GEORGIAN YOUNG LAWYERS' ASSOCIATION

PUBLIC-PRIVATE PARTNERSHIP

PUBLIC - PRIVATE PARTNERSHIPS

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CONTENT

The purpose of this paper is to provide a brief overview of what Public Private Partnerships (PPPs) are; what are the advantages of such structures; how they can be established and controlled; why they are necessary; how they are funded; and look at some of the experiences of certain countries. It is not possible to provide a comprehensive report here on any one aspect although further, more detailed, papers can be produced in need.

1. PPP – A DEFINITION

1.1. Introduction

Over the last 20 or so years Public Private Partnerships, or 'PPPs', have become increasingly important as a way of implementing and financing many different types of social and economic infrastructure projects. Not only has there been rapidly growing interest in discussing such structures but, more importantly, more projects around the world are actually being financed in this way, although this has seen a temporary decline during the more recent global economic recession.

Countries such as the United Kingdom have utilised PPPs for many years, broadening the application and therefore the number of such projects. More recently, countries such as India and Australia have also become very wide users of the structures and a large number of other countries are even more recent adopters or indeed are in the process of using these techniques for the first time.Nowhere is this more true than in rapidly growing emerging economies; with central and eastern Europe having been through the process over the last 20 years and sub-Saharan Africa now starting on that process.

History

Public Private Partnerships in the widest sense are not new although the term PPP is a relatively recent name. Concession contracts are one of the central parts of a PPP and certain types of concession were in existence as long ago as the Middle Ages.

During the Industrial Revolution in the UK in the 19th Century a large number of the major infrastructure projects in the transport and public utilities sectors were undertaken using private sector investment.

The widespread application of funding public sector works using private sector money can arguably be claimed to have started in the United Kingdom in 1992 in what was called the Private Finance Initiative or 'PFI'. More and more countries have seen the benefits of utilising PPP structures and are following the example and learning from the experience that the UK and other countries have now gained.

1.2. Structures

The phrase 'Public Private Partnerships' is a generic term that encompasses many different types of structures. Some of these structures include the majority of the aspects of a PPP whilst others only include some. To add to the confusion many people use terms such as BOT, BOOT, BOO, DBFO, concession and others as synonyms for PPP. As such, it is important that we look at the most common of the various different structures that can be included in the phrase 'PPP'.

Essentially a PPP is a long term partnership between the public and private sectors underpinned by a legal agreement most often known as a 'Project Agreement'. It uses private sector money and expertise to deliver public infrastructure or services whilst delivering a number of other benefits. The majority of the risks associated with the design, construction, operation and financing of a project are transferred to the private sector company or consortium that is the project partner whilst the risks and responsibilities best handled at a Government level are retained by the public sector. In most projects the private sector would be represented by a consortium of construction and operating companies, together with their lenders and investors.

As such, the private sector would typically bring the skills, technical knowledge, efficiency, experience gained on similar projects, and other practical benefits as well as the majority of funding required. The public sector would typically provide certain assets (such as the existing facility that is to be upgraded or land for a new project), subsidies or tax incentives, and in most cases long term contracts or revenue stream depending upon the project and structure used.

The basic principles of a PPP can be summarised as follows:

- Provision of services through assets
- Efficient allocation of risks

- Payments linked to measurable outputs
- Value for money
- Payment spread over whole term of the contract

All of these aspects are detailed below:

1.2.1. Outsourcing

The simplest form of cooperation between the public and private sectors is outsourcing or 'contracting out' of certain services. This involves a simple commercial contract for a private sector company to provide services to the public at an agreed price. The private sector does not provide financing but it retains the majority of the risks and as such this type of contract is not always included in the definition of a PPP.

1.2.2. Joint Ventures

As with any joint venture this would involve the two (or more) parties, one of which is an authorised governmental body, joining forces for a particular venture. This often involves establishing a jointly owned special purpose company and the parties would share in the financing, operation and risk of the venture.

Whilst this type of structure is often included in the term PPP it still often fails to meet a number of the central aspects of PPP structures and as such does not really fall within the scope of this paper. Some PPPs are indeed Joint Ventures but the majority of Joint Ventures are simply that and so would not be classed as true PPPs.

1.2.3. BOT / BOOT

Build Operate Transfer ('BOT') or Build Own Operate Transfer ('BOOT') are techniques that have been used to develop projects for many years and are probably the most well known basis of a PPP. With a BOT / BOOT the private sector is primarily responsible for developing the project including the finance, design, build and operation of the project for an agreed term, which may be as long as 25 to 30 years. Once this term has elapsed the project is then transferred back to the public sector.

An acronym that is also often used is DBFO (Design Build Finance Operate), especially with regard to highway projects. This, in many ways, is simply a variation on BOOT.

1.2.4. BOO

BOO projects are essentially the same as BOOT projects with the obvious exception that there is no transfer of ownership or control back to the public sector, with the asset being retained by the private sector. It is often thought of as a private sector business with contractual oversight by the government.

1.3. Flexibility

One of the greatest attributes of a PPP is the flexibility in the way the legal and financial structure can be organized and thus the variations that can be introduced in order to ensure the best possible structure for any given project. As we have already seen, PPP's cover a range of different structures and techniques and as such provide an almost infinite number of alternatives to the project partners.

Some of these structures are closer to the simple outsourcing or joint venture agreements whilst others such as BOO are closer to full privatisation. The type of structure will clearly depend upon the underlying project and each partner's appetite for risk as well as the reasons that the government wishes to enter into a PPP in the first place. It will also depend upon how many (if any) similar projects have been undertaken in that country or sector, hopefully building on lessons learnt from previous experience.

Given realistic expectations and an open minded approach the flexibility that a PPP can bring can often unlock projects that would otherwise not be possible. It is important to state though, that simply by using a PPP structure does not make an impossible project possible, nor indeed a bad project into a good one.

1.4. Sectors

It is already clear that PPP's cover a whole range of techniques and that they can offer a flexible way to undertake a project. Because of this, the economic sectors in which PPPs can be used are almost limitless.

Having said this, some sectors lend themselves to the technique more readily than others and some sectors are of a higher priority than others. As such, there is a clear pattern as to which sectors tend to attract a PPP structure first in any given country and which sectors tend to be included later. Much of the reasons for this arethe 'drivers' behind the need for the underlying projects and these are examined in more detail later in the paper.

