fund for PPP project preparation, and the international advisory panel. The PPP Center aims to strengthen the interaction between it and the implementing agencies' PPP units, to ensure efficient coordination and accountability during the project life cycle. The implementing guidelines developed in cooperation with the National Economic Development Authority (NEDA) and DOF, and supported under TA 7796, cover the PPP appraisal process, probity advisory services, institutionalization of PPP best practices, VGF, material adverse government actions,[3] and termination payments. The center has also developed a comprehensive operational PPP manual for national government agencies. All these were adopted by the PPP Governing Board in late 2014 and issued in 2015.

10. **Adequate funding and indirect liabilities**. Each year, the government is expected to provide funding under the General Appropriations Act for right-of-way acquisition and resettlement through inclusion in the annual national expenditures plans. Lack of funds for these preconstruction activities can delay the implementation of PPP projects, particularly their timely financial closure. Implementing agencies need to improve their system of assessing and budgeting for the funds. In addition, in the proposed revision of the BOT law, a contingent liability fund is proposed to ensure fiscal sustainability and enhance the capacity of the implementing agencies to discharge their obligations under the risks allocated to them. The fund is proposed to be a portfolio-wide, off-budget fund, based on the pooling of the contingent costs of the risks allocated to the government under the PPP contracts. Lastly, there is a need to institutionalize the Viability Gap Funding (VGF). Some types of infrastructure projects have high economic benefits but an unattractive commercial rate of return at user pricing that is affordable to the public. These projects are generally characterized by substantial investments, long gestation periods, uneven cash flows, slow ramp-up in revenues, and risk–reward requirements that make the projects unacceptable to private investors without a VGF instrument.

11. **Implementing long-term transport master plans**. The Philippine Development Plan, 2011–2016 identified the country's inadequate infrastructure as a constraint to economic growth. The government is adopting integrated transport master plans for the Mega Manila, Cebu, and Davao regions to guide sector investment plans in a coherent manner. It is also important to finalize the Philippine Transport Infrastructure Development Roadmap guiding the country's transport infrastructure investments in the next 20–30 years. Such transport infrastructure master plans are fundamental to the viability of a PPP project pipeline. They enable investors and lenders to integrate their project with the transport infrastructure investment program.

12. **Facilitating financing via capital markets and commercial banks**. Infrastructure financing activities in the local capital market currently include loan syndication by banks and corporate bond issuances of holding companies with infrastructure exposure. Developments in the capital market present opportunities for accelerating private sector participation in infrastructure investments. The challenge for the private sector is to take advantage of a liquid

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[2] ADB. 2011. *Technical Assistance to the Republic of the Philippines for Strengthening Public–Private Partnerships in the Philippines.* Manila (TA 7796-PHI, cofinanced by the governments of Australia and Canada).

[3] Any event or action under the control of the government that would adversely impact the economic balance of the project and thereby interfere with the private parties' obligations under the various agreements.

financial market, and for the government, to facilitate the channeling of capital market resources to PPP projects.

13. **Facilitating involvement of local government units**. A significant infrastructure gap at the level of local government units (LGUs) is compounded by their weak PPP management capacity. The government will facilitate the emergence of a solid pipeline of LGU PPP projects through the PPP Center. The PPP Center envisages supporting preparation of feasibility studies and bidding documents for at least five LGU PPP projects and signing memorandums of understanding with at least five LGUs to provide programmatic capacity building, such as for the adoption of the LGU Code, Internship Program, LGU PPP Manual, and the establishment of PPP units as regular units within their organizational structures.

