

The Outlines of PFI Promotion Committee Report

For realization of the true public-private partnership

1. Introduction

- In accordance with Article 2 of the PFI Law Supplementary Provisions, the Committee for Promotion of the Private Finance Initiative (hereinafter referred to as the “Committee”) examined the efforts of the Japanese government etc. towards projects based on the PFI Law, and studied comprehensively how PFI should be developed as well as how to resolve the issues that are important for more efficient utilization of PFI.
- There were 8 meetings of the sub-committee convened, between July and November of 2007. Hearings were held with private businesses (economic organizations, financial institutions), related ministries and local public entities. In addition, the Committee examined the results of surveys with administrators of procuring public authorities (hereinafter referred to as “Procuring Authorities”) and public comments, and organized them.
- Each issue and future direction for how to handle it have been discussed, and the Committee selected issues to be discussed deeply regarding which effective measures should be taken without delay.

2. Current situation etc. of PFI in Japan

2 -1 Current situation of PFI in Japan

- Since the enactment of the PFI Law, the number of the PFI projects has been increased, and large scale PFI projects have appeared.
- The number of projects which has started operation of facilities constitutes the majority, where we realized various issues relating to operations of PFI projects.

2 -2 Key measures taken by the Committee and the government since the 2005 PFI Law amendment

- The Committee and government discussed and took measures for urgent and important issues (Calculation of VFM, bidding system, equal footing such as tax system and governmental subsidies and enhancement of information distribution functions).

2 -3 Response to the current policy issues

- PFI is expected to be an effective method to solve current policy issues, such as achieving fiscal soundness of local public entities, local revitalization, effective utilization of the government assets, the aging of the social capital stock, and global warming countermeasures.
- There is also a need to take sufficient consideration of the international trends for standardization of the PPP/PFI agreements etc.

3. Current PFI issues and the direction for handling them

3-1 Awareness concerning the current situation

- Private-sector suppliers are not satisfied with current situation because, from their experiences of actual projects, the public sectors and private-sector are not in equal positions.
- Some Procuring Authorities are reluctant to use PFI because it is burdensome, and not a method that can be easily used, and furthermore its benefit is not easy to confirm.
- Based on the above perspectives, we have grouped together to form 15 individual issues, and discussed the measures for each.

3-2 Individual issues

1) Clarification of the output specifications

- (1) **The need for clear forming of concepts before preparation of output specifications**
 - It is pointed out that the Procuring Authorities draft output specifications

without organizing what Procuring Authorities really need, and as a result, the private-sector suppliers are forced to propose what they cannot propose effectively. To solve this problem, the Committee will discuss tentatively the document named “Business Concept” which states the result of discussion about the needs of the Procuring Authorities.

(2) The need for embodying, clarifying and elaborating the output specifications

- The output specifications are supposed to be the documents that show the bidders the intentions of the Procuring Authorities and even after the successful bidder has been determined, they are supposed to be the standard for confirming whether or not the service levels are in line with the intentions of the Procuring Authorities.
- Therefore, there is a need to embody, clarify and elaborate the output specifications, and thus, there is a need to create a detailed guidance showing how to prepare output specifications, and to promote the standardization of the output specifications by project type.

(3) The need for clarifying the relationship between the costs and the contents of output specifications (quality of service)

In order to respond to the complaint by private-sector suppliers that there are excessive and unrealistic contents shown in the output specifications which cannot be achieved within “target price”, the following options should be discussed:

- ① Set the “target price” in line with the output specifications, and calculate the PSC and PFI-LCC, after fixing the contents of the output specifications; and,
- ② Upon clarifying the output specifications to the greatest extent possible, present “reference price” which does not constitute the ceiling, or present the basis for the calculation of the “target price”.

Following these discussions, the result should be incorporated into “PFI Project Process Guideline” (hereinafter referred to as the “Process Guideline”) provided that they can be achieved under the current

applicable laws.

2) Promotion of the standardization of agreements etc.

- Standardization of the agreements etc. should be made for reducing the costs etc. related to the drafting agreements and arranging the projects etc.
- In this case, standardization documents should include not only the provisions but also the philosophy in the background of each provision (hereinafter referred to as “Standard Contracts Model and Commentaries”). The provisions in the model agreement are supposed to be amended flexibly and appropriately depending on the situations and detailed instruction about how to use it should be included in its commentary.
- Only one simple standard agreement is insufficient: instead, standard agreements should be made by types of projects.

