



Technical Advisory Panel

Ex-Post Review of Selected PPIAF Activities

Summary and Overview

Review of PPIAF Activities for Fiscal Year 2006

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Prepared by the Technical Advisory Panel

May 2007

Introduction

PPIAF's Technical Advisory Panel (TAP) is responsible for providing an ongoing independent evaluation of the impact of the Fund and its program. Additionally the TAP is charged with providing advice to the Program Management Unit (PMU) or Donor Group at their request, and commenting upon the program's broader direction or strategy in pursuit of its goals as outlined in its charter. With this mandate, this year's summary report undertakes to do two things: 1) Provide a habitual annual portfolio review of the quality and perceived impact of PPIAF activities, commenting as well upon the Fund's strategic direction; and 2) Review a recent proposal for a new Sub-National Technical Assistance Program.

Part 1: Annual Portfolio Review

PPIAF was formed to provide timely and flexible grants for technical advice in support of governments seeking innovative private participation in projects and institutions. Its further mandate is to provide assistance in the dissemination of "best practices". TAP's great challenge has been to provide periodic assessments of the effectiveness of such interventions and the degree to which scarce resources are being deployed towards fulfillment of PPIAF's overarching goals. Each year, through detailed reviews of reports of recent activities, conversations with Task Managers, and discussions with the PMU, TAP members explore the areas in which PPIAF is providing support. The output of this process is a series of written and oral reports prepared for the Donors, PMU and others. The most specific purpose of this exercise is to test for impact, innovation and ultimately value for money of the PPIAF activities.

Selection of grants for review by the TAP is as broad as possible; covering a range of geographies, sectors, and funding amounts. (The breadth of review occurs somewhat automatically however, due to the variety in background and areas of specialization among the TAP.) This year the TAP reviewed 20 distinct activities. Most were completed prior to review, although a few were still in process. The PMU has at times encouraged such reviews of unfinished activities, feeling they will benefit from the TAP input. However, these undertakings will not have undergone the normal peer review and internal quality review process. This is most meaningful with respect to larger knowledge management activities. (Detailed reports on each of the individual activities, size of the grants, purpose of their deployment, have been attached as Annex 2 of this report.)

Activities Reviewed by TAP

What follows are highlights of activities reviewed, along with the TAP member observations and conclusions. Most panelists are new this year bringing, it is hoped, fresh perspectives and observations as to PPIAFs effectiveness in helping governments and others get the technical assistance they need. However, TAP has over the years provided numerous recommendations and it seems desirable that this “institutional memory” be preserved. The report notes therefore the PMU’s responsiveness to past suggestions.

1) PPIAF Assistance to PPP Units

In the 90s most private sector involvement in infrastructure took the form either of out-right sales or divestitures of state-owned infrastructure companies or very long term concession contracts. But regulation of privatized entities presented numerous political and technical challenges. And long-term concession contracts provoked many severe regulatory disputes. In the wake of such setbacks, active consideration is given today to the ways in which responsibilities and incentives can be better allocated between public and private sector player to reduce conflict, attract suitable private sector involvement, and provide sustainable benefits. And much more thought is going into the proper design of public private partnership (PPP) arrangements. A PPP program is one under which private contractors are paid by Government agencies based upon whether the provider is actually able to deliver results or outputs rather than simply inputs. Typically the private sector is responsible for delivering a set of guaranteed outputs over a longer period of time than in a standard service contract. Such concession or other arrangements must be very carefully structured and negotiated. A government PPP Unit is intended to improve the number and quality of PPPs, attract further PPPs, and/ or attempt to ensure that PPPs meet service quality criteria such as affordability, value for money (VFM) and risk transfer.

A representative sampling of PPIAF undertakings responding to requests for assistance in creating and operating effective government PPP units was deemed timely and critical for review by TAP. Three activities were chosen for study, designed variously to: 1) define a PPP; a PPP Unit and the criteria of success before presenting 8 case studies from around the world; 2) look carefully at Indonesia as a case study of a PPP Unit in creation, and 3) assist in the development of three handbooks addressing the topic of South Africa’s experience with Municipal PPPs. (These principles of action for PPPs at the sub-national level are a work still in progress. See further comments on Sub-National Assistance initiatives later in this report)

The TAP reviewer found that the PPIAF activities provided excellent overviews of the subject. Their conclusions fairly reflected the issues on the ground, and the case studies were likely to be powerful in defining the way ahead for countries that want to make progress using public, private partnerships. An additional conclusion also emerged however: PPP Units in themselves are not a stand-alone solution. The government’s commitment to PPP programs and the degree to which it empowers a PPP Unit to implement this mandate is crucial to success.

