



## Consultant's Report

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### People's Republic of China TA 8940: Municipality-Level Public–Private Partnership (PPP) Operational Framework for Chongqing

### Roles and Responsibilities for Managing PPPs in Chongqing: Best Practice Principles

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Asian Development Bank



# **Roles and Responsibilities for Managing PPPs in Chongqing: Best Practice Principles**

**Report to ADB**

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## Acronyms and Abbreviations

BOT	–	Built Operate Transfer
CMU	–	Contract Management Unit
EOI	–	Expression of Interest
EU	–	European Union
ICC	–	Investment Coordination Committee
IIFC	–	Infrastructure Investment Facilitation Center
NIBJ	–	National Investment Bank of Jamaica
PFI	–	Private Finance Initiative
PFMA	–	Public Financial Management Act
PICKO	–	Private Infrastructure Investment Center of Korea
PIMAC	–	Private Infrastructure Management Center
PPP	–	Public Private Partnership
PV	–	Partnerships Victoria
RFP	–	Request for Proposal
SoPC	–	Standardization of PFI Contracts
UK	–	United Kingdom
VfM	–	Value for Money

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# 1 Introduction

This report aims to help the Government of Chongqing establish the institutional framework required to set up a successful Public Private Partnership (PPP) program. It provides an analytic framework for thinking about how best to tailor PPP institutional design to Chongqing's needs and circumstances, backed up with empirical evidence from the success and weaknesses of PPP Units in a range of developed and developing countries. Importantly, it highlights how good institutional design is not about following a one-size-fits-all “best practice” approach, but instead requires a clear understanding of the municipality's needs, capacity, culture and administrative traditions.

This report draws on previous research conducted by Castalia analysing the characteristics that underlie successful PPP Units. This document is set out as follows. It first looks at the role of PPPs in infrastructure development compared with other procurement options (Section 2). It then looks at the various reasons why a PPP Unit might need to be developed (Section 3). It then presents some lessons on good institutional design that have been learned from international practice (Section 4). Following that, there is a summary of general rules for organisational design (Section 5). Last of all, this document evaluates these options to develop recommendations for Chongqing (Section 6).

## 2 Where do PPPs Fit in Infrastructure Development?

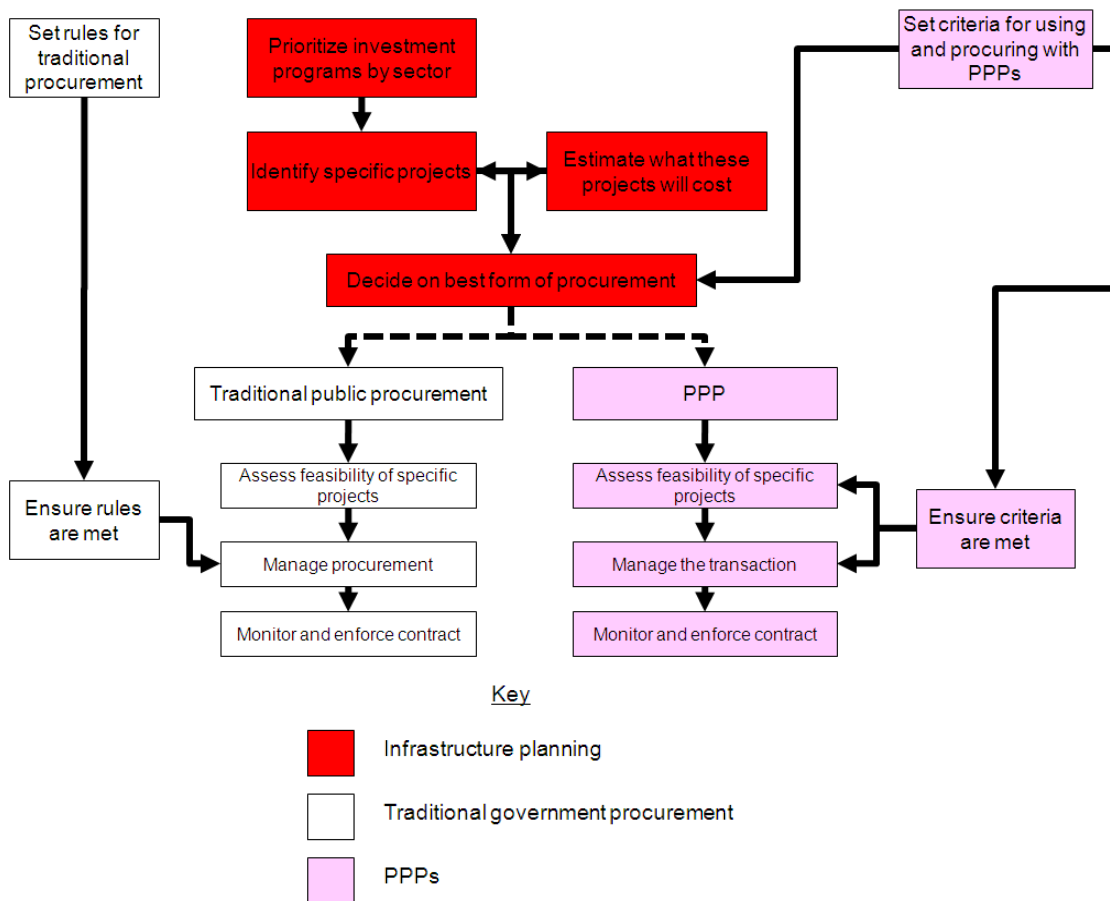
All infrastructure projects, both PPPs and more traditional procurement options, invariably involve some form of government support. This can be either explicit, such as subsidies or grants, or implicit, such as the opportunity cost of using land in a particular way. As such, it is logical to ensure that only the best projects—those that provide the greatest benefit to society—receive funding. This is typically determined through a cost-benefits analysis.

This “investment” decision, is entirely independent of, and must always precede, the “procurement” decision, which considers whether or not delivering the project via a PPP mechanism will maximise value for money (VfM).

The main functions that are required for infrastructure development are shown in Figure 2.1. Processes relating to the investment decision are highlighted in red. Those functions that are unique to PPPs come after the investment decision and are highlighted in pink. These functions will be the focus for this paper.

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**Figure 2.1: Generic functions needed to develop infrastructure**



### 3 Why Create a PPP Unit?

The successful delivery of a PPP program requires a specialised set of skills different to that of traditional public sector procurement. Specialized PPP Units are generally created in response to weaknesses in the existing government's ability to effectively manage a PPP program.

