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The Concept of Public-Private Partnerships: A New Approach To Transport Infrastructure Financing?



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Dr Declercq has received two Masters from the Free University Brussels, Belgium in Communications Science (1988) and Industrial Location and Development (1992). In 1997 he received his PhD in Business Management from La Salle University, New Orleans, Louisiana, USA. He has worked in a variety of positions as a special advisor to the Belgian Government, the European Commission, the European Dredging Association and other organisations. He is presently Managing Director of Strategic and Economic Research Corporation (STRATECO), Director of the Centre for Intermodal Research (CIR), both in Belgium, and Senior Advisor at PriceWaterhouseCoopers in The Netherlands.

Abstract

Implementation of a trans-European transport network is of the highest priority in the European Union. Since inter-European dredging projects are essential to the realisation of a trans-European transport network, the European Dredging Association (EuDA), with the co-operation of Directorate General VII, Transport, sponsored a study to determine the feasibility and form of utilising public-private partnerships. This article is based on the study commissioned by the EuDA and executed by the Centre for Intermodal Research (CIR).

Introduction

In view of the stringent budgetary constraints in Europe and considering the urgent need to realise many projects for the trans-European transport network, the possibility to combine public and private financing has received renewed interest. The idea of Public-Private Partnerships (PPP) has been studied within the European Union (1997) with the objective to see how they could contribute to the implementation of the trans-European transport network.

THE CONCEPT OF PUBLIC-PRIVATE PARTNERSHIPS

Comparing the various approaches to private sector co-financing (World Bank, EU, EIB,...), it is suggested that there are fundamentally common views, as demonstrated in Figure 1, but that perspectives differ from public and private partners.

The *private partner* has a predominantly commercial perspective. Their first interest in participating in PPP's is to obtain an acceptable return on investment. At present, the risk for the private partner is substantially higher than in traditional public works contracts. The risks are not only related to the financial return (which could eventually be guaranteed by the public authorities), but also to the insecurity of public policy and changing regulations. Both substantially increase the uncertainty/risk of the project and gradually rise in relation to the duration of the project. In many cases, the private sector still shies away from PPPs because the uncertainties (and thus risks) are still too high compared to traditional collaboration forms between the public and private sectors (co-operation).

The *public-partner* prioritises societal needs (e.g., cohesion and integration). Public authorities have a high interest in establishing PPPs to reduce the (financial) risks in large infrastructure projects as well as public

