ADVANTAGES AND LIMITATIONS OF THE PUBLIC PRIVATE PARTNERSHIPS AND THE POSSIBILITY OF USING THEM IN ROMANIA

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Abstract

Public-private partnership (PPP) is a means for the public sector to complete infrastructure projects by using the skills and the experience of the private sector. In many cases, PPP may also mean that the private sector finances public infrastructure investments. PPPs can present difficult and complex contractual issues for both the public and the private sector partners. The goal of this paper is to emphasize and to analyze the advantages and the risks posed by the public-private partnerships starting from the presentation of the experience acquired by the actors involved in the construction and the use of the Channel Tunnel. In addition, the paper aims to analyze the situation of the PPPs in Romania. Taking into consideration that, in the context of accession to the European Union, an increase in the number and importance of the PPP projects was observed at the level of several member states, the interest of the Romanian local public authorities in PPPs is prefigured to increase in the next period. The final part of the paper analyzes the causes of the reluctance manifested by the Romanian local authorities in using private resources to accomplish public investments.

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Introduction

The public institutions' role is to provide services to the citizens in order to the increase their living conditions. The goals of the public sector reform are to transform administration into a "service" responsive to the requirements of the market-type mechanisms and to the public interest, to make citizens act as private "customers", to size in a genuine way the public need, to decrease the public expenditures and increase the quality of public services. The studies showed that the public sector "generates" weak performances, the public services are not innovative and not flexible enough, they are over regulated, too slow and are not consumer or citizen-oriented. Moreover, the organizational structures characteristic to the public sector, reflected in the hierarchical organization and the bureaucratic structures, are rigid. The traditional public services are stable and rigid, while the practices used in the private sector are innovative, flexible, and they adapt and change over time. There is definitely a need to apply the theories and the practices used in the private sector to the public sector in order to increase the quality of the public services, to reduce the budgetary allowances for the public services, to become citizen-friendly, and to increase the efficiency and the effectiveness of the public sector. The "best practices" promoted by the developed countries might be considered models to be followed by other countries. However, we have to be aware that "these best practices" are specific to a cultural, economic and social context, and when they are followed by a different country, some adjustments are required. There is no unique solution, no single model that can be followed. However there is a form of "association of decisions and public and private means within the framework of the same system of action, aiming to comply simultaneously the consumers' and citizens' expectations", which is known as public-private partnership (Matei, 2006).

Public-private partnership describes a government service or private business venture, which is funded and operated through a partnership between the government and one or more private sector companies. In some types of PPP, the government uses tax revenues to provide capital for investment, and it jointly runs the operations with the private sector or it contracts out the service to a private company. In other types (notably the private finance initiative), private sector provides capital investment on the strength of a contract with the government, which is responsible to provide agreed services. The contributions of the government to a PPP may also be in kind, which is the case of the transfer of existing assets. In the case of projects that are aimed at creating public goods, such as infrastructure sector, the government may provide a capital subsidy in the form of a one-time grant, in order to make it more attractive to the private investors. In some other cases, the government may support the project by providing revenue subsidies, including tax breaks or by providing guaranteed annual revenues for a fixed period of time.

In the new Romanian legislative framework, the term "Public Private Partnership" was replaced with "Public Works Concessions" and "Service Concessions", which are particular forms of the broader concept. Still, the concept of "Public Private Partnership" remains valid for any transaction that transfers the general responsibility for delivering

a public service from the Contracting Authority to a private company. In other words, this change is merely semantic. Internationally, these types of Concessions are considered specific types of PPP structures. The concept of the PPP is broader than just Public Works Concessions and Services.

Advantages and risks of PPPs

A Public-Private Partnership is a contractual agreement between a public agency (federal, state or local) and a private sector entity. Through this agreement, the skills and assets of each sector (public and private) are shared in delivering a service or facility for the use of the general public. In addition to sharing the resources, each party shares the potential risks and rewards in the delivery of the public service and/or facility. Sectors where PPPs have been used successfully are transportation, water/wastewater management, urban planning, infrastructure and utility development, financial management and education.

The Public-Private Partnership projects are long-term partnerships (typical projects have the duration between 20 and 40 years). Another distinctive feature of the PPP projects is the fact that the private partner carries the risk for the invested capital, not the public sector, as it is the case of projects based on outsourcing. PPP projects enable the risk to be optimally spread, and each subject of the partnership to take the risks they are able to manage best.

Another specific characteristic is that, differently from other types of projects where the public sector enters into co-operation with the private sector, the outputs of this co-operation are defined from the beginning. Therefore, on one side, the public sector exactly specifies the type of the service the private sector has to provide, its quality, the price and the control mechanisms. On the other side, the private sector implements the entire project by ensuring its funding and maintenance (Tetřevová, 2006).

