CAN PPPS HELP CLOSE THE INFRASTRUCTURE GAP IN THE TRANSITION ECONOMIES?

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INTRODUCTION

Many of the transition economies are currently enjoying a period of strong growth, in some cases fuelled by the high price of natural resources, in most cases by competitively-costed skilled workforce and in all cases by a strong commitment to market-based reform. However, as growth accelerates, it puts pressure on the infrastructure to keep pace.

Infrastructure is also a critical ingredient of a country's competitiveness and productivity. Inadequate infrastructure across a number of sectors inhibits the investment of productive capital and restricts output. As infrastructure services include education and health, the lack of these services can also contribute to high levels of poverty and inequality. Consequently for all these reasons – to sustain economic growth, boost competitiveness and social development – many countries need to make large investments in their infrastructure.

Given the often insufficient resources available from national budgets, Governments are turning to the private sector to meet these challenges. One of the instruments to upgrade existing and build new infrastructure with the help of the private sector is Public-Private Partnerships (PPPs)[5]. In particular, a new interest in PPPs is emerging from countries of Eastern Europe, the Caucasus, and Central Asia.

In this context public perceptions too are changing. A recent survey of Governments, private sector and NGOs and community groups from transition economies expressed optimism that the participation of the private sector in PPPs would improve the delivery of public services[6]. But how realistic is such optimism? Can PPPs really help the transition economies, most of which are low income economies, some very poor and from an investor perspective, suffer from unpredictable and high risks?

I. THE INFRASTRUCTURE DEFICIT AND PPPS

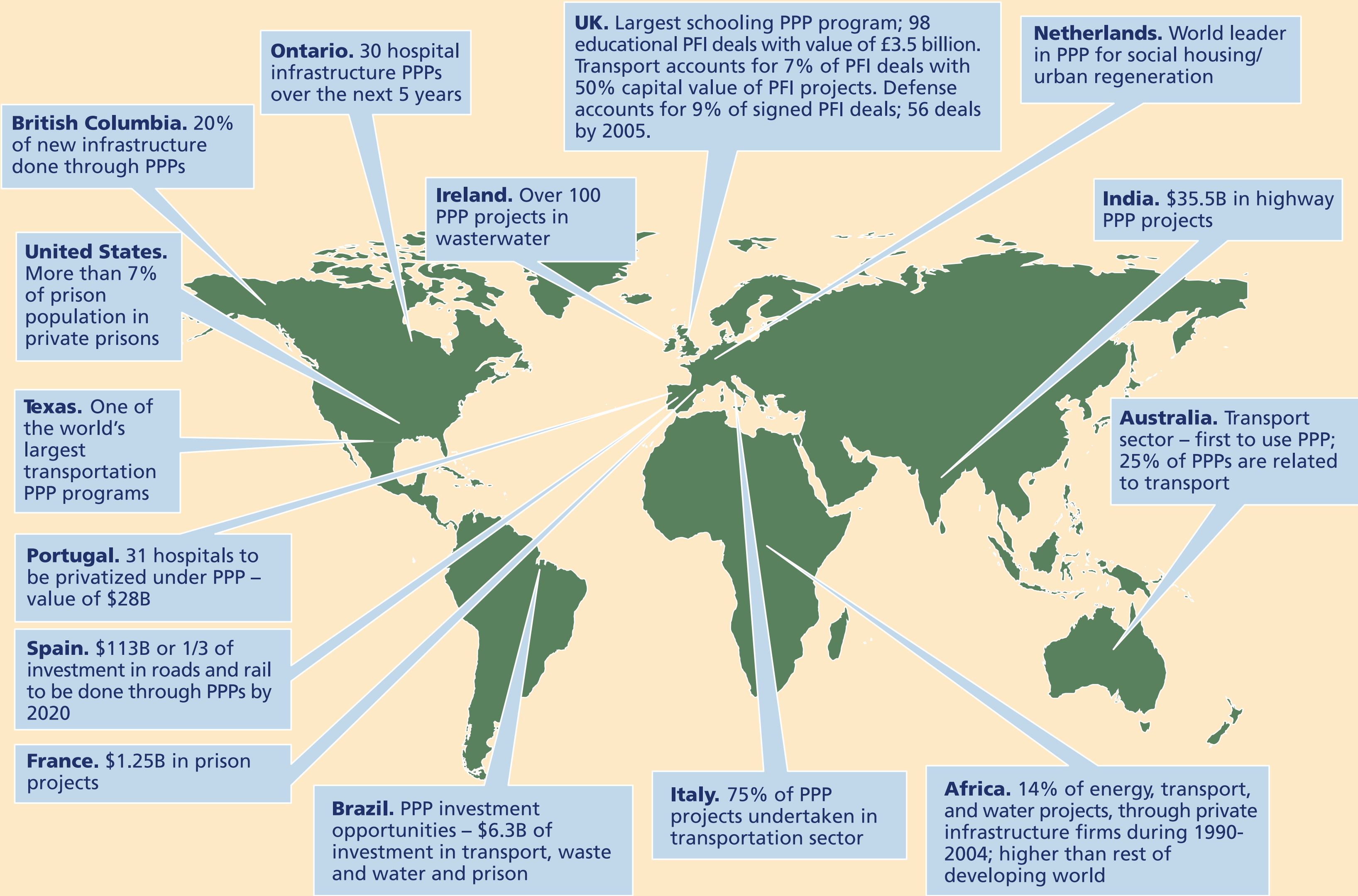
Public infrastructure issues have a daily influence on the lives of citizens in transition and market economies, across continents and cultures, from St. Petersburg, Russian Federation, to St. Petersburg, Florida, and everywhere in between. As can be seen in the figure, serious infrastructure needs are felt in every part of the globe[7]. The numbers shown tell only part of the story, however, because it is difficult to measure the true costs to society and the many unquantifiable externalities that come with the lower productivity, reduction in competitiveness, and increase in the number of accidents that result from the infrastructure deficit. Unlike with many other global problems that have been rightfully brought to the world's attention by both NGOs and Governments, underinvestment in infrastructure may be one of the world's most unnoticed problems.

