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STATUS OF PROGRAMME IMPLEMENTATION

PROMOTING BEST PRACTICE IN EFFICIENT PUBLIC-PRIVATE PARTNERSHIPS

SUMMARY OF THE GUIDELINES TO PROMOTING GOOD GOVERNANCE IN PUBLIC-PRIVATE PARTNERSHIPS

Note by the secretariat

Summary

The UNECE Committee on Economic Cooperation and Integration (CECI) mandated the preparation of a practical guidebook on good governance in Public-Private Partnerships (PPPs), which was subsequently endorsed by the International Conference on Knowledge sharing and capacity-building on promoting successful Public-Private Partnerships in the UNECE region (Tel Aviv, Israel, 5-8 June 2007).

The Guidelines on Good Governance in PPPs is prepared to assist governments looking for best practices in establishing and maintaining partnerships with the private sector. This document is a summary of the Guidelines and provides a general overview of the main governance issues in this area.

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I. ATTRACTIVNESS OF PUBLIC-PRIVATE PARTNERSHIPS

1. Public-Private Partnerships (PPPs) are very attractive to governments who are seeking resources to improve their infrastructure and public services.

A. What are Public-Private Partnerships?

2. Public-Private Partnerships are partnerships between public and private sectors that involve private investment in public infrastructure, a long-term service provision and the transfer of risk to the private partner. 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.

3. Recently, the contractual type has come to the fore. One model of this type is the concession where the 'user pays'. Most PPPs outside the United Kingdom are concessions. Another model of the contractual type in the United Kingdom is the Private Finance Initiative (PFI) where the public sector pays and where a contract agreement is signed between the private partner and the public sector. This model has now been adopted by parts of Canada, France, the Netherlands, Portugal, Ireland, Norway, Finland, Australia, Japan, Malaysia, the United States and Singapore (amongst others) as part of a wider reform programme for the delivery of public services.

B. Why Public-Private Partnerships?

4. PPPs offer a number of benefits:

(a) Better value**.** The decision by a 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:

(i) Lower cost
(ii) Higher levels of service
(iii) Reduced risk

(b) 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.

(c) 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).

(d) 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[1].

(e) 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.

C. Growth of Public-Private Partnerships worldwide

5. Many governments have been attracted to this model and a number of growth patterns and trends are already apparent:

(a) 15 year pattern of growth and development – spreading steadily to emerging markets;
(b) High level of maturity and sophistication in some countries – Western Europe (United Kingdom, France, Portugal, Spain), Australia and New Zealand;
(c) Some 450 billion pounds financed in the United Kingdom – 750 deals;
(d) Impressive track record in Canada, South Africa and South East Asia;
(e) Strong interest in the Middle East;
(f) Significant initiatives in countries in transition; and
(g) Clear policy direction in Central and Latin America and South Asia.

II. IMPORTANCE OF GOVERNANCE

6. As seen in the Table below[2], countries tend to go through a number of distinct phases before a PPP programme becomes fully operational. Only at the third phase, where relatively few countries are currently situated, does the programme become really significant.

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1 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’.