3) The need for guidance for risk analysis and risk management

- There is a need to show guidance which specify the points to be considered in the actual practice of risk management, such as risk workshops, assessment of risk, specific risk management methods, basic handling measures when risks come true and the roles etc. of financial institutions in risk management etc., that do not appear in the current “Guidelines for Sharing Risk“.

4) Realizing more transparent bidding process that can take advantage of the private creativity

(1) Securing transparency

- Concerning the role and management of the evaluation board, private-sector suppliers complained that the evaluation procedure is not transparent because of the non-disclosure of the non-selection reasons etc. However, the disclosure of non-selection reasons is provided in the “Process Guideline“ amended in June of this year, and thus helping

Procuring Authorities with understanding and using the amended guideline is now important. Further, the more detailed guidance for the evaluating procedures should be incorporated into the guideline.

(2) Enhancing the dialog process

- Dialog process that was stated in the Understanding at the Directors Meeting of Related Ministries in November of 2006 should be more widely used, and detailed procedures should be incorporated into the Process Guidelines.
- In addition, we should continuously discuss how to improve tendering process under the current laws.
- Furthermore, discussion should be made about the incorporation of multiple staged evaluation process and dialog process into law.

(3) Bidding process facilitating a more creative proposal by private sector

- In order to take further advantage of the private sector creativity, discussion should be made about the utilization of Value Engineering (VE) proposals and Variant Bid which does not comply with the output specifications presented by the Procuring Authorities, but meets the needs of the Procuring Authorities and increases the Value for Money.

5) Appropriate handling of the issues at the operations stage

(1) Introduce a mechanism for appropriately dealing with the changes in the initial output specifications due to changes of laws or technical advances etc.

- The study results should be incorporated into the Standard Contracts Model and Commentaries.

(2) Improve the monitoring and payment mechanisms so that the private-sector suppliers will operate appropriately

- ① The need to link the output specifications, monitoring and the payment mechanisms

- In order to support and promote the pioneering efforts of some Procuring Authorities, present the relevant guidance in the guidelines and the Standard Contracts Model and Commentaries, etc.

② Education concerning the importance of the role of monitoring etc. by financial institutions and unitary payments

- Provide education concerning the importance of the role of monitoring etc. by financial institutions, and, in case of BOT, education concerning introduction of unitary payments, in order to provide strong motivation for satisfaction of the service level.

③ Discussion on creation of guidelines etc. for direct agreements

- Discuss creation of the guidelines for direct agreements, and to promote the publication of direct agreements in order to share know how.

④ Study on how to improve the payment mechanisms such as appropriate incentives etc.

- Study methods for improvement of the payment mechanisms which give appropriate incentives, such as the payment of bonuses etc., and the result should be incorporated into the Standard Contracts Model and Commentaries..

⑤ Study on effective methods of monitoring at the construction stage

- Study effective methods etc. of monitoring at the construction stage, considering unique features of PFI, and incorporate the result into the Guidelines for Monitoring.

(3) Need for a neutral entity for dispute resolution

- Incorporate the structure for processing disputes between the Procuring Authorities and the private-sector suppliers into the Standard Contracts Model and Commentaries.

(4) Handling issues after the expiration of contract period

- Need to study measures which prevent the functions of facilities etc. from significantly deteriorating when they are delivered to the Procuring Authorities upon the expiration of the contract period.

(5) Importance of the management skills of the private-sector suppliers where the weight of operations is high

- Study specific measures to improve the management skills of private-sector suppliers, especially in case of projects where the operations of facilities are important.

6) Ongoing study concerning VFM assessment

- VFM assessments will continue to be studied.

7) Study of financing

(1) Study of the methods for financing

- Concerning the financing for PFI in Japan, because the costs of loans are usually lower than the costs of bonds, financing through loans is the mainstream method, and to date, secondary markets where PFI loans are traded have not developed.
- However, there is the possibility of changes the interest rate and in the supply and demand balances, so there is a need for ongoing studies on the methods of financing in order to develop the PFI financing markets and to provide various options.