Closing the infrastructure gap will not happen with ease. According to recent findings from the Organisation for Economic Co-operation and Development (OECD), $71 trillion will be needed to improve even the most basic public infrastructure worldwide.[8] All in all, to meet this need, countries across the world would need to spend 2.5 per cent of annual GDP on telecommunications, road, rail, water, and electricity transmission and distribution up to 2030. On top of this, another one per cent of annual GDP needs to be spent on energy infrastructure; and factoring in other investments not included in these estimates, such as seaports and airports, would push costs even higher. This may be an unnoticed crisis, but it is a serious one as well.

Currently, around 70 per cent of global infrastructure investment comes from the public sector, 22 per cent from the private sector, and 8 per cent from Official Development Assistance. The above-mentioned infrastructure deficit cannot

[5] One of the problems about writing about PPPs is that many now use PPPs to refer to virtually every type of interaction between the government and the business community. This is confusing. This article thus uses the word PPP to refer to a very clear and focused definition of the term relating to infrastructure.
[6] Survey carried out by a project by the Geneva International Academic Network (GIAN), a Swiss foundation that promotes cooperation between Swiss Universities and United Nations agencies.
[7] Closing America's Infrastructure Gap: The Role of Public-Private Partnerships, Deloitte Touche, 2006
[8] Source: http://www.deloitte.com/dtt/cda/doc/content/us_ps_PPPUS_final(1).pdf, 3

Projected infrastructure investment needs



Sources: Australia National Public Private Partnership Forum, HM Treasury, e-Privatization.com, Projects Today, Public-Private Infrastructure Advisory Facility, EuroMoney, Infrastructure Journal, Deloitte Research.

be addressed through current resources and methods. As a result, government leaders across the world must become more innovative and modernize their methodologies to be better stewards of public money. In all parts of the world, policymakers have sought ways to leverage the private sector's managerial strengths, achieve greater value for money in their investments, and transfer project risk to the private sector. Thus, many have begun to implement contractual agreements between their government agency and the private sector known as public-private partnerships. PPPs in infrastructure – energy, transport, municipal services, telecommunications, social services – can be defined as concessions or other contractual arrangements whereby the private sector operates, builds, manages and delivers a service for the general public typically in return for a payment.