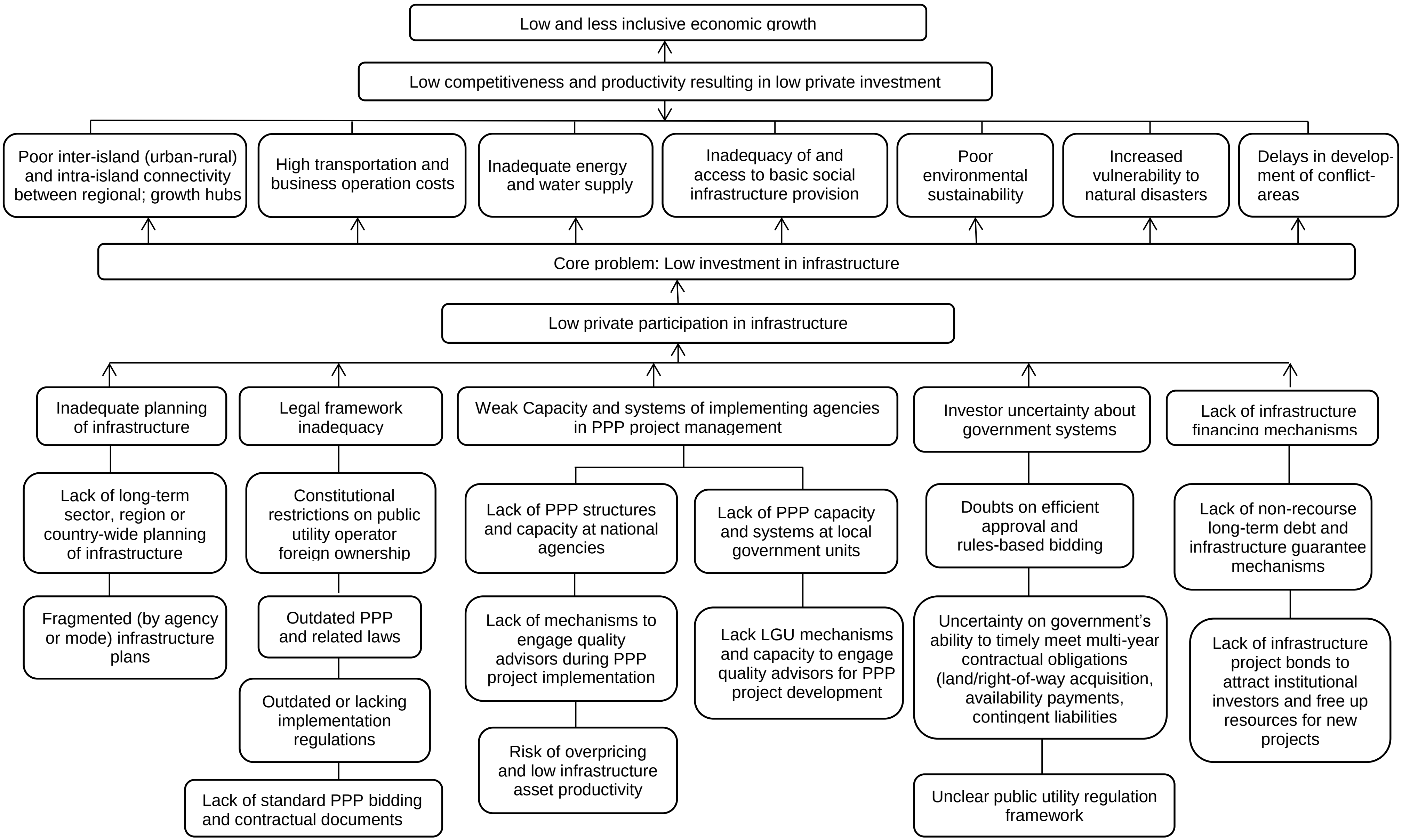
3. ADB Sector Experience and Assistance Program

14. Recent support from ADB has been instrumental in assisting the current government's revival of the PPP program. Such support was articulated through TA 7796, which was approved in March 2011 and is expected to close in July 2016. The TA amount is $28.2 million—$2.0 million from ADB, $22.0 million from the Government Australia, and $4.2 million from the Government of Canada. The government contributes $72.0 million equivalent to the PDMF component. The second phase of the capacity development TA is being processed in parallel to the proposed program, with the following outputs: (i) stronger capacity of national and local implementing agencies, (ii) better performance of the PPP Center, (iii) assistance in developing infrastructure financing facilities and mechanisms, and (iv) broader scope of the PDMF to engage PPP procurement probity advisors and construction supervision consultants, and to support development of LGU PPP projects. The TA is expected to be cofinanced by the governments of Australia and Canada for a total amount of $21.37 million.

