

PAKISTAN
POLICY ON PUBLIC PRIVATE PARTNERSHIPS
*Private Participation in Providing More and Better Public Services through
Improved Infrastructure*

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A. Background

The Government recognizes the importance of improving and expanding infrastructure services for sustaining economic and social development in its Medium Term Development Framework (2005-2010) (MTDF). Improved quality and service coverage in power and water supply, sewerage treatment, transport and logistics are vital for Pakistan's economy and the livelihood of its people. Tight fiscal constraints require innovative approaches - away from the traditional role of the Government as the service provider - to ensure that the massive investment needs are financed with the assistance of the private sector. The Government estimates that less than 50% of the infrastructure investment needs can be covered by public funds under the MTDF. A combination of policy reforms, institutional support, incentives and financing modalities is required to encourage private-sector participation in financing, constructing and managing infrastructure projects.

Since the early 1990s, Pakistan has established a policy and regulatory framework for Public Private Partnership (PPP) in the telecom and energy sectors. Unlike in these regulated sectors, the framework for PPP infrastructure service procurement in transport and logistics, and municipal services in water supply, sanitation, solid waste management, social sector, and real estate does not exist. Experience in the regulated sectors suggests that a policy, tariff standards, technical design and service standards, and model contracts are useful for accelerating the closure of transactions and instilling confidence in all participants.

The closure of PPP investments, especially at the provincial and municipal levels is a very challenging process and often year long efforts do not result in closure of a transaction. Various levels of Government jurisdiction and regulation blur clear assignment of ownership and accountability. The Local Government Ordinance, 2001 (LGO) assigns accountability in the unregulated municipal services to local Government. However, the local governments usually lack the requisite skills and financial resources to fulfill service functions at acceptable scope and service standards.

Many economically and socially worthy projects lack the ability to raise the requisite revenues to ensure adequate returns for the investor risk. Also infrastructure projects require long gestation periods to ensure affordable tariff levels, which expose private investors' investment to undue risk. PPPs with appropriate arrangements in the sharing of risks in financing, operating and maintaining infrastructure services are a solution.

B. Introduction

PPPs have been adopted by various governments around the world as a service delivery tool. Instead of the public sector procuring a capital asset and providing a public service, the private sector creates the asset through a dedicated standalone business (usually designed, financed, built, maintained and operated by the private sector) and then delivers a service to a public sector entity / consumer, in return for payment that is linked to performance. PPPs permit the public sector to reduce their capital expenditure (and redirect to promote urgent social needs) and convert the infrastructure costs into affordable operating expenditure spread over time. PPPs allow each partner to concentrate on activities that best suit their skills. For the public sector that would mean focusing on developing policies and identifying service needs, while for the private sector the key is to deliver those needs efficiently and effectively. PPP agreements are especially useful in unregulated sectors where transactions can be structured in a manner that allows 'regulation by contract' on a project to project basis.

The Government has set up the Infrastructure Project Development Facility (IPDF) under the auspices of the Ministry of Finance (MOF), to generate PPP projects with public sector Institutions (line ministries, provincial Governments, local bodies, state owned enterprises etc.) undertaking PPPs. IPDF provides direct access to a professional PPP Unit that will help Institutions to improve proposals and prepare them for tendering, without becoming a contract signatory to those transactions. Once approved by IPDF's Project Feasibility Committee, the project may be submitted for any necessary complementary financing to a proposed independent financing body - the Infrastructure Project Financing Fund (IPFF) - for any 'residual' financing needs that are not available in the market.

Both IPDF and IPFF are tasked to provide easy and timely access for Institutions, to ensure that viable good quality PPP deals are concluded in a timely manner to meet Pakistan's increasing infrastructure demands. The day to day operations of both institutions will be independent from the Government and reporting to the Government will be made through their respective Board of Directors.

A separate Task Force (TF) of senior officials from Ministries and provinces has been established to advise on overall PPP policy reforms, aided by a Secretariat established in the IPDF. The Secretariat is supported by Working Groups tasked to focus on specific topics of that policy. It is intended that the deliberations and recommendations of the Task Force will shape the PPP enabling environment in Pakistan, in parallel with the operations of the IPDF and IPFF.

PPP project evaluations will focus on, but will not be limited to, the following sectors:

- (i) **Transport and logistics** including provincial and municipal roads, rail, seaports, airports, fishing harbours as well as warehousing, wholesale markets, slaughter houses and cold storage.
- (ii) **Mass Urban Public Transport** including buses, and intra and inter-city rail.
- (iii) **Municipal Services** including water supply and sanitation; solid waste management; low cost housing, and health / education facilities.
- (iv) **Small Scale Energy Projects** hydroelectric and captive power generation projects - other than those being facilitated by Private Power Infrastructure Board (PPIB) and the Alternative Energy Development Board (AEDB).