Support from the United Nations

The United Nations views partnerships between government and the business community as a potentially positive mechanism to boost investments in infrastructure and meet the challenges of globalization. Many of the commitments to address the global challenges of poverty and sustainable development have been set out in the Millennium Declaration.[9]

Given the scale of these challenges but the lack of resources of governments, the United Nations has not surprisingly identified the wide range of core business capabilities which the private sector provides, namely their resources and role in developing new technologies, providing essential goods and services and managing large scale operations, as essential for achieving the Millennium Development Goals (MDGs). In some commitments such as in bridging the "digital divide" the Declaration explicitly encourages partnerships with the private sector. Accordingly, the United Nations and its various agencies, such as the United Nations Development Programme (UNDP) and the Department of Economic and Social Affairs (DESA), the Global Compact, and the five United Nations regional economic commissions, take PPPs seriously.

A good illustration of the importance that the United Nations attaches to PPPs was the final declaration of the Johannesburg United Nations World Summit on Sustainable Development in 2002, which made repeated references to PPPs and recommended the promotion of "Partnerships with the private sector, taking [into] account the interests of and in consultation with all stakeholders, operating in a framework of transparency and accountability, to improve the access of everyone to essential services"

Different models

In Europe there are various types of PPPs, established for different reasons, across a wide range of market segments, reflecting the different needs of Governments for infrastructure services. Although the types vary, two broad categories of PPPs can be identified: the institutionalized kind that refers to all forms of joint ventures between public and private stakeholders; and contractual PPPs, which have experienced a strong upsurge in recent times and cover a wide range of legal arrangements. PPPs are being used in large national and European infrastructure projects, in local development projects and in the form of the outsourcing of different kinds of public services. One recent notable trend has been the use of PPPs in the delivery of social services such as health projects, education, as well as urban renewal and in new businesses related to the information technologies.

Often the PPP model is confused with privatization. Whereas privatization entails the complete shifting of functions and responsibilities from the public to the private sector, PPPs bring about relationships in which public and private entities meet both common and independent objectives by sharing project goals, pooling resources, and shifting responsibility to the entity that can most effectively bear the burden of risk. As can be seen in the diagram there are in fact a wide range of different PPP financing mechanisms that distribute various levels of risk and reward to either the public or the private sector.

[9] The Millennium Development goals (MDGs) were derived from the United Nations Millennium Declaration, adopted by 189 nations in 2000. Most of the goals and targets were set to be achieved by the year 2015, based on the global situation during the 1990s.

Genuine results

What is more, PPPs are not just good theory. Increasingly, from this varied background, there are signs that the value from PPPs, in their ability to draw on the best of both the public sector – its public interest concern, its enforcement and regulatory capacity – and the private sector – its resources, management skills and innovation – for real social gains, is being realized.[10] In all parts of the world, the PPP revolution has created an impressive track record of successful projects across a variety of infrastructure sectors, resulting in brand new and renewed bridges, roads, schools, airports, water systems, housing developments, and hospitals. In particular, the United Kingdom has pioneered this new form of public financing; since the first PPP deal took place in 1987, HM Treasury reports that 590 projects have been signed, totaling £ 53.4 billion ($108.5 billion at 2.0311 dollars to the pound) and representing between 10 and 15 per cent of all of the country's investment in public infrastructure.