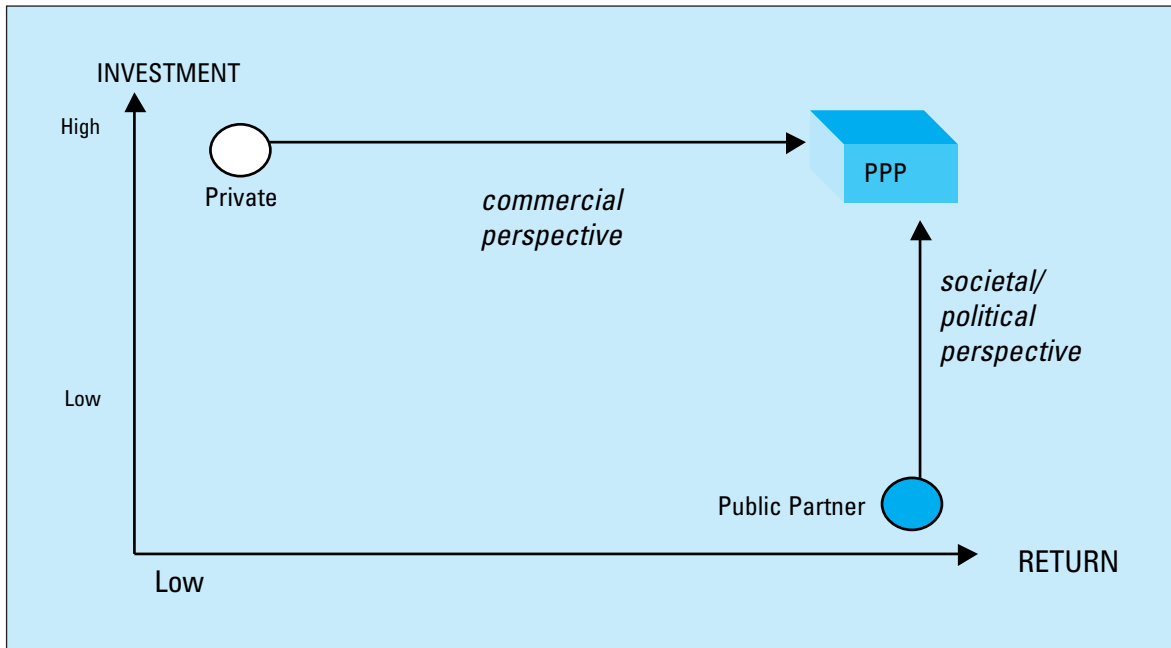


Figure 1. Public-Private Partnership (PPP): Perspectives.

financing volume. The objective of public authorities of PPP is therefore to allocate risk between the public and the private sectors according to each party's ability to manage and bear each risk. This means that a PPP should be flexible in distributing risks, including the problem of project ownership where private participation can be in other structures than taking partial or total ownership of projects, e.g., via a participation in the capital investment programmes or by sharing in the cost risk and/or the revenue risk.

The following definition for Public-Private Partnership is proposed: "The Public-Private Partnership is a form of collaboration between a public and a private partner for a well-defined period of time and related to one or more specific phases of a planned project. The responsibilities of both the private and public partners are explicitly defined in the Partnership Agreement, including punitive damages for both partners in case of non-compliance with the terms of the contract".

The key factor is that the project risks must be allocated to the public and private sectors, respectively, according to each party's ability to manage such risks without destroying the economic balance of the project. It is emphasised that this definition is rather restrictive. Others tend to take a pragmatic view and define all forms of collaboration between the public and private sectors as partnerships.

STRUCTURE OF CO-OPERATION AGREEMENT VS PARTNERSHIP

The allocation of project risk and responsibility between partners clearly differs according to the type of public-

private collaboration. Based on both factors, two main groups of public-private collaboration can be identified, namely the co-operation and the partnership (see Figure 2). Each of these variants originates from the principle that the public sector transfers to the private sector a number of responsibilities related to a traditionally public activity. Both the public-private co-operation and the public-private partnership include a contract between the public and the private partners of a project. The difference between both is the content and structure of the agreement.

Co-operation agreement

The co-operation agreement defines the contribution of the private partner(s), the period of the time of the contracts the financial contributions of both parties and other conditions. In many cases, the co-operation agreement specifies penalties for the private partner in case of non-compliance to the conditions of the contract. What is generally missing in the co-operation agreement is the well-defined and written description of the engagement of the public partner. A public-private co-operation that includes also a description of possible penalties for the public partner in case of non-compliance differentiates the public-private partnership from the co-operation. This aspect is directly related to the risk assessment of public-private collaboration.

Risk Assessment

Two main types of risk can be identified in relation to the collaboration between public and private partners. The first is the *project risk* related to realising large infrastructure projects. Under project risks one can distinguish:

- Technical risks (using new techniques or applying existing methodologies at a larger scale or under