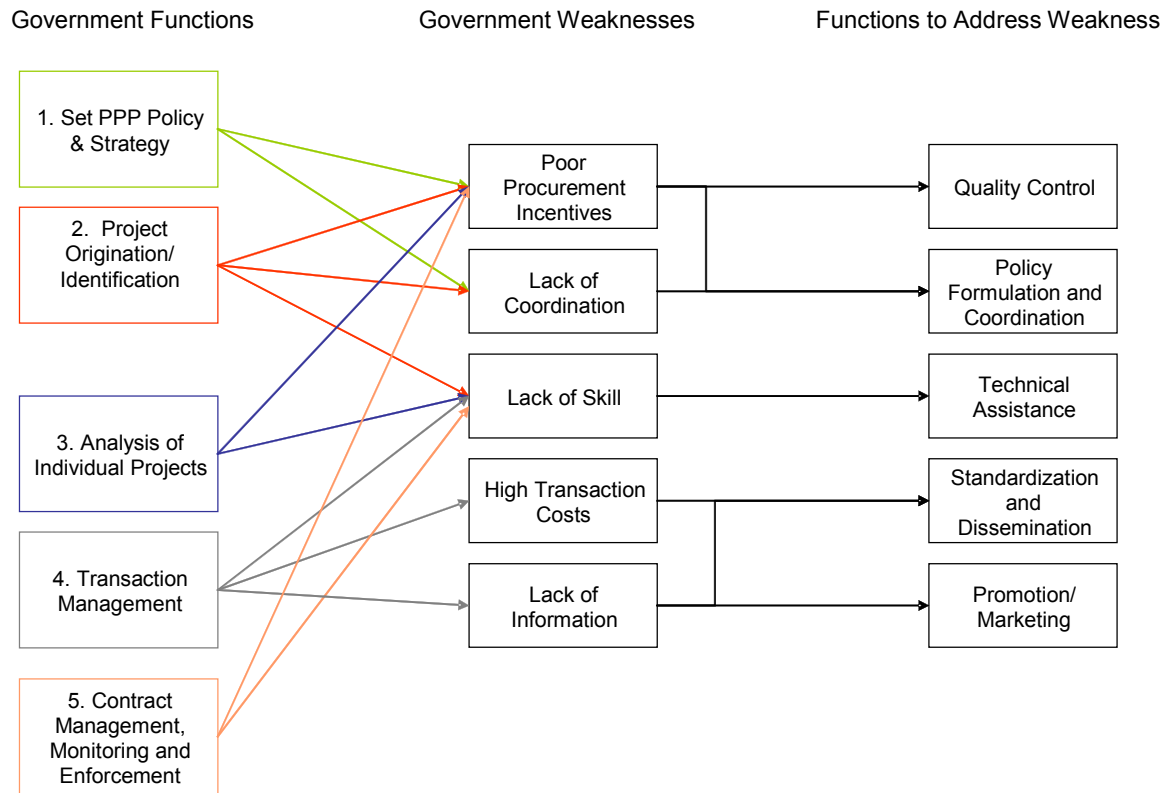
Governments in different jurisdictions suffer from different institutional weaknesses in PPP procurement. PPP Units therefore need different designs in different jurisdictions, so they can address the specific government weaknesses concerned. In other words, the medicine must fit the disease.

Figure 3.1 shows:

- In the left-most column, the functions governments typically play as part of PPP development
- In the middle column, challenges associated with each of these functions
- In the right-most column, the ways in which PPP Units can respond to government challenges.

The items in each of these columns are discussed in the sections that follow.

**Figure 3.1: Government Functions, Challenges, and Roles of PPP Units**



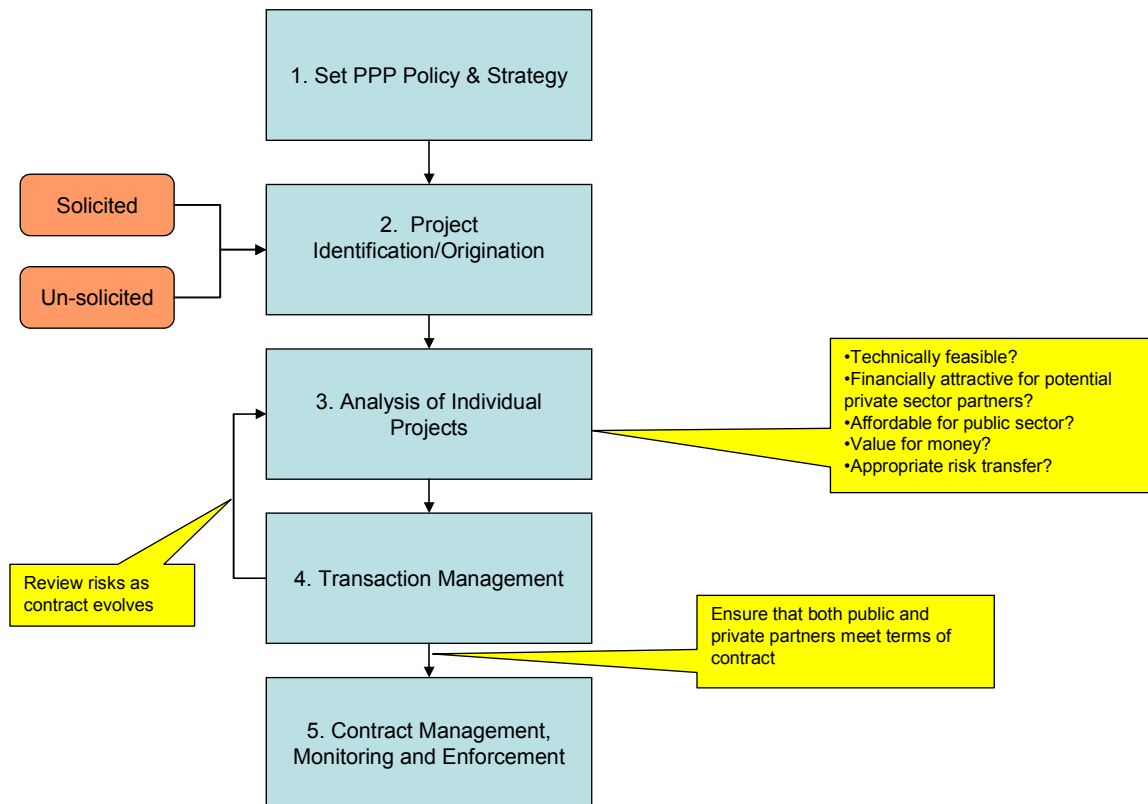
### 3.1 Government Functions in PPP Procurement

To understand the institutional features of various PPP Units, it is important to clearly delineate the possible functions of a Unit relative to the overall set of government functions and tasks that need to be performed to procure and implement PPPs.

Figure 3.2 again summarizes the main functions that must be performed, with additional annotations to Figure 3.1, showing what happens at different stages of PPP procurement.



**Figure 3.2: Summary of Government Functions with Respect to PPP**



A specialized PPP Unit may perform all or some of these functions. The main functions are:

- **Step 1: Set PPP Policy & Strategy**—These activities involve setting overall policy for PPPs. This means deciding what sectors will be priorities for PPP, and which types of agreements will be the focus of the PPP program
- **Step 2: Project Origination**—The government needs to be able to identify suitable PPP projects. PPP projects can originate in one of two general ways:
  - Solicited proposals, in which a government agency develops the idea for a specific PPP transaction
  - Unsolicited proposals, in which a private investor or operator develops the idea for a specific PPP project, and brings it to the government

Some governments work with a mix of solicited and unsolicited proposals while others allow for development of solicited PPP proposals only. The role of the PPP Unit in developing these proposals differs considerably from one country to the next. PPP strategies in Chile, the Philippines, South Korea, and South Africa all include a mix of solicited and unsolicited proposals.

- **Step 3: Analysis of Individual Projects**—Having received or developed a project concept in Step 2, the government next must analyze the opportunity. Such analysis usually involves:
  - A pre-feasibility study and feasibility study, to determine whether the proposed project is technically feasible and would be financially attractive to a private investor or operator. Some agency of the government typically assumes responsibility for feasibility studies for solicited proposals. The private operator typically (though not always) assumes responsibility for feasibility studies for unsolicited proposals. In many cases, the government and private partners will each do their own feasibility studies
  - Governments may also, but do not always, evaluate whether:
    - ♦ Given other fiscal priorities, the government has sufficient funds, or can mobilize sufficient financing, to uphold its obligations under the project
    - ♦ Whether the project offers risk adjusted “value for money” versus some counterfactual (the counterfactual is referred to in the UK, Victoria and South Africa as the “public sector comparator”), and
    - ♦ Whether the appropriate risks are transferred to the private operator/investor (and away from the government), given the remuneration the private operator/investor will receive.
- **Step 4: Transaction Management**—Transaction management encompasses the entire procurement and tender process. PPP procurement can proceed in a number of different ways, but usually involves, in the case of a competitive tender for solicited proposals:
  - Notice of procurement to request expressions of interest (EoIs) in the PPP opportunity
  - Issuance of pre-qualification documents with detailed criteria for pre-qualification
  - Evaluation of pre-qualification applications followed by a short-listing of a number of firms that meet the pre-qualification criteria
  - Issuance of a request for proposals (RfP) with procurement documents. These procurement documents usually include a draft contract and annexes to the contract with full technical and financial details on the opportunity
  - An iterative process of question and answer between bidders and the government. This iterative process may, in some cases, require the government to make changes to the procurement documents in accordance with suggestions, or to clarify the terms of the tender. Bidders usually also take the opportunity to conduct their own due diligence of the opportunity at this stage
  - Submission of bids by a fixed deadline
  - Evaluation of bids by the government agencies responsible for the procurement, and

- Notification of the winning bidder and final negotiation and signing of the PPP contract.

