

ISSUE PAPER:
How Can Government Ensure the Success of Private Sector Participation in Infrastructure?

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INTRODUCTION

The availability of modern and efficient infrastructure such as national roads, bridges, water supply networks and ports is crucial to any country's development and economic growth, besides which it can also improve perceptions of the country as a viable investment destination. Infrastructure also has the potential to improve standards of living and health, and ultimately, the potential to reduce poverty. Being a developing economy where real growth and the improvement of welfare depend on rational policies for capital accumulation, the Philippines needs a rational infrastructure strategy to keep growth rates high in the forthcoming years. Infrastructure's potential to contribute positively to growth therefore makes it a key issue in the national government's budgetary planning process. Such potential makes it necessary to determine the extent to which public funds can and should be allocated to infrastructure development.

In recent years, the overall fiscal resources of government to finance all types of expenditure have been declining. Consequently, the national government's ability to effectively allocate funds for all types of infrastructure has grown inadequate. As several categories of public spending, including infrastructure, have experienced diminished funding, tapping the private sector for infrastructure development has become an option; but is it a viable one?

Literature on private sector participation in public infrastructure suggests that reasonable grounds for PSP exist if conditions such as the following are met:

- 1) The government is constrained by its budget to finance only a small portion of the infrastructure projects identified by national and regional planners and beneficiaries.
- 2) The portion of the infrastructure portfolio that cannot be financed by national government consists of projects which have high economic internal rates of return (EIRR) and high financial rates of return (FIRR).
- 3) The portion of the infrastructure portfolio that cannot be financed by the national government consists of projects which the government cannot develop nor construct at a lower cost and over a shorter period than the private sector can.
- 4) The portion of the infrastructure portfolio that cannot be financed by national government consists of projects which the government can neither operate at a lower cost nor more efficiently than the private sector.
- 5) The ex post fiscal cost of PSP is outweighed by ex post economic benefits from projects.

If the aforementioned conditions are met, and they generally are in the Philippines, then PSP in infrastructure appears imperative. For its part, the national government has supported the creation of the Philippine Infrastructure Corporation (PIC) to infuse initial equity into large infrastructure projects, in the hope that it will attract private proponents and financing in the future. The creation of the PIC somehow indicates that the national

government implicitly views the ex ante benefits from PSP as outweighing potential ex post fiscal costs, to the extent that the creation of the PIC was justified.

Moreover, Republic Act 7718, better known as the Build-Operate-Transfer (BOT) Law and considered a landmark piece of legislation responsible for making the Philippines a pioneer in this development effort, was passed. Enacted more than a decade ago, however, the Law and its Implementing Rules and Regulations (IRR) needed amendments to be able to address the constantly evolving business environment more effectively, taking into consideration, as well, the lessons learned in the course of the law's implementation.

Thus, on 15 to 16 October 2005 the Forum on Private Sector Participation in Public Infrastructure was held to introduce the AER-EPRA partnership on the PSP project to the AER fellows whose involvement and support for the project were secured. An initial consensus on the PSP areas that would serve as the foci of the reform advocacy under the AER-EPRA partnership was arrived at. The AER-EPRA partnership was constituted by the Action for Economic Reforms (AER) and the Economic Policy Reform and Advocacy Project (EPRA) of the Ateneo de Manila University.

On 29 November 2005, the Multi-Stakeholder Team (MST) on Private Sector Participation (PSP) in Public Infrastructure organized by the Economic Policy Reform and Advocacy Project of the Ateneo de Manila University conducted a forum entitled, *"How Can Government Ensure the Success of Private Sector Participation in Infrastructure?"* Aimed at widening and strengthening the ownership of economic reforms through participative policy formulation and further promoting PSP in nation building, the forum gathered department heads and technical managers of government agencies dealing with private sector participation in public infrastructure. More specifically, present at the forum were eighty-seven registered participants, sixty-five of whom were from thirty-one government agencies and three academic institutions. There were also five delegates from the NGO consortium partner of EPRA and two from the USAID, the sponsoring agency.

