

Public–Private Partnerships

Strategic Development Plan 2011–2030

The Timor-Leste Strategic Development Plan calls for significant investment in infrastructure. To achieve this successfully, the government is considering a number of financing and implementation options. This includes the use of public–private partnerships (PPPs) to provide strategic infrastructure. The potential for PPPs to provide key social services is also being explored.

The government has made clear that to be adopted, a PPP will need to demonstrate an overall community benefit and be consistent with the government's plans and priorities.

What are PPPs?

PPPs are agreements between the public and private sectors for the provision of assets and/or services. PPPs can be used in most infrastructure and social sectors, including power, water, transportation, telecommunications, education, and health.

Unlike contracts issued under traditional procurement, PPPs often combine construction with operation of the assets for a set period of time. For example, a PPP for a port may combine construction of new wharves, storage areas, and facilities to load and unload freight with their operation for a number of years. PPPs also often require the private operator, rather than the government, to finance construction and operation.

Under a good PPP, the public sector first identifies what service it needs (for example, port services or operation and maintenance of a power station). It then organizes a competitive tender to procure the service. The private partner will receive payments from users, or from the government, or from a combination of both, in exchange for the services provided.

PPPs provide strong performance incentives for the private partner, as payments are made only in exchange for services provided. PPPs also provide strong incentives to maintain the assets, as these must be kept in operational order so the services can be provided reliably and to a high standard.

Good PPPs are based on five principles:

- certainty,
- fairness,
- transparency,
- accountability, and
- competition.

Why are they so attractive?

There are three main reasons why governments throughout the world are using PPPs:

- PPPs provide extra capacity and know-how from the private sector, helping to overcome capacity constraints within the government;
- by shifting the burden of capital spending to the private sector, PPPs can help governments provide more services with less up-front costs to the government; and
- PPPs contribute to enhanced efficiency in delivering services. A feature of a good PPP is that it shares project risks with the private sector provider, reducing the risk borne by governments.

The end result is that PPPs help the government provide better quality, more reliable, and lower-cost services. They can help governments to overcome service–supply bottle necks that can constrain development.

PPPs are attractive because they achieve collaboration of the public and private sectors. Through collaboration, the public and private sectors can do more than if they worked alone.

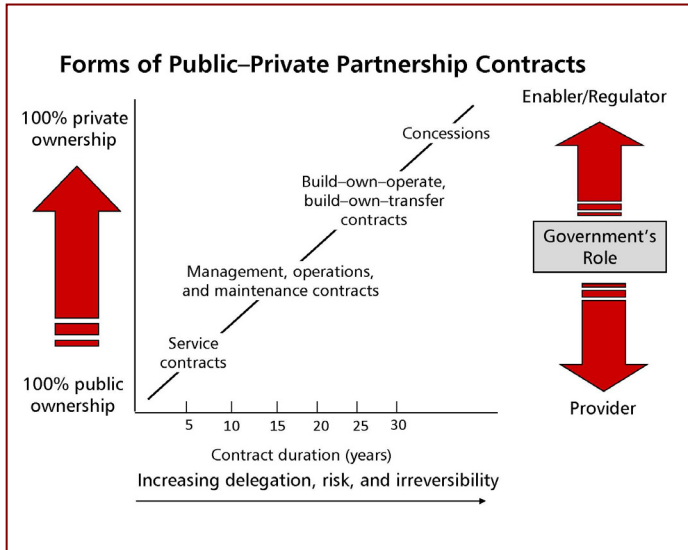
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ADB's support for PPPs in Timor-Leste is led by the ADB Private Sector Development Initiative, based in Sydney and cofinanced by the Australian Agency for International Development.

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What are the different forms of PPPs?

PPPs can take different forms depending on the nature of the service to be provided. PPP contracts fall into four broad categories:

- **Service contracts** are the simplest form of PPP. The private partner does not operate any public assets, but simply contracts with the public sector to provide a specified level of service. These contracts are typically 2–3 years in duration, and are common for such services as road maintenance.
- **Operation and maintenance contracts, and management contracts** typically involve the operation of public assets by a private partner. The private partner receives a management fee based on performance and, in some cases, a profit-sharing incentive. Contract periods are usually limited to 3–5 years. An example of this in Timor-Leste is the contract held by Manitoba Hydro to support management of the electricity system. Operation and maintenance contracts are also being considered for the Hera and Betano power plants.
- **Design/build-operate-transfer** involves significant investment by the private partner, which constructs and operates the infrastructure required to provide the service. The assets are returned to public ownership at the end of the partnership. Contract periods are often 20–30 years, allowing sufficient time for the private operator to earn a fair return on its investment. Many power plants, airports, and ports around the world have been built using this PPP structure. Some components of the future Tibar Bay port may be built using this contract structure.