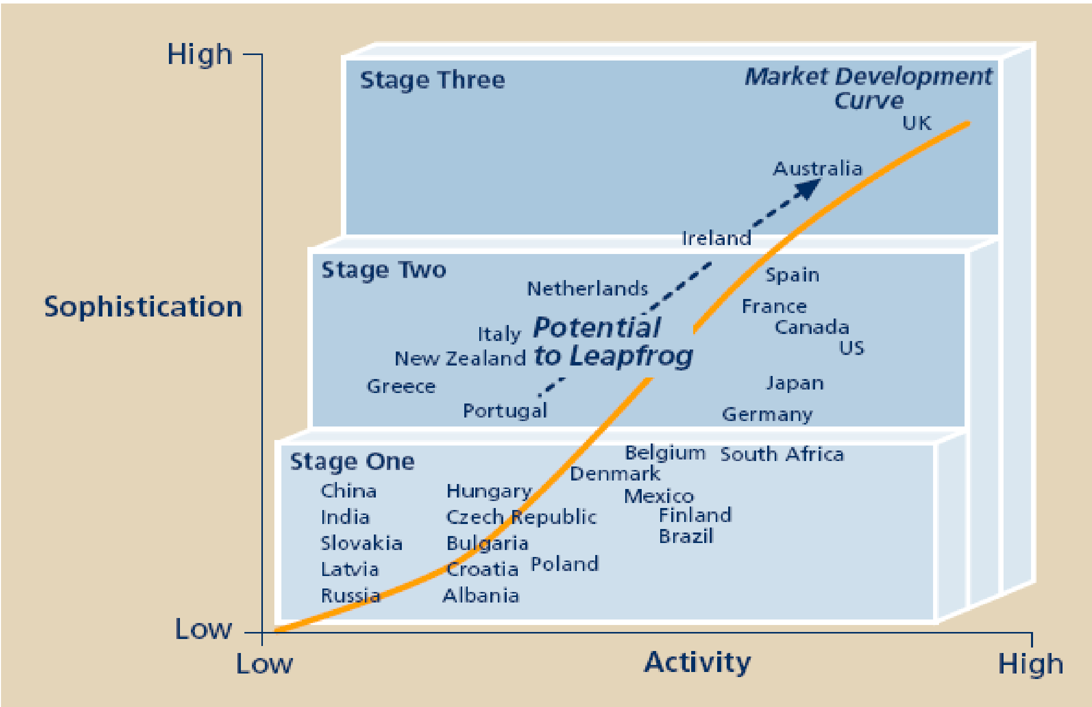
2 One of the misconceptions about PPPs is that they require less public sector involvement. In reality they entail more. They require for example, a strong public sector, which is able to adopt a new role with new abilities. In particular, strong PPP systems require managers who are not only skilled in making partnerships and managing networks of different partners, but also skilled in negotiation, contract management and risk analysis. Indeed, asking private partners to deliver government services places more, not less, responsibility on public officials.

***Table.* Three Stages in PPP Development**

Stage One	Stage Two	Stage Three
• Define policy framework • Test legal viability • Identify project pipeline • Develop foundation, concepts • Apply lessons from earliest deals to other sectors • Start to build marketplace	• Introduce legislative reform • Publish policy and practice guidelines • Establish dedicated PPP units • Refine PPP delivery models • Continue to foster marketplace • Expand project pipeline and extend to new sectors • Leverage new sources of funds	• Fully defined, comprehensive “system” established • Legal impediments removed • PPP models refined and reproduced • Sophisticated risk allocation • Committed deal flow • Long-term political consensus • Use of full-range of funding sources • Thriving infrastructure • Investment market involving pension funds and private equity funds • Well-trained civil service utilises PPP experiences

Source: Deloitte and Touche USA LLP

***Figure.* PPP Market Maturity Curve**



Source: Deloitte and Touche USA LLP

7. Moreover countries climb up the ‘maturity curve’ as the methods of PPPs become more sophisticated and activity is high (see Figure). Thus although there are attractions to using PPPs their implementation is not easy and moving up the maturity curve is far from automatic.

8. The key challenge is the difficulty in developing the institutions - both formal and informal - and ‘rules of the game’ related to PPPs, which is reflected in the following:

(a) Protracted negotiations between public and private partners;
(b) Slowness of reaching closure;
(c) The lack of flexibility in risk sharing;
(d) The cancellation of many projects with all the resultant waste;
(e) Lack of transparency of the selection of partner;
(f) The failure to use competitive tenders; and
(g) The emergence of ‘conflict of interests’.

9. Poorly constructed, non-transparent deals also lead to disappointment. This can also lead in turn to a backlash against the concept and generate political opposition towards PPPs as a whole.

10. The goal, therefore, in moving up the maturity curve is developing the required institutional strength or good governance, specifically:

(a) A coherent PPP policy: providing clear direction and leadership;
(b) Institutional capability: with skills in identifying, instigating and delivering and monitoring projects;
(c) Legal and regulatory framework that offers clarity, simplicity and predictability in legal processes;
(d) Transparency, openness and fairness in selecting the best partners. This will enhance confidence between the partners;
(e) Accountability to citizens and other stakeholders for performance and delivery. Stronger participation of stakeholders in PPP decision-making along with the accountability of their performance to members of the public will improve the reputation of PPPs and in turn, generate more political support; and
(f) Sustainable development: ensuring the outcomes have the maximum developmental impact and respect for the environment.

