Analysis on Public-Private Partnership

Slovenia

CSOs as equal partners in monitoring public finances

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BALKAN
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This document has been produced as a part of the project "CSOs as equal partners in the monitoring of public finance" which started beginning of 2016 and is implemented by a consortium of 10 organizations from 7 countries and will last for four years.

The aim of the project is to improve the transparency and accountability of policy and decision making in the area of public finances through strengthening the role and voice of NGOs in monitoring the institutions that operate in the area of public finances. In this way, the project will strengthen CSO knowledge of public finance and IFIs and improve CSO capacities for monitoring. Additionally, it will help advocate for transparency, accountability and effectiveness from public institutions in public finance. Moreover, this project will build know-how in advocating for sustainability, transparency and accountability of public finance and IFIs. This project will also increase networking and cooperation of CSOs on monitoring of public finance at regional and EU level. Lastly, it will increase the understanding of the media and wider public of the challenges in public finance and the impacts of IFIs.

Key project activities are research and monitoring, advocacy, capacity building and transfer of knowledge/practices and networking in the field of the 4 specific topics: public debt, public-private partnerships, tax justice and public infrastructure.

More information about the project can be found on http://wings-of-hope.ba/balkan-monitoring-public-finance/ and on the Facebook Page Balkan Monitoring Public Finances

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CONTENT

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1. UNDERSTANDING PPPS IN SLOVENIA

PPPs are now being promoted worldwide by global institutions and consultants. Development banks, national governments, the EU and donor agencies are providing subsidized public finance specifically for PPPs.

Public-private partnerships were legally introduced into the Slovenian legal system with adoption of the Public-Private Partnership **Act** (hereafter: PPP Act) in **2006**. The main reason for the adoption of the PPP Act was to strengthen the cooperation between the public and the private sector in the area of providing services of general interest and public infrastructure.

The PPP Act **regulates** the purpose and principles of private investment in public projects and/or of public co-financing of private projects that are in public interest. The PPP Act also regulates the **methods** of encouraging public-private partnerships and the institutions concerned with its encouragement and development, the conditions, procedures for creation, the forms and methods of operating public-private partnerships, the special features of works and service concessions and of institutional public-private partnerships. Furthermore, the PPP Act regulates the **transformation** of public companies, the system of law that applies to resolving disputes arising from public-private partnerships, and the jurisdiction of the courts and arbitration services to decide on disputes arising from such relationships.

Although the cooperation between the public and private capital was already possible before the PPP Act, the cooperation under those provisions was rather limited. Possible forms of public-private partnerships are defined by PPP Act as:

a) **Contractual** Partnerships that may have **form** of:
- ➢ A concession, or
- ➢ A public procurement partnership.

b) **Institutional** or equity partnerships, which can be established:
- ➢ By founding a new legal entity;
- ➢ Through the sale of an interest by the public partner in a public company or other entity of public or private law;
- ➢ By purchasing an interest in an entity of public or private law, recapitalisation; or
- ➢ In another manner in comparative terms legally and actually similar and comparable to the aforementioned forms and through the transfer of the exercising of rights and obligations proceeding from the public-private partnership to such person.

c) The PPP Act divides the **procedure** for forming a public-private partnership into three basic

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phases:
- Phase 1: preliminary procedure,
- Phase 2: public tender,
- Phase 3: selection of public-private partnership contractor.

The process of forming a public-private partnership can begin under the Slovenian legislation either by initiative of the public or private sector.[1]

PPPs come in many forms, giving rise to a bewildering array of acronyms like BOOs, BOTs, BLOTS, BOOTs, BROTS. Each represents a slightly different arrangement, or contract, between the private sector and a government as to who designs, builds, finances, owns, develops, operates and manages an asset over how many years.