Finally, on 9 December 2005, thirty-two fellows from the Action for Economic Reforms and other organizations had a meeting to discuss and evaluate the November consultation with government officials.

Overall, discussed at the aforementioned forums, albeit in varying degrees, were the following issues:

- The private sector participation's not being limited to Build-Operate-Transfer undertakings
- The need to ensure the financial capability of project proponents and to require financial closure before a notice to proceed is issued.
- The need to review and propose amendments to the BOT law
- The need for government to have a clear social plan—a development vision to help the private sector determine the area where it can strategically invest

BACKGROUND

On July 2004, a Department of Trade and Industry-led committee was constituted to prepare the draft of the Amendments to the Implementing Rules & Regulations to the BOT Law, conduct public consultations and submit proposed amendments to the inter-agency BOT IRR Committee. From August 2004 to Jan 2005, dialogues with various stakeholders were conducted to assess the gaps and improve the policy framework of the government's BOT/PSP Program. The BOT Center, DTI's main infrastructure privatization body, spearheaded efforts to amend the Implementing Rules and Regulations (IRR) of the BOT Law in an effort to achieve the following over the short term:

- improve the government's policy on Public-Private Partnerships (PPP)
- enable the government to effectively address the dynamic developments in public-private infrastructure head on
- make the BOT Law IRR flexible and more responsive to the needs of both government and the private sector.

By 18 March 2005, a public hearing was held on the proposed IRR amendments. This was followed a month later by a final meeting of the inter-agency BOT IRR Committee which deliberated on and approved the IRR amendments. After a week, the final draft of the IRR was sent to the IRR Committee members for their signature, prior to its publication.

The amended IRR was signed by majority of the members of the BOT-IRR Committee. Its publication in a newspaper of general circulation was set for 2006. The IRR would take effect fifteen days after publication.

Thereafter, training and capacity building activities with the implementing agencies and local government units were to be scheduled, and the BOT Law amended. Per the long-term policy agenda of the Department of Trade and Industry (DTI), the BOT policy framework had to be strengthened, consistent with the government's agenda on infrastructure investment through private sector participation. The task of amending the said law was set to be undertaken by DTI, assisted by Economic Modernization through Efficient Reforms and Governance Enhancement (EMERGE) Project and EPRA.

MAJOR POLICY AREAS/CONCERNS FOR CONSIDERATION

At the November 2005 forum the following were identified as the major areas that needed to be studied and amended in the BOT Law:

- **Processes** (approvals, procurement and implementation, procedural delays)
- **Institutions** (oversight and regulatory agencies, the BOT Center and the private sector)
- **Policies** (on government support, risk allocation, NG-LGU collaboration, sectoral concerns)

On the other hand, the following issues and questions pertaining to PSP-MST and corresponding recommendations surfaced in at least one the three forums mentioned above:

- User fees and toll rates. Users in the Philippines complained whenever toll charges are raised, when, in fact, the Philippines' neighboring countries charged higher.
- The awarding of projects. Unsolicited proposals for BOT projects tended to dominate the project pipeline. This occurred even if the intent of the BOT Law was to promote solicited bids.
- Continued deliberations and discussions. There was a perceived need to bring various perspectives together in order to improve the policy framework governing PSP in public infrastructure.
- Financial reports. These should not be the sole basis for PSP project approvals; emphasis should also be put on impact evaluation. The investing private sector was not only concerned with the money but with efficiency as well.
- Ways to better harness the participation of the private sector. Government should convince investors of the inherent and long-term benefits of private sector investment in public infrastructure by providing incentives and clarifying pertinent issues such as the definition of public goods,¹ among other measures. Government should also abide by the terms of its contracts with the private sector in order to belie the apprehensions of prospective private sector participants in public infrastructure. Over the years, rescinded contracts, litigations, etc. have discouraged PSP in public infrastructure.
- Legislation. A champion in Congress who could advocate, sponsor and push legislation towards better regulatory functions in the administration of PSP should be found.
- Unsolicited proposals. The BOT law should be designed so as to rule out government guarantees for unsolicited projects, without compromising the financial viability of these projects.
- Government guarantees. The President had the prerogative to offer/approve guarantees. The BOT Law itself did not specify guarantees. As technical bodies like the Investment Coordinating Council (ICC) of NEDA could only issue recommendations, there was need to strengthen their decision-making ability. Also, even as some guarantees were assumed by government after the signing of contracts, future studies should nonetheless look at guarantees given both before and after project approval.
- The assumption of risks. Independent Power Producers (IPP) agreements that served as templates for other BOT agreements had flaws in terms of government guarantees' covering market-determined risks. Moreover, government agencies like the NEDA used high-end projections to justify the approval of projects so that a method to calculate the risk and returns of government guarantees should be institutionalized. Another point: in countries like Malaysia, government risks in IPP contracts were

¹ Traditionally, public goods were defined as goods that were non-excludable and non-rival. A service or good became excludable (the consumer would have to be charged) if the private sector's ownership, operation and management of such public good, i.e., utilities and infrastructure, were feasible. Given such a set-up, profits and cost-recovery became possible, which meant that goods that were formerly free or subsidized should now be charged their full cost (inclusive of profit margins). Setting clear criteria as to which goods or services should be charged full costs (ergo PSP was possible) and which should remain free or subsidized (and should therefore remain in government's management) was critical.

denominated in the local currency. Similar means to reduce government risks should be identified in the Philippines.

- Procedural aspects of BOT schemes and PSP. The government's technical evaluators were competent, but problems arose whenever the higher-ups ordered changes in the assumptions used just so a project would be approved. There was thus a need to study the proposal and approval processes to identify loopholes. Moreover, as the technical approval of projects took a very long time (3 to 5 years) and entailed substantial costs, any change in the procedures should take particular note of the time element.
- Financing. The development of domestic capital markets could lessen the financing problems of infrastructure projects. The Philippine Export Import Bank could be involved in PSP financing. As local governments had their own PSP projects, their experience with BOT projects could be tapped to determine how the BOT Law could be improved. In the course of doing so, the LGU's capacity to take part in PSP schemes could be developed. The Visayas-wide water coalition was cited as a possible participant in the consultations.
- Getting the general public to accept PSP. For PSP to gain public acceptance, government would do well to clarify how PSP would be governed fairly, efficiently, and for the common good, with bias for the poor and vulnerable. The type of infrastructure, the relevant regulatory bodies and frameworks for the various sectors were crucial because if the regulatory bodies and frameworks for natural monopolies² were perceived inadequate and wanting, then PSP would be rejected by the general public. Clear and persuasive arguments for charging full costs for basic utilities and services that were formerly free or subsidized were also needed for PSP to be generally accepted.

OTHER WORKSHOP PROPOSALS/RECOMMENDATIONS

In line with the proposed amendments to the BOT Law, it was suggested that the following activities be undertaken:

- Extensive consultations with all BOT stakeholders (*national agencies, local government units, private sector, investors, academe, civil society, etc.*)
- The preparation of a discussion paper and policy studies leading to the finalization of the proposed amendments
- The drafting of the proposed bill
- Advocacy work

The three workshops also yielded the following, more specific observations/recommendations:

² Natural monopolies were such because of the non-rival nature of the infrastructure (e.g. national highways) involved. Increasing returns to scale (e.g., electricity, water, etc.) made the private owner/ operator/ manager of the infrastructure or utility a natural monopolist.