11. Clearly, countries are at vastly different levels of understanding and sophistication and each needs to find its own path. They need to develop their own systems in the context of their own economic development, relying on their own experiences, legal framework, political climate and strength of the business community and commercial environment. However, fully designed PPP ‘governance systems’, as shown above, work best.[3]

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[3] Looking back to when countries were being assisted to establish PPP programmes at the start of transition in the 1990s, it was assumed that once a single viable PPP project had been implanted in a country further deals would flow automatically. However, even while many individual projects were started, these single projects never translated into a deal flow. The reason for this disappointing performance is that other actions and processes need to be developed. Specifically, a holistic approach is required, which involves the integration of policies and institutions surrounding the project.

III. SEVEN PRINCIPLES OF GOOD GOVERNANCE IN PUBLIC-PRIVATE PARTNERSHIPS

12. The purpose of the UNECE Guidelines is to assist governments to realize the benefits from PPPs through strengthening their governance.

13. The guidelines set out seven ‘principles’, described below.

A. Principle 1: Policy

14. Typically, most governments fail to elaborate an overall PPP policy. This lack can lead to confusion over the goals of PPPs, which increases the likelihood of failure. A coherent PPP policy on the other hand sets down a ‘roadmap’ for implementation, identifying clear objectives and principles, the pilot projects, realistic targets and the means of achieving them. Improved policy coherence can increase the support of the population for the PPP approach.

15. While governments should have clear goals and objectives in their PPP policies these goals will vary according to their own economic development. For high-income countries the preferred goals of PPPs are to enhance economic efficiency and provide the taxpayer with the best value for money. In contrast, in low-income countries, PPPs need not only to increase efficiency but also improve accessibility of basic services to citizens, especially those who are economically and socially disadvantaged[4].

16. In fixing the policy objectives, governments should also consult closely with the beneficiaries and with the stakeholders. Some states have only embarked on a PPP policy once the key players had agreed on the PPP approach. Ireland, for example, set out its PPP policy only after a signed agreement with the Irish associations of employers and trade unions respectively. Achieving inter ministerial consensus in PPPs is also a critical challenge and developing an inter-ministerial working group to evaluate PPPs is often a good starting point.

B. Principle 2: Capacity-building

17. PPPs involve complicated structures that require new skills, which are found more in the private than the public sector. Governments need to find the necessary skills to develop PPPs. Governments can build the necessary skills in a combined approach which internally establishes new institutions and brings together the skills required and also at the same time uses external consultants to advise on financial and legal issues related to projects.

18. A critical aspect of building the necessary capacity is to create a PPP unit. The goals of the PPP unit are to:

(a) Establish a project pipeline;
(b) Support the regional and local authorities in implementing their PPP programmes;
(c) Defend the process both within government and outside; and

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[4] Even in high-income countries, however, there is a strong view that economic efficiency goals are too close to commercial criteria and that social goals should be more prominent in shaping policy.

(d) Build the capacity within the market place in order to create a wide choice of competent private sector partners.

19. There is a strong correlation between having a PPP unit and PPP success. Those countries, which have established PPP units, tend to have a more extensive PPP programme and a larger number of projects. Thus, a PPP unit is a part of the PPP ‘governance system’ and is a key factor in a successful programme. But the PPP unit should, however, not be itself a cause of governance concern. It is therefore important that in designing such units to ensure that they are located at ‘arms length‘ to the private sector and that their performance is evaluated by independent bodies.

C. Principle 3: Legal framework

20. Legal processes in many jurisdictions are insufficient and complex and fail to provide sufficient security and incentives to investors in PPP arrangements. Investors in PPPs need predictability and security in legal frameworks, which means fewer, simpler and better rules. In addition, the legal framework needs to take account of the beneficiaries and empower them to participate in legal processes protecting their rights and guaranteeing them access in decision taking.

