

## ABOUT THE AUTHOR

**TANYA SCOBIE**

Operations Officer, has been with the health and education team in IFC's Infrastructure Advisory Department for the last three years. Before that, she worked for Private Enterprise Partnership (PEP) Africa in Johannesburg, heading up the advisory work in education, and prior to that with the Health and Education Investment Department as an education specialist.

**APPROVING MANAGER**

Robert Taylor, Infrastructure Advisory Services.

# IFC SmartLessons

*real experiences, real development*

## Private Finance Initiatives: How to ensure delivery of high-quality public services—without the mandate to do so

*IFC's Infrastructure Advisory Services Department works with governments and the private sector to set up public-private partnership (PPP) agreements for the design, construction, delivery, and management of public services. But in many cases, governments resist turning over control of core services to private sector partners, particularly in the areas of education and health care. As a result, private finance initiatives (PFIs) have become the most common structure for PPPs in these sectors. PFIs limit private involvement to the delivery and management of the infrastructure, while keeping the delivery and management of core services in the public domain. This approach may minimize political risk for the government, but it limits the private sector's ability to bring its efficiencies and innovations to bear on a project.*

*This SmartLesson examines specific challenges that PFIs create, and presents some options for working within the parameters of a PFI to maximize project outcomes and development impact—bearing in mind that we are advisors, and governments are not obliged to follow our advice.*



In Egypt's 290 new schools, the government will maintain control over the design and delivery of education services.

### **Background: The Private and Public Mix in Social Services**

For centuries, partnerships have existed between the private and public sectors to deliver education and health care, often led by religious institutions. As governments became

larger and wealthier, they took control of activities deemed to be vital to national development, including delivery and financing of education and health care. Also, many governments and development professionals were skeptical of private sector involvement in key services, suspecting that the outcome would be the "fleecing" of government and a loss of equitable access to quality services as the focus moved from people to profits.

However, despite electoral promises, policy interventions, and millions of dollars (sovereign and donor), governments still face deficiencies in the quality and coverage of service. So they have begun to turn back to the private sector, encouraging participation by removing barriers to operation, creating enabling regulations, and entering into contractual arrangements with private sector providers. These arrangements, broadly known as public-private partnerships, are designed to take advantage of the relative strengths of each party by redistributing risks and responsibilities

to that party best suited to carry them. But many governments, fearful of losing control of core services, have been reluctant to enter fully into PPPs.

### **Enter: The Private Finance Initiative**

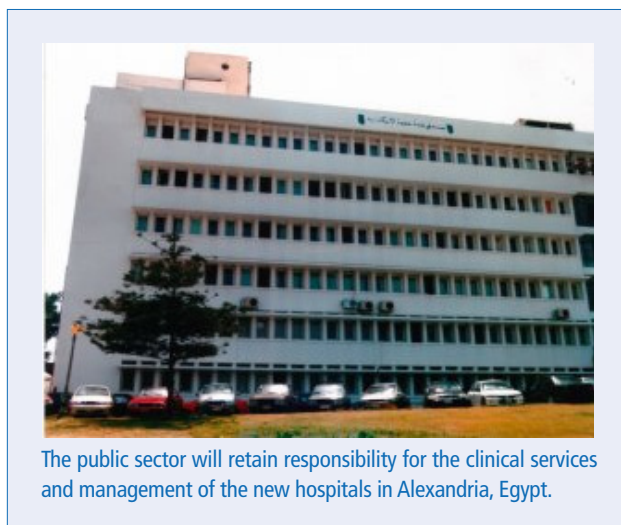
As a result, many governments retain control of the design and delivery of the core services (teaching, in the field of education, and delivery of medical care in the health sector), while outsourcing to the private sector the design and delivery of the hard assets. This PFI structure, developed in the United Kingdom in the early 1990s, has been widely adopted.

Advocates of PFIs claim that they are better for countries trying a public-private partnership for the first time, because they are contractually less complex and ideologically more palatable—less complex because fewer risks and rewards are pushed into the private sector and therefore do not need to be governed by the contract; more palatable because politically it's an easier sell to skeptics of the private sector and to unions with a vested interest in the status quo.

Those who prefer purer forms of PPP—where the private sector takes responsibility for part or all of the design and delivery of the services themselves—argue that PFIs do not come close to exploiting all of the potential benefits of private sector participation, particularly the efficiencies, innovation, and discipline that result from having to make money in order to survive.