In simple terms it is true to say that it is the transport and municipal infrastructure sectors that are typically the first to explore the benefits of PPPs.

Specific projects would include the following:

- Highways
- Bridges
- Airports
- Water / Waste water treatment plants
- Power / energy

With projects in the following social sectors being close behind:

- Hospitals
- Schools
- Prisons

Clearly each country can vary depending upon individual circumstances.

In some ways the sectors and, by extension, the size of projects that tend to lead in the development of PPPs is a little curious given that it would be far easier for all concerned to start with smaller, less politically sensitive projects in order to build a greater understanding of the disciplines used before moving on to the more complex projects. This phenomenon is explained when the drivers that push Governments to justify PPPs are considered – see section 5 below.

1.5. User Pays PPPs / Government Pays PPPs

One other important aspect that needs to be understood is to define where the income for the private sector partner comes from. The PPP concept includes; both pure PPPs,that is projects where the main

source of revenue for the private partners is from the government in the form of regular payments or a unit charge; as well as concessions where the main source of revenue is user charges levied by the private partners on the beneficiaries of the services. PPP projects can vary from 100% use pays to 100% Government pays, with everything in between depending upon the type of project and the contracts negotiated.

2. ADVANTAGES OF PPP STRUCTURES

As explained earlier, PPP structures are varied and very flexible in their application which makes them an ideal option in many different types of project across numerous sectors. But what makes the PPP approach such a good one and what are the real benefits? Some of the major advantages are considered below:

2.1. Financial

Probably the largest single benefit of using PPP's is financial or, more accurately, budgetary. This is looked at in more detail later but essentially PPP's mean that projects can be undertaken that would otherwise have to compete for scarce Government resources. The fact that the cost of developing projects using a PPP structure is spread over the whole life of the project not only enables more projects to be completed sooner but the structures also remove much of the financial uncertainty of large projects from the Government. This in turn enables a Government to use its financial resources more efficiently.

2.2. Risk Sharing

One of the basic principles of a PPP structure is that risks are efficiently allocated or shared. In the early days of developing PPPs it is easy for a Government to believe that 'risk sharing' means passing as much risk as possible onto the private sector. Whilst this is possible it is very unlikely to be the most efficient structure, as whilst the private sector might be capable of taking all the risks it would normally need to charge a premium to accept certain of the risks and / or pay for insurance cover.

Efficient allocation of risk means that the private sector takes the risks for the parts of the project that it is best able to assess or con-

trol and the government retains the risk for the elements that it is best able to control or fall very definitely within normal government activities.

The private sector would typically take the vast majority of the financing risk, the risks associated with the cost of building and delivering the project on time, maintenance costs and downtime and even the risk of a fall in demand for the output in many circumstances.

The government would retain risks mainly associated with changing legislation and budgetary issues although may underwrite a certain level of demand depending upon the type of project.

The efficient allocation of risk improves the prospects that the project is run more efficiently and thus at a lower cost over its lifetime than would otherwise be possible. It also ensures that the Government is insulated from many of the risks and unexpected costs in the future.

2.3. Greater Certainty

By allocating many of the risks to the private sector the Government obtains greater certainty. The greater certainty begins with the cost of the project, as a PPP will provide a fixed price contract for the delivery of the facility. Whilst it is true that a fixed price contract will always cost more at the outset it is also true that most infrastructure projects undertaken by Governments normally over-run in both time and cost and ultimately cost much more. Depending upon the magnitude of cost over-run this can jeopardise the whole project.

It is also a proven fact that when a consortium builds a facility that it will be responsible for maintaining for many years, the quality of construction is often superior than if it is a simple building contract. This enables the private sector to keep maintenance costs down and the facility to have less down time for general maintenance or repair. This in turn enables the government to be seen to deliver better services, with greater availability and at a cheaper, and certain, cost.

2.4. Value for Money

Not only does the Government have certainty of cost but generally much greater value for money given the increased efficiency and cer-

tain other aspects of working with the private sector. Like the efficient allocation of risk, value for money is one of the core principles of PPP's. This topic is explored in more detail later.

2.5. Speed of Delivery

When entering into a PPP with a fixed price contract it is in all the parties' interests to ensure that that facility is delivered on time and it is unusual to see the over-runs that can bedevil purely public sector projects. It is worth noting that a UK National Audit Office report published in 2014 highlighted that 16% of large, ongoing government projects were not expected to be delivered on time or on budget. Often the private sector parties will begin to be paid for the operation and maintenance of the facility as soon as it is operational and as such it acts as an incentive to ensure that the facility is actually delivered on time. It is normally in the government's interest to have any facility operational as soon as possible. Details will of course be included in the contracts signed.

Perhaps of even more importance is the fact that by utilising private sector investment to fund public sector projects, more projects are able to be undertaken by the public sector and can be delivered many years in advance of what would be possible if reliant upon the restricted Government funding available.

The impact of having, say, a new motorway five or ten years earlier than would otherwise be possible can have a major impact on the economy of the Country as a whole. This can be a major benefit of utilising the private sector to deliver public sector projects but can be very difficult to quantify in exact terms.

2.6. Encourages Foreign Direct Investment

Governments the world over encourage foreign investors because of the obvious impact on GDP, jobs, tax and many other aspects of the economy. Major infrastructure projects require massive investment and can be ideally suited to using foreign investment if corporate governance, tax and other issues are acceptable.

Some countries prefer to concentrate on trying to provide the fundamentals of a good investment climate whilst others have gone further

and established a range of incentives in order to encourage FDI.

Indeed a number of projects can be sited in areas already designated as special economic zones intended to encourage foreign investment.

What cannot be disputed is that encouraging foreign investors to invest in PPP projects is an extremely effective way of attracting potential investment into the country.

2.7. Access to International Finance

It is in the interest of any Country to have good access to international financial markets whether this is the capital markets or the loan markets. Given the size and often complex nature of the financial structure, PPP projects are ideally suited to utilise these markets in the right conditions.

By developing a (hopefully good) track record, each subsequent approach to the international financial markets often becomes easier with longer maturities and lower margins possible although this will of course ultimately depend upon the underlying project.

As such, using PPP structures to access the international financial markets raises the profile of the Country on those markets and can actually prove beneficial when the Country wishes to access the markets in its own name – potentially increasing maturity and reducing margin.

