THE BASE METHODOLOGY TO SAFE IMPLEMENTATION OF PUBLIC PRIVATE PARTNERSHIP ON THE EMERGING MARKET OF THE SOUTH EAST EUROPE

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Abstract

The market of the South East Europe (SEE) is recognized as emerging market of the transition countries which needs priority investment in different infrastructure projects for sustainable development. Infrastructure of a country is understood as the fundamental service foundation of economy, society and overall development. It is very well known that adequate services are necessary for the development of the economy, including transport, electric power, telecommunications, water supply etc. The transition countries are financially constrained and they have big problems in financing infrastructure projects, especially during the global financial crisis. These projects are generally characterised by high development and maintenance costs, and historically it was seen as the role of the government to fund and manage these assets. A way to fund and manage these assets in this challenging environment is via Public Private Partnership (PPP). Financing and development of infrastructure on the base of PPP means introducing the private sector in financing and management of public services and physical infrastructure.

The key question is how to implement PPP on the emerging market of the SEE?

The methodology to implement PPP has to be understandable, functional and practicable. It has to cover core tasks and performers which can produce planned results. The base Methodology for safe implementation of PPP needs cohesion of the following important elements: training, projects development, finance structure arrangement and implementation. The units and individual experts of the organisation structure need strong cohesion and it is necessary that everybody understands individual and complete process. Training Unit has task to train experts of the beneficiaries for PPP. It has to have corresponding infrastructure and equipment, good trainer, experience in education and training and possibility to organise training. The Project Developer (project development and finance structure arrangement) has task to develop PPP projects. The Developer will develop projects based on strategic document of the beneficiaries (municipalities, cantons, entities and state). Certified experts from Training Unit will be included. Implementation of the PPP project is guided by the Beneficiary (including certified experts trained according to their needs), with assistance of the Developer.

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This Methodology for safe implementation of PPP has strong cohesion units and activities “top to down” to follow up feasible and sustainable investment process.

Keywords: Project financing, Developer, Circular cooperation.

Introduction

SEE countries are generally developed countries and countries with transitional (Anon. 2012 : 31) economies, and they all need greater investments in all social and economic segments. Overall economic development of the countries greatly depends on investment possibilities, results and quality. This is especially related to the infrastructure as an exceptionally significant social and economic segment, without which overall development is inconceivable. Every infrastructure sector is relevant and especially the following: roads, railways, water supply lines, gas lines, solid waste disposal, telecommunications, electrical power/electricity, schools, hospitals etc. All these infrastructure forms are traditionally under the competence of public institutions and organizations with regard to ownership, management and financing.

Demand for faster development in SEE countries is increasing and requires, inter alia, faster infrastructure development. On the other hand, this requires countries’ governments to make larger budget appropriations and increased debts. Actual investment needs and financial possibilities of the country should be reconciled, which is not always possible, due to limited financial sources of the public sector. Difficulties arise from other social demands that are evidently high by comparison with infrastructure segment, especially when it is known that due to the increase in infrastructure, in addition to great benefits, operating costs and maintenance costs also increase, and efficiency of the public sector in this respect, generally, is not adequate. When analysing efficiency of the invested resources it is very important to analyse operating and maintenance costs in this segment, because these costs are very high and difficult to control with the public sector, regardless of the experience and large number of introduced standards (Anon. 2013b; Anon. 2013c; Anon. 2013d; Anon. 2013e; Anon. 2013f).

By introducing the private sector in infrastructure management and financing, possibilities of financing and investments are expanding, public sector operative costs are decreased, and overall development is enhanced. In this way, investments in infrastructure gain their full significance and justification in view of social-economic aspect (Anon. 2013b; Anon. 2013c; Anon. 2013d; Anon. 2013e; Anon. 2013f).