- Some BOT contracts could not be located, pointing to the necessity of having a central depository for both the draft and final versions of BOT contracts.
- As the issue of private sector participation was not limited to BOT concerns alone, a review of other modalities was advisable.
- An assessment of ex ante safeguards and ex post accountabilities should be made. Lessons learned from other previous BOT projects had to be reviewed and applied so that effective amendments to the BOT Law as well as its IRR could be suggested.
- Better and wider access to and the sharing of information especially on BOT projects through websites and other medium should be promoted. Government agencies should also encourage and support officially-sponsored research in PSP through information sharing, for example. As things stood, policy researchers and concerned citizens had limited access to information on BOT contracts when, in fact, discussions on contracts should be conducted and there should be greater transparency, public participation and flexibility in the contracting process. In this regard, the use of contract reopeners was recommended. Creating a body to address the concerns raised by individuals and NGOs, for example, was also recommended.
- An independent body could also be created to review contracts, but this would mean an additional procedure in the already lengthy process of project approval. This recommendation, in a sense, ran counter to the suggestion that the process of approval should be streamlined.
- Decentralization should be factored into the implementation of infrastructure projects. The missing-middle phenomenon on the national and LGU levels, i.e. the absence of a regional government or inter-LGU structure that would coordinate and harmonize infrastructure and investment development efforts across cities and municipalities, should be reassessed to effect viable coordinating mechanisms between investment and infrastructure development plans.
- Amendments to the BOT Law should include processes to strengthen the scope of implementation and the applicability of Swiss challenges, which allow investors other than the original proponent to submit offers with potentially better terms.
- If investors assumed all the risks, there was no need for ICC approval.
- The government's contracting capabilities with the private sector should be strengthened. The government should identify policy levers it can push (apart from guarantee provision) so that it can negotiate better terms at the bargaining table.
- Institutional issues and political conflicts of interests should be addressed in order to encourage private sector participation in public infrastructure projects. This could be done by rationalizing the regulatory functions of government. Functions should not be confined to one agency/office only.
- Economic and political incentives that spur correct decisions to be made should be looked into.
- Despite the big number of projects that could be undertaken in the health sector, there was a paucity of investors in the said sector. The reluctance of investors, particularly of the local chief executives (LCEs), stemmed from their belief that they would have to subsidize their constituents' payments relating to private sector-operated health facilities (traditional patronage politics). Further, LCEs and the people involved in the projects were not well versed on the business management side of the projects.
- The capacities of the national and local officials involved in BOT projects, specifically their business management acumen, should be enhanced

- A balance should be struck between efficiency and equity (i.e., economic constituency against political constituency). Sometimes decisions were overruled due to political rather than economic considerations.
- Regulatory bodies should be strengthened, if they existed at all. For water services outside Metro Manila, for example, there was no independent regulator. Instead, a National Water Resource Board under the Office of the President was assigned to regulate the provision of water for drinking, irrigation etc. The possibility of creating a separate regulatory body should be looked into.
- BOT projects should be properly marketed and packaged so that the local chief executives would consider and accept them.
- There should be a provision on prescribed and uniform contractual agreements to protect the interest of the government and ultimately, the consumers. Contracts drafted by the operator/proponent tended to be in the said party's favor.
- The rights of an original proponent upon the nullification of a contract were not protected by the BOT Law. However, any Supreme Court ruling on the matter also became part of jurisprudence, and would thus also form part of the BOT Law; hence, it need not be included among the proposed amendments.
- Strict monitoring before and during the implementation of projects/contracts should be ensured. Occasionally, projects ran out of funds as early as the construction phase—this might have been avoided had the projects been properly monitored. Monitoring, which is the responsibility of the implementing agency, allows problems to be identified and addressed more readily.
- Greater detail and focus should be put into the Medium-Term Development Plan.
- More discussions and debate on the following issues were necessary:
 - solicited proposals versus unsolicited proposals
 - profitability versus social acceptability/social impact
 - efficiency or economic constituency versus equity or political constituency
 - financial viability versus affordability
 - incentive versus cost