2.8. Access to International Expertise

As well as gaining access to the expertise available on the international financial markets, the PPP structure promotes access to international expertise in building and contracting, engineering, maintenance and operation, technology and all the other services required to build and operate a world class infrastructure or other major project.

In addition to the actual contractors, bankers, lawyers, accountants, consultants and many others with great experience are also involved. The host Government cannot but gain from working with such a wide range of people with international experience that can be drawn upon and shared.

3. GOVERNMENT OVERSIGHT OF PPP PROJECTS

3.1. PPP Units

Most countries around the world that use PPPs have established specialist PPP units to oversee the projects although exactly what functions these units perform and where they are located varies considerably. Deciding the responsibilities of the unit and where it is located within the Government structure is critical to the ultimate success of any projects undertaken.

The new units are required simply because new skills are needed that traditionally are found in the private sector and not in the public sector. Once a Government starts to undertake PPPs they need the capacity to design projects and allocate risks in such a way that will be attractive to the private sector as well as the contract management skills to oversee the arrangements over the long life of the projects. A review of international practice undertaken by the World Bank reveals that the services provided can be very diverse; ranging from a basic function through to an almost complete role.

Almost all the Government PPP units worldwide provide at least information and guidance to other Government departments and this can include standardised contracts or detailed procedures for identifying, evaluating, and procuring PPPs. Having said that, many of the rules concerning the evaluation and appraisal of project opportunities are the same as those for conventionally procured projects. The procurement rules are usually – and should be – the same. However, some units do much more than this. For example, in Canada the P3 Office promotes the benefits of PPPs as it is very common for new countries to be against the use of PPPs but once they are better understood those countries become firm believers. Some units, such as the Gujarat Infrastructure Development Board in India provide a complete service including funding for PPP preparation; play an active role as a project developer; contract monitoring; and have approval power over the projects.

One major question is whether the units should be cross departmental or more sector specific and that would largely depend upon the number of projects being undertaken. Some examples of sector specific units would include the Private Power Infrastructure Board in Pakistan that facilitates power generation projects and the Prison

Service and the Highways Agency in the UK. But for sectors that do not have so many projects a sector specific unit cannot be justified but the ability to draw upon a central, more general unit can still be invaluable. Local authorities in the UK that develop school and hospital projects rely on the support of central bodies as this is the most efficient and effective solution.

The most common 'location' for a PPP unit is as a separate group but based within an existing Government Department and that is normally the Finance Ministry and this reflects the importance of getting the financing right for such projects. There are of course other options and these can be ever more independent of existing Government institutions.

One option is to have the unit within a ministry but to rely on long term consultants from the private sector as is done with South Africa's PPP unit. Greater independence is gained, however, if the unit is set up on an autonomous basis so that is attached to the Government but not an integral part, as with the Philippines' BOT Centre or Pakistan's Private Power Infrastructure Board. A more remote approach still is with a separate but Government owned company that is overseen by a board consisting of the public and private sectors, as with Partnerships British Columbia in Canada. The most independent is a JV owned partly by private sector companies. For Example Partnerships UK was established in 2000 with a 51% private sector shareholding and it focused on structuring and negotiating PPP projects and all the other commercial aspects and it received performance based payments linked to deal closure. However this structure proved to be controversial and it was closed down in 2010.

Perhaps the most important aspect of whether any individual country will be successful in adopting PPP structures is the need for real political will, so one overriding consideration is the benefits of the newly formed PPP unit being highly visible and having strong influence.

By establishing separate units, private sector participation becomes central and in order to have successful PPP projects it is important that private sector thinking and modes of working are thoroughly understood but that the projects are shaped by the policy perspectives and objectives of the government. The unit's role is therefore not to create policy but to create the bridge between Government policy and projects funded largely by the private sector.

4. CONTRACTUAL FRAMEWORKS

There are a number of bodies around the world that have made movement towards establishing frameworks for Public Private Partnership contracts. The development of frameworks can bring many advantages and, as a generalisation, it is Governments and supranational bodies that favour the growing use of frameworks; the most obvious being the UN, OECD and the EU – all having published very large, detailed works on the subject. However, many of the advisors and practitioners are rather more cautious and believe that too much reliance on frameworks brings restrictions that can outweigh the benefits.

4.1. Benefits

The most obvious benefit to the establishment of frameworks is that it removes the need to reinvent a contractual structure for each project. As the structure of the financing and the way in which the responsibilities, risks and benefits are divided amongst the various parties can be an extremely complex and time consuming process it also means that the structuring of any project is also an expensive process.

If a framework exists much of this work, and therefore cost, can be saved and the time saved means that the project may well be able to start earlier than without the use of a framework.

Frameworks also enable many of the lessons learnt from previous projects and other countries to be passed on quickly and efficiently to less experienced parties. Often it is the finer detail that can be the most difficult to pass on.

As PPPs have continued to develop and the idea of using frameworks has expanded there has been a move away from general frameworks and towards specific frameworks for certain types of projects and certain sectors, such as one framework for highway projects, and another, different, framework for the water / waste water sectors. The principle appears to be to develop a suite of frameworks that can be chosen from and the most appropriate one applied to any given project.

One other major benefit of using frameworks is that consistency is achieved. This can be of great value to a Government that will argue that it does not want to do five different projects in the same sector

on different terms as it makes the ongoing monitoring of the projects more difficult.

4.2. Drawbacks

There are clearly some powerful arguments for the benefits that using frameworks can bring but there are also some powerful arguments that the drawbacks to using frameworks outweigh the benefits.

The very reason for the success of PPP's is that their flexibility means that they can be adapted to most situations if the fundamental aspects of the project are right. This flexibility ensures that the best, most efficient and cost effective structure is used for each project. As each project is unique, by definition, each PPP is likely to have unique aspects in order to achieve the best structure. This in turn makes it very difficult to use a standard structure or framework.

Perhaps the issue that causes many practitioners and advisers the biggest concern is that using a framework can erect certain barriers to the open minded approach that is essential to arrive at the best structure. Certainly in any given situation if a framework is used as the starting point and then adapted it is likely to create a different outcome than if there are no preconceived ideas.