Due to increasing **importance** of the award of concessions within the **EU**, and the absence of clear rules governing the award of concession (representing a lack of legal certainty, an obstruction of the freedom to provide services, and internal market distortions), the **Directive** on the award of concession contracts was adopted in 2014. This Directive defines "concessions" as works or services concessions, whereby
- "works concession" means a contract for pecuniary interest concluded in writing by means of which one or more contracting authorities or contracting entities entrust the execution of works to one or more economic operators the consideration for which consists either solely in the right to exploit the works that are the subject of the contract or in that right together with payment;
- "services concession" means a contract for pecuniary interest concluded in writing by means of which one or more contracting authorities or contracting entities entrust the provision and the management of services other than the execution of works to one or more economic operators, the consideration of which consists either solely in the right to exploit the services that are the subject of the contract or in that right together with payment.[2]

Namely, the **Directive** distinguishes between the concepts of concession and the concept of a public contract on the basis of the main distinctive criterion: the substantial operating risk. The preamble to Directive on the award of concession contracts defines an operating risk as the risk of exposure to the vagaries of the market, which may consist of either a demand risk or a supply risk, or both a demand and supply risk. Demand risk is to be understood as the risk on actual demand for the works or services

[1] Concessions and public private partnership, Institute for PPPs http://www.pppforum.si/en/podrocje/koncesije-in-javno-zasebna-partnerstva/
[2] Legal elaborates, analyses and studies, Institute for PPPs, http://www.pppforum.si/en/produkt/legal-elaborates-analyses-studies/

which are the object of the contract. Supply risk is to be understood as the risk on the provision of the works or services which are the object of the contract, in particular the risk that the provision of the services will not match demand.[3]

The **Law** on PPPs is a **new** form compared to public procurement and concessions laws - are something that is already known and well established, which requires a lot of effort in the **preparatory** phase of the project, where it is necessary to identify all of the **risks** and their **distribution**, **obligations** and **rights** of both partners.

The main **challenges** are **time** management, meaning that PPP projects want to be in the shortest time frame possible and in practice that means ignoring a planning project phase, which is the key stage of preparation of PPP projects. The MF **monitors** and also **advises**, if the public partners wants to. Further, in practice some other **deficiencies** of PPPs have also been observed like a **lack** of transparency, no greater efficiency than in the public sector, delays, cost overruns, construction flaws, quality problems, legal disputes, failed contracts, bankruptcies and service cuts.[4]

PPPs represent a **network**, various forms of cooperation between public authorities and the business community, whose **goal** is to provide **private initiative** to finance, management, construction, renovation, maintenance of infrastructure and **public service delivery**, characterized by **long-term contracts** and **risk sharing** and the **effects** of the business. When PPPs perform well on this criterion, the question of the level of costs arises.

The complexity of PPPs means that there are very high legal and accountancy expenses involved for both government and companies, with tendering periods lasting an average of 34 months.[5] PPPs use turnkey **contracts** which are much more **expensive** than ordinary contracts. The higher costs of a PPP reflect the higher payment required by a contractor to accept construction risk. When taking the whole process including negotiations into account, PPPs projects often last much longer than traditional procurements. However, a PPP **contract** will often be re-negotiated, resulting in higher costs. About 25% more than conventional contracts. Nor is **risk** transfer necessarily the best policy option.

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[3] Legal elaborates, analyses and studies, Institute for PPPs, http://www.pppforum.si/en/produkt/legal-elaborates-analyses-studies/

[4] Švigelj, M., & Horvatin, N. (2013). The Impact of the Financial and Economic. Crisis on Public Private Partnerships. Mednarodna revija za javno upravo, XI(2), 77–89.

[5] Iossa E. and Martimort D. 2011 Risk Allocation and the Costs and Benefits of Public-Private Partnerships CEPREMAP Working paper no. 1104 http://www.cepremap.ens.fr/depot/docweb/docweb1104.pdf

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Governments are not like companies. Many **public** services involve governments carrying risks for the rest of us because this works best – the risks of ill-health or unemployment, for example.[6]

There are several reasons **governments** decide to **choose** a PPP over traditional **procurement**. The main underlying motivation is to achieve **improved value for money (VFM)** or improved services for the same amount of money as the public sector would spend to deliver a similar project (Grimsey & Lewis, 2005, p. 346).[7] Other advantages of using a PPP are that it enables the provision of infrastructure without increasing public sector borrowing, eases pressure on the public-sector budget, reduces the risk of a government arising from projects (Hodge, 2010).[8]

Total **social cost** includes production **cost**, transaction cost and the cost of externalities (e.g. quality) (Boardman & Vining, 2010). Boardman, Poschmann and Vining (2005) find that project complexity and uncertainty, asset specificity and the lack of contract management skills are the main causes of transaction costs. However, Boardman and Vining (2010) argue that the appropriate **criteria** for decisions should be based on allocative efficiency. They advocate the use of **cost-benefit** analysis to estimate the net social benefits of alternative projects.

