

Public Private Partnership (PPP) in Five ASEAN Countries

- Overview -

1. Objective

The objective of this project is to examine the Public Private Partnership (PPP) regulatory framework and other related issues in five ASEAN countries: **Indonesia, Malaysia, Philippines, Thailand** and **Vietnam**. We focus on these five countries since each has promising market/demand for infrastructure development through private party participation, while the national PPP regulatory or institutional development is still in a stage of transition. As an output, recognizing differences in the maturity levels of the PPP frameworks of the selected countries, we design a '**Comparative Table**' which compiles key elements of the five nations' regulatory/institutional status in the same table, and a '**Country Profile**' which details the latest PPP development of each individual country. The subsequent descriptions provide a brief introduction to PPP, in conjunction with highlighted topics of the ASEAN countries, as guidance before going into the Table and Profiles. We hope that the outputs of our research, together with this overview, will add some information on 'PPP in ASEAN' for both policy makers and practitioners who mutually play a vital role in PPP development in the region.

2. What is PPP?

The concept of PPP is not a new one. It is recognized that 'concession schemes' can be traced back to a river project in Medieval Europe. A milestone in today's era was the 'privatization' initiative under the Thatcher Government in Britain, proposed amid the early 1980s recession. The program sought minimal government involvement, coupled with higher efficiency in the provision of public services, through selling state-controlled holdings to private parties. Likewise, a key driver of promoting PPPs comes from expectations of higher quality/quantity of public services and/or lower investment costs through the introduction of private sector business skills, innovation, or financial resources.

It should be emphasized, however, that PPP differs from mere privatization, which essentially transfers the responsibility for service provision to the private sector. Neither is PPP a simple outsourcing, in which private parties are employed temporarily for a limited task in a project. In the PPPs, governments retain the ultimate accountability for service delivery and private parties simultaneously take a significant project risk over a middle or long period of time. In view of the concept and its features, PPP can generally be defined as, 'cooperative arrangements between public and private parties for utilization of private resources in the provision of social services which have previously been subject to traditional public procurement'. The arrangements encompass contracts in many sectors and for many services, and usually entail long-term undertakings (more than 20 years) for large scale infrastructure projects.

3. PPP Development in ASEAN Countries

The use of the terminology associated with PPP in the ASEAN region is not a recent event. Among the five selected countries, emulating the British initiative, the **Malaysian** Government announced its intention to revitalize its economy in 1983 under the name of privatization. Since then, the country has developed a PPP model through the issue of 'Privatization Guidelines (1985)', the 'Privatization Masterplan (1991)', and 'PPP Guidelines (2009)'. The **Philippines** Congress enacted a 'Build-Operate-Transfer (BOT) law' in 1990, which was the first law concerning PPPs in Asia (Malaysia had designed its policy outside the national legal framework). The subsequent amendment of the BOT law in 1994 and establishment of Implementing Rules and Regulations (IRR) have amplified the notion of PPP.

The other countries also prepared prototype regulations in the early 1990s for governing and mobilizing private involvement in specific forms of project: **Thailand** legislated its 'PPSU Act' in 1992 to set general requirements and procedures for several types of projects (e.g., Build-Operate-Transfer (BOT), Build-Transfer-Operate (BTO) schemes); **Indonesia** issued a Presidential Decree in 1992 to permit private participation for IPP (Independent Power Producer) projects; The **Vietnamese** government promulgated a decree in 1993 to establish a regulatory framework of BOT contracts. In recent years, these three countries in particular have been active in formulating or elaborating core/surrounding regulations, as is illustrated by: '**State Undertaking Act B.E. 2556 (2013)**' in Thailand; '**Presidential Regulation No. 67 (2005)**' and its amendments (in 2010, 2011, and 2013) in Indonesia; and a new decree which will unify '**Decree 108 (2009)**' on BOT and '**Decision 71 (2010)**' on PPP in Vietnam (See the 'Country Profile' of each country for further information).