Probably, the answer is to have frameworks for the basic, core aspects of a PPP thus securing some of the time and cost savings but not to have a framework for the finer details that could stifle the open minded, flexible approach.

4.3. UN / UNIDO / UNCITRAL

Under the auspices of United Nations Industrial Development Organisation (UNIDO) a whole range of steps have been taken to develop the use of PPP's.Perhaps the most ambitious task undertaken by UNIDO is the work to establish a series of standard framework contracts for use in similar contracts across different countries. Many of the arguments for and against the use of frameworks have already been explored earlier in this paper but trying to establish frameworks that can be used across borders is far more difficult with potentially many more drawbacks than when that goal is restricted to a single country.

In 1996 the United Nations Commission on International Trade Law (UNCITRAL) decided to prepare a 'Legislative Guide on Privately Financed Infrastructure Projects' (the full version can be found at: http://www.uncitral.org/pdf/english/texts/procurem/pfip/guide/pfip-e.pdf) and this work was adopted by the Commission in July 2000. A 222 page book was published, which amongst other issues looked at:

- General Legislative & Institutional Framework
- Project Risks & Government Support
- Selection of the concessionaire
- Construction & Operation of Infrastructure: Project Agreement
- Duration, Extension & Termination of Project Agreement
- Settlement of Disputes
- Other Relevant Areas of Law

This work included 71 recommendations spread throughout the areas addressed. These recommendations were intended to be adopted by any country wishing to promote privately financed infrastructure projects. The Guide presents and explains best practices and aims to help Governments assess the adequacy of their legal infrastructure and give guidance on how to amend legislation in order to encourage PPP structures.

Throughout the Guide, frameworks are provided covering the wider aspects of enabling legislation as well as the finer detail of aspects of contracts for specific projects. Whilst individual countries around the world have adopted their own structures and systems the majority of these have used this paper as the starting point. The main recommendations from this paper are outlined below:

4.3.1. Legislative and Institutional Framework

Any legislative and institutional framework adopted should ensure transparency, fairness and the long term sustainability of any projects as well as removing restrictions on private sector participation in infrastructure projects. The laws should also clearly identify exactly what powers are held by any institutions and whether these are exercisable broadly or only in certain sectors or regions.

Mechanisms should be established that ensure the coordination of all the parties involved to progress any projects as this will greatly reduce both time and costs at all stages of the project. These mechanisms should also ensure autonomy and political independence as well as making all procedures and decisions publically available.

4.3.2. Selection of Concessionaire

The law should provide a transparent and efficient process to ensure open competition and any bidders should clear minimum pre-selection criteria. Given the wide range of expertise required on the majority of PPPs the bidders should be allowed to establish consortia but any one company should only form part of one consortia. Most projects would go through a staged process where the initial bidders are shortlisted and must pass minimum pre-selection criteria and some countries will bias this process towards domestic partners and then those that pass the initial process will be requested to submit final bids.

Evaluation must focus on technical soundness; operational feasibility; quality of service and; social and economic development potential offered by the proposals. The financial criteria should include: present value of all construction, maintenance and other related costs; the extent of any financial support, if any, expected from the Government and; soundness of the proposed financial structure.

4.3.3. Implementation

The Project Agreement between the contracting authority and theconcessionaire is the central contractual document in an infrastructure project and it defines the scope and purpose of the project as well asthe rights and obligations of the parties. Legislation varies greatly from one country to the next, with some countries having general legislation that simply does not preclude PPPs, whilst in other countries it is necessary to amend legislation in order to specifically allow them. Looser legislation is better for the development of PPPs as in order to maximise value their structure should be flexible and adapted to any given project.

In almost every case, because of the wide variety of disciplines re-

quired from the private sector in a PPP they are bid for by a consortium. Once successful, this consortium will typically form a project company or SPV that will be awarded and implement the contact.

Ownership of assets is one area that can be crucial to the tendering and implementation of any PPP project as different countries have different political views on what can and cannot be transferred to the private sector, even if this is on a temporary basis and as such the documentation will need to be extremely specific on this aspect.

Finance in almost all PPP projects is left to the concessionaire as that is the basis of the concept. This will include all finance required to construct and operate any facility although there may well be a structure whereby some of the costs are charged back to the Government on an agreed basis, as with shadow tolls for roads as an example. The majority of funding is raised from banks and international capital markets as lenders are secured against long term government contracts. Tariffs, off-take agreements and other forms of charging are at the centre of any PPP project and also ultimately can represent the highest level of disputes later in the project so it is crucial that any structure is stated in the documentation in great detail but nevertheless it remains flexible to cater for future eventualities. Typical tariff agreements would use some form of rate of return or capped pricing increases as these would encourage efficiency and protect both sides but any such agreement will need to be reviewed over the lifetime of the project in order to cater for changed circumstances.

4.3.4. Operation

Performance standards including such things as quality and availability of service are central to the Government's wishes and contracts will always have penalty clauses if these agreed standards are not met but many contracts also have financial and other incentives to exceed the minimum requirements.

PPP projects are typically long term and it is almost inevitable that during the period of the contract that there will be many changes to legislative, economic and other conditions that have a direct or indirect impact on the agreement. It is imperative therefore that any contracts have both pre-defined remedies for any changes that might be foreseen but also that there are stated mechanisms for how any un-

foreseen changes will be handled. If these clauses are not in the original contracts then it will inevitably lead to disputes at a later stage.

Within any agreement will be a clearly defined dispute procedure. This will outline what constitutes a dispute on either side and what are the remedies available to the other party. Any potential for dispute should be identified at an early stage and remedied before they can become a serious breach of contract. Most contracts allow for independent arbitration (normally binding) to settle many disputes as this is both quicker and cheaper for all parties although any major disputes are still likely to lead to the injured party seeking full legal redress through the courts.

4.3.5. Transparency

The overarching conclusion that can be drawn from every part of the UNCITRAL paper is that PPP projects will never be truly successful unless every part of the process from tendering to structuring to award and implementation and operation of the contracts is completely transparent. Without this it is impossible to ensure value for money and delivery of a quality service.

4.4. UK Government

As has previously been noted, the UK Government, working firstly with the Treasury Taskforce and then Partnerships UK, has a lot of experience in structuring PPP's. Inevitably in the early days each contract was written individually and as such each contract was different. This led to many projects that were essentially the same being taken forward on different conditions.