For the private **companies** involved – the banks, the builders and the service companies – PPPs represent an extremely attractive business **opportunity**. A single **contract** can give them a flow of income for 25 years or more – usually underwritten to a great extent by the government itself. The companies can **lobby** politicians to ensure that governments create PPPs, and renegotiate them as necessary during the long years of the contract.

In Slovenia there is no the so-called PPP **Unit**, which would be the **central body** for the implementation/monitoring of PPP projects. The **Department** for Public Private Partnership is an organizational unit within the **Ministry** of Finance, which is tasked with developing, monitoring and helping implement PPPs in Slovenia. In this capacity, the PPP Department publishes manuals for operating PPPs, formulates expert proposals for amendments to regulations and the adoption of other

[6] Why Public-Private Partnerships (PPPs) don't work, David Hall, Public Services International Research Unit University of Greenwich, UK. January 2014
[7] Grimsey, D., & Lewis, M.K. (2005). Are Public Private Partnerships value for money? Evaluating alternative approaches and comparing academic and practitioner views. Accounting forum, 29(4), 345–378.
[8] Hodge, G. (2010). Reviewing Public-Private Partnerships. Some Thoughts on Evaluation. In G. A. Hodge, C. Greve, & A. E. Boardman (Eds.), International Handbook on Public-Private Partnership (pp. 81–112). Chelteham, UK: Edward Elgar

measures that might improve practices and eliminate problems, and performs other tasks provided for by the PPP Act.[9]

The **Ministry** of finance (MF) arguments for **implementing** PPPs projects are: lack of public budgetary resources to implement all the necessary projects and provide all the necessary services; Respecting the rules of the **Stability and Growth Pact** (SGP); Lacking of infrastructure; Higher environmental standards; The growing expectations of citizens; Transfering of knowledge and experience of the private to the public sector. The ministry defines its **characteristics** such as contract for the purchase of services rather than means, the specification of outputs rather than inputs, payment is linked to the services rendered, and management of PPPs in its entire lifetime. The main **risks** identified by MF regarding PPPs are committing to burden future budgets and the transfer of the present costs to future generations. On the other hand, moral hazard - the private sector shall cease to behave rationally if risks are not distributed by a rule.

Information about PPP **projects** has started collecting in 2008 by the MF by law, the last report collecting and mapping PPP projects was made in 2009. For the reason, the problem is that the contracting **partners** do not send **data** to the MF, despite legal obligations, mainly for the reason that if the data is not sent to the authorities about PPP projects the law does not foresee any **penalty** provisions.

In Slovenia there has been **no** general analysis or overall **study** done in the field of PPPs.

PPPs have been used mainly at the **local level** (the **state** has carried out only one "infrastructure" project - Nursing Home in town of **Idrija**) e.g. in social housing, kindergartens, waste management, sports infrastructure, cultural buildings, car parks, public lighting and photovoltaic installations. The Slovenian government plans to support the expansion of the port of Koper, with PPP being considered as a possible procurement model.[10] The **largest** PPP projects are in the field of **construction** of municipal infrastructure (the first PPP project - water cleaning plant in Maribor), other big infrastructure projects do not exist in Slovenia for now.

The following elements normally characterize PPPs in Slovenia:

- The relatively long **duration** of the relationship, involving cooperation between the public

[9] Slovenia, PPP knowledge lab
https://pppknowledgelab.org/countries/slovenia

[10] Slovenia, PPP knowledge lab
https://pppknowledgelab.org/countries https://www.ljubljana.si/en/news/energy-renovation-of-buildings/
/slovenia

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partner and the private partner on different aspects of a planned project.

- The method of **funding** the project, in part from the private sector, sometimes by means of complex arrangements between the various players. Nonetheless, public funds - in some cases rather substantial - may be added to the private funds.
- The important **role** of the economic operator, who participates at different stages in the project (design, completion, implementation, funding). The public partner concentrates primarily on defining the objectives to be attained in terms of public interest, quality of services provided and pricing policy, and it takes responsibility for monitoring compliance with these objectives.
- The distribution of **risks** between the public partner and the private partner, to whom the risks generally borne by the public sector are transferred. However, a PPP does not necessarily mean that the private partner assumes all the risks, or even the major share of the risks linked to the project. The precise distribution of risk is determined case by case, according to the respective ability of the parties concerned to assess, control and cope with this risk.[11]