Although, PPPs will become an integral component of the Government's overall strategy for the provision of public services and public infrastructure across all sectors, this does not imply they are the preferred option for improving the efficiency of services delivery but that they enjoy equal status among a range of possible service delivery options available to the Government. Sector specific policies may be developed as necessary to provide more detailed guidance on the approaches and norms to be adopted in particular sectors when seeking PPPs. The federal government will coordinate with provincial governments on the development of policies concerning services for which provincial and local governments are concerned. Regardless of sector or level of government, PPPs should be pursued where they represent priority projects, are affordable to the government and consumers, and represent value-for-money, i.e. they provide a better approach than public procurement.

C. Objectives

The Government's objectives in promoting PPPs are to provide:

- **More services**, as there is a huge backlog in basic services such as water and sanitation, solid waste management, transport and rural electricity. Not only do we need to catch up with the backlog, we need to start building infrastructure for future needs as well.
- **Better services**, as the quality of existing services is deteriorating due to lack of incentives and funding for infrastructure maintenance and up-gradation. The result is unclean water, unhygienic living conditions and inability to provide proper health care and education.
- **Affordable services**, as certain segments of the population cannot pay cost recovery tariffs, whereas the private service provider needs to recover costs in order to sustain operations. In such cases the Government will provide targeted (to low income consumers), explicit

(not hidden as budget support) performance based (only provided once the service - such as 24 hour clean drinking water to the consumer's dwelling - is actually delivered).

- **Timely services**, as the Government does not have the capacity or the fiscal space to meet the immediate service demands of its citizens.

These objectives will be achieved through:

- **Faster project implementation** (as design and construction risks are usually passed on to the private sector in PPPs) and higher quality / lower cost (as in PPPs private sector compensation is linked to its performance and the overall operations / maintenance risk is also passed on to it). IPDF will play a key role in ensuring that projects are structured in a manner that ensures proper risk allocation.
- **Leveraging public funds** with private financing from local and international markets. For every Rupee that the Government spends it will strive to leverage the maximum possible from the private sector. The Government would like to limit its contributions to providing targeted subsidies to low income consumers, to allow cost recovery by the private service provider. IPDF will provide 'residual' long term financing that may not be available in the market.
- **Enhanced accountability** in service delivery - by linking service provision to a firm contractual arrangement. The Institutions (relevant implementing agencies) will define the service levels very clearly in the contracts in terms of outputs and outcomes required from the private sector. They will be required to put in place strict monitoring mechanisms. Non performance by the private sector will be penalized and may result in termination.
- **Public sector management shift** from Budget expenditure to whole life cycle cost management. Most of the services in the public sector are of poor quality because the Institutions are not efficient in determining whole life costing of assets, with the result that once they are commissioned they are not maintained and refurbished / upgraded in time. Since the focus in engaging with the private sector is on services it provides, the private sector will ensure that the underlying assets are of good quality and maintained adequately.

D. Implementation Structure

The focal point for implementation of the Government's PPP program is the IPDF, which, according to its mission statement has been established, to:

Promote and facilitate the closing of transactions involving private investment and management of public infrastructure, especially in the unregulated sectors at the provincial and municipal levels. IPDF is a catalyst to increase the number and volume of public infrastructure transactions that provide value for money for the beneficiaries of the facility, while assuring that private sector providers are able to earn adequate returns for quality services. Through the transactions and facilitation of policy making IPDF will also support the creation of an enabling policy environment and provide hands on knowledge transfer especially to the local Government level.

In order to deliver on its mission statement, IPDF will act as the principal facilitator and coordinator for PPPs in Pakistan, with focus on the following 'pillar' functions:

Pillar I: Provide transaction support to Institutions to structure viable PPP Projects that provide good value for money. This also entails (i) building public and private stakeholder awareness and skills, and (ii) feed back and assistance to the TF as its secretariat to create a suitable policy, legal and regulatory framework for PPPs.

Pillar II: Act as an independent evaluator and monitor, ensuring superiority of PPP projects to public funded alternatives in terms of service scope and delivery, effective to alleviate fiscal constraints, and in compliance with environmental, social and financial safeguards.

Pillar III: Act as an independent agent in determining the need for supplemental public grant funding to make PPP projects affordable and financially viable, while minimizing public grant funding through intelligent design and a competitive process.