Under the centralised body of the Taskforce and then Partnerships UK the main aspects of these contracts were brought together to form the basis of a framework for future contracts. All later contracts then used a basic framework in order to ensure consistency but it is still considered best practice to leave the finer detail to individual project negotiation in an attempt to ensure that the benefits brought by flexibility and innovation are not stifled at the contract stage. This structure is based on the recognition of the potential drawbacks whilst trying to harness many of the benefits of utilising frameworks.

5. DRIVERS

5.1. Infrastructure Needs

For any country to prosper it needs to have good infrastructure. Not only does there need to be a sufficient quantity of all the various aspects of infrastructure but it needs to be of sufficient quality, well built, well maintained and efficiently utilised. The infrastructure must satisfy the needs of the country and the population and operate on a cost effective basis.

This sounds relatively simple, but many governments around the world have proved not to be successful in achieving these aims almost always due to a lack of investment. Governments have historically been guilty of not maintaining infrastructure properly and often not considering efficient maintenance as a way to ensure the most cost effective use of the infrastructure over its lifetime. Governments are often guilty of having a shorter term view (ie the lifetime of that particular term of office or, at the most, two terms) than the lifetime of the asset and how it may be operating in 25 years time is all too easily seen to be somebody else's problem.

Some types of infrastructure, such as communication, can have a far greater effect on the wider economy than may at first be supposed. Roads are perhaps the best example. If by using private sector funding a road can be built five or ten years earlier than would be possible if it were funded by the public sector, the benefit gained by that economy, given the more efficient movement of goods and people, can be enormous.

In many cases the private sector would prefer a greenfield scheme as they are able to have more involvement from the outset and maximise the advantages that they bring but it is not always necessary to embark upon a greenfield project as the refurbishment or updating of existing facilities can often provide a more cost effective solution and PPP techniques can be applied in either circumstances.

5.2. Existing Infrastructure

Whilst any country clearly has a certain level of infrastructure, this, for many different reasons, may not meet the various demands that are placed upon it. It may be badly built or maintained, it may be in

the wrong place or outgrown, it may not have kept pace with technology or changes in the law, or may not be suitable due to any number of other factors.

It is generally recognised that the quality and quantity of infrastructure available effects the economy as a whole as it impacts on most aspects of efficiency whether production, transport and communication, or services. This is especially true in emerging economies as it is clear that the existing infrastructure is holding up the development of the economy.

The most common drivers, or reasons to upgrade infrastructure are discussed below:

5.3. Quality

The question of quality can be equally applied to both the original build and the ongoing maintenance of a facility. Unfortunately many of the facilities in emerging economies are often not built with the best methods or materials available at the time of their construction, as a result of which they have deteriorated more quickly than might otherwise be the case and do not operate as efficiently as they should.

In many cases maintenance has been carried out poorly or ignored in an attempt to save money in the short term. This 'short sighted' approach is almost always a mistake in the longer term but appears to work in the short term and passes the problems onto others in the future. Again, this is common worldwide but perhaps even more exaggerated in emerging economies.

5.4. Focus

By their very nature, infrastructure projects are meant to last many years and whilst an attempt is always made to predict future demands many things can change unexpectedly due to outside influences. This is particularly true as younger economies start to grow.

Perhaps the most notable difference is that the amount of international trade increases sharply leading to a need for much better transport infrastructure – most obviously on roads, railways and ports. Even where good roads or rail links exist they may well be pointing in the wrong direction as new ports are developed for example.

There has also been a decline in regions that were historically centres of heavy industry and an increase in the numbers of people living in large cities and, in particular, capital cities. This can mean that services such as waste water treatment plants may have too much capacity in some areas but, more importantly, can be severely overstretched in other areas.

5.5. Modern Requirements

Much of the infrastructure that may now be considered to be inadequate may well still be performing as was intended when it was built. However, modern requirements are rather different than they were a few decades ago, often as the result of rapidly improving technology.

The best example of this is telecommunications. The massive growth in mobile telephones, the internet and data traffic has meant that old cables have had to be replaced with fibre optic cables, aerial masts and satellite dishes.

Whilst modern technology makes most manufacturing processes more efficient, nevertheless there is a continual upward trend in the need for energy from both manufacturers and individuals. At the same time, environmental considerations are becoming ever more important leading to very expensive adaptations to existing power stations and the need to build new, cleaner, more efficient power plants.

As a general rule, modern requirements are for more, bigger, better whilst demanding that everything is safer, cheaper and more environmentally friendly. These often conflicting considerations can render what are otherwise perfectly good facilities obsolete. Again, the sheer speed and scope of change from what was acceptable in the past to what is required now can be so large that demands for new infrastructure are massive.

5.6. Changing Circumstances

As with the drivers listed under 'focus' above, changing circumstances can lead to very different demands needing to be met than were taken into consideration when the facility was planned. Again these circumstances are often unforeseen and are often caused by large increases in traffic and people flows.

5.7. Increased Expectations

It is true that each successive generation expects more than the last and as each of us gets older we have increased expectations. In developed countries around the world there is an inexorable rise in living standards and all this leads to ever increasing demands on the infrastructure.

Modern lifestyles consume more products and expect higher standards in almost every aspect of life from cleaner, safer water to better and faster transport links. The individual people in emerging economies also want an improvement in their lifestyle and living standards and are increasingly impatient for this. Inevitably if these changes are not seen it is the Government that is blamed whether this is justified or not.

These higher expectations are often even more pronounced from foreign businessmen and tourists, as inevitably these tend to be wealthier individuals that are prone to make comparisons with their own country.

5.8. Government Needs

Of all the drivers behind the need to develop infrastructure and the benefits of utilising PPP structures it is ultimately the Government's needs that decide which projects are undertaken and on what basis.

Government needs, like most other needs, are often influenced by external sources. Any government should have a desire to improve the country and the safety and wealth of its citizens. What actions any given Government takes depends upon their political viewpoint, financial resources and many other factors.

5.8.1. Government Borrowing / Balance Sheet

Good fiscal management and issues relating to cost of borrowing, credit rating and the like prevents countries from borrowing too much and thus restricts the amount of funds available for infrastructure development.

Every Government in the world has a 'wish list' of projects that it would like to complete but funding them all is simply not possible.

