



UNDERSTANDING THE CONTEXT OF PPPS IN VIETNAM

Infrastructure is one of the most important development-related interventions that can be made in a society. It is not only a vital input that can be provided by the public sector to support economic growth, but it is also a key tool in accelerating and increasing standards of living for the general population.

Vietnam has been experiencing a high pace of economic development, which demands ever-increasing investment in infrastructure. As with most developing countries, however, the country's public resources are currently limited. In order to sustain current growth levels and achieve sustainable growth standards, Vietnam will need to double investment to \$20 billion annually between 2017-2022. Given current public budget constraints, it is estimated that over 50 percent of the funding required will need to come from the private sector. Public-private partnerships (PPPs) are one mechanism for increasing the involvement of the private sector in infrastructure development. In order to boost PPPs in Vietnam, the government is currently in the process of drafting a new draft law on PPPs.

While the draft law has the potential to significantly reduce barriers to PPPs and boost private investment, the consultation process has revealed a broad divergence of viewpoints about what exactly is a PPP, how it is defined, and thus how it should be addressed within a broader national legal framework. This short policy brief is thus designed to address some of these key questions.

WHAT'S EXACTLY IS A PUBLIC PRIVATE PARTNERSHIP?

Unlike public procurement, in PPP projects the government engages private partners who establish "special purpose vehicles" to design, build, operate and maintain an asset or facility to deliver the outputs or services specified in the contract. This output or service is then compensated in the form of direct user charges and/or availability payments from the government, conditional on meeting specific key performance indicators (KPIs).

Functionally, PPPs are agreements between a government and private partner(s) to **deliver** an agreed upon quantity and quality of **service** in exchange for a **unitary charge** paid by the government or a **user charge** (a toll) levied on the direct recipients of the service. PPP agreements often take the **whole-life approach**, according to which the private partner is usually responsible for both the construction and operating phases. It follows that there must be some degree of **risk-sharing** between the public and private sector, which is determined on the basis of which party is best able to manage each risk.

One should keep in mind that public procurement, privatization, and PPPs are three distinct forms of developing infrastructure, all of them require a certain role of government, as well as the involvement of the private sector. The boundary between them is somewhat blurry, but **the three defining features of PPPs are a focus on service delivery, a life-cycle approach to the assets, and risk-sharing.**

FOCUSING ON SERVICE DELIVERY

In our discussions with our Vietnamese partners across government, we observed a strong focus on building infrastructure assets rather than on delivering services, reflecting a traditional public procurement mindset. This mindset may result in suboptimal provisions being included in the draft PPP law.

Yet international best practices reinforce the success of this service-driven focus on PPPs over an asset-driven focus. In the case of the Amman airport in Jordan, for example, the PPP agreement didn't specify

how many square meters the airport should be or how many passengers it should accommodate. Instead, the agreement stipulates specifications to make sure that the services required from the airport can be delivered smoothly. For instance, the contract specifies

- The minimum space a passenger should have in the check-in area during the peak hours;
- The maximum queuing time for passport control and customs;
- The maximum time for baggage delivery upon disembarking;

When the contract is designed this way, the government doesn't need to know how many people are going to use the airport or how space can be used effectively. These decisions should be left for the operator who understands these issues much better and is, therefore, in a much better position to handle associated operation risks. This is a very different way to think about infrastructure than has been traditionally thought about in Vietnam and changing the mindset about PPP is a critical prerequisite for any effective PPP Law.

A LIFE-CYCLE APPROACH TO THE ASSETS

PPP involves a long-term contract between a private partner and a government entity, typically over 20 to 30 years. The long-term PPP contract, along with the bundling of infrastructure and services, incentivizes the private sector to integrate service delivery and maintenance considerations during the design and construction phases of the project. This incentivizes the private sector to achieve whole-of-life savings from the contract.

The private partner is not paid during construction of infrastructure but is compensated for the capital expenditure investment to build the assets over the operational period. The compensation is made by either user charges or the government's payment (availability payment made against the performance of the private partner and is subject to penalty for poor performance). The private partner must take maintenance risks to meet the performance indicators specified in the PPP contract. Therefore, the private partner is incentivized to design and construct the infrastructure in a manner that minimizes the maintenance costs, leading to long term savings in the overall life-cycle cost.

To achieve life-cycle cost savings, the government should avoid form of PPPs that the private partner is not responsible for both operation and maintenance, or that the private partner is not incentivized to save the overall life-cycle cost. Build – Transfer (BT) form is an example that the private partner is not responsible for operation and maintenance, therefore, there may be no incentive for the private partner to reduce the costs of construction to increase margin.

