Policy brief

Public-private partnerships and concessions in Southeast Europe

Can infrastructure be improved without increasing public debt?

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POLICY BRIEF

Public-private partnerships and concessions in Southeast Europe – can infrastructure be improved without increasing public debt?

Public-private partnerships (PPPs) for the construction, financing and operation of public infrastructure have been promoted by international institutions in Southeast Europe for more than two decades. Yet there has been far more talk than action, and where projects have taken place, they have often not lived up to expectations.

The main motivation for public authorities attempting PPPs has been to "build now, buy later". At first glance, the model appears to suit governments who want to be seen to be improving infrastructure without increasing public debt.

The debt needed for PPPs is often accounted for as private debt, with the public authority and/or users gradually paying for the infrastructure after it is built. However, this effectively represents buying infrastructure with a credit card, with all the pitfalls this can bring.

In recent years, by far the most concessions in the region have been issued for small hydropower plants. There have also been some commercial concession projects such as tourist resorts, airports, shopping centres, power plants and sports facilities, but very few availability-payment-based PPPs.

Lack of transparency, institutional capacity and incomplete legal framework

A common feature in all the countries is a lack of transparency about planned, ongoing and completed PPPs and concessions. Some countries, such as Bulgaria, Macedonia and Montenegro, at least have a PPP/concessions register, but these provide only very basic data. They contain no information on the conditions of the contract, or on how implementation is going in reality.

This makes it very difficult to analyse any problems and whether they lie in the legal framework itself or in poor implementation. Nevertheless, several observations can be made:

- All the countries have legislation on concessions, but not all have on PPPs.
- All the countries suffer from a lack of capacity to prepare and manage PPP implementation.
- Decision-making on whether to implement a project as a PPP/concession or not is deficient in all the countries. Even where there are public consultation requirements, as in Montenegro, this does not have much impact.
- Most of the countries have a central body to oversee PPP implementation (Serbia does not). Few bodies publish evidence that they consistently check the quality of implementation.
- State auditors' involvement has so far been patchy, and regular audits are not legally required in most countries. Thus, there is insufficient evidence on the value for money of projects.
- Serbia, Montenegro and Bosnia-Herzegovina allow unsolicited offers for concessions and have inadequate legal frameworks to make sure they serve the public interest.

Only one successful PPP project - the **Čair street lighting project** in Macedonia - was identified during the research. This is most likely due to a combination of poor project implementation and lack of reporting on results, whether positive or negative.

Inherent risks of PPP projects

As well as country-specific legislative and institutional issues, PPPs carry a number of inherent risks:

1. Failure to obtain value for money

The main factor in deciding to use a PPP or not should be getting better value for money, but this is rarely the case. It is also unlikely that a PPP would prove to be better value than traditional public procurement, for three main reasons:

- Private sector borrowing is more expensive than public sector borrowing.
- Unlike public authorities, private companies expect to make a significant profit.
- The preparation of PPPs is long and costly.

These increased costs are supposed to be offset by the efficiency gains from using the private sector. However, it is doubtful whether these gains are really enough to offset the higher costs.

For each PPP being considered, a “public sector comparator” calculation or similar tool needs to be used to assess whether it would offer better value for money than public procurement. However, there is no standardised way of doing this, so it is open to manipulation. Often, no calculation is done at all.

2. Corruption and lack of transparency

Any infrastructure project is an opportunity for corruption, but PPPs may be even more prone because of frequent lack of competition and the complexity of projects (see below).

Together with weak rule of law in most Southeast European countries, this makes for a toxic mix that can cost the public dearly.

In Montenegro, MANS has examined the close links of many of the **small hydropower plant** concessionaires with the ruling Democratic Party of Socialists and shown how they are profiting from feed-in tariffs.

Other concession projects such as the **TQ Plaza shopping and residential centre in Budva** and **Bazar shopping centre in Podgorica** have also been hit by corruption allegations, with investigations ongoing.

The Drisla landfill PPP in Skopje, Macedonia, has also attracted lawsuits from a competitor regarding the choice of an obscure Italian company in the tender procedure.

Public consultations, and publishing feasibility studies and draft contracts are crucial. However due to the complexity of PPPs and some concessions (see below), even full transparency is not a panacea.

3. Lack of competition

Unsolicited proposals, lack of competition in the tender process and significant changes during the preferred bidder stage are all issues in PPPs and concessions in the region - and beyond.