This approach of broadening the financial possibilities through introduction of private sector for needs of infrastructure development requires few prerequisites and conditions that countries’ governments have to prepare and fulfil. One of the most
important prerequisites for success is knowledge and good practice. Attaining needed knowledge and practical application for the PPP is not simple, which is proven by the fact that SEE countries tried to implement PPP projects and failed many times or only partially succeeded in implementation. Fact that these countries, except for Turkey and Greece in part, have not applied and used PPP in all possible options shows how great is the gap in knowledge and practical application of the model. Connection between knowledge and practice in development of the processes and projects is not satisfying at the moment and does not provide appropriate results. This is why this paper addresses such specific and applicable topic, which will significantly help and enhance application of the PPP in SEE countries (Anon. 2013a; Anon. 2013b; Anon. 2013c; Anon. 2013d; Anon. 2013e; Anon. 2013f).

This paper will firstly present significance of the PPP for infrastructure development and project orientation toward “project financing” principle, and then it will present methodology of the safe PPP implementation in SEE countries. The methodology is based on cohesion between three factors: education, project development and project implementation. Basically, this implies transfer of the knowledge and experience, and continuity of the cyclic cooperation between same persons through overall process up to the final PPP project results.

PPP significance and characteristics

Private financing of the infrastructure occurs as a result of inability for traditional financing models to meet increased demand for infrastructure development, and need for more rational and cost-effective operation. This should be understood as a new possibility for investments and management, i.e. as an upgrade to the traditional system of financing and managing projects and assets.

The essential difference between these two approaches, especially in a view of investing and project appraisal, is visible from the beginning to the end of the project.

While preparing infrastructure project, the public sector does not analyse strictly refunding from the investment directly, nor provides sources for return of invested funds directly. Although public sector sometimes works like this, it is certain that while analysing the project it does not only consider financial assessment but it compulsory takes into consideration socio-economic assessment of benefit. Public sector plans refunding from total of budget funds, meaning that funds are returned even from the sources that have no direct linkage to the investment. However, in public infrastructure investment, in direct charging (telephony, motorways, gas...) refund is accurate and uses direct sources, which is usually always the rule of private sector in all forms of infrastructure. The private sector for their commitment to the project does not take into account the socio-economic assessment, but solely bases its
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interest on financial estimates and project cash flow. Money is the heart of the PPP projects, which is why projects are based on the principles of “project financing”. The main reason for this approach is the fact that private funds (equity and debt) are under the market assessment and values, and are strictly controlled in terms of the expected higher value, i.e. capitalization (Kendrick 2004; Stiglitz and Walsh 2005).

Through the PPP model, in terms of state, capital investments in infrastructure are realized without additional budget burdens, risks and maintenance costs, particularly with administrative bureaucracy. The largest part of the burden transfers to the private sector. “Projects can be developed without exposure to increasing debt or exceeding the state budget. Public sources are then available for the achievement of other policy objectives, such as education and health. As a result, the image of the country – or even financial rating – gains an improvement, making the capital market of the country cheaper and more attractive for foreign investment…” (Perrot and Chatelas 2000 : 19).

PPP in a country is applicable as a system to all public services and physical infrastructure such as telecommunications, energy, transport, drinking water, wastewater, solid waste, heating, schools, hospitals, prisons, military equipment and military installations and other. Introduction of the financing systems to the transition countries and the countries with weak economy can be a good precondition for direct investment (domestic and foreign), the opening of public works and other benefits for the economy, because public services and infrastructure are improved in accordance with requirements of the economy and living standards of citizens. While using the planned private financing models, investment in infrastructure increases significantly in a short period of time. “Public-Private Partnership is not indicating only a reliable increase in the private sector in financing of capital investment projects on the basis of flow-generated revenue of the future facility, but also incorporates benefits of private sector in skills and expertise in construction and operation work, more efficiency throughout the project cycle” (Perrot 2000 : 19).