PPPs in Bangladesh and Jamaica, for example, are not always procured through competitive tender but through direct negotiation or an ostensibly competitive process where selection criteria were unclear.

- **Step 5: Contract Management, Monitoring, and Enforcement**—Contract management refers to the activities required after contract signature and before the end of the term of the contract. Some party, often a line agency responsible for the sector in which the PPP project takes place, has responsibility for monitoring and enforcing the contract. “Monitoring”, in this case, means checking to ensure that the private operator/investor fulfils its responsibilities under the contract, by delivering the services it has promised at the price agreed. “Enforcement” means applying the penalties or requiring the remedies included in the contract when the private operator/investor fails to live up to its contractual responsibilities. Contract management may also include renegotiation of contract terms if either the private or public partner finds itself unable to meet its contractual responsibilities.

A government’s decision about which specific functions are allocated to the PPP Unit will depend on:

- The functions allocated to other government agencies
- The ability of the government to coordinate the performance of different functions by different agencies within its overall machinery of government.

Table 1 describes the functions of a number of PPP Units. Checks (✓) are assigned where a PPP has **primary** responsibilities for a certain function or, even if they do not have primary responsibility, that function is **formally** assigned to them through a law or their charter. Otherwise a cross (✗) is assigned.

In practice PPP Units often assume roles different from those formally prescribed, either because they are particularly ineffective in fulfilling a formal function, or because they prove so effective or influential that their involvement extends beyond their formal mandate. Table 1 also notes examples of some of these nuances.

**Table 1: Responsibilities of PPP Units throughout the PPP Life Cycle**

Jurisdiction and Unit	Development of PPP Policy & Strategy	Project Origination	Analysis of Individual Projects	Transaction Management	Contract Monitoring and Enforcement
Bangladesh, IIFC	✗ Executive Branch (Prime Minister)	✗ Line agencies originate projects	✓ Advises Private Infrastructure Committee (PICOM) in Prime Minister's office	✗ Assists line agencies as requested only	✗
Jamaica, NIBJ	✗ Has strong influence on policy but not exclusive responsibility	✓ Private partners sometimes go directly to NIBJ instead of line agencies	✓	✓ Though not exclusive. NIBJ leads the cross-sectoral Enterprise Team assigned to manage each transaction	✗
Philippines, BOT Center	✓	✗ Line agencies and local government units originate. Unsolicited proposals from private sector are also allowed	✓ Advises Investment Coordination Committee (ICC) and usually asked to review project proposals	✗ Sometimes asked by implementing agencies or the ICC	✓ Formal role includes monitoring but has, in practice, done so only on an <i>ad hoc</i> basis. Often asked to assist in contract renegotiations
Portugal, Parpública PPP Unit	✓ Advisory to Ministry of Finance	✗ Line agencies originate projects	✓	✗ But often asked by Ministry of Finance to sit on tender committee	✓ Does some monitoring for Ministry of Finance but not contract management. Often asked to assist in contract renegotiation
South Africa, Treasury PPP Unit	✓	✗ Though has, in some cases, identified potential PPP opportunities for line agencies	✓	✗ PPP Unit is a full member of the steering committee for transactions, and	✗ Do monitor performance of some contracts, and have assisted in contract renegotiations.

Jurisdiction and Unit	Development of PPP Policy & Strategy	Project Origination	Analysis of Individual Projects	Transaction Management	Contract Monitoring and Enforcement
				implementing agencies know it is in their interest to involve unit as early as possible	Implementing agencies manage contracts
South Korea, PIMAC	✓	✗ Line agencies, local governments. Unsolicited proposals from the private sector are also allowed	✓	✗ But often asked by line agencies to assist	✗ Conducts quarterly surveys of PPPs, but contract management done by line agencies
United Kingdom, Partnerships UK and Treasury Taskforce	✓	✗ But Partnerships UK helps line agencies identify suitable projects	✓	✓	✓ Treasury has a monitoring role, as does UK national audit office
Victoria, Australia Partnerships Victoria	✓	✗ Has helped line agencies identify projects in their portfolio that would be suitable	✓	✗ Line agencies manage the transactions but PV approval required at several stages	✗ Line agencies responsible, but PV provides guidance

## 3.2 PPP Units Can Address Government Weaknesses

There is no obvious best-practice with regard to which functions are covered by the central PPP Unit, as shown in Table 1. Accordingly, the actual allocation of functions in each individual case needs to be considered within the context of the specific government weaknesses that the Unit needs to address.

The weaknesses PPP Units are meant to address can be classified into the following categories:

- Poor incentives for procurement of PPPs
- Lack of coordination within the machinery of government
- Lack of necessary skill
- High transaction costs
- Lack of information.

These weaknesses correspond to the boxes appearing in the middle column of Figure 3.1.

### 3.2.1 Poor Incentives for Procurement of PPPs

The main reason government PPP programs are unsuccessful is that government agencies have inappropriate incentives. Government agencies may have incentives to procure too many PPPs, or too few.

On the one hand, line ministries may have an incentive to enter into more PPP contracts than can be managed within the government's fiscal capabilities, if the fiscal consequences are not made clear and palpable to those agencies. As long as a ministry believes that it can shift the costs on to other sectors within the government, it may pursue PPP transactions in excess of what is affordable or what represents value for money. Similarly, a ministry that does not directly bear project-related risks may not be sufficiently diligent in ensuring the private sector bears an appropriate level of risk. As shown in Box 3.1 and Box 3.2, similar experiences with government incentives, albeit in different sectors, motivated Portugal and South Africa to create their PPP Units.

On the other hand, line ministries may have insufficient incentive to enter into public-private partnerships. In many cases, direct involvement in the provision of a public service provides ministry officials with opportunities for influence and patronage that may not be available otherwise. PPPs introduce explicit contractual arrangements and commercial incentives for the service providers, and so typically reduce opportunities for patronage. This is particularly true when PPPs are competitively procured. Hence, the beneficiaries of patronage may be unwilling to allow PPPs to take place, even when a PPP would be best from a public policy perspective. More generally, agencies may fear that PPPs will bring job losses or loss of influence for certain offices or departments within the government agencies responsible for procuring PPPs.

In many governments, both incentives will likely be present at the same time, with the same ministry both holding back projects that should be advanced, and promoting projects that should not proceed.

Some governments have tried to address the problems these incentives create through public sector management reforms. Such reforms may include the introduction of performance contracts for heads of agencies, or public finance reforms, such as the introduction of accrual accounting designed to capture contingent liabilities. However, the full set of consistent and coherent reforms may be difficult to implement, and may be

beyond the technical capability or the political will of many governments. For example, as described in Box 3.2, South Africa's PPP Unit was created to prevent line ministries from pursuing PPP projects that allowed them to circumvent formal budgetary limits (which had been established through law by recent public finance reforms). In such cases, the creation of a specialist agency designed to offset the inappropriate incentives facing other agencies may be an appropriate institutional response.