(2) The need for utilization of regional financial institutions

- Study measures for promoting the transfer of know how in order to utilize regional financial institutions. Also, projects that have a huge effect on regional economy are expected to or needed to be developed by the close cooperation by regional three parties: local public authorities, regional financial institutions, and regional corporations. Thus, there is a need to study creating a network of regional financial institutions etc.

8) The need for equal footing such as subsidies and taxes

- There is a need for continuous efforts to realize equal footing such as the subsidies and taxes.

9) Share know how of, utilize, and make necessary adjustment with, other PPP methods

- Study the direction of future PFI, considering the designated manager system, and market testing.
- There is a need to provide advice etc. to local public authorities through cooperation by related national ministries, concerning the practical issues concerning the various PPP methods.

10) The need for further improvement in the roles of consultants

- While the consultants have played significant roles in developing PFI, there is a need to discuss the creation of guidance for appointments of consultants, in seeking to have further improvements in this role.

11) Study an efficient structure for sharing the know how between the public and private sectors

- There is a need to establish more efficient structures for accumulating and sharing the information and know how concerning the PFI projects to date, and for utilizing lessons from the existing projects.

12) The need for expanding the players

- There is a need to improve the PFI procurement process in order to facilitate foreign corporations to join PFI, such as introducing rules that are in line with the international standards or, promoting a more transparent procurement process, etc.

13) Study for expanding the PFI market

- There is a need to increase the projects attractive to the private

businesses, which are more complex and larger in size, through promoting the transfer of risk, in order to promote market participation by the private businesses.

- There is a need to utilize PFI, especially in the areas that allow efficient and effective utilization of private sector skills and funds, in order to provide high quality public service, while handling the increasing management costs associated with the aging of the existing stock.
- There is a need to study deeper, from the aspect of utilizing the private sector creativity through consideration of various discussion on how to utilize the private sector's creativity (not limited to PFI).

14) Steps for the prevention of global warming

- The global warming countermeasures including the reduction of green house gases in PFI projects should be included in the guidance for preparation of output specifications.
- In many PFI projects, utilities such as electricity are outside the scope of PFI contracts and thus they are not included in the PFI-LCC. However, for improving VFM, and reducing green house gases, these treatment may not be desirable and thus we should study the appropriate and practical measures for including such utilities in payments under PFI contracts.

15) Study on the disaster management and other current policy issues

- There is a need to study on the possibility of utilizing PFI in the disaster management area.
- Concerning the measures for fiscal soundness of local public authorities, local revitalization, effective utilization of the government assets, the aging of the social capital stock, global warming measures etc, mentioned in in 2 -3 above, there is a need for having deeper studies on how to use PFI to solve these issues.

3-3 Points to be considered when studying the specific measures related to

above issues

1) Provision of more useful guidance

- In addition to amending existing guidelines, there needs to create methods for centralizing and sharing the knowledge, which can deal with constant change and various situations, without being limited by the existing framework.

2) Sharing and encouraging the broad use of know how and lessons

- There is a need to create manuals and databases of good practice case studies, as well as urging the Procuring Authorities to disclose information regarding good practices and lessons from each project.
- In order to share and encourage the broad use of know how and lessons, there is a need to provide an opportunity for capacity building including seminars providing specialized knowledge and skills required for PFI.

4. Issues that should be focused on, and have immediate measures taken for

1) Issues by individual specific processes

- Discuss and take necessary steps for, as soon as practical, ① clarification of the output specifications, ② promotion of the standardization of contracts, ③ provision of guidance for risk management etc., ④ realization of better bidding process which is more transparent and urges creative proposals by private sectors, and ⑤ provision of guidance for handling issues in the operation stage.

2) Share know how of, utilize, and make necessary adjustment with, other PPP methods

- Take measures necessary for further promotion of the trend “from public to private”, through originally expected effects from the PPP methods.

3) Global warming countermeasures

- Concerning the global warming countermeasures, study and take measures to provide guidance about how to deal with the problems in

each PFI project.

4) Equal footing such as subsidies and taxes

- There is a need for constant efforts for realizing equal footing, so that the taxes and government subsidies etc. do not constitute disadvantage of PFI projects.

5. In conclusion

- What is sought for now is speed in line with the ever changing world we live in, and based on this report, it is expected that government will take measures in order to make PFI easier to use for both the public and private sectors, and to achieve the true public-private partnership.