UNDERSTANDING THAT RISK-SHARING IS NOT BLAME-SHARING OR PROFIT-SHARING

It is also important to emphasize that risk-sharing is not blame-sharing or profit-sharing. The essence of risk-sharing is the combination of “sticks and carrots” to create incentives through a contract mechanism to produce the right outcome and prevent bad things from happening. The objective of risk-sharing or risk transfer is to achieve efficiency and optimal cost. Risk should be transferred to the party that can manage the risk more efficiently (mitigating the probability and/or consequences of the risk of transferring them to a third party at an efficient cost). If the public sector transfers to the private partner the risk that the private partner is not the best party to manage, the private partner will require a higher risk premium than the likely cost to the Government. Therefore, the project's cost will be increased.

Melbourne City Link is a very instructive case to illustrate this point. This project requires a very sophisticated engineering for a network of roads and tunnels built on time and budget and operated as the world's first 100 percent electronic toll road in Melbourne, Australia. The Government of Victoria has optimized the efficiency through passing the risks relating to cost overruns and construction delay to the private sector. This is a fixed-price contract with steep penalty and reward: if the project is delayed, then the private investors have to pay \$500,000 fine per day, but if the project is finished early, then they can collect 60 percent of the total toll. With this risk structure, the private partner has strong incentives to be innovative and efficient to mitigate the risks. There are a number of analyses and reports showing that the traditionally procured projects had higher median cost and time overrun than PPP projects.¹

In conclusion, the world has actually experimented with a variety of mechanisms for providing infrastructure. There are some periods and some countries in which all infrastructures are provided using the public sector. There are some places where private provision of infrastructure is desirable. The private sector is very good at ensuring productive efficiency (measured by output/input ratio), whereas the public sector is good at creating allocative efficiency (ensuring competition among the investors and access, affordability, and safety for the users). The essential goal of PPP – which is the marriage between the public and private sectors – is to drive both of these efficiencies. In this sense, private is not the new public.

The job of the public sector is even more critical in the age of private sector participation in infrastructure. The notion that the government will outsource infrastructure to private sector and take a hand-off approach is actually not the right one. The nature of delivering infrastructure services using PPP is a very different kind of activity from what the government has been doing. It's very important to understand that the expectation with respect to responsibilities and challenges are now very different for the government. This implies that the organization, management, and governance of PPP should also be different from the traditional public procurement.

PPPS IS NOT AN OPTION FOR ALL INFRASTRUCTURE PROJECTS

PPPs is a procurement option that brings many profits to the public sector. It does not only help to provide an additional source of finance for development, PPPs also attract private sector's expertise and innovation to deliver higher long-term efficiency and effectiveness. However, PPPs cannot be viewed as a magic option that would work for all infrastructure projects. PPPs may also have some weaknesses and pitfalls that make it inappropriate for some projects.

To maximize the benefits of PPPs, the Government should select sensible and suitable projects for PPPs before deciding to apply PPP option. Lack of government funding should not be the main reason for deciding a PPP option for the implementation of a project. The PPP projects are usually more costly than conventional public projects due to higher cost of capital and transaction costs. A project can be considered for being implemented as a PPP only when efficiency gains from improved project delivery, operation and management, and access to advanced technology can offset the additional costs. The draft Law should require a value for money (VfM) analysis to confirm the suitability for PPP before selecting PPP as a procurement option.

¹ The Australia's National PPP Forum commissioned the University of Melbourne in 2008 to compare 25 Australia PPP projects with 42 traditionally procured projects. The study found that traditionally procured projects had a median cost overrun of 10.1 percent, whereas PPP projects had a median cost overrun of 0.7 percent. The median time overrun was 10.9 percent and 5.6 percent respectively.

An appropriate project preparation and structure will help to confirm the VfM that PPP can bring. It should be done by a professional team with adequate expertise and skills. The Government should establish a dedicated entity equipped with right resources to screen, select, prepare, and structure PPP projects in the way allowing the Government of Vietnam achieve the optimal benefits of PPP.

CONCLUSION

The private sector is very good at ensuring productive efficiency (i.e. producing outputs), whereas the public sector is good at creating allocative efficiency (i.e. ensuring competition among investors; ensuring access, affordability, and safety for users). The essential goal of PPPs is to drive both of these efficiencies. In this sense, the private sector is therefore not a replacement for the public sector. The nature of building infrastructure using PPPs is a very different kind of activity from traditional public procurement. This ultimately implies that the organization, management, and governance of PPPs should also be different from the traditional public procurement.