**Box 3.1: Reasons for Creation of Parpública's PPP Unit**

Portugal's PPP Unit was created specifically:

- Out of a perceived need for better transfer of information to all branches of Government on: a) contract design, and b) procurement, because of poor experience with PPP efforts in the past
- To ensure better efficiency in provision of services and not just the swift, off-budget completion of infrastructure projects.

PPPs were initially pursued in Portugal in the early-mid 1990s as a way to move large infrastructure investments off balance sheet. PPPs were seen as particularly important at a time when, because of EU membership, there was so much importance placed on Portugal's fiscal policy.

More recently, Portugal's PPP policy has evolved as part of broader policy goals to move the Government from year-on-year budgeting toward a multi-year budgeting. There was little consideration for the inter-generational or long-term life-cycle costs of these projects. As part of the reform effort, Portugal rationalized the decision-making process for PPPs by:

- Promoting consideration and more transparent presentation of the long-term budgetary implications, in order to ensure the project's financial viability. It did this by explicitly reviewing the long-term financing shortfall for which Government would be responsible
- Requiring evaluation versus a public sector comparator, as a way of standardizing evaluation criteria, if not also assessing potential value-for-money and efficiency gains from PPP.

**Box 3.2: Reasons for Creation of South Africa's National Treasury PPP Unit**

South Africa's PPP Unit was developed to counteract the risk that line ministries would use PPP to circumvent formal budgetary limits established through law by the Public Finance Management Act (PFMA). PPPs were, until creation of the PPP Unit, mostly used with this goal in mind. Shifting risk to the private sector or achieving greater efficiency or value-for-money through private sector involvement were only secondary goals.

A single specific transaction provided the catalyst for creation of the PPP Unit. The Ministry of Public Works wanted to design a 30-year BOT contract for two prisons. Treasury found out about the transaction and asked to review the contract. Treasury's review found that, whereas the prisons indeed offered value for money, they were extremely expensive to build and therefore not affordable from an overall fiscal perspective.

The PPP Unit was established to set clear rules for public and private partners, while providing better fiscal oversight. As a result of the country's early experience with PPPs, the new regulations on PPP now require that PPPs meet three criteria:

- Affordability
- Risk Management
- Value for Money.

Treasury approval is required at four stages

- Upon completion of feasibility study
- Upon completion of bid documents (including draft PPP agreement)
- Upon selection of preferred bidder and preparation of value for money report
- Upon finalization of negotiations with bidder and finalization of PPP agreement

PPPs are now used in South Africa primarily to transfer specific risks to a private sector operator who is better able than the public sector to bear such risks.

**3.2.2 Lack of Coordination within Machinery of Government**

PPP policy is typically established by a central Unit of government, such as a Department of Finance (as in South Africa), the President's or the Prime Minister's office (as in Jamaica). Implementing that policy requires the coordination of many more agencies. Agencies across a number of sectors—for example roads, education, health, justice and water—need to identify projects. These agencies need to ensure that the projects fit within the policy criteria. The Ministry of Finance should also be involved, to assess the fiscal cost and risk of the project. Regulatory and planning agencies may be involved in planning, permitting, land acquisition and tariff setting. Achieving coordination between such a wide array of organizations is a struggle for most governments, particularly those in developing countries.

In many governments, individual agencies operate within “silos”, with little information sharing or cooperation with other agencies. Sometimes the silos are reinforced through competition between political figures in charge of those agencies. The silos may also derive from the institutional history, from inappropriate legislation, or from the tradition of secrecy within the government.

In a silo situation, agencies with related functions may not be able to coordinate their activities sufficiently to make PPPs happen. For example, a complex PPP transaction in the water sector may require coordination between the Ministry of Finance (which would provide subsidies where tariffs do not reach cost-recovery levels) and a regulator or a line ministry (which would set the tariffs, coverage targets and other policy objectives). However, in practice, decisions on tariffs and subsidies are often made independently of



each other. In such a situation, the agency in charge of tariffs can restrain tariff increases, believing that the revenue shortfall should be filled by subsidies, while the agency that makes decisions on government expenditure may refuse to provide funds for subsidies, arguing that the cost of service should be met from tariffs. The result of such coordination weaknesses is that the sector remains unable to cover the costs of providing a good service, while PPP transactions become unviable.

In cases where policy-making and implementation are poorly integrated, it is tempting to create a new agency to cut through the lack of integration, and to provide over-arching guidance and control. This is not always the best solution. For example, an agency charged with “making something happen” may not understand all the sectors it works in, or be sensitive to broader sector objectives or good governance requirements. There are various solutions to poor coordination between agencies. There are also several ways to ensure that a whole-of-government approach to PPP transactions prevails. Creation of a central PPP Unit *may* be a solution, if other forms of coordination are less viable or more difficult to implement. Section **Error! Reference source not found.** discusses some alternative possible solutions for addressing the coordination problem as well as the other government weaknesses identified in Figure 3.1.

### 3.2.3 Lack of Skill

PPP procurement requires specialized skills that often are lacking in government, particularly in developing countries. It is common for a government to focus on the need for skills involved in managing a successful transaction. Such skills, however, can often be procured through external advisory services. More important are the skills involved in managing the complexity of the public-private interface: understanding how particular PPP projects fit within the government’s sector and service delivery objectives, and how the allocation of risks under any particular project fits into the government’s overall fiscal strategy.

When PPPs turn out to be unsuccessful, their weaknesses often derive less from poor management of the transaction process, but more from lack of attention being paid to the government policy reforms that may be required for success. Such attention would involve the design of explicit and sustainable subsidy schemes, improving the government’s planning capacity, and ensuring that the government appropriately performs its on-going role within the public-private partnership. For example, weaknesses of many management contracts can be attributed to clashes between the publicly-appointed Boards of government companies and the management contractors.

Because so many other factors, other than skills, can affect the outcome of a PPP, it is important to be clear about which skills the government is lacking. Training requires time and resources, and hiring technical experts as full-time staff can be expensive. Many PPP Units address a lack of skills by outsourcing short-term work that requires specific technical expertise, or by hiring longer-term consultants to work with full-time staff. Box 3.3 describes how different PPP Units sought to ensure they had available the right skills to carry out their responsibilities.

### Box 3.3: How PPP Units Ensure They Have the Right Skills

- The Philippines BOT Center, now PPP Centre, makes extensive use of long-term, local, in-house consultants
- The UK Treasury PPP Task Force utilized a mix of public-sector employees and professionals seconded from the private sector for a fixed number of years
- The South Africa National Treasury PPP Unit carries out much of its own technical work in-house, but hires some specialist consultants for short-term contracts
- Australia's Partnerships Victoria engages contractors to do some of the policy and technical work (such as legal drafting). Much of the project-specific work is done internally, however, with one or two officers from Partnerships Victoria involved in each project. If consultants are hired they are typically hired as outside advisors for 6-12 months, working from their own offices and not as internal staff
- Portugal's Parpública uses outside consultants only when they have a specific engineering question they need to consider
- Korea's PIMAC tries to do as much of the work in-house as possible, with at least two PICKO staff assigned to each project.