Some of the countries, for example Bosnia-Herzegovina and Serbia, allow unsolicited proposals for concessions. These can in theory introduce innovative ideas but can often result in projects which are not really priorities and are carried out at excessive cost due to lack of competitive tender.

Even where PPPs are procured through a standard tender procedure, due to the size and complexity of the projects, there are often very few bidders. For the **Kosova e Re coal power plant**, there was only one bidder; and in the **Vinča waste management project** in Belgrade there was a competitive dialogue procedure in which only one consortium ultimately made a final offer. Even in the European Union lack of competition can be a problem but the additional political risks in the Balkans exacerbate this issue.

Even where there is more than one bidder, once a preferred bidder is chosen, a space opens for the company to try to obtain further benefits from the contract. The competition has now been eliminated and at the end of a time-consuming and expensive procurement procedure, the public authority is not very likely to say no and risk sending the whole process back to the beginning.

4. Complexity

PPP contracts have to try to anticipate and address every situation which could occur during the whole 2-3 decades of the project. They also have to try to put a price on the risks and benefits, which is extremely difficult and leaves a lot of room for negotiation.

Any risk taken on by the private partner gives it a reason to ask for more money. As a result, there are numerous background studies and calculations as well as huge contracts that are extremely difficult to understand, implement and monitor - even if they are publicly available.

Grasping the full implications of the contract requires experienced corporate lawyers, and the private partner may well have a superior legal team working on contract development compared to the public partner.

The complexity makes it easier to “hide” provisions that are excessively favourable to the private partner and to get governments and parliaments to approve contracts harmful to the public interest.

5. Impacts on public services

PPPs can impact on public services in three ways:

- **Poor contract design or implementation**. E.g. the first wave of UK hospital PPP projects was associated with average reductions in bed numbers of around 30%. Poor contract design and implementation in water supply PPPs has also proven widespread worldwide. Cases of such contracts being cancelled and water supply being "re-municipalised" have increased rapidly since 2000. By March 2015 the number of cases had grown to 235 in 37 countries.

- **Contract failure, and disruption while a solution is found**. Contract failures are not unique to PPPs, but finding a new contractor for a traditional project is quicker than re-launching a PPP.

- **Contract inflexibility crowding out funding for non-PPP budget streams**. In reality, public budgets expand and contract according to the economic situation and government decisions. So, if a health service or schools budget has a PPP contract with fixed costs for 30 years, but fluctuating income, it is the non-PPP services which will suffer from cuts. The UK National Audit Office has recently confirmed that this is a major problem for non-PPP hospital services in the UK. It is also likely to be a problem with the **Vinča landfill and incinerator** project, which is very likely to crowd out any investments into waste prevention and recycling in Belgrade, and with the **Kosova e Re power plant** project in Kosovo which will land the government with as yet unquantified availability payments.

6. Who pays if it all goes wrong?

For all the talk of risk transfer, reality has shown that if a PPP goes wrong, it is the public sector that ends up paying. Its leverage is usually limited as it cannot push the private partner too far and risk it walking away from the project, as it needs the public service to be functional.

If the project fails completely, the public authority has to pay the cost of taking over the service again. This has happened several times, for example in the **Hungarian M1/M15 and M5 motorway** cases, the **London Underground PPP**, and this year's **collapse of Carillion** in the UK and Ireland.

Conclusions and recommendations

The Southeast European countries examined in this study clearly have specific weaknesses in their legal framework, institutional capacity, and in most cases also more widely with the rule of law. But even outside the region, PPPs have a number of inherent risks, many of which cannot be mitigated.

These issues underline a central contradiction expressed by anonymous employees of the European Investment Bank during a 2009 evaluation exercise: "*If you're a good public sector, you shouldn't need PPPs. If you're bad, you shouldn't go near them.*"

This raises a fundamental question as to what would be the best approach: Regulate PPPs and concessions properly and invest in human and institutional resources in order to make them work better, or try to avoid them altogether?

The answer is probably a combination of both. Existing contracts need to be properly implemented and it is important to increase oversight and enforcement of this process. But given the inherent risks of PPPs, as well as the problems with low capacity and high levels of corruption in the region, setting up new PPPs is generally not to be encouraged.

Concessions can be simpler than PPPs and can be useful in certain circumstances, but in the regional context they need to be subject to better democratic and auditor control, and should be relatively short-term to avoid countries being locked into unfavourable long-term contracts.