- **Concessions** involve the rehabilitation and expansion of an existing asset and its operation over time under an exclusive license (i.e., a license is issued and it is not possible for new operators to enter the market). The Timor Telecom contract is an example of a concession. These are the most complex PPPs. They require careful structuring and monitoring if the public is to be protected and the PPP is to provide good value for money. Contract duration is typically 20–30 years.

When are these partnerships appropriate?

In principle, PPPs should be used whenever they offer greater efficiency than traditional public procurement. PPPs can even be suitable for small projects. In the health sector, for example, small output-based service contracts provide hospital laundry services in New Zealand, while full health services in 12 districts in Cambodia are contracted out to a nongovernment organization that provides both fee-based and free services. Both cases have resulted in net savings to the government over public service provision.

PPPs can generally be ruled out when direct government control is essential to the service (e.g., the operation of defense infrastructure and court systems).

PPPs are not, however, the answer to all infrastructure or public service shortcomings. Even in mature PPP markets, such as the United Kingdom, PPPs represent less than 20% of the total value of infrastructure investment.

What makes a PPP different from traditional procurement?

Successful PPPs require careful risk allocation and contract structuring. A PPP contract must have detailed specifications regarding outputs, payments, and the roles and responsibilities of each partner. It is not just a simple contract where a private supplier is paid upon delivery of an asset or service—the normal situation under traditional public procurement.

A PPP is a multiyear agreement in which both the private and public partners have obligations. For successful implementation, both the public and private sectors must have the capacity to honor their obligations.

Are PPPs more costly than traditional procurement?

Critics of PPPs argue that they are more costly than public procurement because the private sector has a higher cost of borrowing than the public sector. This does not mean that the public sector can provide infrastructure at a lower total cost than the private sector.

The international experience is that good PPPs are more likely to deliver assets and service on time and within budget than if they were delivered through traditional public procurement.

Why? Because under a good PPP, the private sector has strong incentives to deliver on time and within budget. Penalties may apply when this is not the case. Moreover, good PPP contracts include maintenance, which prolongs the life of the assets. Over time, maintenance costs can total as much as (if not more than) the initial construction cost. In traditional public procurement, infrastructure is built without a budget allocation for maintenance, so the assets quickly fall into disrepair. High replacement costs are then incurred. These are easier to avoid with PPPs.

Do they result in higher costs to users?

Properly structured PPPs generally result in lower costs of service delivery than public provision, and these savings can be passed on to users. When prices do increase, it is usually because service quality improves, service coverage increases, or government subsidies are discontinued.

In Latin America in the 1990s, for example, many water PPPs resulted in price increases for users. This was because under the public service providers, large volumes of water had been distributed for free. When private companies took over the distribution, they discontinued the free water allocations because the government refused to subsidize them. In such cases, the burden on poorer users can be avoided by including a subsidized service component in the partnership. Many PPPs now have a "lifeline service" or community service obligation component to protect poor users.

Where have they been successful?

Successful PPP transactions far outnumber failures. Some of the most successful PPP programs have been run in Australia, Chile, India, Republic of Korea, and the United Kingdom. Brazil and Portugal have also completed many successful PPP transactions. The following are examples:

- in Chile, the private sector now provides most of the new investments in power, gas, telecommunications, airports, major highways, rail freight services, and water and sanitation;
- in the Republic of Korea, 145 PPP transactions were completed between 1994 and 2007, with an annual average private investment of \$1.5 billion;
- in India, more than 450 PPP projects have been successfully negotiated, representing close to \$40 billion in investment;
- in the United Kingdom, one of the first countries to adopt PPPs, more than 700 PPP projects have been implemented in various sectors;

- in Brazil, which adopted a PPP law in 2004, more than 67% of power distribution and 20% of power generation assets are operated by the private sector under PPP arrangements; and
 - in Portugal, one of the first mainland European countries to adopt PPPs, the national motorway system was built using PPPs. In doing so, it has kept pace with the traffic demands of its country, vastly improved highway safety and travel times, and leveraged private investment.
- PPP's thus have a long, successful history.

Why do some fail?

