

S-E-A-W-U-N CONFERENCE HANOI

Private Sector Participation

Options for Infrastructure Development & Public Service Delivery

The views expressed in this paper are the views of the authors and do not necessarily reflect the views or policies of the Asian Development Bank (ADB), or its Board of Directors, or the governments they represent. ADB does not guarantee the accuracy of the data included in this paper and accepts no responsibility for any consequences of their use. Terminology used may not necessarily be consistent with ADB official terms.

Hanoi June 2005

presented by: **Lutz Kleeberg**

Options for Infrastructure Development and Public Service Delivery

BACKGROUND

- **Private sector participation in the water and sanitation sector was initiated and introduced as a sector strategy by the Indonesian Government in 1992 and thereafter intensively sponsored by USAID (PURSE Project), The World Bank (TAP4I Project and ongoing DBL initiatives) and ADB (PSP Sumatra, West Java, and Botabek).**
- **Statements and recommendations hereinafter reflect the presenter's experience gained during his assignment in the ADB financed "PSP Botabek" project form 1999 to 2001.**

LESSONS LEARNT

- If PSP is perceived as an option of building infrastructure and public services it is required to build a broad information data base and a common perception on PSP essentials and requirements at all political levels
- PSP can be introduced to any public service sector at various levels of intervention
- However, depending on the degree of intervention, specialized expertise is required at both sides of the table
- Preparing a PSP contract is not a project – it is a process

NOTE

- **DESPITE** substantial demands and enthusiasm at both sides of the negotiation desk, many of the donor supported and capital intensive PSP projects in the Indonesian water sector did not materialize
- Most cited reasons are “conflicting interests” between the contract parties and the principle stakeholders – in other words: foreign investors could not meet the **PERCEPTIONS** of their local contract partners
- Allocation of project risks between the contract partners and an appropriate return on investment are critical

THE BASIC QUESTIONS

Whether or not the service provider is a state agency (public works company) or a stated owed enterprise (SOE) or a private company - governments must respond to the same basic questions:

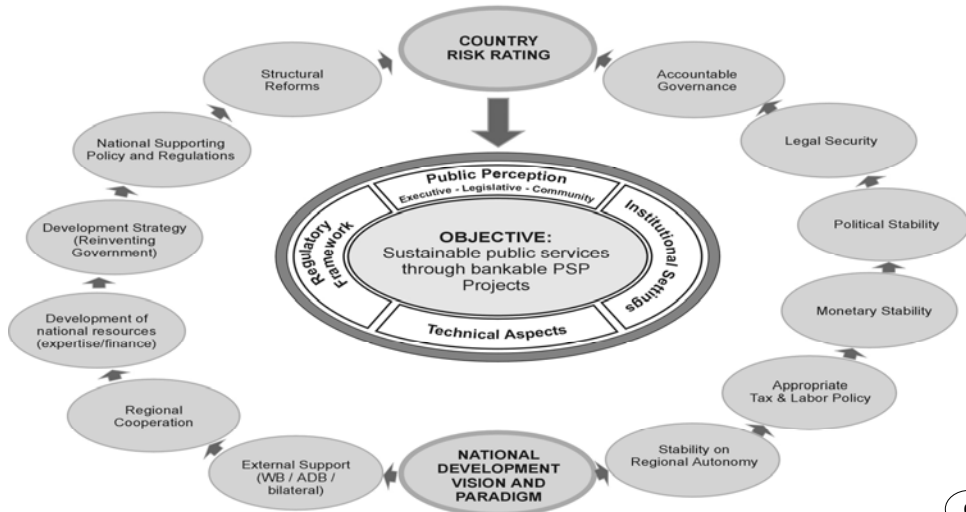
- Who is best prepared to deliver certain strategically important public services efficiently under given socio-economic and political conditions efficiently?
- What are the specific regulatory efforts or forms of public intervention needed to ensure adequate and sustainable services at an affordable price?

THE PROMISE & THE CHALLENGE

The promise of the private sector to establish demand oriented and sustainable public services comes with closely related challenges:

- Rules and regulations for effective PSP engagements
- Balanced and performance based PSP contracts
- Cost covering customer tariffs
- Getting the “Public” on your side
- National regulatory regime (supervisory services)

FUNDAMENTALS OF PSP



THE HEADINGS

“Sustainable public services through bankable PSP projects”

Implies that a PSP sponsored project is:

- Socially acceptable
- Environmentally sound
- Technically feasible
- Economically viable

... and that the Operator is delivering:

- Demand-driven quality services

... and that the Government is pursuing :

- Sustainable management of water resources
- Enhancing environmental compliance

BANKABILITY (1)

Debt service profile

Lenders will require an interest rate (fixed or floating) on debt lower than the forecasted return on equity

Debt to equity ratio

Debt/equity ratios in project finance tend to range from 90/10 to 60/40 depending on the risks the project is facing

Debt service coverage ratio

DSCR compares the cash flow of the project after operating expenses (i.e. the cash flow available to meet the debt service) against the amount of debt service (interest plus principal) payable over the same period. Lenders will typically require a DSCR ranging from 1.2 to 1.5 when there is no demand/market risk for the output of the project and a higher level where there is demand/market risk is present

BANKABILITY (2)

Loan life coverage ratio

The loan life coverage ratio (LLCR) measures the net present value of future cash flow available for debt service against the outstanding amount of debt. Lenders usually require a minimum LLCR in the range of the DSCR

Risk allocation/transfer

Risk is the probability of an event occurring and the consequences of its occurrence. A key success point for a project is a thorough identification and a fair allocation of risks between the various parties involved

WHAT CAN THE LOCAL GOVERNMENT DO?