All models of private investment in infrastructure are mainly based on the concession rights, being the legal framework for financial processes, which is why these projects are often simply called “concession projects”. The concession is briefly defined as the granted right, and consequently concession infrastructure projects would be the projects in which the owner (the grantor) gives exclusive right to the concession user (concessionaire) with the aim of building the infrastructure facility or provision of services in the field of infrastructure, etc. The concession is granted for a period of time for a fee. After the expiry of the concession period, the concessionaire is obliged to transfer the facility on grantor. Concession relationship is always regulated by a written contract, and the procedure of assigning concession rights in the field of infrastructure, as a rule, is prescribed by law. In this regard, there are a number of national and international rules, making a significant contribution to the implementation of
PPP in terms of market security and openness. As an example: “Recommendation 1 Constitutional, legislative and institutional framework for privately financed infrastructure projects, to ensure a transparent, fair and long-term sustainable project. Undesirable restrictions toward the participation of private sector in infrastructure development and operational work should be eliminated” (Anon. 2001).

Using the word “concession” and “concession project” is usual to all projects where there is such legal basis on which it is clear that an authorized institution assigns this kind of right. Given that the legal basis is assumption that provides possibility of investment, utilization, operating performance and transfer of facility, in the broadest sense, experts from the fields of business and finance have developed investment models and procedures in this area. The models used for these investments also include actual private investment on the basis of concessions. A large number of these models of private investment, which are found in a PPP group, are in some way (in practice accepted) synonyms to “concession projects”, although concessions may be assigned to public capital companies, which also can be found in practice (Anon. 2013a; Anon. 2013b; Anon. 2013c; Anon. 2013d; Anon. 2013e; Anon. 2013f).

Project financing in PPP projects

PPP projects include many participants of the process, but key participants are the following: government, concessionaire and financiers.

Financiers of these projects are significant participants in the processes and have in most cases a decisive role. Everything depends on their relationship to and evaluation of PPP projects. For this reason it is important to note that they define these projects exclusively as financial processes, because each project as a whole is observed from aspect of financial investments and financial returns. In addition, the worldwide term “project financing” is accepted as the principle that PPP projects are based on. The basis of this business philosophy is that the return on investment is expected and required exclusively from the income of the project. Because of that, financiers are seeking bankable and safe projects. “Project financing” is a project self-financing model, where lenders and investors (debt and equity) are seeking for a safe return of funds in the project cash flow and where the project resources (objects) as a result of investments are certain. True, there is no full guarantee for the invested funds, and that is why the projects are carefully prepared and evaluated in detail. This kind of self-financing requires structuring of debt and equity so the project cash flow is adequate for recovery of funds and for profit. This means that the project is based on cash flow, which is generated (created) by the realization of the project, with assigned concession rights. The financial aspect of the project, including risk management, along with banking and government guarantees must be comprehensive and professionally processed. Finally, projects must be feasible and sustainable. In order
to secure investment and realization, it is necessary to prepare multiple analyses for PPP projects, related to the net current value, internal rate of return, etc. It is also necessary to prepare due diligence which is one of the most effective and the most comprehensive estimates (Anon. 2013a; Anon. 2013b; Anon. 2013c; Anon. 2013d; Anon. 2013e; Anon. 2013f).

Due diligence includes assessment from the commercial, financial and legal aspects. In the application of this approach, it is important to understand the business of the company (the concessionaire), where many questions should be answered, taking into account the risks, business trend, return of invested funds and other. So, in this process (due diligence) an in-depth analysis is conducted, which is important for the concessionaire, who wants to know all the information. The concessionaire is trying to get an answer to all questions, and does not allow the public sector, either intentionally or unintentionally, to suppress some significant information (Anon. 2011; Anon. 2012; Anon. 2013a; Anon. 2013b; Anon. 2013c; Anon. 2013d; Anon. 2013e; Anon. 2013f; Mankiw 2006).

