



Managing government exposure to financial risks in PPPs

Timothy Irwin

(tirwin@worldbank.org)

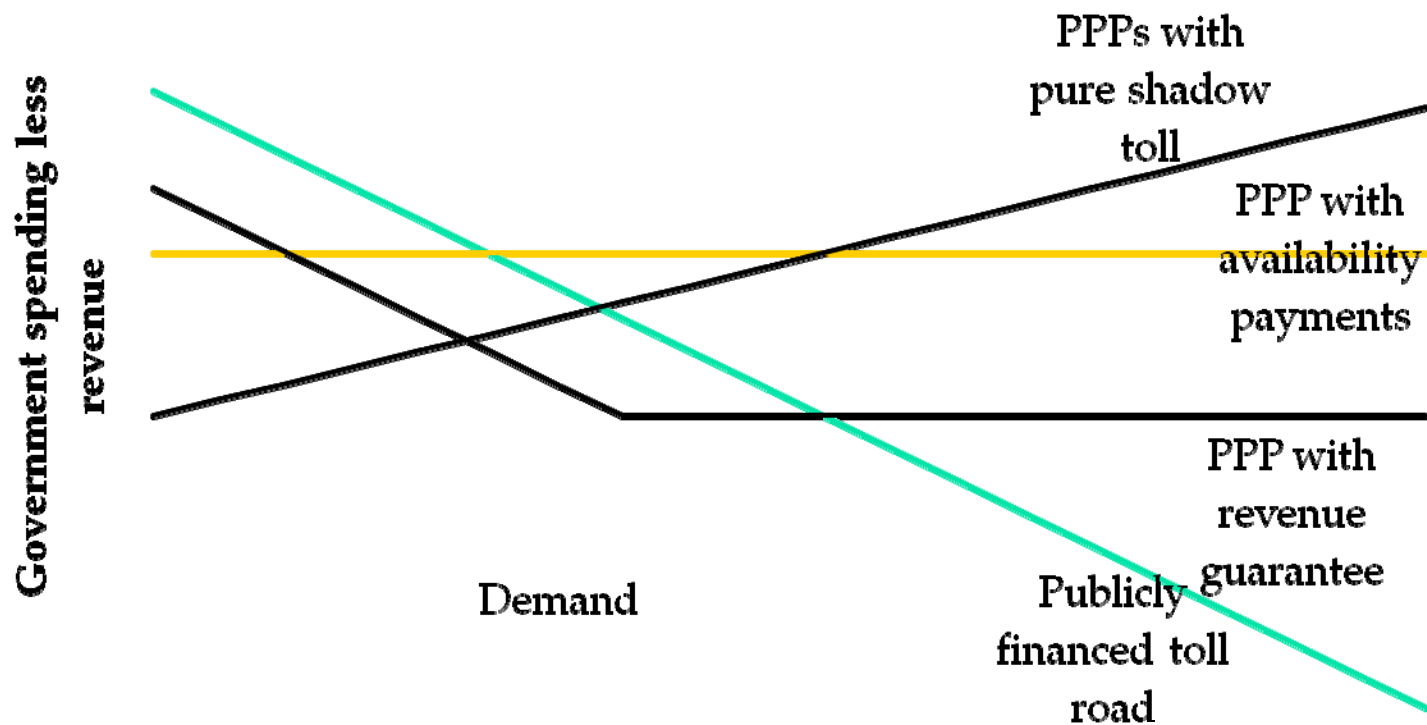
World Bank

Riga, 6 March 2007

Overview

- PPPs typically reduce government's exposure to risk compared with public finance
- But they often expose the government to unfamiliar risks that may be difficult to deal with
- Good decisions about PPPs and fiscal management require that governments understand the risks, quantify some of them, and have good rules for controlling and reporting exposure to risk

Government's exposure to demand risk in a public road and three kinds of PPP (net spending as a function of demand)



Examples of guarantees

- Guarantees for 19th century PPPs (e.g. Bridge of Bordeaux 1817, Pennsylvania canal 1819, Warsaw-Vienna railway in 1838)
- Modern simple debt guarantees (e.g. A2 Motorway in Poland)
- Revenue guarantees (e.g., Hungary, Chile, Korea)
- Compensation on early termination

When should governments bear risks?

- Governments should be wary of bearing a risk just as a way of giving a disguised subsidy
- They should instead try to bear just those risks they can best manage
- Managing can involve three things:
 - Influencing or controlling the underlying risk factor
 - Anticipating or respond to changes in the risk factor
 - Simply absorbing the risk

Some decisions are helped by quantification

- Decisions whether to bear certain risks are easier if the government quantifies its exposure to risk—in particular if it estimates
 - The most it could have to spend
 - The amount it can expect to spend
 - The present value of its commitment (taking account the timing and risk characteristics of the possible payments)
- Estimates may be rough, but they are better than nothing

Good fiscal-management rules also help

- Financial reporting according to the best accounting standards (e.g. IPSAS/IFRS)
- Additional disclosures to fill in gaps left by accounting standards (e.g. Chile)
- Control by ministry of finance or cabinet of decisions to take on major risks
- Inclusion where possible of decisions to bear risks in budget decisions alongside ordinary spending decisions (e.g. USA)

More