As *realistic* purists, we at IFC respond to the requests of our clients and have therefore advised on various PFI transactions. For example, our first two education mandates are limited to PPP solutions that do not involve the design or delivery of core services: One is with the government of Egypt to design, build, finance, and maintain 290 primary and secondary schools; the other, in Botswana, is to design, build, finance, and maintain the country's second public university, the Botswana Institute of Science and Technology. We have also signed two hospital PFI mandates in the past year, in Mexico and Egypt, though in those cases we also expect to include some clinical-support services, such as labs and diagnostic imaging (less politically sensitive than core medical services) to increase private sector responsibility and efficiency.

In our PFI-type projects, we can rest knowing that the buildings will be fit for their purpose (as defined by the government), will be built on time and within budget, and will not crumble shortly after construction due to inadequate maintenance or shoddy materials and workmanship—all problems routinely encountered in traditionally procured projects. The private sector is contractually obliged to ensure these things, and if they don't, they pay the price—enough so that the government can recoup any damages, and the project (the students and patients) won't be affected. The government's planners also know what to expect regarding capital and operating budget requirements for the life of the project (typically about 15–25 years). Also, there are some (valid) claims that well-managed infrastructure leads to improved service delivery:



Among other things, in well-designed and well-maintained hospitals, cross-infection and reinfection rates are lower, and patients report higher satisfaction due to the pleasant environment. And in well-designed, -equipped, and -maintained schools, teachers can focus on teaching rather than getting the leaking roof repaired, and students can concentrate in classrooms that have adequate ventilation.

### **The Downside of PFIs**

This is all good. But what if the governments fail to do their part—designing and delivering the core service? These are public-private *partnerships*, and if one of the partners—the government—doesn't keep its end of the deal, the project fails: The buildings are underused or, at the extreme, stand empty; services are not delivered. Under a PFI agreement, the private sector is held in close check, to ensure that it delivers what is required under the partnership. The government...not so much. The private provider has little control over the performance of its partner, and the impact of the project on education and health outcomes depends to a great extent exactly on the actions of the public sector.

### **The Challenge: Getting Governments to Deliver on Their Part of the Partnership**

As advisors to the government on the structuring of PFI projects, how can we help ensure that our clients perform on activities outside the formal scope of our services?

Before we can answer this question, we need to understand why governments fail to deliver. Presumably, they don't set out to mess up, so *what is it that can get in the way of designing and delivering high-quality education and health care services under a PFI?*

**1. The government's project-management team lacks capacity and authority:** This is the biggie, since it has all sorts of repercussions. The two main culprits are:

- *Poor technical and strategic capacity: The team is typically staffed with civil servants (from the line ministry and other relevant government agencies) with varying*

degrees of experience in traditional public sector projects and, depending on the country, little or no practical experience in PPP projects. This lack of experience or capacity directly impacts the quality and timeliness of critical strategic decisions for the project (what, for whom, and when) and the huge amount of work needed to ensure that, once construction is complete, the facility is well-staffed, the curriculum or medical services meet the needs of the community, and, ultimately, that students and patients use the services.

- *Insufficient authority: If the team is unable to make most decisions (of course, major decisions are made at the cabinet level in all projects) without going through various other committees, even good work at the team level can be overturned or dragged out due to bureaucracy.*

**2. The project is a feather in the president's cap:** Most projects are at least somewhat politically motivated, but when political motivations affect critical decisions that determine the project's success, there are problems. For example:

- *Poor strategic decisions — such as a leader's predetermining the project location for political reasons, rather than in the best interest of the facility, or making the facility big, just because bigger must always be better than smaller.*
- *Unnecessary pressure on the project timeline — such as forcing groundbreaking or construction completion to occur within a presidential term.*

**3. The project is driven by special public sector interests:** In health care, for example, the medical professionals sometimes view new facilities and equipment as essential to fulfilling their vision of health care delivery, but they do not fully consider the fiscal or market consequences. As a result, new PFI hospitals can be designed, built, and equipped, and then end up being underused or expensive to operate—less likely under a full PPP.

## Lessons Learned

The following lessons involve possible changes in our PFI mandates—approaches to help address the issues noted above and to help ensure that successful projects result from PFI transactions.

### **1) In IFC's mandate with the government, require consultation at key decision points by the government's project-governing authority.**

This ensures that IFC be heard regarding major decisions that affect the path of the project—such as hiring of key staff, hiring of other strategic advisors, final decisions on location, growth profiles, project size, delivery mix, and so on. Although the government wouldn't be obligated to follow IFC's recommendations, the requirement would at least ensure that we are aware of key decisions before they're made, rather than after the fact.