The basic implementation condition of a PPP project is its ability to achieve, from the point of view of the public sector, a greater benefit in relation to the expenditures, compared with the situation when the public sector implements the given project by itself, using its own forces and from its own sources, i.e. respecting the principle of value for money.

The most important advantages of PPP projects for the state are (Valdimarsson, 2007):

- **Transfer of risks** is the most important driver when the state looks at the advantages of PPP projects**.** In PPP projects, there is a possibility to transfer most or all of the risks to the private entity (for a price). Risk and opportunity go hand in hand. The private entities can and want to explore opportunities, even though they involve risks.
- **Minimizing the government** by outsourcing non-core activities is another important advantage. One of the state's objectives is to reduce the government and move as much as possible of its tasks over to the private sector.
- **Possibility for multiple uses of the facilities**. The state is not stimulated to explore this possibility, since it does not compete on the market. The possibility

for the private sector to use the facilities in multiple ways represents another advantage of PPP.

- **Constant cash flow**. The state budget is formed of fixed budgets for each ministry. Major investments are temporary modifications of the budget of a ministry, and this problem can be difficult to deal with within the budgetary process. Avoiding major investments by having a constant cash flow is an important driver when the state looks at the advantages of PPP.
- **Quicker execution of a project** (once contract is signed).

The advantages and risks of PPPs projects can be synthesized as follows:

Table 1: Advantages and risks of PPP

Advantages	Risks
Possibility for smaller investments	Limited influence of public authority over the investment
Possibility for conducting other public investments	Increase of the prices charged to the users of the infrastructure
Savings to the budget	Reduction of bargaining position of public authorities
Transfer of new technologies	High transaction costs
Sharing the risk	Poorer quality of the services
More competition on market	Limited accessibility to services
More competition on market	Decrease of employment in the public sector
Guarantee of the services for a longer term	Financial risk for public partner
Decrease of the political influence in economy	Opportunity risk for public partner
More transparency in the economy	Political risk for private partner

Source: Brzozowska, 2006, p. 24

Successful PPPs are characterized by comprehensive planning, clear contractual rules and contingencies, competitive procurement and credible contract enforcement.

Issues of an investment project of public interest carried out through a public-private partnership. The case of the Channel Tunnel

Ever since its appearance, the concept of public-private partnership has aroused keen interest. At the international level, the interest for the promotion of the public-private partnership is directed towards three main courses:

- investing in infrastructures;
- increasing the efficiency of the financial resource usage;
- better commercial usage of the invested funds.

However, carrying out an investment project of public interest through public-private partnership may generate many problems both for the public authorities, as well as for private investors. "The Channel Tunnel" investment project represents an eloquent example in this respect.

Connecting the United Kingdom to continental Europe, the Channel Tunnel is one of the largest privately financed transport projects in the history. Crossing the English

Channel through the tunnel, which links the United Kingdom and France, takes only 35 minutes as compared to the 75 minutes-crossing by ferry.

The organization of the project was based on a concession contract stipulating that the project was to be financed without resorting to financial or commercial public funds or to public guarantees. The concession was initially decided for a period of 55 years, but it was later extended to 65 years. The concession contract was awarded to Eurotunnel (a group of ten building companies and five banks), but the actual construction was carried out by the consortium Transmanche Link based on its own project. Eurotunnel was not able to review or substantially modify the project, and was thus forced to control and manage the project costs and configuration in the best possible way, during the seven-year construction programme. This proved to be a very difficult issue, mainly because the English and French authorities established an institution: the Independent Safety Authority, who imposed significant constraints on the project leading to many expensive requirements for the project.

One year before starting the construction (1988), the Channel Tunnel construction and equipment costs were estimated to 2.7 billion GBP. In June 1993, the total financing requirements were estimated to 4.9 billion GBP, the initial budget being exceeded by more than 80%. In May 1994, the financing requirements reached 10.1 billion GBP. The Channel Tunnel Project was mainly financed through bank loans from a great consortium of over 100 European and Japanese banks.

Due to major financial difficulties, Eurotunnel did not allocate sufficient financial resources in order to place at the future clients' disposal an attractive and competitive service able to be commercially operational. Although the completion of the construction stage had been planned in the summer of 1991, the passenger transport services started in December 1994. Subsequently, these services had to overcome a number of technical and operational problems. Consequently, instead of creating a strong positive impact on the market by launching trustworthy, completely operational services that should have been better than those of its competitors (the ferries), the launching performed by Eurotunnel was an embarrassing failure with a postponed and gradual opening of irregular and often defective services, with delays and long waiting times.