21. One of the key challenges in many countries at the initial stages of developing PPPs was the failure of the law to adequately define the framework for PPPs. This led to many projects being started without competitive tenders and with clear conflicts of interest. It also failed to prevent, in some cases, the private sector from raising sharply the prices of services to the consumer who was often not in a position to pay. This led to the introduction of new regulation and controls.

22. These new rules, however, in some cases went too far and raised the cost of entry so that only large firms had sufficient resources to compete for tenders. SMEs, for example, could not afford the cost of preparing lengthy documents, prospectuses and feasibility studies. On the government side the stiffer requirements for due diligence, feasibility studies, etc. proved difficult as they did not have the necessary expertise to conduct the analyses themselves. Nor had they the resources to pay the legal and financial consulting firms to carry out this work. As a result of the new rules in some countries, the PPP process has become very complex and few, if any, PPP projects have since been started in these jurisdictions. One solution to overcome such an impasse is to simplify the law and remove the over burdensome 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.

D. Principle 4: Risk sharing

23. Theory in project finance suggests that risks should be borne by the party best able to manage them, but many PPP projects often fail to come to fruition because the parties have failed to agree on the allocation of risk, with each side trying to shift the risk to the other. It is also difficult to calculate risks, especially in transition economies when the rate of economic growth is sometimes less predictable, which makes forecasting demand, especially in transport projects, a difficult exercise. PPPs allow risks - which are most able to be managed by the

private sector - to be transferred to them. However, governments also need to accept their share and help to mitigate those allocated to the private sector in mutual support.

24. At the beginning of the transition process in Central and Eastern Europe and the Commonwealth of Independent States, PPPs were often promoted as offering assets to governments, such as roads and bridges, etc., at virtually no cost and no risk. Some projects were undertaken as fully private ventures. For example, in 1994, the M1 motorway, that covered a stretch of road from Vienna in Austria to Budapest in Hungary, was the first fully private motorway in Europe built without any taxpayers' money. However, problems occurred and the state was obliged to re-nationalize the project. The lesson from this experience, and others in this period, is that the cost and risk for infrastructure projects that require major capital expenditures is too high for the private sector to assume alone and the public sector must therefore assume its share and provide certain types of subsidies. Accordingly, there is a wide range of different subsidies, which governments might provide to make the project attractive to the private sector. The use of subsidies, however, has to be tempered as one of the important benefits of PPPs is the transfer of risk to the private sector and the placement of its revenue 'at risk' in case it does not meet its obligations to the project. It is important therefore that the government designs the partnership in order to continue to use the risk to its investments as an incentive to the private sector to perform well.

E. Principle 5: Public-Private Partnership procurement

25. The governance challenges regarding procurement include the lack of capacity in organizing competitive tenders especially at local levels, the public suspicion at non-transparent PPP deals, and the poor administrative procedures for competitive tendering that exclude SMEs. The selection of the bidder should be undertaken following a transparent, neutral, and non-discriminatory selection process that promotes competition and strikes a balance between the need to reduce the length of time and cost of the bid process and, acquiring the best proposal. Along these lines, there should be zero tolerance for all forms of corruption.

26. Governments realize that as PPPs become more commonplace, they need to go further to ensure total transparency in the selection of partners. In Canada, for example, the use of 'fairness and process auditors' – third party independent experts – provides a level of assurance to government sponsors, bidders and the public that the procurement process was fair, equitable, and appropriate. The most challenging areas of procurement for emerging markets are to ensure that there is a sufficient number of companies willing to bid. Competition amongst a number of companies is the most effective way to achieve successful results. In emerging markets however there may be too few private companies ready to enter into partnerships. In such cases it is best to halt the project and to undertake it, if possible, by more traditional means.

27. Many countries see in PPPs means of attracting foreign direct investment (FDI). Ensuring a highly efficient and effective competitive procurement process will attract foreign lenders, investors and contractors that will strengthen the market. Some countries, with a view to attracting FDI, undertake "outreach" surveys to obtain feedback on the PPP procurement procedures. The primary goals of these surveys are: to reduce time taken for the procurement process; to reduce procurement costs for both public and private sectors; and to maintain consistency in standardizing procurement documents.