Pillar IV: Recommend ready transactions for (i) viability gap grant financing for MOF approval, (ii) long term loan financing (gap that cannot be provided by the market) at market terms to IPFF, and (iii) Guarantees for MOF approval.

E. Viability Gap Funding

The Government will provide viability gap funding (VGF) - or targeted subsidies - for PPP projects that are economically and socially justified but fall short of financial viability. This would be an explicit subsidy that is performance driven (based on private party achieving measurable outputs) and targeted to socio-economically disadvantaged users or groups of users.

For that purpose, the MoF will issue VGF Guidelines setting the criteria for eligibility to receive funding from the viability gap fund, the procedure for applying, approving, disbursing and monitoring the fund, and the arrangement for managing, controlling and governing the Fund.

The MOF will constitute a dedicated VGF Company responsible for, (i) providing for the procedure to be followed for submission, appraisal, approval, disbursement and monitoring of viability gap funding, (ii) approving viability gap funding for eligible PPP projects and (iii) disbursements and monitoring VGF

F. PPP Project Life Cycle

To improve credibility and transparency of PPP projects, uniform bidding processes and publication of bidding and selections will be established. The life cycle undertaken by Institutions (assisted by qualified and experienced

transaction advisors) procuring PPPs shall at a minimum include the following steps:

- (i) **1st step. Needs and Options Analysis.** Transaction advisor conducts Needs and Options Analysis to determine the best solution to provide the service / build infrastructure. IPDF assists the Institution in evaluating recommendations of the Transaction Advisor.
- (ii) **2nd step. Initial Viability Analysis.** Transaction Advisor prepares a Pre-Feasibility Study including estimates of project costs and an initial indication whether the project is viable and affordable. IPDF assists the Institution in evaluating recommendations of the Transaction Advisor.
- (iii) **3rd step. Technical, legal, environmental and financial due diligence.** Transaction Advisor conducts in-depth Legal, Technical, Site / Environmental, Market and Financial Due Diligence along with extensive stakeholder consultation. IPDF assists the Institution in managing the Transaction Advisor.
- (iv) **4th step. Affordability and value for money test.** The Transaction Advisor prepares a robust financial model to determine project viability, bankability, affordability and the value for money it offers. This includes estimates of viability gap and the need for subsidies. IPDF assists the Institution in this process.
- (v) **5th step. Market Test.** Transaction Advisor continuously conducts market testing to determine under which technical conditions the market is willing to offer the services. IPDF assists the Institution in reviewing the market test and the need for viability gap and other funding support by IPFF and determine the final PPP design parameters. The assigned IPDF project manager submits project to IPDF Project Feasibility Committee. Subsequent to IPDF Project Feasibility Committee endorsement, IPDF submits the proposal to Viability Gap Fund for approval in principle.
- (vi) **6th step. Bidding.** IPDF assists the Institution to conduct a competitive bidding process (and to determine the lowest viability gap funding need for a PPP project, if required).
- (vii) **7th step. Approval of Viability Gap funding (if required).** Based on IPDF's evaluation and Project Feasibility Committee endorsement, IPDF submits recommendation for subsidy to the Viability Gap Fund.
- (viii) **8th step. Signing of Agreement and Financial Close** (and the Institution, the private sponsor, and Viability Gap Fund sign tripartite project implementation agreement, if VGF involved).

- (ix) **9th step. Project Monitoring by Institution** (and by Viability Gap Fund for milestone based disbursements if subsidies are involved)

G. Unsolicited Proposals

Government's policy on unsolicited proposals aims to balance its desire to stimulate innovation and to create new opportunities for the private sector, with the need to ensure that the Government and consumers get value for money in PPP transactions. Genuine effort, reasoned analysis and a demonstrated appreciation of the requirements of the public sector should be the minimum considerations before a public sector entity even entertains an unsolicited proposal, let alone provides any rewards or incentives.

The Government would verify project viability with the assistance of independent transaction advisors. If the project is deemed viable, it would be tendered out on a competitive basis (exceptions may be provided on a case to case basis in social sectors (health and education) projects where needs are urgent and quality service providers are limited).

The original proponent shall be invited to participate in the bidding process and may be reimbursed of its pre-determined costs in project preparation in case it is not awarded the contract. The reimbursement amount must be provided for, in the bid documentation as a provisional amount, payable by the successful bidder to the proponent. If the public sector entity aborts the project it will be liable to pay the proponent for costs incurred up to the pre-determined/agreed budget amount.