Using PPPs as a tool to help develop infrastructure and other projects makes more projects possible sooner. Having said that it is still important to understand and account for the fiscal risks and exposure to contingent liabilities that PPP projects can bring.

5.8.2. Votes

Ultimately, any Government actions in a democracy are based around their desire to be voted back into power at the next election, which of course means keeping voters happy.

Given changing circumstances and the increased expectations of the population, together with improved technology and all the other external factors, if a Government does not provide improved services they will not be successful in keeping the voters happy. It is up to the Government to find the most efficient way to provide these services.

By utilising PPP structures Governments can provide the infrastructure that is needed whilst demonstrating good, sound, financial management and ensuring that they or future Governments are protected from many risks in the future.

6. FINANCING

6.1. Infrastructure Spending

Around the world, the demand for more or better infrastructure is increasing all the time and nowhere is this more true than in any emerging economy. It is simply not possible for these countries to fund all of the required projects from their own resources or within the prudent bounds of borrowing. Not only is it not possible but the question has to be asked whether it is desirable.

As an example, in 2000, the City of Warsaw publicly stated that it had identified needed – not desired, but needed – projects costing some $5 billion. If we use the city of Warsaw as an example of just one city's needs it is easy to see that relatively urgent infrastructure spending in emerging economies can easily be in hundreds of billions of US dollars.

More recently, India announced an estimated infrastructure spending requirement between 2012 and 2017 ofINR40,992 (approximately $692bn at today's exchange rate) of which 50% is expected to be met by private investment partners. India is now one of the major users of PPP structures and Shri Manmohan Singh, (Indian Prime Minister at the time) stated "PPP projects take much less time to complete and the Government does not have to bear cost overruns. This will not only enable us to leverage our limited public resources but also improve efficiency and service delivery".

6.2. Needs vs Financial Resources

Matching needs to financial resources is a challenge for all, from individuals to companies to Governments. By working with the private sector and adopting PPP structures it is possible for Governments to undertake many more projects, much sooner and meet more needs than would be possible if these structures are not adopted.

Whilst the pool of financial resources is not limitless, nevertheless for the right projects that are properly structured the pool is extremely large and growing all the time. It is certainly limitless in comparison to more traditional methods of funding infrastructure projects.

Even if a Government or Municipality has the financial resources

available via taxes or other budgetary income, or indeed if it has the capacity to access the international financial markets directly, the financial resources may be sufficient for a few of the more important projects but almost certainly not for all of the projects. Using PPP structures for public projects effectively transfers the limiting factor on the number of projects that can be undertaken away from financial resources and on to other factors such as the number of experienced Government personnel to negotiate, award or monitor contracts. It is important not to attempt too many projects simultaneously too soon.

6.3. Costs

By using a PPP structure it allows the authorities to substantially reduce capital expenditure as the initial infrastructure costs are effectively converted into ongoing operational costs.

It is often said that the costs put forward under a fixed price PPP contract are higher than those put forward for the same project but under a more traditional structure. At face value this may appear to be true but it is important to understand the reasons and then to appreciate that ultimately it may prove to be cheaper. One reason for this apparent conflict is that the risk for cost or time overruns has been passed from the public to the private sector. Whilst not every project has cost over-runs it is a fact that many public sector projects do. This is highlighted by the lates UK National Audit Office report stating that 16% of major UK projects are not expected to complete on time or on budget and this is mirrored in reviews in most other countries around the world. Whilst every project is different in many cases the higher initial cost of securing a fixed price contract can often be much cheaper, and certainly carries lower risk, than bearing the high cost overruns that seem to accompany many government projects.

6.3.1. Cost of Funds

Whilst every project / Country / Municipality is different it is true that in the vast majority of cases the cost of funds is higher if raised by the private sector than if it was provided by the central or local government. Statistically the cost of funds can be 1% to 3% more for projects in the UK. This is purely a reflection of the limited or non-recourse structure of projects and the fact that funders are taking on

a larger risk than if they had full recourse to a sovereign borrower. This is why project bidders on the private sector side often request sovereign guarantees.

However, the cost of funds is only one part of the overall package - typically financing costs represent approximately one third of the total costs. The other efficiencies found in a PPP structure will normally more than compensate for the increased cost of funds. The other aspects are discussed in Whole Life Costs below.

Just as importantly is the fact that as the public sector funds are very limited there is a definite opportunity cost to using funding for projects that can obtain funding from other sources. By using PPP's for some projects Government funds can be retained for use on projects that do not lend themselves to this type of structure or indeed for any other public sector requirements.

6.3.2. Whole Life Costs

Of all the arguments used to outline the benefits of using PPP structures, virtually all of the financial benefits can be summarised into one even more powerful argument – that of whole life costs.

As we have seen, the actual cost of funds is normally above that available to the public sector directly, but the whole life costs are normally much lower. As such, using a PPP structure over traditional procurement methods can be considerably more cost effective over the lifetime of the projects although the actual amount can vary considerably from one sector to the next and indeed between countries.

The reason that the total costs are lower is that the overall structure is far more efficient and savings are made in most areas. The synergies of one consortium combining design, construction and operation can be significant . Briefly the reasons for this are:

Design. When a consortium knows that it will be responsible for the ongoing maintenance and costs incurred of a facility, more care is taken to ensure that the facility is designed to assist long term maintenance and reduce operating costs even if this may be more costly at the outset. This approach is very rarely taken when projects are undertaken solely by the public sector as there is an almost total focus on reducing the initial cost not the whole life cost.

Construction. Similarly, when a consortium knows that it will be responsible for the ongoing maintenance and costs incurred of a facility, more care is taken at the construction phase in order to ensure the quality of all aspects of construction. Experience also shows that many projects are completed ahead of schedule as it is often in the consortiums interest for this to happen. This means that the facility is in use sooner and providing the benefits quicker than would be the case under conventional procurement. In 1999, the UK National Audit office calculated that only 30% of non PPP projects were completed early or on time but in a recent UK HM Treasury report it concluded that 89% of PPP projects did so. This experience is common around the world.

Maintenance. With the design and construction having been optimised to ensure the least downtime and the most cost effective maintenance, the cost of maintenance can often be dramatically reduced when compared with public sector facilities and indeed the facilities are normally far better maintained than public sector facilities. The contract will ensure that certain standards are maintained but it is in the consortiums' interest to do this, as properly maintained facilities are ultimately cheaper than having to 'catch up' later.