#### 3.2.4 High Transaction Costs

Where each PPP transaction is a bespoke deal, and each is considered on an *ad hoc* basis, the transaction costs for both the private and the public sector are likely to be high. The costs of implementing a PPP can be reduced through:

- Preparation of standard “off the shelf” legal documents and operations manuals. Standardized documentation can help to limit the time that line ministries and their transaction advisors spend preparing basic documents. Continued use of standardized documentation can also limit the amount of time governments spend clarifying tender documents or negotiating contracts with private sector partners, because private sector partners will already be familiar with the basic terms of PPP contracts from previous transactions. The UK Treasury, for example, has a guide to Standardization of PFI Contracts (SoPC) with the goal of: “promote a common understanding of the main risks which are involved in a standard PFI project... to allow consistency of pricing and approach across a range of similar projects and... to reduce the time and costs of negotiation by enabling all parties to agree to a range of areas that can follow a standard approach without extended negotiations”<sup>1</sup>
- Standardization of procedures and requirements (such as acquiring permits) for bringing a project from inception to closure.<sup>2</sup> Such standardization can reduce redundant government activity and the time required to grant approvals. Korea's PICKO, for example, helps facilitate the permitting and authorizations that the private partner needs to implement the PPP.

Standardization of documentation, procedures and requirements can also lower transactions costs for the private partner. Over time, these lower transactions costs should, at least in theory, pass through to the government in the form of more

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<sup>1</sup> Standardization of PFI Contracts, Version 3. HM Treasury. April, 2004. p. 9.

<sup>2</sup> Standard requirements may include any permits (for example, construction or natural resource permits) needed from other government agencies.

competitive bids. A PPP program with high quality documentation and clear procedures can reduce the effort and risk-adjusted value of time the private partner must commit.

### 3.2.5 Lack of Information

Finally, investors may not have adequate information about the opportunities available in a particular country, or may have misperceptions about the risks involved. A PPP Unit could improve the flow of information by focusing on the need to promote PPP opportunities in a way that no other government agency would be able to. A PPP Unit may even become a recognized “brand”, like Partnerships UK, so that information from this Unit would be seen as being reliable and valuable.

## 3.3 How Government Weaknesses / Gaps Determine Unit Functions

PPP Units can contribute to the success of a PPP program when the PPP Unit addresses the weaknesses identified in Section 3.2. As shown in Figure 3.1, we believe PPP Units contribute to the success of a PPP program if they fulfil five functions, namely:

- **Technical assistance to the public sector, private sector, or both.** In Bangladesh, the Infrastructure Investment Facilitation Center (IIFC) was established to address a complete lack of experience, among line ministries, in procurement and most forms of interaction with the private sector
- **Policy formulation and coordination.** In some cases the Units are the **only** source of PPP policy. In Victoria, Australia, Partnerships Victoria is the embodiment of the government’s PPP policy
- **Quality control of PPPs**, throughout the life of the contract, and not only prior to contract signature. In South Africa, for example, the PPP Unit was established to stop fiscally irresponsible PPPs being designed to skirt new government budget reforms. In Victoria, Partnerships Victoria was established to make sure the government was getting value for money for its PPPs and transferring optimal (rather than maximum) risk
- **Promotion/marketing of PPPs**, possibly extending to origination of PPPs. In South Korea PICKO was established to help both the private sector and government agencies better grasp the potential benefits of PPPs
- **Standardization and dissemination of information** about the PPP program. In nearly all the cases we surveyed, the PPP Units have taken at least some efforts to:
  - Standardize procurement and thereby lower the transactions costs of procuring PPPs
  - Develop a well understood pipeline, thereby increasing bidder interest.

## 3.4 PPP Units are Not Always Needed

There are many examples around the world of successful PPPs being implemented without a central PPP Unit. The Government of Victoria, for example, implemented PPPs for tram and suburban train transport in Melbourne, as well as a major toll road, before the Partnerships Victoria Unit was established. These transactions were managed by task forces reporting jointly to the Department of Treasury and Finance and the relevant sector Ministry.

Government weaknesses and gaps that may justify the creation of a PPP Unit are not necessarily universal, and a PPP Unit may not be the only solution to a government

weaknesses and gaps, or may only be part of a broader set of institutional solutions. Table 3.2 lists examples of how governments may fulfil the functions of PPP procurement and implementation without (or in conjunction with) PPP Units.

**Table 3.2: Alternatives to Addressing Government weaknesses and gaps**

Government Functions	Possible Institutional Solutions
Set PPP Policy & Strategy	<ul style="list-style-type: none"> <li>▪ PPP policy and strategy determined at executive level, enshrined in a government policy statement or legislation</li> </ul>
Project Origination/Identification	<ul style="list-style-type: none"> <li>▪ Teams within implementing agencies conceive or identify their own projects</li> <li>▪ Private sponsors are allowed to propose (unsolicited) projects, with a mechanism to competitively tender the proposals while compensating the project sponsor for effort put into developing the proposal</li> </ul>
Analysis of Individual Projects	<ul style="list-style-type: none"> <li>▪ Teams within the implementing agencies undertake their own analysis, or outsource the function to private advisors, and manage the advisors</li> </ul>
Transaction Management	<ul style="list-style-type: none"> <li>▪ Teams within the implementing agencies hire transaction advisors and manage the work of the transaction advisors</li> </ul>
Contract management, monitoring and enforcement	<ul style="list-style-type: none"> <li>▪ Project officers within implementing agencies manage the contracts</li> <li>▪ A sector regulator monitors the contract and enforces contract if there are breaches</li> <li>▪ A specialized and independent contract management unit (CMU) is established to manage the contract, staffed by highly competent individuals from either the public or private sector</li> </ul>

## 4 How to Set Up a PPP Unit?

In order to understand whether or not to set up a PPP unit, it is important to first look at how to decide whether or not a PPP Unit would be effective. In some cases, Governments may have problems that PPP Units cannot solve. Therefore, the first questions to ask in designing a PPP Unit are: what are the problems the government would currently face in implementing a PPP program, and whether a PPP Unit would be likely to solve those problems.

### 4.1 Lessons from Theory and Practice for PPP Unit Design

PPP Units have tended to work well where a government has identified a specific problem or objective, and had political willingness to back it. PPP Units in Portugal, South Africa, the UK and Victoria were created this way. All had different objectives, but because the Units were designed with those objectives in mind, backed by political support, and were placed within a system with adequate coordination mechanisms, enforcement power, and clear decision-making processes, they worked well.

To continue with the metaphor from Section 3, policymakers need to first diagnose the disease, and having done that, ask whether a PPP Unit will be an effective medicine. This

means avoiding the temptation to devote resources to a “miracle pill” when more difficult, longer-term therapy may be really be necessary.

Once policymakers have defined their PPP-related problems, and determined that a PPP Unit may indeed be a good solution to those problems, they should begin thinking about the context for the PPP Unit, its roles and responsibilities. Thinking about roles and responsibilities begins with the following questions:

- Why the government wants to do PPPs, and what they expect from those PPPs
- What functions the government thinks are necessary to achieve these goals
- What existing capacity the government has to fulfil these functions, and whether, in particular, existing entities can fulfil some of the roles themselves
- How an additional institution like a PPP Unit could be most useful and what weaknesses in existing capacity the institution would need to address in order to meet the government’s PPP objectives. The assessment of weaknesses—what we have called government weaknesses and gaps—should drive thinking about what the PPP Units will do.

After this diagnostic phase, three of the most important design questions will be:

- The PPP Unit’s responsibilities
- Its level of decision-making power
- Its appropriate location within government.

#### **4.1.1 Responsibilities of the PPP Unit**

Despite the fact that the PPP Units we found to be most successful were those that fulfilled the most functions, we do not believe that **all** functions related to PPP procurement need reside within a single PPP Unit. In the UK, there is now a separate PPP policy unit as part of Treasury, and a technical assistance/project development body, Partnerships UK. Some of the individual line ministries in the UK also have their own project development teams. When responsibilities are divided amongst agencies, it is most important that the lines of responsibility are formalized and clear to public and private partners alike.