PPP have begun to show real benefits:

- Better value: The decision by government to pursue PPP delivery is often based on analysis to determine that the PPP approach will deliver value to the public through one or more of the following:
  - Lower cost
  - Higher levels of service; and
  - Reduced risk
- Access to capital: PPPs allow governments to access alternative private sources of capital, allowing important and urgent projects to proceed when otherwise they may not be possible. There is now a far greater availability of financing for PPPs than was the case a decade ago. New infrastructure funds are being established with pension funds a key contributor. What is more these funds are not just investing in mature markets, they are entering emerging markets, which is also developing local capital markets.
- Certainty of outcomes: Certainty of outcomes are increased both in terms of "on time" delivery of projects (the private partner is strongly motivated to complete the project as early as possible to control its costs and so that the payment stream can commence) and in terms of "on-budget" delivery of projects (the payment scheduled is fixed before construction commences, protecting the public from exposure to cost overruns).

[10] The beginnings of PPPs in the 1990s in the then transition economies were not auspicious. Several major projects that started out as PPPs had to be renationalized and many banks lost a lot of money. The size of the risks that the private sector was asked to accept were over ambitious while macroeconomic conditions of high inflation undermined their commercial viability. The result was that governments shied away from the model.

- Off balance sheet borrowing: Debt financing that is not shown on the face of the balance sheet is called "off balance sheet financing". Off balance sheet financing allows a country to borrow without affecting calculations of measures of indebtedness.[11]

- Innovation: By combining the unique motivations and skills of both the public and private sectors and through a competitive process for contract award, there is a high potential for innovative approaches to public infrastructure delivery with PPPs.

- Reinventing government: Governments are focusing on doing what they do best in infrastructure, as regulator and facilitator rather than the deliverer of services. The reform of government has set the stage to challenge the bulky bureaucratic systems of the past in both transition and market economies with systems that focus on "measurable outputs rather than inauditable inputs".[12]

On the debit side, by enabling projects to proceed with little or even no capital expenditure by the host Government – the capital cost of the project usually not counting against the government's balance sheet or borrowing limits – the Government nevertheless sometimes takes on certain liabilities – e.g. various forms of guarantees – that can leave the Government vulnerable if the project goes wrong. Also, while PPPs offer the possibility of transferring a number of risks to the private sector, for example all types of market risk, the private sector can still succeed in shifting some risks to the government side leaving the latter excessively exposed if the project fails. In addition, in the case of contributing to achieve the MDGs, PPPs also have certain limits. The private sector, for example, invariably is often not motivated to make investments in remote regions where needs for social services are greatest, but where the citizens are poor and have not the purchasing power to offer them satisfactory returns.

However, these caveats notwithstanding, overall this is a new financial tool and the approach – harnessing the respective skills and resources of the Government and the private sector for social gain – constitutes a significant opportunity for the transition economies.

II. THE CHALLENGE

However, while PPPs constitute a new opportunity, this new model is also a considerable and quite complex challenge. As said before PPPs are not privatization and demand a greater input from government than is often anticipated. Indeed, before embarking down the PPP route, transition economies should consider a number of lessons gained so far.

Political leadership

Firstly, we have learned about the importance of political leadership and the need for a clearly defined PPP policy, not only in establishing PPP programmes but also in launching PPP projects. Strong leadership pulls things together and overcomes resistance to create a level playing field for both public and private sectors. For PPP to succeed it needs a champion from the highest political level of government. And PPP projects must be high priority projects in the country's development plan to make the champion credible.

Begin with transparency

Secondly good governance is central, beginning with transparency. Government and the private sector have begun to accept that a transparent competitive bidding process will ensure political sustainability and value for money. Either no competitive tender to select a winning bid or the manipulation of the bidding procedures to benefit favoured bidders undermines the whole PPP rationale: the best project results from an open competition. Indeed, as in the case of the United Kingdom, if there are only a few bidders, Governments advise their agencies not to use a PPP method.