Efficiency. Simply, modern facilities of whatever nature operate far more efficiently than older ones and so the total cost of providing the service is reduced. This, combined with the better design, better quality of construction and better maintenance ensuring less downtime leads to a far higher efficiency overall. These benefits can often be obtained more quickly by using PPP structures than having to rely on more traditional government funding.

Innovation. When consortiums are bidding in competitive situations and are looking for additional benefits to bring to a project in which they will be involved for many years they are far more likely to be innovative in finding measures to reduce total costs. This can be at any stage from design or construction through to maintenance or operation and this innovation is also done at the total risk of the private sector, thus the public sector gets the benefits of innovation without carrying the risks.

Approach. It is a fact of life that many Governments when looking for cost benefits are only interested in the initial costs. The private sector consortium is far more likely to be prepared to spend more at the outset if it will reduce the whole life costs.

6.4. Cash Flow

It is not just costs or the 'profit and loss account' or 'balance sheet' that should be considered in the procurement process but also cash flow. One other very real benefit of adopting a PPP structure is that it allows the authorities to greatly reduce the cash required at the outset of a project and enable the facilities to be paid for from the flow of income in the coming years. This removes the 'lumpiness' of funding projects using the traditional methods and allows for much better planning in the future. It also enables more projects to be undertaken at the same time and so increases the authority's ability to deliver the infrastructure improvements required.

7. KNOWLEDGE TRANSFER

One of the major benefits that comes with the move towards using PPP's is a by-product. It cannot normally be said that one of the reasons that any Government wishes to use a PPP structure is that it will increase their commercial knowledge but nevertheless knowledge transfer is a major benefit. This is true in any situation but especially so when the country in question is undergoing transformation to a fully functioning market driven economy.

7.1. Lessons Learnt

Lessons are learnt not just by the public sector but by the private sector also. It is certainly true that the public sector has the most to learn as PPP structures are based primarily on private sector skills that are now being used in the public sector. However, as PPP's really are partnerships and the whole purpose is to deliver better, more efficient public sector services, the private sector has to learn about the delivery of such services and the constraints imposed.

The learning process is long and, like in so many other areas, it never stops. The public sector employees have to learn a whole new range of often very complicated skills just in order to be able to negotiate, award or monitor contracts. Unless these lessons are learnt (or good, long term advice is taken at the outset) many of the finer details or benefits will not obtained for the public sector as the private sector is not in the habit of giving things away in negotiations.

7.1.1. UK Experience

As we have already seen, the roots for PPP's might be traced back to medieval times although it was probably 1992 that the modern PPP structure was really born.

The UK has tended to lead the way in many innovative financing structures and other areas of Government financing and the relationship with the private sector such as in privatisations and compulsory competitive tendering of public services. The structured financing of PPP's has been a logical development of privatisation and compulsory competitive tendering having aspects of both and indeed arguably including both in the wider definition of PPP.

The UK Government started to introduce privatisation in the early 1980's. This process took many years and transferred whole ownership of formerly state owned entities into the private sector. Market forces ensured that the newly privatised companies were operated far more efficiently and drew on private sector expertise to maximise profitability and improve working practices. Whilst this process often led to job losses the new companies were able to compete on the world stage without being a constant drain on Government resources. Companies from sectors as diverse as telecommunications, banking, airlines, steel production, power generation, transport, oil & gas and many others were involved.

Also in the 1980's many public services were put out to public tender. Thus the in house providers of services such as refuse collection, leisure facilities, cleaning, maintenance and catering had to compete with the private sector to provide the best, most cost effective service. This process again ensured that the operations were run far more efficiently under the new regime than they were when they were provided by local Government.

This is not the forum to debate the politics of these two programmes but it is widely recognised that the gains in efficiency of service and reduced costs have been tremendous.

In 1992 the British Government abolished certain legislation that restricted the use of private funding for public projects and the use of PPP's as we know them today started to accelerate rapidly. The number of projects successfully funded continued to grow as both the public and private sectors gained in experience and in 1997 the British Government recognised the need to establish a centralised co-ordinating body to maximise the knowledge transfer and the Treasury Taskforce was created.

7.1.1.1. Sectors

PPP structures have become widespread in the UK with most sectors benefiting.

Transport. Bridges were amongst the first PPP projects in the UK and river crossings are the only part of highway infrastructure that the British public were originally prepared to pay a toll for using. Despite this, many major highways have now been built using PPP's

often based on a shadow toll mechanism. Shadow tolls are simply where the Government pays a fee to the operator for each vehicle that uses the highway rather than charging the users directly. Many highways and bridges are maintained on a PPP basis and their use has also been used in other aspects of the transport infrastructure. Some 10 years ago, the London Underground £8 billion extension received much publicity due to the very public debate concerning certain aspects of the proposed PPP contract.

Prisons. Most aspects of the provision of prisons, from the design, build, finance and operate through to transportation of prisoners has been undertaken through PPP. This has included new prisons and outsourcing existing ones and from the very large prisons to small police custody centres.

Property. The property requirements of many Ministries have changed substantially over the years. Given that the public sector has a lot of experience in financing property it is a sector that easily lends itself to a PPP structure. The Ministry of Defence in particular has freed up huge financial resources that can be better deployed elsewhere.

Health Care. The most obvious impact that PPP has had on the health care sector has been in the provision of new hospitals. To date this has been in every aspect (ie design, build, maintain as well as services such as providing catering and cleaning facilities) except the front line medical staff although even this is now under consideration. At the smaller level new community health centres have also been provided.

Schools. In a very similar way to hospitals, virtually every aspect of schooling has now been subject to PPPs with the exception of front line teaching staff.

In such a brief look at PPPs it is not possible even to list out all the different ways in which PPPs have been utilised in the UK in the last twenty years but it would not be far wrong to state that they have now been used in the vast majority of services delivered by the UK Government.

7.2. Painful Lessons

It is true of any learning experience that not all the experience or lessons learnt will be good but that there will also be painful lessons. In many ways more can be learnt from a bad experience than from a good one as long as the reasons why things went wrong are properly analysed.