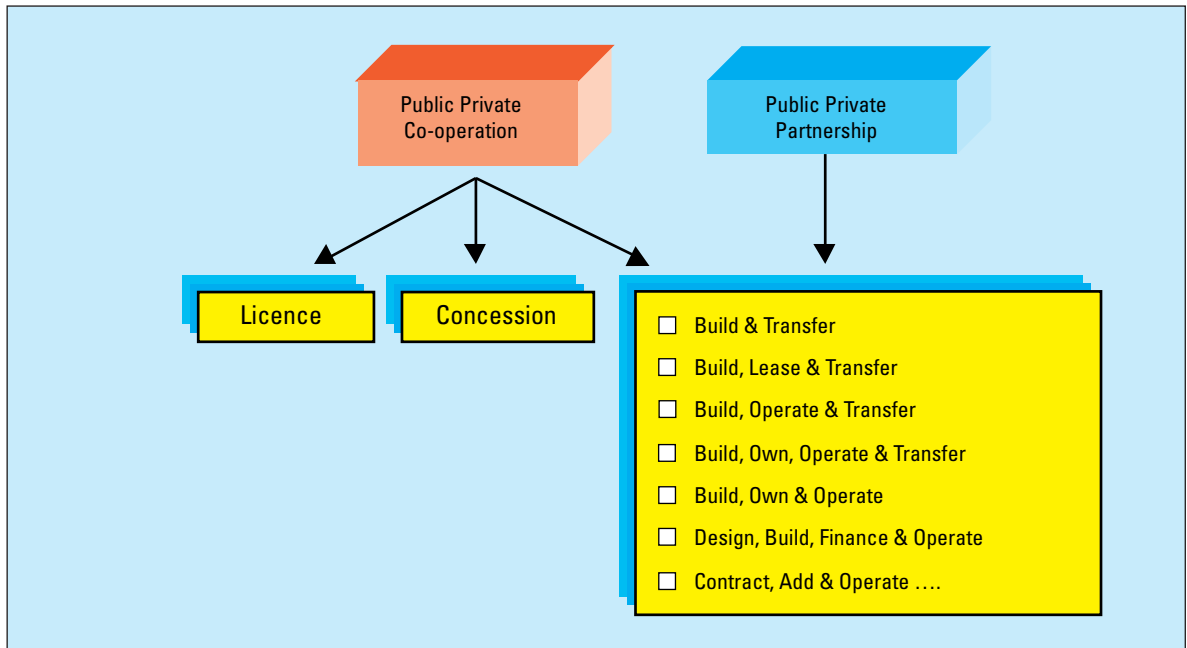


Figure 2. Structures of Public-Private Collaboration.

- different conditions, and such);
- Schedule risk (delays in execution);
- Commercial risks (cost escalation, budget control, and such).

Most if not all of these risks can be borne by the private sector.

There are however other categories of risk or uncertainty, in particular for transport infrastructure, that are outside the control of the private sector. These risks can be described as *structural risks* and they cannot be shifted to the private sector, in particular in view of the public character of the risks. Such risks should therefore be carried by the public sector to guarantee minimum conditions for project success.

Structural risks include:

- Planning and permits risk (e.g. delays in planning procedure, negative environmental impact assessment, not granting construction permits...)
- Political risk (new government changes plans, ...)
- Regulatory risk (the design rules are changed, ...)

COMMITMENT AS A DIFFERENTIATING FACTOR

The difference between traditional co-operation and public-private partnership should be sought in other domains than the role and contribution of each partner. Most studies do not explicitly define and qualify the commitment of both partners sharing the risks and responsibilities. In particular these elements differentiate the PPP from traditional forms of 'co-operation' as demonstrated in Figure 3.

Types of PPP

Three different types of PPP can be distinguished, based upon the participation level of the four stakeholders.

The first type is the 'basic PPP' where the public and private partners team up for operating a specific project and outsource all non-core activities to outsiders.

The second is the 'controlled PPP' where the provider of the financial resources is formally included in the project and is able to participate in the decision-making process and therewith in the controlling of the project's risks.

Finally, the third type of PPP incorporates all stakeholders during the life cycle and can be considered an 'integrated PPP'.

The basic PPP is the cleanest form and enables the public-private partnership to scan the market to find the best available option in terms of investor(s) and contractor(s).

The controlled PPP is the strongest form of collaboration given that the investor is a partner in the PPP and will constantly monitor the project in order to secure its expected return on investment. The investor will act as a continuous auditor.

The integrated PPP incorporates also the constructor(s) as a partner. An important question here is the level of involvement during the project life cycle.

The well-defined distribution of risks (and benefits) between the public and private partners is undoubtedly the key element for a successful PPP. The level of participation of the stakeholders is the crucial factor. The risks for each partner vary according to the structure of the PPP (basic, controlled or integrated PPP).