Capacity building

Thirdly, we have learned about the need to build capacity in government for running a PPP programme. This requires building skills within the Governments. Sector ministries and contracting agencies responsible for preparing PPP projects generally have limited capacity to assess commercial issues, allocate risks and manage procurement. To address this constraint, several countries have set up dedicated cross sectoral PPP units at the national level to guide and complement

[11] As of 11 February 2004, Eurostat defined the treatment of Design, Build, Operate and Finance (DBOF) projects as being eligible for off balance sheet borrowing, which was clarified in the February 2005 report "Standing Committee on the impact of Investment on the GGB".
[12] Al Gore, The Gore Report on Reinventing Government, New York: Random House, 1993.

the efforts of line ministries and local government units. With fifteen years of PPP experience in Europe, research shows that a strong correlation exists between a well-functioning PPP unit and successful PPP implementation, and this has been achieved in both complex and difficult settings.[13]

Capacity building is particularly needed in the preparation of PPP projects that will attract bidders and assure a truly competitive outcome from the bidding process. And a sustained pipeline of bankable projects is needed to keep private investors interested. Inadequate project preparation results in failed bids, sometimes with no bidder and other times with one who eventually hopes to obtain the contract on a negotiated basis.

It is thus necessary to train public servants in PPP models – training in project design, contract writing, monitory and evaluation systems, risk management, and to understand contract vulnerability, dispute resolution, among others. Governments will also wish to consider feasibility studies for PPPs – an essential step to reduce the risk of the project, as well as to understand the project challenges and opportunities – and to develop the market for its PPP programme through PR marketing and dissemination involving chambers of commerce, private sector representations that increase the chances of finding good partners for projects. Officials need to learn also about the industry, because few within the public sector know the business representatives or their objectives. Indeed, there is opposition within the public sector to partnerships with the private sector and such training can overcome resistance.[14] Ultimately, capacity building is needed across the board but it is a long, complex process that requires patience and persistence.

It is to find solutions to this problem that a strategy for PPP capacity building should adopt a combined approach that is building the skills within the Government as mentioned above and at the same time hiring advisors from outside with the necessary PPP experience, preferably early on in the process. No amount of training will assist local government officials in negotiations with large private companies with their large highly qualified teams of legal advisers and global experience.

Focus on maximizing the social impact of PPPs

The fourth lesson learned is that Governments will have to be sensitive to the special needs of the socially and economically disadvantaged. The UNECE region sadly is dominated by a perception that PPPs are exclusively a vehicle for efficiency improvement and value for money. Little attention is given to social objectives, increasing accessibility, poverty alleviation etc. Also, most Governments of countries – low and high income ones alike – see PPPs as a financing tool to move expenditures "off balance sheet". There are a huge number of conferences on PPPs in Europe, but the social side of PPPs is virtually totally ignored. The interesting e-discussions for example, that the UNDP recently led on how pro-poor PPPs can advance the Millennium Development Goals would be difficult for the private sector involved in these events to comprehend.[15]

This is a pity. If PPPs were developed with more attention to social and developmental objectives the popular view of PPPs would improve. Today, the popular perception in western Europe of PPP is broadly negative, seeing PPPs more "private plunder" than public good.[16] Equally importantly, if success is to be achieved with meeting the MDGs, an effort must be made to build bridges with this constituency of large companies where there is massive financial, technological and management potential to help the poor.

In addition, many of the transition economies now considering PPP options have very low per capita incomes, public sectors with limited or no experience of PPPs, and few, if any, public sector financing alternatives. What is more, many inhabitants in these countries endure inadequate housing, poor transportation facilities and roads, and dangerous levels of emissions from industry, including power plants. In such countries it is even more important to think of PPPs not just as "bricks and mortar", but also as impacting on real people, communities and vulnerable groups.[17]