In network industries, which are based on the associated distribution networks, this analysis is also necessary due to the nature of the industry. According to the “industrial organization” network industries are part of the national economy, so their importance is higher. This is where the following analysis is conducted: the macroeconomic aspect, taxation, regulation, management, human resources, represented technology, industry, environment, equipment, property, marketing, production, etc. (Mankiw 2006 : 267). This analysis is mainly conducted by a team of experts of various profiles: lawyers, financiers, experts for human resources, technologists, IT professionals, etc. Overall team work is included in the final assessment document called “Due diligence report”, which will serve the public sector and the concessionaire during negotiations and when reaching the final decision (Anon. 2013b; Anon. 2013c; Anon. 2013d; Anon. 2013e; Anon. 2013f).

This analysis is necessary because positive evaluation of concession projects requires not only sound elements of the project, but also a sound environment, where the project is implemented. Therefore, concession projects of great complexity and attachment to public and private sector require extremely regulated legal and business environment. These “two environments” in reality are one environment, because the concessionaire and other entities are not separating them. Their interdependence is essential for the realization of concession projects as for the grantor, so for concessionaire and the other service users. In essence, the economic and social development policy should be based on sound legal and business framework, which provides security and business attractiveness to investors, and which is particularly important for investment in infrastructure through PPP model (Stiglitz and Walsh 2005; Kendrick 2004; Perrot and Chatelus 2000; Anon. 2013b; Anon. 2013c; Anon. 2013d; Anon. 2013e; Anon. 2013f).
Methodology to safe implementation of PPP projects

Practice shows that the implementation of PPP projects requires essential knowledge of all participants in the process, especially with the three key participants. The biggest problem of knowledge occurs in the public sector, where education is needed, according to the understanding of many. However, current practice shows that it is not enough. In many places, although high quality education is already performed, projects are not implemented or are implemented with a lot of mistakes. Problem after training occurs in practical work and with skills from project preparation to completion of project. Therefore, it is not just a matter of education, but also of the following question: how to implement an overall training and connect knowledge acquired with the practice, and to ensure continuity in the implementation of projects by the end user? (Anon. 2011; Anon. 2012; Anon. 2013a; Anon. 2013b; Anon. 2013c; Anon. 2013d; Anon. 2013e; Anon. 2013f)

Methodology to safe implementation of PPP projects provides an answer to this question, because it is based on cohesion of three factors: education, project development and implementation of projects. Special attention is paid to the continuity of the cyclic cooperation between same persons through the whole process to the final results of the PPP projects. (Anon. 2011; Anon. 2012; Mankiw 2006; Anon. 2013b; Anon. 2013c; Anon. 2013d; Anon. 2013e; Anon. 2013f)

Continuity of cyclic cooperation between same persons (experts) from education to the realization of the project goes through the developer, which is a key link of education and practical realization of projects. The developer has to be experienced, and has to cover all aspects necessary for the project, such as engineering, legal, finance, etc. Also, project management skills of the developer have to be particularly high, because this mode of work in the final implies transfer of a good knowledge and experience (Anon. 2012; Anon. 2013). Education is the starting point of circular cooperation, so it is very important who is a teacher and what it teaches. Education program (Anon. 2013) must be well designed, with no redundant theories outside investment. It is important that the education program covers basic topics that are part of essential knowledge for practical application. Among other things, the unavoidable topics of education must be of crucial importance for the development and implementation of projects. This particularly applies to:
- Development, Significance and Models of the PPP;
- PPP Project Management;
- PPP Project Risk Management;
- Institutional and Legal Framework for PPP and
- Procurement, Negotiation, Contracting, Conflicts and Post contract claims (Anon. 2013a; Anon. 2013b; Anon. 2013c; Anon. 2013d; Anon. 2013e; Anon. 2013f).
Experts come to the education intended for the end user (Beneficiary) of future investment PPP projects (e.g. municipality, canton, public companies...). This is because the ultimate beneficiaries of the projects are most important. Without them and their needs there is no possibility for realization of projects, and they are also the most interested parties. After education and certification, experts are working with the developer to develop projects that are necessary to the end user where the experts come from. They are familiar with the needs of the environment from which they come from, and developer applies his practical knowledge in the preparation and realization of projects. The developer and experts are working on twinning principle, with the aim of developing projects and practical training of experts for managing the PPP projects. Education and Training Centre (Training Unit) must be closely linked to the Project Developer, because their activities have to be synchronized, so that experts and final users could have a clear picture of the dynamic plans of projects, their preparation and implementation. (Graphic presentation of relationships of the Methodology to implement safe PPP is in Appendix). The role of the developer is extremely important because it represents a link to the application of knowledge in practice, with the active participation of certified experts of the project end-user (Anon. 2013a; Anon. 2013b; Anon. 2013c; Anon. 2013d; Anon. 2013e; Anon. 2013f).