The Channel Tunnel offers three services:

- a rail loading and unloading service for motor vehicles (cars, buses, and trucks);
- a passenger transport service operated by the British, French and Belgian railway authorities; and
- rail goods transport services operated by the British, French and Belgian railway authorities.

The Rail Usage Contract represents the only source of income for the Eurotunnel Company. The authorities that operate the goods and passenger transport services pay a fixed amount of taxes depending on the volume of traffic passing through the tunnel. There is a minimum taxation level, a mechanism meant to ensure a guaranteed level of cash flow to Eurotunnel in the first 12 years of operation.

The public authorities believed that the benefits from international and local transports would result in reducing the traveling period and in increasing the transport capacity (thus eliminating the local train overcrowding), while other benefits would result from creating new jobs.

Both the forecasts related to the goods traffic as well as those related to the passenger traffic were mainly overestimated. Although the cornered share of the traffic across the Channel (competing with the air and naval transport) was correctly forecast, the intense competition and low tariffs led to low incomes. The traffic across the Channel as a whole was overestimated. When the decision was made, a number of 16.3 million passengers were forecast for the Eurostar trains in the opening year. In 1995, the first year of complete functioning, the real number was 2.7 million passengers.

The volumes of goods going through the Tunnel were sporadic, and they decreased in 1997 due to the closing caused by a fire broken out in a freight train. The total volume of goods has increased in time, indicating a replacement of the naval transport by the Tunnel. The Tunnel reached and exceeded the market share forecasts made in 1980 for the transportation of goods through Eurotunnel, but the forecasts for 1990 and 1994 were overestimated. The forecasts for the transportation of goods for the first year were of 7.2 million gross tones, nevertheless, the number for 1995 was 1.3 million gross tones, and in 2001 it increased to 2.4 million tones.

The main lessons to be learned from this short description of the history of a public-private partnership are the following:

- Forecasting the incomes obtained from the new investment projects is subject to great uncertainty. Forecasts should be validated independently especially in the case of public-private partnerships and tested with pessimistic scenarios;
- The capital invested in a project should reflect the risks of the respective project. The public investors should make sure that the structure of the capital for the proposed business is appropriate for the risks implied by the project. If the risk/capital ratio is too low, the project will not be financially robust and the incomes will be lower than expected. Moreover, the risk exposure of a low investment can discourage the shareholders from the private sector to take decisive action for the problems of the business. Anyway, the impact of continuing with a too low risk capital will probably generate appeals to the public sector for increases in the financial support. If the market does not want to subscribe sufficient capital, it gives a clear signal related to the risk of the project, the consequences of which must be considered by the departments in question;
- The contractual arrangement should reflect the long-term approach of the project assets. In the case of the Channel Tunnel, there was a weak link between the general contractor (Transmanche Link) and the operator (Eurostar). Consequently, the former manifested little interest in keeping costs and financial requirements under control and handed to the operator a project with extremely severe conditions. Both, i.e. the general contractor as well as the operator, as separate entities, should have had their own shares of risk during the whole period of the project.

The situation of the PPPs in Romania

The legal framework applicable to PPPs can be found in the laws applicable to work and service concession contracts, i.e. Government Emergency Ordinance no. 34/2006, and in the methodological norms concerning the assignment of work concession contracts and of service concession contracts (Government Decision no. 71/2007). However, it is necessary to distinguish between contractual PPP (CPPP) and institutional PPP (IPPP). Whilst the CPPPs are created based on exclusively contractual relationships (concession contracts), the IPPP imply the participation of the private partner together with the public one in a joint capital entity (a joint venture or a business enterprise). According to a survey performed by Price Waterhouse Coopers (2008), at the European level, approximately 60% of the PPP-type projects are concluded in the form of concession contracts.

In comparison with other countries in the European Union, in which the PPP projects have frequently been used for the fulfilment of various investment objectives, in Romania, the PPP projects are still in the preparation phase. For example, in the next period, according to the intentions of the Ministry of Transportation and of the Romanian Highway and National Road Company, the following projects will be completed through PPPs: the Comarnic-Braşov highway section, the Sibiu-Piteşti highway, the Ploieşti – Buzău – Focşani highway, the Iaşi – Roman – Târgu Mureş highway, a number of expressways and a bridge over the Danube River at Brăila. In the previous period, the PPP component (more specifically the service concession) was noticed in various stages of the implementation of projects financed from the ISPA (*Instrument for Structural Policies for pre-Accession*) Programme: 6 domestic waste management projects in Piatra Neamț, Bacău, Galați, Argeş, Dâmbovița and Teleorman, and one water management project at the regional level in Craiova (Stan, 2008).