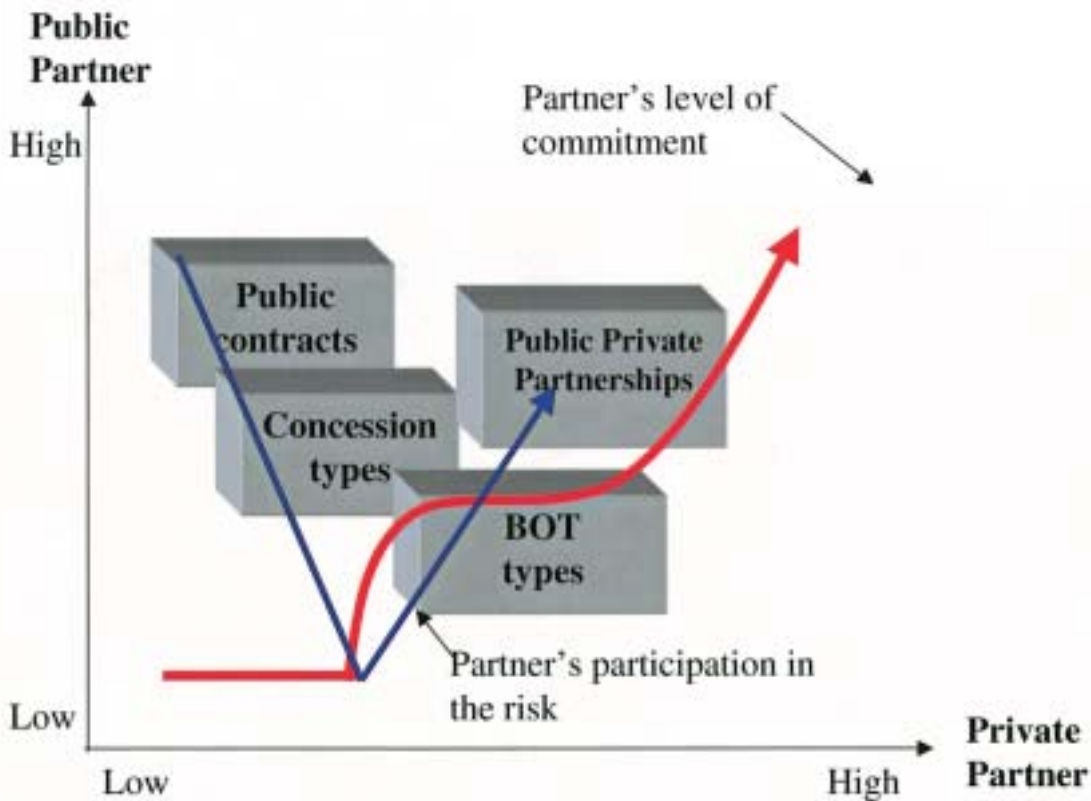


Figure 3. Commitment in public-private collaboration.

The other partners predominantly confront the public partner with a possible non-compliance with the stipulations of the PPP contract.

Public partners

Depending on the type of partnership, the level of risk for the public partner could be reduced to an acceptable level. The controlled or the integrated PPP is the optimal selection for the public partner, given that the participation from the start of the project of the investor(s) and contractor(s) will increase the (financial) stability of the project.

Private partners

It is logical that the private partner will carefully assess the commercial viability of a project before engaging in such a venture. For the private partner, however, structural risks come on top of the project risk. For the private partner, the participation of the investor in the controlled PPP increases stability and consequently reduces the project risks, both in financial as in political terms. For private partners in PPP's, the risk is the deciding factor for a participation.

The greatest risks could well be run by the investors, or equity provider, whether they are a partner in the PPP or outsiders. The best option for the investor is also the early participation in the project, either in the controlled or the integrated PPP. However, even as a partner,

the fact remains that the investor provides the financial resources and therefore is the most vulnerable partner to possible changes.

Finally, there is the contractor. The risks for contractors are generally limited as long as they remain outsiders from the project. In this case, the period of their involvement is confined to the beginning of the project, when risks both political and commercial remain limited. In case of a partnership (integrated PPP), the constructor increases risks but will at the same time increase long-term expected revenues from the project.

Conclusions

The overall project risks can never be fully eliminated for companies and public bodies participating in a transport infrastructure investment. The selection of the optimal PPP structure will remain a project-based decision for which no general assessment rules exist. Careful preparation of a PPP is an important success factor. The key factor is that the project risks must be allocated to the public and private sectors, respectively, according to each party's ability to manage such risks without destroying the economic balance of the - project.