2) PPP Schemes for Toll-roads

Some forms of infrastructure may be less suitable for private management or ownership than others. Whether public, private or public-private partnership -- there are few definitive answers. But there are important sector and country specific lessons. TAP reviewed a series of activities

where PPIAF provided funding to governments to help design and implement PPP concession strategies for highway development; the goal was to determine the extent to which these interventions provided lessons for the sector.

The advantages of PPPs are often classified in two parts: those associated with efficiency gains from appropriate incentives, with private firms sometimes building faster and underestimating costs by less; and those relating to political economy considerations. PPPs also have acknowledged shortcomings at times. They may involve high contracting costs. When the upfront investment in the road needs to be financed with tolls, this can at times distort toll levels if set above marginal costs. Possibly most important, a host of "soft budget" problems, like generous guarantees, poor budgetary accounting and pervasive renegotiations, have been observed in some PPPs, at times calling into question whether efficiency gains are genuinely achieved.

Even though the three countries assisted by PPIAF were far from a representative sample, two tentative conclusions emerged from a review of these undertakings. The second wave of PPPs currently under way in middle income countries in the road sector stand a reasonably good chance of doing significantly better than public provision. Whereas in low income countries, the use of PPPs can sometimes involve additional costs because of the risk premium demanded by private firms. Private participation in the road sector may be beneficial but schemes that require a private firm to finance a road and then pay for its investment based on long term toll revenues, combined with government guarantees, may need more refinement. This could entail more limited risk transfer, simpler and shorter arrangements, and/or mechanisms to limit foreign currency risks. It was the contention of the TAP reviewer that many of these questions remain unanswered, and the continued support of PPIAF for countries reforming their highway concession programs may be crucial.

3) Systems of Regulation

The systems created to regulate tariffs and service quality are a continuing source of controversy. Many infrastructure services have elements of natural monopoly, and governments prefer some regime of public control over tariffs and the quality of service. But difficulties have been legion when designing such systems, as well as handling disputes in a manner judged equitable by all players. Establishing a government regulatory agency with the discretion to change allowed tariffs and other terms of service has the advantage of flexibility especially when confronted with unforeseen events. The disadvantage is that such a system may lack the certainty or commitment that a concession contract can appear to offer. An additional fear is that discretionary agencies may be "captured" by special interests. But an emphasis on political independence combined with inexperience has at times translated into a failure to build and maintain popular support for the regulatory regime. While it was hoped that these new regulatory institutions would depoliticise tariff-setting and create more stable revenue streams for investors, after a decade of experience with it is opportune to ask: how effective have regulators truly been in meeting their objectives? Have they been able to squeeze efficiencies out of operators and minimize costs? Have consumers benefited from improvements? And has risk been reduced for investors through more predictable and credible regulatory decisions? International debate and research on infrastructure regulation is increasingly focusing on these issues.

One of PPIAF's key areas of activity has been support for the creation of new regulatory agencies and building their capacity to operate effectively. While these activities are well upstream of actual private investments in infrastructure, they play a crucial role in creating the enabling environment for accelerated investments. Most recently, PPIAF has been supporting studies and activities that focus on issues of regulatory governance, performance, effectiveness and impact. Some now argue that the key challenge is to figure out ways in which the decision-making discretion of capacity-challenged regulators can be constrained – for example by writing low discretion tariff-setting rules in primary or secondary legislation or regulatory rules or licenses or contracts. That is, detailed formulae and rules could be designed to set tariffs and the discretion of regulators would be restricted to a limited number of issues. One of the projects reviewed by TAP includes an important effort at devising such “low-discretion” tariff adjustment rules for infrastructure regulators. In the future hybrid regulatory systems could evolve as well where regulatory agencies operate within the bounds of regulatory contracts or rules that constrain discretion by providing more specificity to issues such as tariff decision-making. Other regulatory projects reviewed by TAP involved the development and application of indices to benchmark regulatory governance and performance, design of regulatory systems, means for confronting the challenges of regulating state-owned utilities, and suggestions for better design of private management contracts and pro-poor regulation.