Implementation of PPP projects is a novelty in Slovenia, because there is no tradition of public-private partnership projects in Slovenia. Municipality of **Ljubljana** is at the forefront of PPP development in Slovenia. After winning local election in the year 2006 the city administration scheduled 22 major projects ranging from urban development, traffic, environmental protection, health, sports and culture. At the moment the municipality is involved in several large on-going PPP projects and several PPP projects are planned in the near future. At the moment the Municipality of Ljubljana is involved in The Sports Park Stožice, Emonika City Center, and Partnership Šmartinska District Redevelopment and new PPP projects are announced. Moreover, PPP projects under way or in the planning phase are the following: Parking house Kozolec 2, WiFi Mesh metropolitan network, Center of the quarter community Šmarna Gora, Gym hall PeganPetkovšek, Kolezija, Sheltered apartments in Šiška, Sports centre Savsko naselje and Sports park Črnuče. Majority of PPP projects in the Municipality of Ljubljana could be characterized as Public-Private (Collaboration) projects where public **procurement** relationship was used:

- Municipality invests land, communal infrastructure and arranges spatial planning acts and
- Private investors construct and finance the project, and at the end of construction part of the project (flats, hotel, parking places, retail stores, shopping centre, bar…) remains in the ownership of the private partners. It is the form of Contracting.

[11] Damjan Kavaš. 2012. Possible PPP models for cooperation in the Municipality of Ljubljana. Ljubljana : Institute for Economic Research.

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- More complex forms of PPP (BOT) are not used.[12]

In 2017 the **City of Ljubljana** and the consortium of companies **Petrol and GGE** signed the **contact** on **energy renovation of public buildings** under the ownership of the City of Ljubljana - which includes schools, kindergartens, cultural objects and health centres. It is the **biggest** public-private partnership project in Slovenia in the area of **energy** contracting in Slovenian **municipalities**. Comprehensive **energy renovation** is foreseen in 26 building, and in other 23 buildings partial energy renovation[13] with the implementation of individual measures for more efficient use of energy is envisaged. The **total** investment into the renovation of these buildings is **worth** 14.9 million euro out of which the consortium of companies Petrol and GGE is investing 7.62 million euro, the amount of 4.80 million euro is foreseen from the European cohesion funds and the share of the City of Ljubljana is 2.52 million euro. All amounts do not include VAT as the VAT for the whole investment is covered by the consortium of companies Petrol and GGE. The **private** partner invests into the energy renovation of the building and generates savings while providing the same or higher degree of comfort in the building, and the **public** partner pays him off with these savings in the contract period. During the **15**-year **concession** the private partner is also responsible for the management and maintenance of the newly installed, that is, renovated energy equipment and systems. To cover the investment the private entity is providing minimally 51% of the assets, up to 32% of assets come from cohesion funds, and the City of Ljubljana provides 17 %. In buildings marked for comprehensive renovation 40% of assets are foreseen from the cohesion funds. Total guaranteed annual heat and electrical energy savings are 8,245,534 kWh, that is, slightly above one million euro (excluding VAT) annually, which also means a reduction of greenhouse gas emissions (equivalent to CO2) of 2,956 tons annually. The **time schedule** foresees that after the approval of the project documentation and introduction into the works the private partner is going to start with the implementation of the investments as soon as in June 2017. The conclusion of works is planned within 6 to 12 months. After the successful handover the private partner is going to guarantee savings until the expiry of the contract period, that is, until 2032.[14]

[12] Damjan Kavaš. 2012. Possible PPP models for cooperation in the Municipality of Ljubljana. Ljubljana : Institute for Economic Research.
[13] The comprehensive renovation includes thermal insulation of the façades, replacement of builders' joinery, ceiling insulation of unheated attics, installation of thermostatic valves, installation or renovation of efficient ventilation systems, renovation of boiler rooms and heating stations, installation of heat pumps, renovation of interior lighting, etc., while partial renovations encompass above all the heating systems and the interior lightning. https://www.ljubljana.si/en/news/energy-renovation-of-buildings/
[14] Energy renovation of buildings, MOL, https://www.ljubljana.si/en/news/energy-renovation-of-buildings/

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Furthermore, two more interesting project of PPPs have been introduced and implemented in Ljubljana for becoming green capital**: Bicycle rental system** (**Bicikelj**): It is a self-service bike borrowing system with 300 bikes and with 600 parking places at 31 stations in the broader city centre area. Residents and visitors can get about the broader Ljubljana city centre area virtually free by bike, as the annual cost of registration for bike use is only €3 and is recorded as a credit to your account. Weekly use of the system is intended above all for visitors to Ljubljana and registration costs are €1. The project was created as a public-private partnership with the ad-space provider **Europlakat**. Ljubljana is already crowded with advertising space and this partnership takes advantage of a law requiring any extension of ad space to be accompanied by an extension of urban infrastructure.

