CEE Bankwatch Network input to EC consultation on an EU initiative on concessions

For more information

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CEE Bankwatch Network welcomes the opportunity to participate in this consultation on concessions, which are becoming the topic of increasing discussion in the EU. Nevertheless we believe that the main problems concerning concessions, and particularly public-private partnerships[1] (PPPs) are not limited to the tendering process or the other issues that the EC's questions highlight.

For several years we have monitored PPP infrastructure projects in Central and Eastern Europe (CEE) – mainly motorway construction and operation – and have been concerned by the apparent lack of risk transfer, poor value for money, and severe impacts on public budgets caused by many public-private partnerships, and about the difficulties involved in obtaining detailed information on the projects. PPPs in infrastructure are being heavily promoted in CEE even though hard evidence from the use of such models so far, both in the region and in the UK where PPPs have been most often used, is mixed or often absent.[2] Several projects in the EU new member states have failed altogether or had to be renegotiated after much time and money had been invested – an outcome which could have been avoided by more careful scrutiny of the use of the PPP model in the planning stages. These include the Trakia motorway in Bulgaria, the M1/15 and M5 motorways and the Szeged water concession in Hungary, the A2 motorway in Poland, the D47 in the Czech Republic and the D1 phase one PPP in Slovakia.

As these issues are not covered by the questions put forward by the Commission, we present many of our points under the last question, which invites 'other comments' to be put forward.

CEE Bankwatch Network's mission is to prevent environmentally and socially harmful impacts of international development finance, and to promote alternative solutions and public participation.

1 Please note that our comments relate only to PPPs for the construction and operation of public infrastructure, and our comments are not necessarily applicable to other kinds of concessions.

2 For a full overview of our concerns regarding PPPs in CEE, see our November 2008 publication *Never mind the balance sheet – the dangers posed by public-private partnerships in central and eastern Europe*.

Profile

0.a. Type of organisation
NGO

0.b Scope of activity
European

0.c Size of the respondent
CEE Bankwatch Network has just under 50 employees, and represents 14 member groups from 12 countries of Central and Eastern Europe.

0.d What sector(s) do you operate in / do you represent?
Other: non-governmental organisation seeking to prevent the harmful social and environmental impacts of development finance.

0.e Country where your organisation / company is based
Czech Republic

II Expected impacts of new legislation on concessions

A General issues

23. In your view, what could be the social impact and the impact on public finances of intensified competition and/or externalisation of services as a result of greater use of concessions, notably with reference to the social protection enjoyed by the employees? Please distinguish between

a) financial impacts and
b) social impacts.

CEE Bankwatch Network believes that a greater use of concessions by private companies for infrastructure construction and operation is something that should be critically examined rather than encouraged, as experience has shown that **they often have significant negative effects on public finances.**
The opportunity to spread the cost of financing the infrastructure over the lifetime of an asset or introducing direct user payment (eg. for roads) no doubt looks appealing to some of today's decision-makers, trying to keep current public expenditures levels down while still investing in infrastructure. However it limits the choices of future decision-makers by tying them into long contracts for infrastructure that they may never have chosen to build.

PPPs are usually more expensive than direct public procurement. This is logical: private sector borrowing is more expensive than public sector borrowing; the preparation of PPPs is long and complex; and private companies expect a significant profit.

It is sometimes argued that this higher financial impact is justified by PPPs being more often completed on time and on budget. However there is little evidence for this, and where it is the case, it seems to result from the use of turnkey contracts rather than other features of the PPP model – but turnkey contracts could also be used in non-PPP contracts.[3] Another issue is that price increases and deadline extensions may be negotiated before the contract is signed, especially during the preferred bidder stage. A 2007 study found that indeed the capital values of 43 UK hospital PPPs increased by an average of 74 percent between the Outline Business Case stage and the contract signing.[4] If this is typical for other PPPs, it is not surprising that fewer increases take place after the contract stage.

Another justification for the higher financial impact of PPPs is that they were envisaged to share significant risk with the private partners, but in reality this has proven difficult to implement. This is firstly because the private sector charges high sums for taking on risk, and secondly because much of the risk in PPPs is ultimately untransferrable. As it is in neither party's interest that a project fails, either the public sector ends up assuming risks (eg. demand risk) or the private partner is paid highly for very low-risk work. Particularly in motorway construction, it has been shown that few projects, especially in Central and Eastern Europe can fully cover their costs from tolls, leading to arrangements involving availability fees, which entail almost no risk for the concessionaire after the construction is finished.