From a comparative perspective, the ways in which the ASEAN countries define their PPPs vary from country to country. For instance, the Malaysian government uses a somewhat general definition of PPPs in its Guidelines whereas PPPs have been designated within regulations in the other countries. Vietnam has legislated the PPPs separately from the BOT law (the government currently intends to unite the two frameworks); conversely, the Philippines have developed the notion of PPPs replacing the term of BOT with PPPs. The regulatory framework of PPPs in Thailand has a lineage from initial attempts at corruption prevention while PPPs in other countries were derived from privatization movements. Despite these variations, it can be said that the fundamental notion of PPPs is shared and the basic form of PPPs has converged among the nations in recent years.

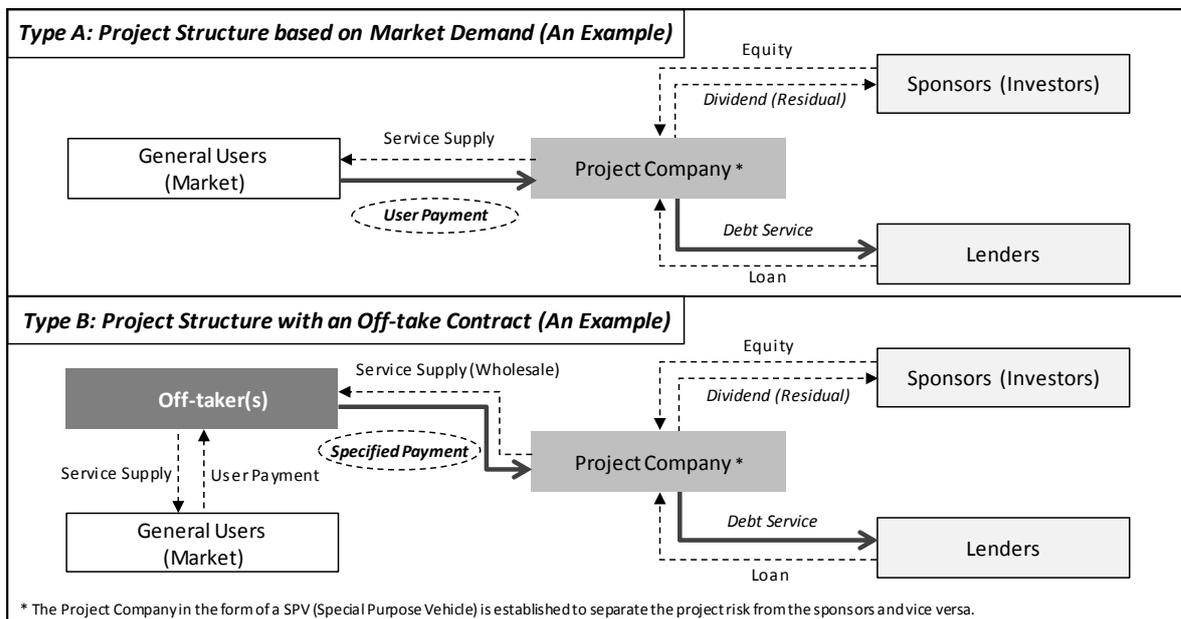
4. Key Project Risks to be Considered for PPPs in ASEAN

In principal, PPP arrangements can be a 'win-win' coalition only if they are carried out through an optimal risk/reward-sharing among all parties involved: **Public Sector Counterparty, Sponsors, (Sub-)Contractors for EPC (Engineering, Procurement and Construction), Project Financing Lenders** such as **Commercial Banks, ECAs (Export Credit Agencies), or MLAs (Multilateral Agencies)**. A rule of thumb for arriving at the best available structure is to apportion the risks to the stakeholders best able to handle them. In order to do so, one must first minutely identify the nature of inherent project risks. We introduce below the four major risk factors, all of which are indispensable for structuring a 'bankable' PPP project, i.e. one which external lenders are willing to finance, in the ASEAN region.