A PPP Unit’s responsibilities should be determined by the government weaknesses and gaps identified in each country. If no existing government agency is well suited to correct those weaknesses, responsibility for correcting them should fall to the PPP Unit. In South Korea, for example, the slow progress of PPI between 1994 and 1998 was attributed to a lack of transparency, insufficient line agency expertise in PPP procurement and development, excessively complicated procedures, and insufficient incentives for the private sector. PICKO was created specifically to address those problems by providing technical support, assist in proposal evaluation and negotiation, promote and educate the private sector about PPP in Korea, and standardize procedures and guidelines for PPPs.

#### **4.1.2 Authority of PPP Units**

This paper recommends that designers of PPP Units think carefully about what sort of authority the PPP Unit will need in order to complete its objectives. The authority must match what the PPP Unit is expected to achieve. If the PPP Unit is expected to have a quality control, or quality assurance function, for example, that Unit needs some sort of

authority that allows it to put a stop to, or alter planned PPP agreements it feels are not well designed.

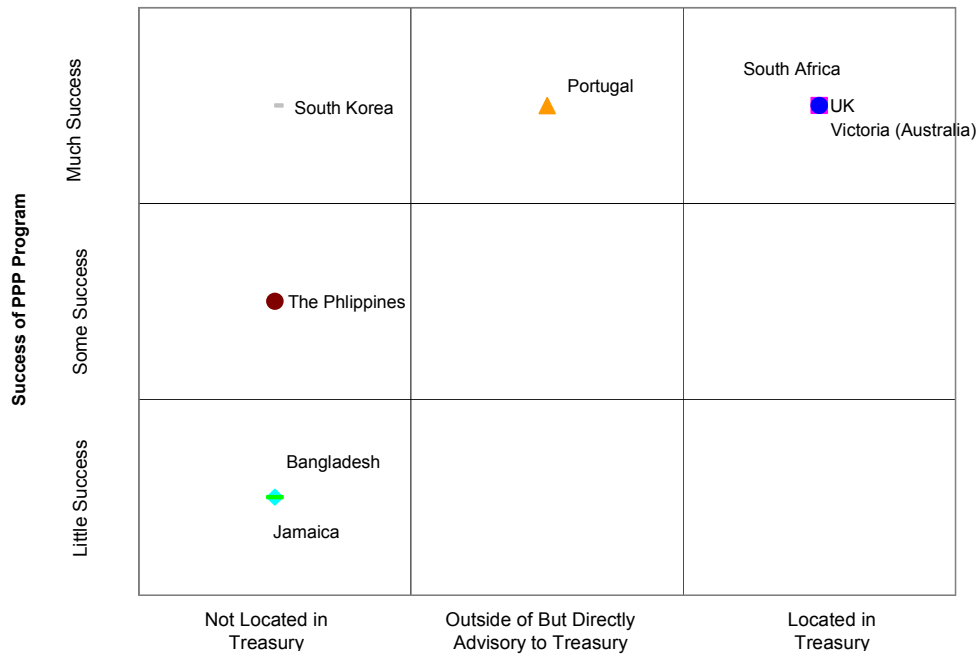
Having said that, the PPP Unit itself should not necessarily have all authority over all PPP functions. Splitting the regulatory functions and project development roles can be desirable. Most project development functions should fall within the mandate of a PPP Unit, but supervisory roles should generally fall within the mandate of other branches of government. Without an independent regulatory role, PPPs are more likely to be used when they are not suitable, and can be used to circumvent traditional procurement rules.

#### **4.1.3 Locating PPP Units**

The location of a PPP Unit is one of the most important design characteristics. Differences in PPP Unit location explain much about the differences between the successes of PPP programs in these countries. PPP Units in Bangladesh and the Philippines for example, operated as quasi-independent Units. The South African and Victorian PPP Units were located within the countries' respective treasury departments (in other words, the ministries of finance). Partnerships UK, while not located within Treasury, was created out of Treasury, and has Treasury representatives on its board as non-executive directors. Moreover, the UK Treasury has its own PPP group, ensuring that the quality control function remains within Treasury.

In South Korea and Jamaica, the units advised a Ministry of Finance, but only to the extent that they may have sat on inter-governmental committees with them. Portugal's PPP Unit reflects a different variation. Parpública is a separate body from the Ministry, but some of Parpública's employees have been hired directly by the Ministry of Finance to advise on PPPs. Figure 4.1 summarises the location of the various PPP Units and their relative success.

**Figure 4.1: Location of PPP Units within Government**



The results suggest a PPP Unit will be effective if located within a strong ministry of finance or treasury. In South Africa, the UK, and Victoria, the Treasury Departments are powerful because they control scarce government resources. Treasury therefore has important enforcement power in these countries, both through:

- Direct power, because Treasury must approve a fiscal commitment to a PPP project before it can happen
- Indirect power, because agencies and ministers may fear future budget cuts in retaliation for behaviour with which Treasury disagrees but cannot stop.

The Treasury also generally attracts higher calibre staff than other government agencies because of its relative power and importance, and has credibility with other ministers.

Moreover, location of a PPP Unit within Treasury is consistent with making sure that PPP programs have the “right” goals, as we have defined them. Line agencies have incentives to enter into PPPs that provide infrastructure or services. They may not always, however, have as strong incentives as Treasury to make sure PPPs are affordable for the government as a whole, or offer the best value-for-money. A treasury department naturally has such quality control incentives.

In a parliamentary system, we do not believe a body created through statute would be better suited than a Treasury Department to fulfil the quality control function. In Jamaica (also under a parliamentary system), we speculate that NIBJ would be effective under the Ministry of Finance, and would likely have struck higher quality PPPs, more consistent with the NIBJ’s goal of reducing fiscal drain. Instead, NIBJ was put under the Prime Minister precisely because the Government wanted to have the flexibility to pursue PPPs that were driven more by political than fiscal priorities.

In non-parliamentary systems, such as the presidential system of the Philippines and many Latin American countries, the appropriate location and legal form of the PPP Unit is less clear. In a country with a strong planning or policy coordination agency, that agency might make a natural home for a PPP Unit.

In countries where legislative acts that control or direct executive functions are common or effective, passing a law to empower the PPP Unit and define its responsibilities may be effective. For example, the Philippines highly legalistic culture makes the decision to create the BOT Centre by statute understandable.

Section **Error! Reference source not found.** highlights further the importance of coordination within the machinery of government, and political support for a PPP Unit's objectives.

## 4.2 Avoiding Designing Ineffective PPP Units

It is not uncommon for PPP Units to fall short of their objectives. There should be no assumption that a PPP Unit will perform well, simply because it is created with good intentions. Lessons can be drawn from poorly performing Units in Jamaica and Bangladesh. These countries each had PPP Units whose performance fell far short of their objectives.

The first observation was that the Units that were least effective are located in countries whose governments are judged relatively ineffective in general. This should be no surprise. In countries where most government institutions perform poorly, it is likely that any new government institution will perform poorly also. However obvious, the conclusion provides a useful reminder of what policymakers should consider first when deciding whether or not to create a PPP Unit.

Often advisors and governments, frustrated with the under-performance of existing institutions, create new institutions that they hope will perform better. It is tempting to overlook the fact that the very reasons that made the existing institutions under-perform may well undermine the new institutions also. If a government wants to develop a PPP program and finds that its existing institutions do not seem up to the job, it should consciously and realistically weigh whether a new institution is likely to do any better. There is always the alternative of trying to fix existing institutions, or expanding the mandate of any institution in which the government already has confidence.