Little attention has been paid to the future budget burdens that may be caused by PPPs. As the authors of a 2007 World Bank paper on PPPs in CEE note:

> *"EU8 countries ... have only limited information on the risks involved in PPPs and limited understanding of the long-term fiscal cost of PPPs. Moreover, these countries make very little of such information publicly available. PPP contracts and their content are considered confidential. This makes it difficult for policy analysts to assess the long-term fiscal cost of PPPs—and for the public to exercise appropriate pressure on policymakers for fiscal prudence."* [5]

Promoters of PPPs claim that they have an advantage of calculating and properly allocating expenditures for maintenance and investments for years to come, which is on one hand true, but on the other hand presents a problem: The rigidity of the contracts means that PPP payments must continue to be made, while in times of scarcity, it is the other non-PPP items in the same public budgets which must be squeezed. The affordability of PPPs for public budgets has already become a serious issue in the health sector in the UK, where the money for capital costs that hospital trusts receive from the government is not sufficient to pay the capital costs for PPP schemes, with the result that the PPP fees are paid for by reductions in service.[6]

In CEE affordability of PPPs for public budgets has already been identified as a problem in Hungary, Croatia, and Slovakia. Hungary and Croatia have been criticised for being too ambitious with their road sector development programmes at the risk of burdening future governments with large liabilities.[7] During the past year, Hungarian media reports have suggested that the government is losing its enthusiasm for launching new PPP projects and is investigating the projects undertaken so far.[8] In Slovakia, it has been estimated that the three planned PPP motorway projects alone would take the country's debt from just over 40 percent of GDP to over 50 percent of GDP.[9]

3 EIB Operations Evaluation Department: Evaluation of PPP Projects Financed by the EIB, March 2005, p.4

4 Mark Hellowell and Allyson M Pollock: *P*rivate finance, public deficits: A report on the cost of PFI and its impact on health services in England, Centre for International Public Health Policy, University of Edinburgh 12 September 2007

5 Nina Budina, Hana Polackova Brixi, Timothy Irwin: Public-Private Partnerships in the New EU Member States – Managing fiscal risks, World Bank Working Paper No. 114, June 2007, p.16

6 Mark Hellowell and Allyson Pollock: Private Finance, Public Deficits – A report on the cost of PFI and its impact on health services in England, Centre for International Public Health Policy, 12 September 2007

7 Andreas Brenck, Thorsten Beckers, Maria Heinrich, and Christian von Hirschhausen: Public-private partnerships in new EU member countries of Central and Eastern Europe, EIB Papers, Volume 10, No. 2, 2005 p.94 and 100.

8 See eg. http://www.realdeal.hu/20100729/ppp-investment-projects-to-be-scrapped

9 Ineko: PPP zvyšujú verejný dlh nad 50% HDP, 2010: http://www.ineko.sk/clanky/ppp-zvysuju-verejny-dlh-nad-50-hdp. Please note that the D1 phase one project was discontinued in early September 2010, bringing this figure down considerably.

The budget burdens of PPPs are particularly harsh in smaller economies such as those of Central and Eastern Europe, but as noted above they can also cause problems in larger economies such as the UK when a large number of projects are undertaken and pressure is put on particular budget lines. **Therefore we would consider an increase in concessions for public services generally to have a negative impact on public finances in Europe.**

Some of the problems with PPPs can be solved by a strong, experienced and transparent public authority, but most, such as the lack of private sector risk during the operation stage involved in most motorway PPPs, or the limitations that PPP payments impose on non-PPP budget lines in the same sector, are difficult if not impossible to overcome. In addition, some of the issues, such as the difficulties in imposing penalties for poor performance when it is in no-one's interest that the project fails, severely impact on the public authority's ability to transfer risk even when relatively experienced in carrying out PPPs.

We would also draw attention to the European Parliament's report on New Developments in Public Procurement[10], which *"expects the Commission to draw lessons from failing PPPs"* and emphasises *"... that the recent financial crisis has shed new light on the ways in which public-private partnerships are often financed and the financial risks shared; asks the Commission to evaluate properly the financial risks associated with the creation of PPPs ..."* We believe that there is a clear need for a proper in-depth assessment of this issue. This issue is also emphasised in the Committee on Economic and Monetary Affairs's *Draft report with recommendations to the Commission on Improving the economic governance and stability framework of the Union, in particular in the euro area*[11], which recommends that the EC *"Establish a clear harmonised framework to measure and monitor debt dynamics, including implicit and contingent liabilities, such as public guarantees in public-private-partnership investments"*.

As for **social impacts**, we have not studied the impacts of PPPs on employment, however the section above outlines some other negative financial impacts that have social effects. As well as the obvious issue of public debt increases, there is the issue of the rigidity of PPP contracts, which means that PPP payments must continue almost no matter what, while other public budget items are the ones that are squeezed in times of scarcity.

