

INFRASTRUCTURE & PUBLIC-PRIVATE PARTNERSHIPS (PPPs)

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Two comprehensive reports on the subject of PPPs have been published in the last twelve months – one by Piper Rudnik Gray Curry, entitled “European PPP Report 2005”, and one by Price Waterhouse Coopers, entitled “Delivering the Promise – A Review of PPP Issues and Activity”. The BAC SEE recommends these reports to readers seeking a detailed examination of the subject. The investments to be carried out in Europe are of a large magnitude, and the envisaged figures include neither community infrastructure nor infrastructure needs of SEE countries, and admittedly works cannot be implemented on public funding alone. The BAC for SEE would be honoured and willing to contribute with its members’ experience on issues related with legal safety, adequate ROI, guarantee against political risk and human capacities, so as to support the work of the European Commission and the efforts of national SEE governments towards the facilitation of public private partnerships (PPPs).

THE NEED FOR INFRASTRUCTURE

Taking into account the recent enlargement to ten new countries, **investments to be carried out in Europe are of a large magnitude (definitely over 600 billion €)**. This figure, as proposed by the European Commission, **only includes «Greenfield» projects**, i.e large trans-European networks, national networks, environment protection infrastructures. It does not include community infrastructures (hospitals, universities, justice, etc). **Furthermore, this figure does not include the necessary investments in South Eastern European countries, which are meant to join the EU or have already started the accession process.**

It was already acknowledged that neither member states or the Union could not implement these infrastructures within a short time span on public funding alone. This realisation is reinforced by the situation in South Eastern European countries.

THE SPECIFICS OF SOUTHEAST EUROPEAN COUNTRIES

The region as a whole is just getting over a very deep political crisis embodied in very painful conflicts. In this context, the need for building infrastructure is overwhelming, and the implementation of infrastructure projects is necessary to **regional cohesion and economic development**. This development will of course take place with private funding also, including that available for public infrastructure.

The necessity of creating confidence in the region is compounded by the extreme geographical split of SEE, which might well lead to wide segmentation and diversity in the necessary decision-making process.

THE SPECIFICS OF PUBLIC PRIVATE PARTNERSHIPS

The basic principles of PPP - the provision of “value for money” for public services by the private sector in return for a performance dependant on service payment from the public sector - is increasingly viewed as an acceptable alternate procurement method to attempt to address the shortfall in public sector funding for infrastructure and services. However, within the abovementioned context, **drawing private investment to public projects is a real challenge**. Answers to facilitate the challenge are situated on three levels:

- each individual State must take its own **responsibilities** and bear the **consequences of its own decisions**
- this will be made easier as soon as, being **part of an integration process**, each State will **benefit from European steps and guidelines**, which will facilitate its work and promote coherence at regional level;
- **decentralization** means that each local authority (city, region) has to face new and important issues, **without adequate funding**

Debates taking place today at European level, within the Commission or the Parliament are particularly relevant to South Eastern European countries.

GENERAL RECOMMENDATIONS

Four main points must be underlined:

1. Legal safety:

In order to ensure legal safety, a **European legal framework should be provided**, which would define conditions for consultation, choice of a preferred bidder, negotiation with the latter and contract implementation. Every stake-holder in a public-private partnership - mainly the financing partners - must be able to feel secure and confident in their investment.

2. Ensuring adequate return on investment

One must be ever mindful that The North American (US and Canada), South American, Chinese, Japanese, Russian, and Indian markets are all rapidly developing and have already begun to draw contractor, equity provider and debt funder/bondholder interest away from the CEE/SEE markets. **The return offered to investors in the SEE must be commensurate with the relatively more risky business environment.**

Competition is becoming global and private sector money will flow to the deals with the best risk/return. **Getting the good deals identified, developed and funded quickly is important.** Therefore, apart from legal safety, two other main issues must be taken into account:

- **risk allocation** between public and private partners, on the one hand, and private partners within the same project, on the other hand;
- **combination of public European funding and private funding** - The care taken by the European Commission to make sure that no private profit can be made from public funding, may hinder the use of PPPs and endanger the balance between the right use of public money and adequate ROI for private funding. It also complicates deal refinancing, which often occurs during the life of a PPP.