Unlike Romania, in Poland and Slovakia for example, 48, and respectively 13 PPP projects were completed in infrastructure sectors in the period 1990-2006 (see Table 2).

Table 2: PPP projects in infrastructure sectors in Poland (and Slovakia) within 1990-2006

	Energy	Telecommunication	Transportation	Water and Sewage
Total Projects Number	19 (6)	13 (3)	8 (1)	8 (3)
Projects Value in mil. USD	2 981 (4 460)	23 365 (3 592)	1 845 (42)	71 (14)

Source: Tomova, 2008, p. 67.

Romania's delay in implementing PPP projects can be explained by the following reasons: the lack of laws in this field (due to the fact that the law provisions cover exclusively the period up to the finalization of the tender by which the company that will make the investment is selected), the lack of experience of the public authorities that should initiate these projects, and the difficulty of completing these PPP projects.

The fact that there are structural funds that can be accessed until 2013 and used until 2015, provide an easier financing alternative for public investments, but, in the same time, it represents an obstacle in the way of implementing PPP projects.

In order to prove the viability of this idea, we are proposing a case study based on a real situation within the Argeş County Council, characterised by the following elements:

A. *The object of the investment project*: the rehabilitation and expansion of a space dedicated to the establishment of a Multifunctional Business Support Centre. Within this Centre, display spaces dedicated to companies will be set up with the purpose of supporting the research, development and innovation activities, as well as spaces dedicated to the provision of business consulting services.
B. *Life period:* 20 years.
C. *Financing alternatives:*
   - Alternative 1: Accessing funds through the Regional Operational Programme, Priority Axis 4, Major Field of Intervention 4.1. In this situation, the co-financing granted through the European Regional Development Fund is of 50% of the eligible expenses of the project, the remaining expenses should be covered through the contribution of the County Council, which would be the beneficiary. Because, according to the cost estimates of the feasibility study, the value of this investment will be 45 millions lei, the Argeş County Council will have to bear costs for 22.5 million lei. The project will not generate incomes during these 20 years.
   - Alternative 2: Concession. In this case, the project will imply three participants: the Argeş County Council in its quality of concession holder, the company (companies) to which the contract is granted, referred to as conceder that will perform the rehabilitation and expansion works and will be entitled to obtain incomes by renting the spaces within the Centre, and the investor (a commercial bank or a group of banks), that will grant the conceder the loan necessary for the completion of the investment project. The current lack of cash in the banking system will probably create some difficulties within the financing process. The resources invested by the Argeş County Council will be represented by the royalty paid to the conceder during these 20 years. It represents the amount by which the conceder will cover the negative cash flows.

If the joint venture contracts a bank loan in the amount of 45 million lei, with a fixed interest rate of 8% per year, for a 20-year period, it will generate an annuity of more than 4.5 million lei for the debtor. Taking into account that not even the most optimistic hypotheses can prove that the conceder will obtain a net benefit of more than 2 million lei per year from the provided services, the large amount that will be paid by the County Council as royalty during the project life (double as compared to the case in which the project would be financed by accessing European Funds) does not justify the use of the PPP.

Conclusion

There are multiple advantages of the public-private partnerships: various solutions for the private financing of public projects, decreasing costs for the central or local administrations, use of private know-how and management within public projects, increased efficiency in the project development, a shorter implementation period, technical innovation and a higher quality level of the provided services. However, the highest interest is represented by the fact that part of the project risks is transferred to the private partner: along with the construction risk, the private partner can also take over the exploitation risk or the availability risk.

The main risk of a PPP consists in the fact that, in the absence of a careful regulation and monitoring of the procedure used for the selection of the private partner and of the completion of the PPP-type projects, such projects can become a risky means of "devouring" the national resources. Moreover, the scarce experience of the central and local authorities in this field represents a serious impediment, because the PPP project preparation process is complex and long.

The great challenges imposed by the adjustment to the market economy and by Romania's integration into the European Union (the transport infrastructure rehabilitation; the water supply, waste recycling; environment protection; insufficient funds; government aid monitoring; ensuring a loyal and predictable business environment) are as many reasons to use the public-private partnership as a way of cooperation among the public sector, the public project launching authority and the private sector that owns funds and competitive management.

From the point of view of the Romanian local public authorities, currently, it is much more profitable to finance public investments by accessing resources through the European Regional Development Fund than through a PPP (with the exception of investments in infrastructure, in the case of which the conceder's benefits may be higher as compared to the investments in other public interest fields of activity, with a similar value). Nevertheless, after 2013, the interest in PPP projects will definitely increase.

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