F. Principle 6: Putting people first

28. Often, members of the public are not sufficiently consulted in PPPs in order to determine their interest in the projects and whether they meet their needs. This lack of transparency and accountability has led to a governance challenge that must be confronted in order for PPPs to move forward. The PPP process should put people first by increasing accountability and transparency in projects and through these improving people's livelihoods, especially the socially and economically disadvantaged.

29. Although it might appear at first hand self–evident that the designers of PPPs would wish to put people at the heart of the project, in the 1990s in some PPPs this was not often the case. The project was considered too 'technical' for ordinary people to understand while the challenge to bring the various partners to agreement so difficult that the interests of the general public tended to be overlooked. This state of affairs, however, cannot be described as good governance. There needs to be established a mechanism to test whether the projects are socially acceptable.

30. To ensure that the interests of people are taken into account the government needs to set the required criteria in the contract. If the private partner fails to meet the standards set, then the government should proceed to penalize the company. It is important moreover to make these penalties sufficiently high so that the private partner cannot ignore them.

31. One of the issues that arise is which body should do this evaluation: the public sector or an independent body? Generally speaking, it should be the public sector, which evaluates whether the contract has been respected. However, an independent body is best charged to evaluate the performance of the project in meeting the public interest as a whole.

32. While public accountability in PPPs needs to be enhanced to ensure that people are put first, it should not go too far and lead to over-bureaucratic control and poor as opposed to 'good' regulation. Generally, an evenhanded approach needs to be adopted and the same rules applied to the partner, domestic or foreign, public or private.

G. Principle 7: The environment and social concern

33. PPP projects must contribute to sustainable development and protection of the environment by balancing the public's current needs with the responsibility of not diminishing the ability of future generations to meet their needs as well. Responsibility of PPP projects rests often with the economy, finance and transport rather than the environment ministries. These ministries tend not to be well versed in environmental issues, whilst the environment ministries often lack the understanding of the economic and business basis of PPP projects. The PPP process should integrate the principles of sustainable development into PPP projects, by reflecting environmental considerations in the objectives of projects, setting specifications and awarding projects to those bidders who fully match the 'green criteria'.

34. The key challenge is to determine whether the PPPs can reconcile the dual objectives of economic efficiency with respect for the environment. There is no doubt that already there is strong evidence that PPPs can have major benefits to the environment. The private sector's ability to manage resources efficiently can save on material inputs to projects and avoid waste

from leakage. Everything, however, depends on the public sector side. They are the agent, which will include in contracts the obligations placed on the private partner to meet ‘green criteria’.

IV. DEMONSTRATING SUCCESS

35. By applying good governance principles the chances of success are increased. The following cases show that well governed projects can achieve real benefits. These cases were selected both for their sectoral variety and geographical spread:

(a) Vancouver landfill project, which transformed a site producing gases (including methane, a green house gas that contributes to global climate change) to generate electricity subsequently sold to a local utility;

(b) Centre Hospitalier Sud Francilien which is constructing a fully equipped hospital serving a large area south of Île-de-France;

(c) The Cross-Israel highway (Highway 6) is a 300 km highway along the eastern part of Israel from Beer Sheva to the Galilee in the north;

(d) The Pamir Private Power Projects (in eastern Tajikistan) is designed to contribute to the country’s poverty reduction strategy by providing reliable electricity supply to poor isolated habitants of the region; and

(e) The Chesapeake Forest project (covering the largest estuary in the United States) aims to restore the Bay‘s environmental habitat by generating revenue from the commercialization of its natural resources.

36. These cases are applying the principles of good governance presented above in the following way:

(a) <u>Principle 1: Policy</u>. Linking policy to clearly defined goals and enhanced efficiency was apparent in the French hospital project. The policy was fixed by central government and the framework implemented by the local authorities and national partners. Policy coherence was enhanced by the use of a previous model – in this case a prison project – that had been successful. It took just 6 weeks from start to closure.