Today's focus in infrastructure regulation is on finding ways to match regulatory design with local levels of regulatory commitment and institutional and human resource endowment. However, the old imperatives of building the capacity of regulators have not diminished. Because PPIAF has a long involvement in regulator capacity building and training, the final project reviewed involved an ambitious and successful effort to construct a body of knowledge that covers all the areas that should be known by regulatory practitioners. TAP considers this a very useful resource for educators and trainers who remain committed to improving the professional capacity and competence of regulators.

4) Universal Access

TAP has always recognized the stewardship role of the PMU and its responsibility for maximizing the impact of scarce resources. One portfolio allocation decision - the partial de-emphasis of assistance within the telecommunications sector- has seemed to make sense as many developing countries have seen startling improvement in the quality of this infrastructure in recent years. But heavy regulation can prove an impediment to incremental private investment. Some government policies can considerably accelerate market growth and encourage the rollout of communication access, especially in lower income communities; whereas others may discourage this process. Therefore PPIAF's focus has been upon funding up-front policy, legal, institutional or governance reforms; credible regulation; or mainstream assistance to pro-poor projects. One such example is a focus on rural telecommunication and universal access.

The concept that regulation should encourage private sector operators to engage in apparently loss-making social duties, such as providing service to remote communities, or unprofitable tasks like installing public payphones, is not new. In the early phases of the concept, emphasis was upon requiring some sort of exchange for the advantages of incumbency, or through the

establishment of Universal Service Obligation (USO) funds through which incumbents would be compensated for costs by new entrants.

However, rapid improvements in technology have meant that increasingly certain services could be extended without subsidy provided the regulatory and market conditions were right. Indeed in some locations universal service has even come to be seen as a possible source of profits. One PPIAF funded project, although not suggesting that the concept of Universal Service funds is redundant, makes an important contribution in the view of the TAP reviewer, by arguing against a presumption of their necessity.

What is the case for the telecoms sector cannot necessarily be said of water and sanitation. Another PPIAF study found that restricted scope for market entrants in this field, underscored the need for careful development of tariff policy as well as continuing performance review. It also emphasized that with a relative absence of market competition, there was a strong need for alternative ‘comparators’. The TAP reviewer concludes that this is a strong start in thinking about Universal Access in this sector.

A final PPIAF study surveyed small scale providers of electricity and water service in three Asian countries and one African country, in communities with very low levels of public utility provision, and little regulation. The TAP reviewer pronounced the PPIAF study ‘ground-breaking’ as it makes the case for treating small private service providers (SPSPs) as a permanent part of the landscape. Such services may be more expensive than the subsidized public networks in unit price terms, but they can still bring advantages; provide greater access, lower connection charges, supply faster repair and fewer cut-offs. It is noteworthy that this study also responds to earlier TAP recommendations that PPIAF support study of market and funding capacity for small and pro-poor projects in regions not yet targeted.

**Review of PPIAF Activities Completed and ongoing Activities in Fiscal 2006
Summary and Overview**

May 2007

Annex 2

THEMATIC REVIEW OF ACTIVITIES

PPIAF Assistance to PPP Units

- (1) **GLOBAL:** Research to Determine Role of Centralized PPP units in Developing Countries in Facilitating Successful PPPs
- (2) **INDONESIA:** Assistance in the Implementation of the PPP program in Indonesia
- (3) **INDONESIA:** Infrastructure Risk Management

PPP Schemes for Toll Road

- (4) **GUATEMALA:** Concessioning Strategies for the Transport Sector.
- (5) **GHANA:** Institutional Framework for Road Concessions.
- (6) **CROATIA:** Enhancing Sustainability of the Road Program

Infrastructure/System Regulation

- (7) **GLOBAL:** Development of a Body of Knowledge for Regulatory Practitioners
- (8) **GLOBAL:** Improving the Regulation of Water and Sanitation Services
- (9) **BRAZIL:** Regulatory Governance in Infrastructure Industries: Assessment and Measurement of Brazilian Regulators