- **Build public perception**
- **Build local management capacities**
- **Build conducive investment environment**
- **Establish institutional framework**
- **Establish regulator**

BUILD PUBLIC PERCEPTION

Comprehensive knowledge and a common perception about the needs of PSP based infrastructure development options helps reducing conflicting interests and increases to probability of successful PSP introduction

BUILD LOCAL MANAGEMENT CAPACITIES

Establish a specialized PSP Unit, engage experts, build profound PSP expertise. Admission of the private sector into, what is regarded as an exclusive public service domain, does not materialize without a drastic change of mindset.

BUILD A CONDUCTIVE INVESTMENT ENVIRONMENT

- Local regulation on PSP procurement procedures to involve the private sector in financing, construction and or operations and management of infrastructure, provision of public services
- Local regulation on establishment of an independent regulator to overview the implementation of the PSP contract
- Local regulation on service tariff, tariff adjustment mechanism and the right of private operators to collect service charges from the public

ESTABLISH INSTITUTIONAL FRAMEWORK

Unbundle sector functions into three independent levels of command:

- policy level, incl. administration & monitoring (local government)
- regulation and supervision (regulatory board)
- operational level (SOE and/or private party company)

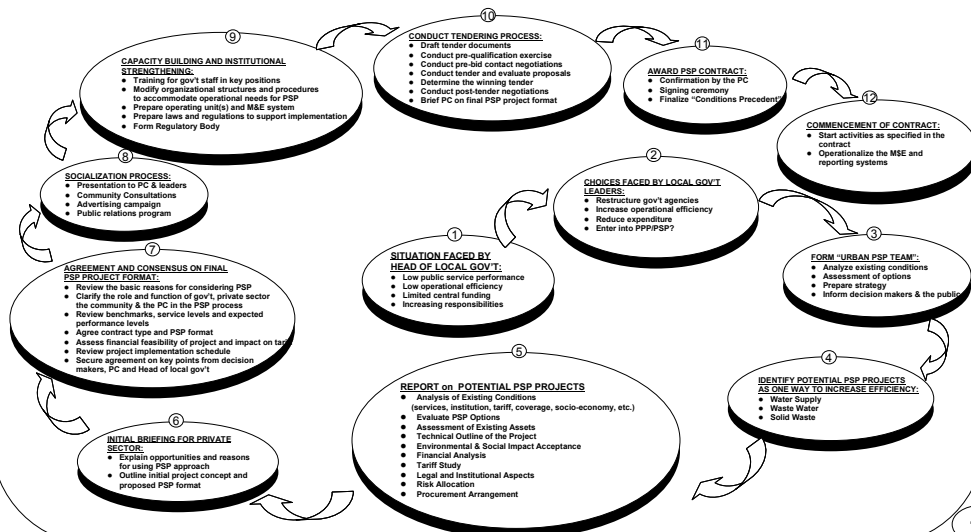
Establish accountable services through:

- (a) Binding business plan for any public operator
- (b) Contract based objective performance benchmarks
- (c) Transparent customer tariff regime
- (d) Replacement of informal incentive with formal awards

ESTABLISH REGULATOR

Establish independent regulator to overview the implementation of public services, incl. the PSP contract, being accountable for supervising the operator's performance and for resolving problems that may arise during contract implementation between the contract parties

THE PSP DEVELOPMENT CYCLE



WHAT CAN THE NAT. GOVERNMENT DO? (1)

At national level consistent policy should be in place to foster investor's confidence. Relevant issues include:

- Define national infrastructure development vision and paradigm
- Seek appropriate external donor support
- Foster alternative infrastructure financing schemes
- Initiate structural reforms, and
- Promulgate enhancing national laws and regulations

WHAT CAN THE NAT. GOVERNMENT DO? (2)

- Foreign investment law, protection for foreign direct investment
- Transparent and unambiguous tax system
- Bankruptcy law to protect the creditor's rights
- Public procurement law to stimulate competitive procurement
- Commercial arbitration law to enable prompt resolution of disputes
- BOT law, respectively a concession law to set-out conditions under which the government may grant a concession
- Intellectual property (IP) laws protecting IP rights, protecting patents, know how, licenses, etc

CONCLUSIONS

A perfect policy environment might not be necessary to begin the process of private sector involvement:

- **Few successfully concluded transactions help policies to evolve and reforms to deepen**
- **Basic political commitment can attract private sector participation if the rewards are structured properly to match the risks**
- **There is a wide spectrum of PSP options and arrangements, ranging from service and management contracts to BOT and concessions**

**Ladies and Gentlemen,
I thank you very much for your attention**