Most probable PPP project in Slovenia will be for the upgrade of the Koper-Divača **rail section** (so called the Second track). The draft investment plan puts the investment value at 1.4bn euro. Prior to that, the OECD will assess the country's plan to make a call for applications for the audit.

In the **EU** PPPs have been created in the transport sector (road, rail) as well as in the areas of public buildings and equipment (schools, hospitals, prisons) and the environment (water/waste treatment, waste management) (EC, 2009, p. 3).[15]

The **recording** of PPPs on or off governments' balance sheets according to the European system of accounts (commonly referred to as the "statistical treatment of PPPs") is a subject that has attracted increased attention over the past few years.[16] The **European Commission** (EC) has taken various views on the relations between PPPs and fiscal discipline. The 2003 report on the European Economic and Monetary Union (**EMU**) (produced before the **Eurostat** ruling) said, "There is the risk that the recourse to PPPs is increasingly motivated instead by the purpose of putting capital spending outside government budgets, in order to bypass budgetary constraints. If this is the case, then it may happen that PPPs are carried out even when they are more costly than purely public investment."[17] In this way, The biggest **attraction** of PPPs for **governments** is that they can be classified as private not public **debt**, and the EU

[15] EC. (2009). Mobilising private and public investment for recovery and long term structural change: developing Public Private Partnerships. Brussels, 19.11.2009, COM(2009) 615 final
http://eurlex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2009:0615:FIN:en:PDF
[16] A Guide to the Statistical Treatment of PPPs, Eurostat and the European PPP Expertise Centre the Advisory Services of the European Investment Bank (EIB), September 2016
http://www.eib.org/attachments/thematic/epec_eurostat_statistical_guide_en.pdf
[17] European Economy No 3 / 2003 Issn 0379-0991 European Commission Directorate-General For Economic And Financial Affairs. Public finances in EMU 2003 (summary of part III, p.102)
http://europa.eu.int/comm/economy_finance/publications/european_economy/2003/ee303en.pdf

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makes this easy by a Eurostat rule which specifies that, as long as the private sector bears construction risk and availability risk, then the finance will not count as government debt. This is an easy test to meet, as the IMF has warned, and so PPPs are always attractive to governments as a way of hiding borrowing.[18]

Governments can nearly always borrow money more cheaply than private companies or private individuals. This is because there is very little risk of defaults. Governments are always there, with large tax revenues whereas no private company is immune from the risk of going bankrupt. Lending to private companies is therefore more risky, and so the interest rate is higher.[19]

The **European PPP Expertise** Centre (EPEC) running in the framework of European investment bank (**EIB**) also assists and advises in the implementation of projects, in particular, this involves the collection and transmission of **knowledge**. The EC and the EIB jointly **fund** EPEC to advise on how to set up and implement PPPs. The EIB is an EU-wide development bank, 100% owned and guaranteed by all the member states of the EU. Moreover, The EIB now provides about 13% of all the finance for PPPs in Europe – as much as all the equity capital invested by the private partners themselves.[20]

However, there is no data yet that **SID** (Slovenian export and development) bank and the EIB are directly involved in the field of PPP, both entities are financial institutions. In the **Juncker investment plan** (EFSA) **SID** bank also represents the **entry point** for an advisory HUB, which operates within the EIB. Given the fact that EFSA is meant for private investment (including PPP) MF assumes that the SID bank will work in this field.

[18] http://www.eib.org/epec/g2g/i-project-identification/12/125/index.htm
[19] Why Public-Private Partnerships (PPPs) don't work, David Hall, Public Services International Research Unit University of Greenwich, UK. January 2014
[20] EIB 2012 PPPs and their Financing in Europe: Recent Trends and EIB Involvement http://www.eib.org/attachments/efs/econ_note_2012_ppp_and_financing_in_europe_en.pdf

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