## 4.3 Summary of General Rules for Institutional Design

To be effective, designers of the PPP Units should understand:<sup>3</sup>

- PPP Units are not a miracle cure. Ineffective governments tend to have ineffective PPP Units. Where government agencies are corrupt and uncoordinated it will be difficult for a PPP Unit to escape the same fate
- Without high level political support for the PPP Program, a PPP Unit will most likely fail
- Well-designed PPP Units have been developed in response to a clear need, and a clear understanding of how existing government institutions fail to meet that need

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<sup>3</sup> Only options that would preserve Treasury's ability to make sure that PPPs meet its core criteria for PPPs, namely, that they show Value-for-Money (VfM), are affordable, and show appropriate risk transfer to the private sector are considered. This means that all options assume the regulatory functions will be left within National Treasury, and only the project development functions will be reallocated (if at all).



- In parliamentary systems, effective PPP Units have tended to be attached to treasury departments (Ministries of Finance). This reflects the natural role of the treasury in coordinating government policies and expenditure, its mandate to manage fiscal risk, and the power treasuries derives from holding the purse strings of government. In non-parliamentary system a PPP Unit may do best if attached to a powerful coordinating agency
- PPP Units with executive power tend to be more effective than those that are purely advisory. It is important, however that the power be coupled with a mandate to promote and facilitate good PPPs, or the Unit may simply wield a veto without adding value.

## 5 Organisational Structure for PPP Units

Once the objective, location and design of the PPP Unit is clear, a detailed business case can be prepared with an indicative organizational structure, staffing levels, salary levels, and job descriptions. This section offers suggestions of what principles should be used to determine the new entity's internal organization, and how the unit should be staffed.

### Internal organizational structure

The optimal organizational structure will depend largely on the selected institutional option for the PPP Unit. Rather than weigh the specific advantages and disadvantages of the various organisational structures in this note (this can be done as part of the detailed business case), the following organizing principles are recommended:

- there should be close coordination between the entity or unit responsible for PPP technical assistance, and units that focus more on providing technical assistance for traditional procurement of infrastructure. There are good reasons for Treasury to think of assisting the line departments in planning and procuring infrastructure in general, regardless of the means of procurement, and regardless of whether government or the public sector ultimately provides the service
- The Head of the PPP entity should have clear incentives in his or her performance contract for accelerating PPPs that meet value for money and fiscal risk management criteria. This may mean that it is not appropriate to have the PPP entity under the same leadership as the entity providing technical assistance for general procurement of infrastructure, or, if they are, that there are clear performance incentives in the director's contract to drive PPP deal flow specifically.

### Staffing

A number of principles for staffing the PPP entity will ensure it has the right skills to drive PPP deal flow. Some important principles for staffing the new entity are:

- The new PPP entity needs a mix of skills, and level of expertise, comparable to the mix of skills and level of expertise of private counterparties to a PPP transaction. PPP transactions require expertise in law, financial analysis, engineering, public policy, urban planning, economic forecasting, financial structuring, negotiation and overall deal management. Private sector teams bidding on a PPP contract will typically have at least one person (and often, teams of people) devoted to each of these disciplines. Ireland's National Development Finance Agency (NDFA), for example, includes 10 full-time professional staff with expertise in corporate finance, accounting, law,

economics and financial analysis. As another example, Korea's Private Infrastructure Investment Center of Korea (PICKO), has a staff of 80 which include economists, finance specialists, accountants, lawyers, and engineers in all sectors covered by Korea's PPP law.

PPP Units around the world face the challenge of attracting and maintaining qualified staff. At Korea's PICKO, for example, the turnover of financial specialists and lawyers is the highest of all of the staff.<sup>4</sup> As noted above, allowing flexibility in salaries and hiring will help the new entity overcome problems it has had in the past in retaining qualified staff, and sourcing qualified legal advice, in particular.<sup>5</sup>

- Staff should be assigned specific sectors, so as to allow them to develop relationships and trust with Line Departments, and to develop expertise in their sectors.

## 6 Evaluation of Options for Chongqing

In order to determine the most appropriate institutional structure, the objectives of the government and their PPP program to be clearly defined. Only then can each option be evaluated to the extent to which it fills this objective.

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<sup>4</sup> "Regulations and Institutions for PPP", presentation by Junglim Hahm. World Bank Institute. Tegucigalpa, Honduras. April 22-24, 2008.

<sup>5</sup> While the proposed Government Components would go a long way towards addressing the institutional challenges in respect of driving PPP transactions, a key concern remains in respect of remunerations levels. Current indications are that at senior management levels within the PPP Unit remuneration levels are below private sector equivalent (see Appendix E). This will continue to hamper the attraction and retention of specialist skills – especially financial and legal. This could be partially addressed by continuing the current practice of utilizing consulting contracts – this however appears to be less cost effective and more critically fails to ensure adequate knowledge transfer and retention to government.

# Appendix A: Summary of Success or Weaknesses of PPP Units

## PPP Units Studied in Detail

Jurisdiction	PPP Unit Name
Bangladesh	Infrastructure Investment Facilitation Center (IIFC)
Jamaica	National Investment Bank of Jamaica (NIBJ)
Portugal	Parpública Ministry of Finance PPP Unit
South Africa	National Treasury PPP Unit
South Korea	Private Infrastructure Management Center (PIMAC)/Private Infrastructure Investment Center of Korea (PICKO)
The Philippines	Built Operate Transfer Centre (BOT Centre)
UK	Treasury PPP taskforce and Partnerships UK
Victoria, Australia	Partnerships Victoria

Jurisdiction and Unit	PPP Program Successful?	PPP Program Successful in Country Context?	PPP Unit's Objectives	Met those Objectives?	Any functions necessary for solving government PPP weaknesses?
Bangladesh, IIFC	Little success. Far fewer, and lower quality PPPs than needed	<b>Little success.</b> Haripur and Megnaghat show that transparent, quality PPPs are possible, but quality has worsened since	<ul style="list-style-type: none"> <li>Advise line ministries and other government agencies in identifying and prioritizing potential infrastructure projects for tender, assisting with evaluation, award, negotiation, and implementation of projects</li> <li>Promote private sector participation in infrastructure in Bangladesh by working with the private sector and serving as a clearinghouse of expertise on public-private partnerships</li> </ul>	Little apparent effect on private participation in infrastructure in Bangladesh	<b>None to few:</b> <ul style="list-style-type: none"> <li>Technical assistance</li> <li>Policy formulation, but no authority to implement</li> </ul>
Jamaica, NIBJ	Little success. Lots of PPP	<b>Little success,</b> given	<ul style="list-style-type: none"> <li>Secure greater efficiency</li> </ul>	No, especially not the reduction	<b>None to few:</b> Managed some transactions, and attempted coordination,

Jurisdiction and Unit	PPP Program Successful?	PPP Program Successful in Country Context?	PPP Unit's Objectives	Met those Objectives?	Any functions necessary for solving government PPP weaknesses?
	activity but low quality	Jamaica's high public debt. PPPs have worsened the situation	<ul style="list-style-type: none"> <li>Reduce fiscal drain</li> <li>Optimize Government's management resources</li> <li>Secure enhanced access to foreign markets, technology and capital</li> <li>Broaden the base of ownership in the society.</li> </ul>	in fiscal drain	but generally ineffective as real power was given to a senior, politically connected figure, not to NIBJ
Portugal, Parpública PPP Unit	Some success. There is still a large debt overhang from expensive PPPs done in the 1990s	<b>Much success.</b> Portugal has a much greater need than other EU members to do PPPs, and has since corrected problems with its earlier program	Generally, to help the government to do better job structuring higher quality PPPs than in the past	Yes	<b>Some:</b> <ul style="list-style-type: none"> <li>Policy formulation</li> <li>Technical assistance</li> <li>Quality control</li> </ul>
South Africa, Treasury PPP Unit	Much success	<b>Much success,</b> despite some concerns about low deal flow and lack of deals which address South Africa's true infrastructure needs	Filter out fiscally irresponsible PPPs while creating a structure for PPPs that would re-assure private investors despite it being a fine filter	Yes	<b>Some:</b> <ul style="list-style-type: none"> <li>Technical assistance</li> <li>Quality control</li> <li>Policy formulation</li> </ul>
South Korea, PIMAC	Much success	<b>Much success,</b> given Korea's budgetary constraints and infrastructure needs	<ul style="list-style-type: none"> <li>Provide technical assistance to government agencies and the private sector. The creation of PICKO responded in part to a perceived need that the government agencies were lacking expertise</li> </ul>	Yes	<b>Most to all:</b> <ul style="list-style-type: none"> <li>Technical assistance</li> <li>Quality control</li> <li>Policy formulation</li> <li>Promotion/marketing</li> </ul>