15. TA support from ADB is being coupled with policy-based lending reflecting the substance of reform initiatives in this area. The first subprogram of the Increasing Competitiveness for Inclusive Growth Program, for $350 million, was approved in 2012, and subprogram 2 (also for $350 million) on 15 December 2014. The program facilitated (based on work under TA 7796) reforms to revive the country's PPP program. The proposed Expanding Private Participation in Infrastructure Program, Subprogram 1, will help deepen the PPP reforms initiated under the earlier program by strengthening the PPP management capacity and systems of implementing agencies and LGUs, improving PPP procurement processes, and facilitating infrastructure financing mechanisms.

16. The approaches of the International Finance Corporation and the World Bank to PPPs have focused on supporting upstream work on sector-specific infrastructure planning as well as working on the preparation and transactions of some projects. The World Bank provided TA of $200,000 to the PPP Center to carry out feasibility studies for two LGU PPP projects. Only one feasibility study has been completed. The World Bank also supported an analytical study of LGU PPPs related to water. Very close cooperation was established with the Japan International Cooperation Agency (JICA), which has launched in 2014 a capacity building TA to five implementing agencies. The JICA TA will help these agencies carry out (pre-)feasibility studies for their selected PPP projects. It involves the PPP Center as the overall coordinator from the government's side.

Problem Tree for Public–Private Partnerships



LGU = local government unit, PPP = public-private partnership
Source: Asian Development Bank

Sector Results Framework (Public Sector Management Investment Climate, 2011–2016)

Country Sector Outcomes		Country Sector Outputs		ADB Sector Operations	
Outcomes with ADB Contribution	**Indicators with Targets and Baselines**	**Outputs with ADB Contribution**	**Indicators with Incremental Targets**	**Planned and Ongoing ADB Interventions**	**Main Outputs Expected from ADB Interventions**
Improved investment Improved competitiveness of selected sectors	Increase in wage employment of youths by at least 5% per annum (2010 baseline) Philippines' ranking in global surveys of competitiveness, doing business, and Heritage Foundation Index of Economic Freedom improved by 15 places (2010 baseline) Cost of rules and regulations for key licenses reduced by 15% (2012 baseline) Philippines' ranking in global survey of logistics improved by 8 places	Structural policy reforms to promote competitiveness implemented An efficient market for infrastructure through PPP projects created Competitive labor markets promoted	At least 3 complaints of anticompetitive practices investigated RIA piloted at 5 ministries, and at least 50% of RIA focal persons are women At least 50% of stakeholders consulted through the RIA process are women All value-added tax refund credits eliminated and all refunds made in cash At least 5 line agencies have PPP units and 100 staff trained on PPP Number of institutionalized PESOs at LGU level increased to 200. (2011 baseline: 89) Establishment of tourism industry skills development program Pilot hospitality quality assurance and accreditation system	**Planned target subsectors** Enhancing Youth School-to-Work Transition Program ($600 million) in 2016–2018 **Pipeline projects with estimated amounts** Expanding Private Participation in Infrastructure Program ($800 million) in 2015–2017 CDTA: Second Phase of Support to PPP Reforms ($27 million) in 2016–2019 **Ongoing projects with approved amounts** CDTA: Strengthening Public–Private Partnerships in the Philippines ($28.7 million) Increasing Competitiveness for Inclusive Growth ($700 million) in 2012–2014	**Planned target subsectors** At least 500 tourism professionals achieved mutual recognition under the ASEAN agreement 100 hostels accredited under the national quality assurance system At least 15 RIAs completed by all pilots **Pipeline projects** At least 15 national PDMF-supported PPP projects awarded Feasibility studies and bidding documents for at least 5 local PPP projects prepared with support of PDMF Construction supervision consultants for at least 5 PPP projects recruited through PDMF **Ongoing projects** Number of persons who found jobs through institutionalized PESOs increased by 10% per annum

ADB = Asian Development Bank, ASEAN = Association of Southeast Asian Nations, CDTA = capacity development technical assistance, LGU = local government unit, PDMF = project development and monitoring facility, PESOs = Public Employment Service Offices, PPP = public–private partnerships, RIA = regulatory impact assessment.
Source: Asian Development Bank.