A. Revenue Risk

Revenue risk is arguably the most fundamental risk in PPP projects. The risk is the product of ‘price risk’ and ‘demand risk’, both of which affect each other. In social infrastructure projects such as toll roads, seaports, power, or water projects, the prices of services are often determined based on a pre-agreed tariff formula, due to the public nature of the services. Thus, the price fluctuation risk is not significantly high in a general sense.¹

The level of the second component, demand risk, in turn varies widely according to project characteristics. For instance, a greenfield logistic or transportation project has a high level of uncertainty in realized demand from general users. This is often the case, because it is difficult to reasonably forecast future demand in the absence of reliable information or historical data at the planning stage. The situation tends to induce severe revenue shortfall due to overestimation of demand. On the other hand, energy/resource related projects often involve an agreement by an ‘off-taker’ (usually, state-owned utility companies in the case of the ASEAN countries) who commits to purchase product for a certain price/amount during a specified period.² Consequently, the demand fluctuation risk associated with the projects is essentially passed through to the off-taker, and, therefore, the long-term revenue stream from the operation is relatively secure (See the diagram below for simplified project structures with/without the off-taker(s)).



From the point of view of bankability, there is an underlying difference between projects with and without the off-take arrangement; i.e., whether lenders need to bear demand risk or not. In a project based purely on market demand (**Type A** in the diagram), debt service payments are

¹ Having said that, there still exist exceptional cases where price level is slashed by a government in the face of unexpectedly low demand or political opposition against pricing.

² The basic form of the off-take contracts in energy projects involves a ‘take-or-pay’ clause where, in essence, the off-takers have an obligation to pay for a specified amount regardless of actual service delivery, as long as the supply capacity is maintained.

made based on the cash flows from the tariff collected directly from general users.³ This indicates that the lenders as well as the project company take on a burden of revenue risk, and thus the project's credibility necessarily reflects the lenders' (somewhat conservative) view of the market. Practically speaking, commercial lenders, who are often risk averse, are reluctant to accept 100 % of the market risk, and hence, some sort of security mechanism (e.g., minimum or fixed revenue guarantees by the government) is required in order to obtain loans from the market-based lenders.

On the other hand, a project with an off-take contract (**Type B**) transfers the revenue risk essentially to the off-taker(s). The lenders focus here will be on whether the tariff payments are certain to be made by the off-taker(s); in other words, the project's creditworthiness strongly correlates with the liabilities of the off-taker(s). The presence of an off-taker makes it easier for commercial lenders to assess the credit risk by isolating it from the demand risk, unlike the former type of project. That is one of the important reasons why the revenue risk mitigation system via the off-take contract has encouraged the entry of international lenders/sponsors into ASEAN PPP markets, particularly through the **IPP (Independent Power Producer)** form of power plant projects. It should nevertheless be noted that when the credibility of a public sector off-taker is not sufficiently high, the entity needs to be further backed up by the central government.⁴ Equally importantly, when a project sponsor (equity holder) concurrently assumes the off-taker role, the sponsor's liability becomes even more critical to the credit assessment of the project.

B. Currency Mismatch Risk

The mismatch risk is brought about by differences in currencies or their compositions between project revenue and loan repayment. Typically, it emerges when a project receives revenue in local currency (as in toll road projects) whereas the majority of outstanding loan funding is denominated in US dollars. In theory, the risk should be eliminated through a natural hedge (e.g., long term financing in the local currency). Otherwise the currency risk could be curtailed using derivatives, such as currency swaps or futures/forward. In economies with underdeveloped financial markets, however, these necessary measures might not be attainable in the first place.⁵ Moreover, it is worthwhile noting that even if the currency mismatch does not seem to exist *per se*, depreciations of local currency could lead to the financial distress of off-takers who commit to pay in hard currency denominated base as happened to the IPP projects amid the Asian Financial Crisis of 1997-98.

C. Political Risk

The term 'political risk' implies a broad range of insecurities stemming directly or indirectly from a host country. These include, but are not limited to: a foreign currency exchange risk; a political violence risk (e.g., war, terrorism); an expropriation and nationalization risk; or a breach of

³ It is worth noting that for the projects with direct delivery to the retail market, there also exist risks in service charge collection (non-revenue water as a typical example).

⁴ In fact, state-owned electricity corporations in developing countries operate at a loss and depend heavily on government subsidiaries, primarily because they are required from the government to sell public services at lower prices.