Jurisdiction and Unit	PPP Program Successful?	PPP Program Successful in Country Context?	PPP Unit's Objectives	Met those Objectives?	Any functions necessary for solving government PPP weaknesses?
			<p>in PPI evaluation and development</p> <ul style="list-style-type: none"> <li>Promote infrastructure projects and educate the private sector about PPI in Korea</li> <li>Review unsolicited proposals as requested by line agencies</li> <li>Review feasibility studies and bidding documents</li> <li>Assist in proposal evaluation and negotiation of agreements</li> <li>Assist in formulation of government policy on PPI.</li> </ul>		
The Philippines, BOT Center	Some success. Considerable volume but inconsistent quality of PPPs. IPPs, in particular, left significant contingent liabilities	<b>Some success</b> , given the country's infrastructure needs.	Technical assistance, PPP promotion/marketing, and monitoring	<ul style="list-style-type: none"> <li>Yes, but not for all PPPs.</li> <li>The BOT Center has only done very little monitoring, and on an ad hoc basis.</li> </ul>	<b>Few to none:</b> BOT Center was assigned many functions but really only effective in its technical assistance role
UK, Partnerships UK and Treasury Taskforce	Much success	<b>Much success</b>	Generally, to improve the quality of PPPs and shift focus away from financing infrastructure to VfM and risk allocation	Yes	<b>Most to all:</b> <ul style="list-style-type: none"> <li>Technical assistance</li> <li>Quality control</li> <li>Policy formulation</li> <li>Promotion/marketing</li> </ul>
Victoria, Australia, Partnerships Victoria	Much success. The quality of PPPs has improved since the new PV policy has come into existence.	<b>Much success</b>	Generally, to improve the quality of PPPs in infrastructure. Ensuring that PPPs provide for optimal risk transfer, maximize efficiency and minimizing	Yes	<b>Most to all:</b> <ul style="list-style-type: none"> <li>Technical assistance</li> <li>Quality control</li> <li>Policy formulation</li> <li>Promotion/marketing</li> </ul>

Jurisdiction and Unit	PPP Program Successful?	PPP Program Successful in Country Context?	PPP Unit's Objectives	Met those Objectives?	Any functions necessary for solving government PPP weaknesses?
			whole life costs		

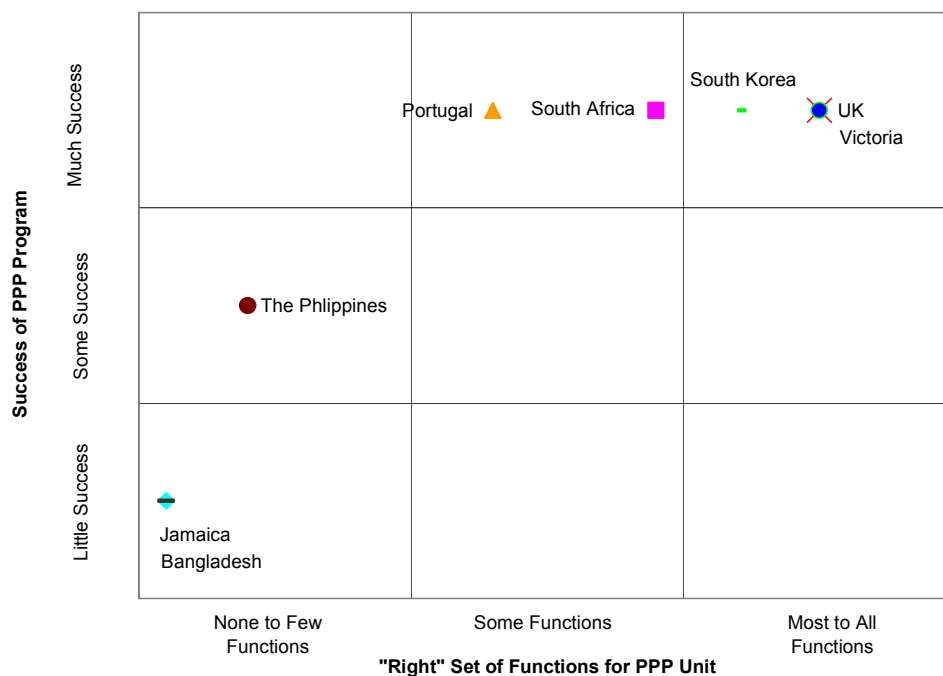
Source: Castalia, 2005

The results from the table above are used to plot Figure A.1. The figure shows a positive correlation between the success of a PPP program, and the functions a first principles-based analysis suggests a PPP Unit should undertake.

Figure A.1 shows how the functions identified correlate with the success of PPP programs. The vertical axis rates the success of each country's PPP program during the time in which the PPP Unit existed, as having "Little Success", "Some Success", or "Much Success". The horizontal axis identifies how many functions the PPP Unit fulfilled, from the list of five functions identified in Section 3 as the right set of functions for a PPP Unit.

The assessment of each PPP Unit's placement on either axis is necessarily qualitative. Figure A.1 is not meant to be precise, but is meant to guide the discussion of the differences between PPP Units and PPP programs.

**Figure A.1: Correlation of Success with Functions**



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Correlation does not, of course, mean causation, but the case studies provide at least anecdotal support for the effect each PPP Unit had on the PPP program within its jurisdiction. To summarize from the case studies:

- Much PPP activity in Bangladesh has happened without IIFC's involvement, suggesting that IIFC has not had much impact on the overall level or quality of PPPs in that country
- NIBJ was the principal driver of Jamaica's privatization program and therefore had considerable influence over Jamaica's PPP program, though it ultimately answered to the Cabinet, a political body
- Like IIFC in Bangladesh, significant PPPs in the Philippines have happened without the BOT Center's involvement in recent years. The power sector PPPs in which the BOT Center was directly involved in the 1990s were of variable quality and have left the Philippines with significant PPP-related liabilities
- The Parpública PPP Unit is the principal driver of PPP policy, and has close links to Treasury which has driven the fiscal reform process in Portugal since 1999. Parpública has had much to do with improving the affordability and value-for-money in Portugal's PPPs while allowing the deal flow to remain relatively high
- The Treasury PPP Unit is central to the PPP development process in South Africa. The PPP development process requires extensive PPP Unit involvement, including Treasury approvals at 4 stages prior to contract signature. Though the PPP Unit has been criticized as too restrictive, it was created with the inherently restrictive goal to ensure that PPPs happen, but not as a way of avoiding budgetary constraints. The PPP Unit's regulations, PPP manual, and many of its completed transactions, are referenced as good practice examples outside of South Africa
- Partnerships UK and Partnerships Victoria are central to the PPP Programs in the UK and Victoria, two of the largest markets for PPPs in the world
- PICKO is an essential player in the evaluation of feasibility studies and bids. PPI activity in Korea has picked up considerably since the Government created PICKO in 1999.