(b) <u>Principle 2: Capacity-building</u>. With the exception of France none of the countries mentioned in the case studies at the time of the project had established fully operational PPP units. Thus it might be suggested that there is no necessity to establish PPP units in order to carry out projects. The advantage of establishing a PPP unit is nevertheless demonstrated. The PPP unit is, it can be argued, helpful not only in undertaking a project but also in transferring the knowledge and experience that can be used in delivering similar projects, e.g. the case of the French Hospital was based on a successful prison project. PPP units thus are conduits of information with an institutional memory and as such are important mechanisms to turn individual deals into a flow of successful projects.

(c) Principle 3: Legal framework. The flexibility of the PPP legal process is necessary so that the law does not constrain but enables the success of the partnership. The French hospital project showed such flexibility. Realizing that new legislation was needed to match the emerging opportunities presented by PPPs, the Government of France instituted measures that made it easier for the public and private partners to reach a deal. The case of Pamir moreover shows the need and desirability to include all the actors in the negotiation process leading to the agreement. By including the relevant players, there is far less chance of the agreement being overturned afterwards.

(d) Principle 4: Risk sharing. Almost all the projects demonstrate the value of achieving successful risk allocation. In the Vancouver case the city guaranteed the provision of land fill gases to the project, i.e. the ‘supply risk’ but it minimized the risk by retaining the responsibility for the management and operation of the gas collection system. In the French hospital project most of the risks were transferred to the private sector at the early stage of the deal. This was clearly appreciated by the lenders to the project and allowed for one of the lowest financing conditions offered for this type of deal to date. The Government of Israel who took on some of the demand risks to encourage private sector participation in the highway project chose a slightly different track.

(e) Principle 5: PPP procurement. The case studies show that the selection process needs to be transparent. This is not just for the sake of ensuring good practices but because open procurement is the best way to select the right partner and thus the best guarantee of success. In the French hospital project, for example, the selection process identified the “right” project for the deal. The selected partner had a great deal of expertise that allowed the transaction to occur more expeditiously than would have been otherwise possible. The same is true for the Vancouver Land fill project where there were five different projects from five different partners. Here again the choice proved to be the right one and contributed directly to the project’s success.

(f) Principle 6: Putting people first. A critical component of “putting people first” is 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, 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 Government of Switzerland, contributed a 10 million US dollars subsidy, which will support the project by keeping tariffs within the narrow limit of what people in the region can pay. Another aspect of “putting people first” is providing them with full information of the project. While there remains a view that the detailed information on PPP contracts over payment, etc. should remain private between the government and the private sector partner, the case studies demonstrate the value of full involvement of the public. This is particularly the case of the Chesapeake Forest Project which involved the public to the full and had as one of the partners a 'not for profit' public interest group which helped in the design of the project's Sustainable Forest Management Plan.

(g) Principle 7: The environment and social concern. The main challenge is to determine whether PPPs can both contribute to economic efficiency and respect the environment. The case studies suggest that both objectives can be met. In the Vancouver land fill project, the environmental goals were achieved using a carefully designed project whose goal was to reduce green house gases. The project in fact reduces gas emissions by approximately 200, 000 tons per year of carbon dioxide, the equivalent of the emissions of about 40,000 automobiles. The private sector was moreover critical to this success. It possessed the technology to turn waste into energy; the public sector did not. The critical feature in ensuring PPPs meet environmental standards is the contract: it is here where the private sector is given the incentive to comply with environmental standards. In the cases of the Chesapeake forest and the Vancouver landfill projects, the contracts were arranged to ensure that environmental targets were met. A further key ingredient of the success in the latter was the important role played by the Vancouver City Government which was fully informed and committed to improving the environment with the project.

V. CONCLUSIONS

37. There is an infrastructure deficit in many transition economies and PPPs are a possible instrument to fill this gap. The key goal for governments is to improve their governance. To assist in this regard the Guidelines highlight seven interrelated principles of good governance in PPPs. A number of case studies demonstrate that improving governance increases the chance of success. However, building this capacity cannot be achieved overnight. In some respects governments will have to devote effort to training their public administrations in PPPs and to develop national PPP training programmes.

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