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[13] Paper submitted by Mme Corinne Namblard, Chairperson of the PPP Alliance to the UNECE Forum on Promoting Good Governance in PPPs', November 2003 UNECE.
[14] Standards & Poor's Survey on PPPs 2007.
[15] Also one has to admit that countries emerging from centrally planned systems associate the word "pro poor" with a communist connotation, so there is little sympathy unfortunately for promoting PPPs as a means of meeting MDGs.
[16] Public service, Private Plunder, 2007.
[17] By taking this approach, the prime target in PPPs is fundamentally what local community and the beneficiaries actually want and need rather than lesser financial accounting objectives. It is thus important to consult at the outset all stakeholders, including employees, on the value of projects where the private

Furthermore, some projects have had a remarkable positive impact on social development. The Pamir Private Power Project (in eastern Tajikistan) for example is designed to contribute to the country's poverty reduction strategy by providing reliable electricity supply to poor isolated habitants of the region to ensure the project is affordable to the population, which is a particular challenge in poor countries. In the case of the Pamir project in Tajikistan, one of the poorest countries in the world, income levels were so low that achieving even a modest return on investment required tariffs that most of the population could not afford. Therefore a social protection clause was placed in the contract and the World Bank with support from the Swiss Government, provided a $10 million subsidy, which supports the project by keeping tariffs within the narrow limit of what people in the region can pay.

Risk sharing

The fifth lesson is that Governments have to play a significant role in PPP facilitation by taking their share of risks and costs. PPPs do not offer free assets, roads, bridges etc. to Governments at no cost: Governments must support projects with certain amounts of funding at the same time ensuring that such subsidies are not over generous so that the private sector still has an incentive to perform well. In some countries Governments are pressed to offer quite considerable financial support at least initially in order to attract the private sector into the emerging PPP market. For example the Governments of both Israel and the Republic of Korea gave a minimum traffic guarantee for toll roads which helped to make their PPP programmes successful.

Proactive public communication and stakeholder consultation

The sixth lesson is the need for proactive communication and stakeholder consultation. Projects easily fail, particularly those that will involve increases in user charges. This was the fate of Europe's first fully private funded motorway between Budapest and Vienna in 1994 which led to the renationalization of the road. Governments need a programme for building consensus among all stakeholders, including civil society, on the benefits of private sector participation in infrastructure, especially in water utilities and toll roads. At a project level private concessionaires need to engage stakeholders through proactive communication. In some cases prices will have to be charged to users and some of the education campaigns will therefore have to persuade drivers, in return for increased safety and security, to pay higher toll charges.

Transparency in domestic financial markets

We have learned too about the important role played by the domestic financial markets in sustaining finance for PPPs. In the 1990s the use of foreign currency denominated debt to finance infrastructure projects was the rule and this exposed projects on local currency revenues to exchange risk. Here long term bond market development and investment guidelines that enable banks, insurance companies, pension funds and other financial institutions to finance infrastructure projects will be key. The banks bring in the pension funds and draw their fees from the management of the funds. In some case the pension funds themselves are setting up their own infrastructure funds to invest directly into infrastructure projects.[18] Already new infrastructure funds are being established in transition economies. As a parallel solution, some countries are setting up funds to mobilize long term funds for channelling to infrastructure projects. The Russian Federation, with its stabilization fund, has done this already.

Legal facilitation

The final lesson we have learned is that the PPP legislation must facilitate projects rather than overregulate them. A number of problems resulted in the early days of PPPs such as the failure to use competitive tenders. These opaque practices created conflicts of interest. The response has been to make PPPs more regulated. But this has gone too far in the other direction. Under new legislation in Poland for example, the local authorities are not able to comply with the new requirements for feasibility studies nor have they the funds to pay for outside consultants, while the stringent rules and high costs associated with competitive tendering make it virtually impossible for domestic small and medium-sized enterprises to compete. Indeed, the President of the European Bank for Research and Development (EBRD) has warned that the PPP process has become too sophisticated, too complex and too expensive.[19] One solution to overcome such an impasse is to simplify the law and remove the over burdensome legal restrictions. While legal regulation is necessary and desirable, it needs to be carefully implemented as the law can make PPPs more complex and less transparent.