Certainly in the UK, whilst the overall experience has been a very good one there have also been a number of bad experiences. The reasons have been various but all of the experience has been used to factor into new agreements in order to continue to improve the whole process. As the vast majority of PPPs undertaken in the UK have been 'behind the scenes' and the public has not been aware of them, the general public are relatively unaware of the revolution that has been occurring in financing and delivering public sector services. Given a number of high profile problems the public perception of PPP is often negative but this is because they are not aware of all of the facts. This is particularly regrettable given the major benefits already obtained that they are largely unaware of.

One 'famous' failure was the failed motorway project in Hungary. This had a very high profile in the region at the time as it was one of the first projects of its type and EBRD was involved in the financing. The reasons for the failure are far too complex to go into detail here but in essence (and of course with hindsight) the motorway was too short, the tolls were too high, the contract not flexible enough, the relationship between the public and private sectors not good enough, there was a free parallel road running next to it and the Government actions that were intended to pacify the users only made the problems with the project worse.

Despite the fact that the many valuable lessons that can be learnt from the difficulties should ensure that any future projects avoid many of those particular problems and are therefore safer, it served to slow down the uptake of PPPs in the region until they were able to look beyond the difficulties to see the many benefits of getting such a project right.

8. GOVERNMENT INPUT

As a Public Private Partnership is a long term partnership between the public and private sectors clearly Government input, both at the beginning and during the lifetime of the project, is crucial. The level and quality of this input can easily make the difference between a successful project and a failed project.

It is extremely important to any project and the long term reputation of a Country that any Government input is limited to the areas that have been agreed upon and that they resist any temptation to interfere with aspects of the project or wider issues that have been passed over to the private sector.

In order to make a success of PPPs there are many crucial elements but by far the most important is political will. With serious political will almost anything can be achieved but without it almost nothing can be achieved. The input will cover a vast range of areas, some of which are considered below:

8.1. Serious Intentions

Any Government, anywhere in the world has a strong desire to be heard to be saying the right things. That is often the easy part. To say the right things and to really mean them are not necessarily the same things and to mean them and to actually act upon them are definitely not the same things. This difference in words, intentions and actions may be for perfectly good reasons or it may be because there were never the serious intentions behind the words.

As the pressure continues to mount to improve infrastructure, the Governments in emerging economies all start to say the right words. As outlined at the beginning of this paper, PPPs are increasingly being accepted as an important contributor towards the future development of infrastructure projects, especially in emerging markets. This, again, is increasingly being recognised by Governments and they are saying the right words. But do they really mean them?

Structuring a Public Private Partnership for a large infrastructure project is a very complex task that needs all parties to be flexible, innovative and to work together as a team. None of this will be possible if one of the parties is not committed to the long term success of the project.

8.1.1. Legislative Change

Legislative issues are the cornerstone of any PPP and even if all parties agree on how the project is best structured the project will not progress unless all aspects of the structure are permissible under national legislation. It is also possible that Governments will not be successful in encouraging serious interest from the private sector, or the project has to be structured in a less than optimum way unless certain aspects of legislation are changed in advance.

In the earlier projects it is likely that there will need to be a number of legislative changes to be passed by the Government – whether this relates to concession laws, tax, security, corporate governance issues or something else will vary from one country to another and from one project to another.

Laws can only be changed if the host Government has serious intentions and this is all the more true if laws are to be changed quickly. Again, how serious any Government actually is can only be gauged upon actions not words.

8.1.2. Decision Making

It is a fact of life that larger organisations tend to be slower at decision making than smaller ones and that coalition Governments tend to be slower than Governments made up of one party with a strong majority. In a coalition Government the decision making process may be slowed down because not all factions agree with the way forward.

Given the complexities and the large number of influences upon developing a PPP infrastructure project it is important that any decisions that need to be made can be achieved quickly otherwise the whole project is held up and, ultimately, will collapse. A Government that is committed to a project will be far quicker at decision making than one that is not so serious in its intentions.

8.2. Co-ordinate / Centralise Knowledge

As we have seen, the level of expertise in PPPs in the United Kingdom grew much faster and has obtained greater depth than would otherwise be the case because a centralised body was established.

When a Government is considering entering into a PPP for the first time there is a vast amount that needs to be learnt very quickly. Inevitably mistakes will be made or, at the very least, contract terms will not be optimised. Without a centralised body to co-ordinate projects and act as a centre of excellence many different parts of the same Government, or different Municipalities in the same country, will need to go through this same steep learning curve.

By establishing a PPP unit the Government can ensure that any legislative change required for one project can consider other projects at the same time and that the needs of one project or sector do not unintentionally conflict with other projects or sectors.

Perhaps the most important role of a PPP unit is performed at the very outset and that is to 'champion' PPPs and to help ensure that Ministers and senior government officials from across Government fully understand the concept and the benefits that can be brought by using such structures. Without this wide base of support any necessary decisions or legislative changes will be more difficult to obtain. Also, when the concept really is fully understood it is far more likely that the Governments words will turn into real actions.

8.3. Corporate Governance

The only other topic in international finance that has seen such a rapid growth as the term 'PPP' is corporate governance. Like PPP, this topic covers a huge range of issues and, to some extent, can mean different things to different people. The two topics are closely interwoven as for a PPP project to proceed, the level of corporate governance needs to be acceptable to foreign direct investors.

Essentially, corporate governance covers issues such as transparency in the award of contracts, the fair application of the judiciary process, investor and minority shareholder rights, regulation, the provision of accurate and timely information and a whole range of other such issues.

If a potential partner is not happy with the corporate governance in a given country it will lead that partner to either insist on a more complicated (and therefore expensive) structure in order to mitigate the risks or not participate at all.

8.4. Reputation / Track Record

A country's reputation or track record is usually dependent upon the Government in power but once a bad reputation is gained it can be hard to change and often there are national characteristics in how any given Government will act.

This reputation covers all the areas covered by Government input from whether they have serious intentions, how quickly they make decisions and any necessary changes to legislation, through to all the general corporate governance issues. A potential partner will need to consider how a Country or Government has acted in the past.

In this context it is not just the private sector partners but, more importantly, the banks and other funders of a project. If a Country has a poor reputation it may not be able to obtain funding for large projects or, at the very least, the funding will be more expensive in order to reflect the higher risks.

This issue of reputation and track record often seems not to be fully understood by Governments. It is possible that they may be able to force changes in one project but at what cost to reputation and future projects?