Universal Access

- (10) **LATIN AMERICA AND CARIBBEAN: REGULATTEL** to develop and implement more effective targeted and sustainable universal telecom access programmes;
- (11) **LATIN AMERICA AND CARIBBEAN: Regional** initiative to build capacity among water & sewerage regulators (ADERASA) Latin America & the Caribbean
- (12) **GLOBAL** mapping initiative for small scale providers in electricity and water supply & survey and mapping of small scale private service providers (SPSPs) (Phase I and II)

Pioneering Transactions

- (13) **LAOS:** Nam Theun II Power Project
- (14) **VIETNAM:** Assisting Contract Negotiations for the Phu My 2-2 BOT Power Project
- (15) **SOUTH AFRICA:** Independent Power Producer – New Generation Capacity Project

GLOBAL: Mapping initiative for small scale providers in electricity and water supply & survey and mapping of small scale private service providers (SPSPs)

Activity Status: Surveys completed, report not yet complete

Deliverables: surveys on small scale service providers in four countries in water and electricity supply

1. Background

Small scale providers are *de facto* providers for millions of people in poorer countries and yet have been remarkably under-studied. To the extent that they feature in discussions on policy it is often in a negative context, with reference to the higher unit prices which they charge for services. Frequently they are seen as at best a temporary stop gap before network services come on stream, and at worst as exploitative overcharging opportunists, operating often on the fringes of legality. In fact they constitute a classic example of a service supply springing up to meet a consumer demand for essentials, such as fuel or water. They occupy the gaps in service provision left by the 'official' networks and so their presence acts as a kind of 'barium meal' revealing the failures of the existing networks to meet consumer needs. The legal situation of the SPSPs simply reflects the legal precarity of many of their customers, living as they often do in peri-urban settlements which are themselves often not fully recognized by the authorities. This precarious legal status contributes to the lack of infrastructure services and thus necessitates a kind of less formal service provision.

2. Outputs/ Consultant Deliverables

The survey does not restrict itself to one or two sub-sectors but covers a whole range, with differing scales. The water sector includes trucks, kiosks, bottled water, small scale pipe networks, pipe and hose operators, and water vendors operating from mobile handcarts. For electricity the survey covers small hydro power, battery recharging points, small scale rural electricity enterprises and solar operators. The four countries surveyed are Cambodia, Kenya (the two for which survey results were made available for review) and also Bangladesh and Philippines from whom results were still expected at the time of writing. The surveys have been completed in all four countries.

3. Intended Impact of the Activity?

3.1 Impact on Client – primarily Government

The implications for government are that there is some indication of the quality of service provided by SPSPs which are often difficult to survey. This is a vital contribution to the development of a universal service policy. There is useful comparison with some public utility services, with some rather surprising results, namely that SPSPs in some respects provide better services than public ones and certainly better than is often alleged. There is also indication of a low level of regulation and some low level corruption by state officials.

3.2 Impact on Private Sector (if relevant)

The impact on the SPSPs themselves should be considerable in that it brings them 'out of the shadows' of public policy debate, and indicates that they play an important role in serving the needs of some very poor citizens.

4. The Structure of the Consultant's Report:

As yet the reports by *Economisti Associati* consist of a progress report covering the state of the survey process, setting out some of the practical difficulties, and country reports. Volume 1 of each country report contains a synthetic text (quite detailed) plus an annex for each subsector. Volume 2 goes into the methodology sector by sector including questionnaires, and Vol. 3 produces the detailed survey results.

5. Effectiveness and Quality of Activity Design and Final Output

The market research is extremely sophisticated with surveys tailored to sectors and sub-sectors and sample sizes tailored to prevalence within the country being surveyed. The response rate to the survey was remarkably high despite the difficulties in obtaining cooperation in some locations due to civil disturbance and some reported 'survey fatigue' in the Philippines. (These factors have led to some delays in completion). The higher than expected number of responses was in part due to the expansion of categories and in part due to initially pessimistic assumptions. The main limitation on the nature of the surveys was the absence of surveys of consumers (and the reviewer declares an interest here having worked for many years in the consumer field). So the welfare of consumers of the services is judged indirectly via the SPSPs. In discussion, this was attributed to financial limitations and the expansion of the survey to a parallel set of questions to consumers would indeed have been costly. Not only would the questions about each service have had to be duplicated from the consumer standpoint, but the number of consumers would have had to be significant for any meaning to be attached to the answers. But this limitation needs to be borne in mind and maybe consumer surveys could be envisaged in the future.