Some PPPs do, nonetheless, fail. Most PPP failures arise from poor contract preparation, inadequate risk management, the absence of competitive and transparent tendering procedures, and/or poor contract monitoring and enforcement. These are a few examples:

- in the United Kingdom, the failure of the Metronet PPP for the operation of 9 of London's 12 Underground lines was largely due to poor contract structuring, where the costs of operations were not adequately forecast;
- in Sydney, Australia, the Cross City Tunnel PPP encountered similar difficulties;
- in Bulgaria, the direct allocation of toll-road concessions to private operators without competitive tender led to high costs put the government in a weak bargaining position; and
- in Indonesia, poor contract preparation led to several failed PPP tenders, as the proposed contracts were unattractive to the private sector.

In Timor-Leste, Manitoba Hydro has limited powers under the management contract to improve operational efficiency, so the government is not achieving as much value for money as it otherwise could. Similarly, the Timor Telecom concession could have been structured with more incentives to reduce user charges and expand services.

These shortcomings do not mean that PPPs should not be used. What they demonstrate is that care is required to ensure that effective PPPs are put in place and that poorly structured PPPs are avoided. To provide maximum benefits to the public, they must be carefully structured and competitively tendered.

Are PPPs suitable for Timor-Leste?

Timor-Leste has a large need for rehabilitated and upgraded infrastructure. New infrastructure must be built and operated, which will require significant capital and expertise. The government can support development by looking at ways in which the private sector's experience, innovations, and service efficiencies can be used to deliver needed infrastructure improvements.

Examples of possible PPPs in Timor-Leste include the following:

- **Dili Airport:** The expansion, modernization, and operation of the terminal could be done by a private partner. The airport would still remain under the authority and ownership of the government, but the private partner would upgrade the facilities and operate them for a set number of years. The private partner would receive a fee from the government for keeping the airport operating to a set standard. There are many examples around the world of successful airport upgrades completed using this model.
- **Tibar Bay Port:** The new port facilities could be built in collaboration with the private sector. For example, the public sector could prepare the site and the private sector could build and operate the wharves and superstructure required to handle freight.
- **Dili and district capital water systems:** The private sector could rehabilitate and operate urban water systems. The government would still own the water systems, but the private partner would operate them. Government payments to the private partner would be made against specified service delivery targets.
- **Government buildings:** The private sector could be engaged to design, build, and/or maintain a range of government buildings, such as schools, hospitals, government offices, and sports facilities. This would cover the facilities only, with government ministries responsible for the delivery of services.

Who are the private partners?

The private partner in a PPP arrangement is usually a consortium of companies: often one company provides financing, another constructs the asset, and a third operates it. In smaller PPPs that do not involve construction or finance, such as a service or management contract, the PPP partner can be a single operator.

Can Timorese companies participate in PPPs?

There are many opportunities for Timorese companies to participate in PPPs, either as partners in a consortium or as the sole private partner in a service or management/O&M contract. Some fear that PPP contracts will mean that Timorese companies will not be able to win because they do not have the necessary experience. This is incorrect.

For larger PPP contracts led by foreign companies, Timorese companies will make attractive partners, as they have the local presence and knowledge required to successfully implement a PPP project.

As in other countries embarking on such programs, the capacity of local firms to participate successfully in, and later lead, PPP consortiums is developed over time.

What can the government do to support successful partnerships?

- **Enact a PPP policy and legal framework,** signaling the government's willingness to engage with the private sector for the delivery of public services and creating a transparent and competitive process for preparing, tendering, and implementing PPP contracts. The Ministry of Finance has a draft policy and decree law ready for consideration by the government.
- **Develop the institutional framework for PPPs,** which includes guidelines for the transparent tendering, evaluation, and award of PPP contracts. The existing Major Projects Secretariat of the of the Conselho de Administracao do Infraestrutura (the Infrastructure Fund Council) could lead the identification, assessment, and preparation of possible PPP contracts, with support from experts as required.
- **Develop the government's risk management and contract monitoring and evaluation capabilities.** Risk management is essential to evaluate the magnitude of the risks assumed by the government under PPP arrangements. Contract monitoring and enforcement ensures that the government pays only for the level of service that the private partners have contracted to deliver.
- **Ensure that all PPPs are tendered on a transparent and equitable basis.** Competition is the only way for the government to make sure that it is not overpaying for the services it is procuring.

What is the project cycle?

The PPP cycle sets out the key stages of the partnership:

- identification, to assess if the project is suitable for a PPP;
- pre-feasibility/outline of business case;
- feasibility evaluation;
- identification and procurement of a private sector partner;
- construction and delivery of a facility;
- operation and maintenance of a facility and payments for services;
- contract management and performance monitoring;
- auditing and accountability; and
- exit and transfer to the government.