The developer performs several complex tasks, among which the most important are the following:

- Research on the needs of end-users for PPP projects
- Preparation and appraisal of projects,
- Advising the end user in the tender procedures, negotiating and contracting (also including assistance in financial arrangements), and
- Assistance in the monitoring and implementation of projects (Anon. 2013a; Anon. 2013b; Anon 2013c; Anon. 2013d; Anon. 2013e; Anon. 2013f).

The Developer will develop projects based on strategic document and project priority list of municipalities, cantons, entities and state. Developed projects would have very clear indicators of feasibility and sustainability. Developer will pay special attention on Environmental Impact Assessment (EIA). Developer, in cooperation with beneficiary, prepares project financial model and they together cooperate with financial institutions and donors. In this phase of the project development the cooperation triangle is very important and it consists of the Beneficiary, the Developer and the Financier (Donor). All projects will be developed using modern software acceptable for International Financial Institutions and other financial institutions and donors (Anon. 2011; Anon. 2012; Anon. 2013a; Anon. 2013b; Anon. 2013c; Anon. 2013d; Anon. 2013e; Anon. 2013f).

All phases of the work carried out by the developer also include certified experts and responsible persons of project’s end-user. Significance of this kind of work is related
to the priority need to implement the project, then to simultaneously transfer practical skills and to provide training for certified experts for independent management of PPP projects. Close cooperation between the developer and experts on the principles of twinning is a guarantee for success in cooperation with the ultimate aim of enabling end-user to independently manage all phases of PPP projects. This will allow the end user to independently plan their development, prepare projects, and carry out the necessary tender procedures, contracting and implementing of projects. These investments are important because they enable higher working activities, employment, GDP growth, increase of living standards, etc. Altogether, it means contribution to economic and social development of user and overall community in which the projects are implemented (Anon. 2011; Anon. 2012; Anon. 2013a; Anon. 2013b; Anon. 2013c; Anon. 2013d; Anon. 2013e; Anon. 2013f; Mankiw 2006; Stiglitz and Walsh 2005; Kendrick 2004; Perrot and Chatelus 2000).

Conclusion

The base Methodology to safe implementation of PPP on the emerging market of South East Europe is a good way to introduce new models of financing and management of projects. Hereby interested end-users have the ability to simultaneously develop and train their staff through the development of projects. It provides users with great benefits, and among other, it enables them to work independently on complex PPP projects.

It is here that special attention, more specifically, is given to the knowledge and practical skills that enable continuity of the work for the end-user in future, good planning and implementation of all relevant activities and investments. With actively pursuing this mode of work, the desired distribution and decentralization of knowledge and good practice in all interested social organizational units from the municipal to the state level is achieved. Therefore, mass and independence in the work of multiple users will certainly contribute to competition and quality of work, and show good results of the implemented projects.

When it comes to Bosnia and Herzegovina (BIH), it should be noted that there are all prerequisites for the realization of the Base Methodology to safe implementation of PPP on the emerging market of the South East Europe, and that the author is the leader of creation and application of this Methodology in BIH. Initial activities to prepare the implementation of this work mode are at an advanced stage. The key actors in the process are defined: School of Business and Economics-Sarajevo (Training Unit), Joint venture of the IPSA Institute Sarajevo and Institute of Economics – Sarajevo (Developer) and public organizations from municipal to the state level in Bosnia and Herzegovina (Beneficiary).
References