An additional issue in PPPs in the health sector in the UK is that since PPPs are so expensive, there has been an average of 30 percent cuts in bed capacity and 20 percent reductions in staff in hospitals financed through PFI in the UK.[12]

PPP concessions in other sectors have also had mixed results. A 2009 PPIAF study on water and electricity quoted in the EC Communication[13] finds that greater efficiency does not consistently translate into either lower costs, or greater investment, meaning that either the starting point was so low that the increased efficiency still only contributes to a minimally functioning service, or that it translates simply into profits for the company. A stark example of such weaknesses is provided by the Sofia water concession in Bulgaria, which in spite of the European Bank for Reconstruction and Development's participation has failed to make sufficient investments into the water supply network, resulting in a situation in which Sofia lost 60.26 percent of water in 2008.

10 European Parliament: Report on New Developments in Public Procurement (2009/2175(INI)) 10 May 2010, http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+REPORT+A7-2010-0151+0+DOC+XML+V0//EN

11 European Parliament Committee on Economic and Monetary Affairs: Draft report with recommendations to the Commission on Improving the economic governance and stability framework of the Union, in particular in the euro area. (2010/0000(INI)) Rapporteur: Diogo Feio, 25.06.2010

12 Allyson M Pollock, Jean Shaoul, Neil Vickers: Private finance and "value for money" in NHS hospitals: a policy in search of a rationale? British Medical Journal 324, 18 May 2002, p. 1205

13 Katharina Gassner, Alexander Popov, Nataliya Pushak: Does Private Sector Participation Improve Performance in Electricity and Water Distribution? Public-Private Infrastructure Advisory Facility, 2009 http://www.ppiaf.org/ppiaf/publications/Trends%20and%20Policy%20Options

We believe that these social impacts should be independently studied before any support is given to expanding PPPs in the EU.

B Specific questions

29. If you are aware of any problem in relation with the award of concessions other than those referred to in the questions above, or you wish to make any other remarks on a EU initiative on concessions, please describe them here (specifying whether it concerns works concessions or services concessions).

In relation to the Commission's statement that:

> *"An initiative on concessions would aim to facilitate the use of concessions and ensure best value for money for both users and contracting authorities, by providing all interested parties with legal security and guaranteeing transparency and equal treatment for economic operators."*
>
> *"It would also enhance competition and the internal market in concessions contracts, and contribute to EU policy goals in the field of Public-Private Partnerships, as explained in the Commission's Communication on 'Mobilising private and public investment for recovery and long term structural change: developing Public Private Partnerships'."*

We would like to emphasise that we do not believe **it should be the goal of the EC to 'facilitate the use of concessions', which already have sufficient legislation to ensure that they can function.** We are also concerned that **the EC's Communication mentioned above contains many statements which jeopardise the EU's supposed neutrality in terms of whether services are provided by public or privately owned entities**, for example in the statement on *"Working with Member States to identify provisions in national legislation that prevent or hinder setting up PPPs, as part of the implementation of the European Economic Recovery Plan."* (This somewhat contradicts a statement elsewhere in the document that *"The ultimate decision to use PPPs lies with the Member States' public authority"*. The Communication overstates the advantages of PPPs and diminishes or misses out some of the disadvantages, and actively promotes PPPs compared with direct public procurement models through instruments such as the Loan Guarantee instrument for TEN-T projects (LGTT) and construction cost based grants in the framework of availability payment schemes.

Here we would like to draw attention to the European Parliament report on New Developments in Public Procurement's scepticism about the extent to which additional initiatives or legislation on concessions is needed:

The European Parliament *"emphasises that due account must be taken of both the complexity of the procedures and the differences between the Member States in terms of legal culture and practice with regard to service concessions; takes the view that the process of defining the term 'service concession' and establishing the legal framework governing such concessions has evolved as a result of the 2004 public procurement directives and the CJEU's supplementary case-law; insists that any proposal for a legal act dealing with service concessions would be justified only with a view to remedying distortions in the functioning of the internal market; points out that such distortions have not hitherto been identified, and that a legal act on service concessions is therefore unnecessary as long as it is not geared to an identifiable improvement in the functioning of the internal market"*.

Instead of EU level legislative initiatives at the current stage we see a greater need to conduct a thorough and independent assessment of the performance of PPPs so far and their financial and social impact. Any further action should be aimed at:

- regulating PPP accounting to avoid off-balance sheet treatment (this issue is already mentioned in the EC Communication on PPPs)

- limiting impacts on public finances, for example by setting ceilings for the cumulative value of PPP projects

- ensuring realistic and fair affordability and value for money analyses,

- disclosure of project documents and cash costs of payments,

- limitating changes to the contract during the preferred bidder stage

We also note the Commission's intentions to form a PPP working group, and support the European Parliament's calls for the Commission *"to take steps to ensure that the composition of [...] the planned new advisory committee on public-private partnerships is balanced, including trade unionists and representatives of the business community, in particular SMEs, and that they work in a transparent manner; demands that the European Parliament be kept properly informed and receive all the available information at every stage and at the end of the process"*.[15]

15 European Parliament: Report on New Developments in Public Procurement (2009/2175(INI)) 10 May 2010, http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+REPORT+A7-2010-0151+0+DOC+XML+V0//EN