### **2) Require pre-mandate and during-mandate reviews and remedial measures in the project management and governance.**

This ensures a certain level of competence in the government's project team. A related measure is to incorporate into our advisory mandates more points of formal, whole-project review during transaction design, giving IFC the right to exit the project if, in our judgment, the government's performance (or nonperformance) is threatening the success of the project.

### **3) Fully inform potential investors, prior to tender, of the government's intentions and work-to-date for the project regarding service delivery.**

Although the investors in a PFI project will not themselves deliver the core services, they realize that an underused facility could have serious political ramifications for future PFI or PPP projects and, hence, their own business. So, rather than a cursory summary of the strategic direction of the project at an investors' conference, investors should demand and the government should provide significantly more detail on the strategy, design, and plan for the delivery of services for the project.

For instance, investors should have the opportunity to meet members of the project management team and key individuals hired to manage the project institution—to get a sense of their qualifications for the task ahead. This makes the government ex ante accountable to the private providers, who have the option to walk away if they don't like what they hear — ideally, a strong incentive for governments to be better prepared.

### **4) Convince the government to incorporate noninfrastructure elements into a standard PFI agreement—making it a PFI Plus—by pushing select bits out to the private sector in small steps.**



For the two new hospitals in Mexico, the private operator's responsibilities will include clinical support services.

High-reward areas might include management contracts for parts of the project, such as administration (for example, all nonacademic activities of the university could be under professional management) or staff (maintained as public employees but under professional management via external contract). This can bring private sector efficiencies to at least some areas of the project operation, but still allow government to retain control of its holy grail, the delivery of the actual service.

### 5) Use stronger language to describe the government's obligations.

PFI agreements contractually bind the government (or the government's representative) to: 1) pay, and pay on time; 2) help the private provider by providing "reasonable assistance" in carrying out the project; and 3) ensure that there is no legal impediment to carrying out the project. Otherwise, contracts focus on the obligations of the private provider. If providers demanded it, perhaps governments would accept stronger language regarding their obligations. An expert panel might independently assess performance on a half-yearly basis and levy penalties if government obligations are not met.

### 6) Offer additional support in various areas to improve operations during implementation.

Such assistance could include management training for hospital administrators, development of a performance measurement system, and so on. Following are some examples of PFIs that have included that sort of extra help:

- *IFC is advising the government of Egypt and Alexandria University on a PFI for the design, financing, construction, equipping, and facility management of a new maternity hospital, blood bank, and teaching hospital with centers of excellence for neurosurgery and nephrology/urology. Although well above and beyond our formal mandate, IFC's technical consultants worked with the client to determine the demand for the maternity hospital, and ensure the correct size and service mix.*
- *IFC is advising on PFIs for two new secondary hospitals in the State of Mexico for the state health insurer. The private operator will be responsible for construction, financing, equipping, facility management, and clinical support services (radiology, labs, dialysis). IFC arranged for the client to visit a completed PFI hospital in another*

*state in Mexico to see the results—a too-large facility operating at less than 10 percent capacity. As a result of the visit, we both agreed to downsize the client's new hospitals and build in a phased approach for expansion—to avoid the risk of oversizing.*

- *For the two hospitals in Mexico mentioned above, IFC consultants also made recommendations to improve hospital management.*
- *For the primary and secondary schools in Egypt mentioned above, IFC worked with the Schools Planning Authority to review the demand analysis and determine the number of schools and their locations, based on proximity and attractiveness to students, safety (for example, not under power lines), and access to site infrastructure such as water, power, and sewage. In this case, IFC checked to verify the need, even though this was not part of our mandate or requested by the client—it was to satisfy ourselves that it would have the intended developmental impact.*
- *IFC's consultants brought significant expertise to the Botswana PFI mentioned above. Our consultants worked closely with the government's academic consultants to 1) ensure that the concept master plan, developed by IFC's team, fits the requirements of the academic program, and 2) contribute to the development of the academic strategy.*

### Next Steps?

As we advise on more PFI transactions, we might structure our mandates to incorporate the sorts of things mentioned above—possibly leading to a new generation of PFIs that not only get the best out of the private providers, but also improve the performance of their government partners and bring about better results for the projects.



#### DISCLAIMER

IFC SmartLessons is an awards program to share lessons learned in development-oriented advisory services and investment operations. The findings, interpretations, and conclusions expressed in this paper are those of the author(s) and do not necessarily reflect the views of IFC or its partner organizations, the Executive Directors of The World Bank or the governments they represent. IFC does not assume any responsibility for the completeness or accuracy of the information contained in this document. Please see the terms and conditions at [www.ifc.org/smartlessons](http://www.ifc.org/smartlessons) or contact the program at [smartlessons@ifc.org](mailto:smartlessons@ifc.org).