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sector plays a significant role. In the above-mentioned schools project, the private contractor in fact asked the children before starting what they wanted, and as a result provided them all with internet addresses.

[18] Ontario teachers pension fund.

[19] Speech M. J. Lemierre, President of EBRD, Conference on Legal Aspects to PPPs, Gide, 2006, Paris.

III. MEETING THE CHALLENGE: RECENT UNECE ACTIONS IN THE FIELD OF PPPS

Clearly, the whole area of public private partnerships is challenging and complex. In response under the new UNECE Committee on Economic Cooperation and Integration a PPP programme has been established with a specific focus on PPP capacity building for good governance. In addressing this challenge UNECE adopts a step by step approach.

Step 1: Guidelines on Good Governance

In June 2007 at an International UNECE Conference in Israel on "Knowledge sharing and capacity building in promoting successful PPPs", delegates finalized the UNECE Guidelines on Good Governance principles in promoting PPPs. The Guidelines identified seven principles of good governance that addresses the challenges mentioned above. They offer ways in which Government can overcome these challenges and use case studies to illustrate practical solutions. In very concrete terms the Guidelines recommend Government to formulate clear results-oriented PPP policies, to promulgate legal process that are "fewer, simpler and better", to establish procedures for transparent and fair procurement, to create participatory structures to put people first in PPPs, to develop fair risk sharing, and finally to introduce criteria for selecting projects that support sustainable development.

Step 2: Training modules

The second step is to use the Guidelines to elaborate toolkits and more detailed guidance to transition economies. Capacity building for PPPs is not just about giving knowledge. It is primarily building competence within Governments, that is the different types of skills which PPPs require. The toolkit is intended to be as practical and project orientated as possible targeting those who are responsible for delivering real PPP projects. The training modules will be prepared in collaboration with training institutions such as the Russian High School of Economics.

Step 3: Training of public administrations

The third step will be to develop more widespread training especially at regional levels. The first training event is scheduled to be held in Moscow in early summer 2008, to test this toolkit for wider application within the Russian Federation and in other countries in the UNECE region. The aim will be to work with national training institutions on training the trainer programmes. Parallel with this training, UNECE will provide a platform for governments to learn from each other, that is, regular exchanges of experiences between PPP agencies established, for example, in countries like France and Ireland with emerging agencies in Tajikistan and Moldova.

Working with international partners and the private sector

In order to make training more comprehensive it is important that the relevant international agencies work together and pool their resources in this area. Accordingly, UNECE is working closely with EBRD and EU on elaborating joint PPP training programmes. In addition, the UNECE has established a network of experts, including leading representatives from the private sector, to contribute to this programme by providing materials and case studies and to become PPP trainers themselves.

Intended results of this work

Thus UNECE, although not a bank, which provides guarantees or project finance, nevertheless has a number of assets – its neutrality, intergovernmental bodies, its groups of experts, its participation in regional cooperation programmes, and its involvement in global United Nations work – which makes it adept in addressing the lack of public sector capacity and governance in PPPs. The impact of training, it is hoped, will be to improve the capacity of Government to deliver projects. This will mean therefore new schools for communities with high concentrations of socially and economically disadvantaged citizens, the construction of hospitals where services had formerly been non existent, new power plants where supplies had been infrequent and households subject to regular power cuts and new roads that link remote communities and bring commerce and prosperity: real tangible benefits for ordinary people who urgently need an increased supply of high quality basic services.

CONCLUSION

In sum, PPPs are on an upward trend all over the world. There is optimism that PPPs can solve many intractable problems. There is evidence too that this hope is justified as new infrastructure funds are seeking out projects and spreading their interest to transition economies. It will however be critical in this process that Governments find ways to implement the UNECE Guidelines on Good Governance, in particular focusing on transparency in the deal-making process to avoid abuses and developing independent monitoring that ensures that procedures are fair and transparent. If approached in the right ways, PPPs can become the newest development in not only the effort to improve public infrastructure but in the modernization of Governments in the whole of the UNECE region, including the transition economies.