3. ***Necessary guaranty for the lender to recoup investment in the event of a political decision damaging the balance of the project.***

This is one of the major issues in a still unstable region. **Sovereign guaranty is often impossible.** EIB statutes do not allow the bank to take such risks. The ERDB is the only financial institution able to take sovereign guaranty on determined projects. The European Commission is currently studying a guaranty tool for trans-national transport networks, which will be of very limited effect. Return on risk should be part of the usual return on investment. It is very difficult to convince private re-insurers. The only tool left is the World Bank MIGA.

4. ***Human training***

Education of the public side of the partnership – right down to the municipal level - is necessary for this form of procurement to flourish and succeed to bring substantial private sector funds to bear against public infrastructure needs.

The compulsory interaction between legal, financial and technical aspects leads to the complex implementation of every PPP project. Thus, two of the main key success factors are:

- **training of public decision makers**, at national and regional level.
- availability of **state of the art trained personnel** to every stake-holder in the PPP process: **decision makers, financial institutions, companies.**

Task forces and organisations dedicated to PPPs, allowing better preparation of stake-holders, training of public servants, gathering and exchange of best practices, must be encouraged.

There is also a lack of funding at the municipal level for the advisors and experts **necessary for PPP framework development, financial modelling and feasibility studies which needs to be addressed.**

SPECIFIC RECOMMENDATIONS

1. ***To implement fair and transparent process***

As a pre-requisite to PPPs, countries need to assure themselves that their PPP process is perceived to be fair and transparent and their markets are perceived to be open and competitive. Unilateral declarations are insufficient; this perception must be shared by other EU countries, the international financial community and the domestic and international contracting community.

2. ***To develop business case and analyze deviations***

A business case must be developed from the outset of the project documenting the favourable economics, value for money and risk transfer objectives to be achieved through the PPP approach and deviations from the business case must be analyzed to assure that the fundamental objectives of the process are maintained. Balance sheet considerations and strictly meeting Maastricht criteria should not be the only or primary reason for choosing PPP.

3. ***To adopt best practices***

Financial models should reflect latest improvements to best practice - for example, the recognition of the public partner cost of shadow toll road liabilities even when annualized under the PPP model.

Best practice models have been implemented in countries such as the Czech Republic, where a centralized PPP knowledge center called PPP Centrum has been established, a number of pilot projects have been identified and enabling legislation defining the limits of what is possible under PPP has been implemented. In parallel, the Czechs have undertaken financial sector reform to improve all aspects of financial intermediation and judicial sector reform to address issues such as property rights, minority shareholder rights, dispute resolution and arbitration and the efficiency of the courts.

Each country should be encouraged to identify the best practices consistent with their laws, customs and priorities and adopt them as quickly as possible. The PPP Center located in Sofia should be used with this purpose and support this process.

4. To reduce the cost of bidding through standardization and length and complexity diminishing

One of the most important issues from the private sector side is the length and complexity of the procurement process. These relate directly to the costs of bidding, which are currently very high. The UK has made some effort to standardize process and documentation but no other country has made any significant progress in this area.

Countries must make every effort to reduce the length and complexity of the PPP process. This may require public sector spending on project definition and framework before involving the private sector and will require some degree of standardization of both the process and the documentation requirements at the national level.

5. To guarantee political stability

Lack of continuous political support and policy change are the most important factors in delaying PPP development. Governments change frequently in CEE/SEE countries and, at the best of times, this results in a long delay while the project is re-evaluated. In the worst case, the PPP is cancelled without immediate compensation for the bidders / investor.

6. To avoid the risk of increasing regulation

In 2004 the EC published a Green Paper on PPP questioning the need for more European regulation of PPP. The EC is now commissioning a report on further PPP regulation. **The private sector is concerned that increased regulation will reduce the flexibility of this process** and decrease its capacity to deliver jobs and boost GDP. A well planned, well executed and comprehensive consultation process lead by the EC regulators is necessary.

THE PART OF THE BUSINESS ADVISORY COUNCIL FOR SOUTHEAST EUROPE

Within the Stability Pact for Southeast Europe, the BAC advises governments and publishes guidelines with the aim of speeding up liberalisation, market opening, free circulation of goods and building of necessary infrastructure.

The BAC will be pleased and honoured to contribute to the European Commission's proposals towards the 4 before-mentioned themes:

- **Legal safety**
- **Adequate ROI**
- **Guaranty against political risk**
- **Human training**