The countries should concentrate much more on the basics of getting project selection and public procurement right, fighting corruption and increasing public participation in decision-making and political accountability. Trying to get the countries to run before they can walk is not likely to end successfully. It is more likely to end up with the countries locked into unfavourable and unenforceable contracts for several decades.

Many of our more specific recommendations apply to project infrastructure planning generally, not only to PPPs, and have been laid out in our recent publication: *Public infrastructure in Southeast Europe: in whose interest?* However, we also have a number of recommendations for public authorities specific to PPPs and concessions.

Start small and get the public involved

- Go for small projects first and learn lessons before considering whether to upscale.
- Consider public opinion in deciding on local needs and interests.

Avoid hidden debts

- Set ceilings on the total amount of future taxpayers' money each ministry or local authority is permitted to commit for PPP projects per annum.
- Disclose the cost to public budgets of ongoing PPPs before starting new ones.
- Publish the annual stream of future PPP payments in government accounts.

Obtain good value for money

- Decide whether to undertake a PPP or concession with other options truly open. If public funding is scarce, scale down projects to a more affordable size.
- Carry out an affordability assessment for each project and publish it, including an assessment of risks for users, taxpayers, workers and the government, also if the project fails.
- Carry out a Public Sector Comparator (PSC) calculation and publish the results. The methodology must be publicly available and explained, and must avoid vague categories that can easily skew the calculation.
- Complement the PSC with qualitative considerations related to the public interest.
- Use tender selection criteria based on the best overall economic option and level of public service - not only on the lowest price.
- Make sure that approved PPP projects must be harmonized and that they incorporate future EU standards (from the related chapter/s) which the WB countries must fulfill at the moment of joining the EU and when the vast majority of PPPs will be still in place or in implementation. Otherwise that will produce additional, not planed costs.

Transparency

- Carry out meaningful public consultation for planned concessions and PPPs at a stage when it is still possible to change or stop the project.
- Publish draft PPP contracts in order to allow suggestions for changes to limit fiscal risks before the contract is signed. Provide also briefer explanatory documents on the real costs.
- In order to limit opportunities for corruption and inflation of projects, publish all tender documents, bids and contracts, including financial details.
- Regularly update registers of concessions and PPPs, not only to name the planned and ongoing projects but also to show how they are performing in reality.

Tender procedures and unsolicited proposals

- Refrain from implementing unsolicited proposals immediately and examine them as part of wider sectoral planning to see whether they are a priority. Carry out an open tender procedure with no advantage given to the company proposing the project.
- Conduct tenders according to EU procurement rules, but stop the procedure if there is only one bidder. If a new tender would likely not bring different results, re-design the project.
- Set ceilings for maximum cost changes allowed in the preferred bidder stage. Have a clear strategy and triggers for walking away from negotiations if the private sector becomes too demanding. If major changes are made in the project, carry out the PSC calculation again and re-open the tender procedure.

Contracts

- Ensure that fines for poor performance automatically exclude the payment of bonuses for good performance in other areas.
- Ensure that the PPP contract stipulates public sector gains of minimum 50 percent of any refinancing benefits, preferably with a ceiling for maximum gains by the private sector.
- Include a clause allowing contract termination in the public interest in unforeseen situations.
- For road PPPs, do not base payment on the expected level of traffic. This may lead to efforts to increase its volume, thus increasing air pollution and greenhouse gas emissions.
- Make sure the private sector partner bears significant financial risk in operating the road.
- Require compliance with current and future environmental and labour standards.

Contract enforcement

- Show how the public authority will ensure adequate capacity and funds to enforce compliance with performance standards. Hiring consultants for the task is not an adequate solution.
- Be aware of when the public authority is entitled to terminate the contract and be prepared to use such powers. Draw up and maintain contingency plans for contractor default.
- Carry out evaluations for all PPP projects, and publish them: once when the initial investment is complete and the service has begun to operate, and later, 4-6 years after operation has begun.

Institutional set-up and capacity

- Avoid promoting PPPs where they are not the best option by approaching procurement as an integrated topic, i.e. developing procurement expertise, not just PPP expertise.
- Oblige the public auditor of each country to audit PPPs and concessions on an annual basis and to publish the annual audit reports on project implementation.
- Strengthen institutional capacity at all levels to manage existing projects and assess new ones.
- Implement adequate checks and balances, such as a central body in the Ministry of Finance to ensure good quality project management. Information on project implementation must be promptly delivered to this body and legislation must foresee penalties for failure to do this.

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