⁵ Note: Malaysia is an exceptional country with developed Islamic Capital Market where financing for infrastructure is provided through Islamic Bond (*Sukuk*) or other Islamic financial products.

contract risk. Needless to say, the emergence of the risk is probable in countries with weak political, economic, social security, or those with a high frequency of regime change and resultant inconsistency in national policy. As a rule of thumb, a PPP contract usually defines that the impact from the risks triggered by host government action should be borne or corrected by the government. When a host country is expected to have a high probability of the political risk emergence, the risk needs to be further insured by guarantees from Export Credit Agencies (ECAs) or Multilateral Agencies (MLAs), or the establishment of off-shore escrow accounts as a protection against currency inconvertibility.

D. Land Acquisition Risk

Land procurement is a notorious obstacle for extensive infrastructure projects, such as transportation or plant projects. The difficulty becomes aggravated by vague and restrictive land tenure systems. Indeed, delays in dispute settlements, strong opposition from citizens, or significant increase of land prices in the course of the acquisition process are commonly observed in PPP projects in ASEAN countries. For mobilizing extensive PPP projects, it is generally necessary for governments to intervene in the cumbersome land issue comprehensively, by taking into account socio-economic and localities issues (e.g., minority ethnic groups or environmental protection movements). In this regard, a series of enactments by the Government of Indonesia over the last few years has prominent features. The government established several forms of 'Land Fund' which could compensate land procurement costs especially for toll road projects. Additionally, the administration has set legal timeframes for the whole acquisition process, and has assigned coordinating roles in land issues to a national agency (See the 'Country Profile' of Indonesia for further information).

In the context of the ASEAN countries, there are other important factors that should be taken into account in structuring bankable PPP projects. For example, ASEAN countries have often suffered from natural disasters (e.g., the 2011 floods in Thailand, or the 2013 typhoon in the Philippines). The **natural force majeure risk** could affect physical and intangible aspects of projects. It is also important to note that the any kinds of risk are a nexus of various factors. In this way, it is essential for private parties to identify country or project specific risks and scrutinize risk scenarios prior to project participation. In the developing countries, with incomplete public data on these risks, bringing them into the project plan implies higher costs. If the governments improve their data bases on such risks, therefore, this would increase their countries' attractiveness.

5. Government Supports for Leveraging PPPs

Governments, of financially-constrained developing countries in particular, tend to perceive the PPP as a tool to save public resources by enabling them to automatically attract private capital and proven technology; this, however, might not be always the case. Indeed, as we have discussed, PPPs are all about risk-sharing. The private party involvements can be achieved only when the governments' side takes effective and sufficient measures to mitigate risks belonging to business-oriented entities.

To assist in the financial aspects of strategically important PPP projects, some of the study countries have prepared (or plan to prepare) **Project Development Funds (PDFs)**, **Financing/Guarantee Facilities**, or tax incentives provided under certain criteria. For example, as an institution for PDF, Indonesia established **PT SMI** under its Ministry of Finance; The Philippine government, together with foreign donors, launched a **Project Development and Monitoring Facility (PDMF)** for pre-investment activities; Thailand and Vietnam are also preparing to create a PDF. With regard to financing or guarantee facilities, the five countries have (are planning to) set up some sort of program in the form of **Viability Gap Funds (VGFs)** or special purpose **Funds for land acquisition**. More detailed information on the forms of government support in each country can be found in our Country Profiles.

Another policy crucial for leveraging PPPs is the establishment of a central organization for PPP policy/project coordination or implementation. This also functions as a 'one-stop shop for PPP' which disseminates information on the national PPP projects or policies to business entities. Examples of this kind of central organization are the '**Public Private Partnership (PPP) Center**' attached to the National Economic and Development Authority (NEDA) in the Philippines, and the '**Public Private Partnership Unit (3PU)**' or '**Unit Kerjasama Awan Swasta (UKAS)**' under the Prime Minister's Department in Malaysia. In Thailand, the new PPP law appointed **SEPO (the State Enterprise Policy Office)** under a new PPP Committee as a central unit to provide recommendations on projects or information about PPP schemes. **Ministry of Planning and Investment (MPI)** in Vietnam and **National Development Planning Agency (BAPPENAS)** in Indonesia plays as an advisor for investors preparing PPP project/ project list. A pilot project of establishing a '**PPP Centre**' in the Indonesian Ministry of Finance will be a touchstone of the movements. Strengthening of functions/ capacity of these central intuitions will further contribute to attracting foreign business investments and facilitating PPP project development in the countries.