On a further point of methodology, the Kenyan survey contains a principal components analysis of the water kiosks sub-sector, which is the main source of water in urban informal settlements. The PCA clearly identifies two components as accounting for 65% of the variance of the variables listed, number of clients, jerry cans filled etc. The analysis is of great importance and yet is under explained and so its potential for policy not realized. It would appear to indicate that various scale factors are related, which is unsurprising, but also that Kiosk operators supply other operators rather than retail consumers. This intermediary role is of great importance for considering the 'morphology' of services and therefore of their understanding. The use of PCAs in this way could be emulated and the findings perhaps elaborated further.

6. Comments from Stakeholders:

6.2 Task Manager

Mukami Kariuki agreed that a vital aspect of the findings was the fluidity of the different sub-sectors, for example, handcart operators in Kenya declining as water supply was improved and

rural electricity enterprises in Cambodia, declining as the grid service expanded. This sometimes led to apprehensions among SPSPs about the expansion of the public networks and indeed to some SPSPs going out of business. She emphasized the need for government strategies to deal with such transition. She observed that there was higher public acceptance of private networked electricity than was the case for water. She emphasized the potential for micro-credit for the development of small scale infrastructure.

6. Value Added/ Cost Effectiveness

The budget of \$343,000 while substantial in PPIAF terms may prove to be good value for a survey of this complexity, variability and logistical difficulty. Time will tell how effective it will prove to be, but the reviewer believes it has enormous potential significance far beyond the countries surveyed.

7. Final Observations

The features that stand out from the surveys are as follows:

Price differentials between SPSPs and public utilities are confirmed as expected, e.g.: SPSP unit prices are 7-8 times higher in the case of electricity in Cambodia for example for rural electricity enterprises, and seven times higher in the case of water kiosks in Kenya, by far the main source of water in urban informal settlements. However, it is interesting to note that in Kenya, comparable private and CBO run services had similar prices. Comparisons need to be heavily qualified. Of particular interest in Cambodia was the lower incidence of connection fees, for the small networks. The bulk of the Cambodian survey revolved around rural electricity enterprises and piped water network operators, and most systems did not charge connection fees; where they did (in about 40% of cases) fees were low, indeed in discussion it was indicated that they were below cost.

In the more diverse Kenyan survey a different picture emerged, notably regarding connection fees which are widespread. In contrast, non-networked services by definition do not have connection charges, but tend to have higher unit prices. While network system losses were significant, the small operations responded quickly to leakages and other malfunctions. Water losses in Kenya were lower than in many public utilities including some of those in richer countries. SPSP services operated seven days a week, and system continuity was better than in many public utilities. A further feature of the results is that the personal nature of the services, often rendered between near neighbors, meant that disconnections and refusals to serve were rare although not unknown. However, some potential clients may be excluded 'up front' because they are considered to be too poor to be able to afford the service.

Comparisons with the public utilities are unrealistic when the level of provision by the latter is so low, only one per cent in the Cambodian water sector in the areas visited. This means that they are actually operating a different type of service. The relationship to the public utilities is nonetheless of importance because the utilities are seen as potential future competitors, for example to the Cambodian electricity enterprises or the water vendors of Nairobi where the municipal service has been recently reformed. This is consistent with anecdotal evidence from some countries that SPSPs in the water sector have opposed the extension of networks and that

such opposition has contributed to the prevention of reform proposals. Regulation by the public authorities does not seem particularly intense least of all in Cambodia. Some Inspectors in the Kenyan water sector and the Cambodian water sector requested informal payments.

The crucial impression to emerge from the surveys so far is that the services do function better than they are given credit for. They may have a customer interaction which is highly localized, although to some extent self-selecting. The unit prices are higher than the public sector services as expected but so are costs and the services have the merit of actually serving poor communities which the public services have failed to do. The rates of profit seem relatively high in percentage terms but are relatively modest when turned into cash. The contribution of this survey is both in setting out the facts of under-reported sub-sectors and thus in paving the way for strategic policy.