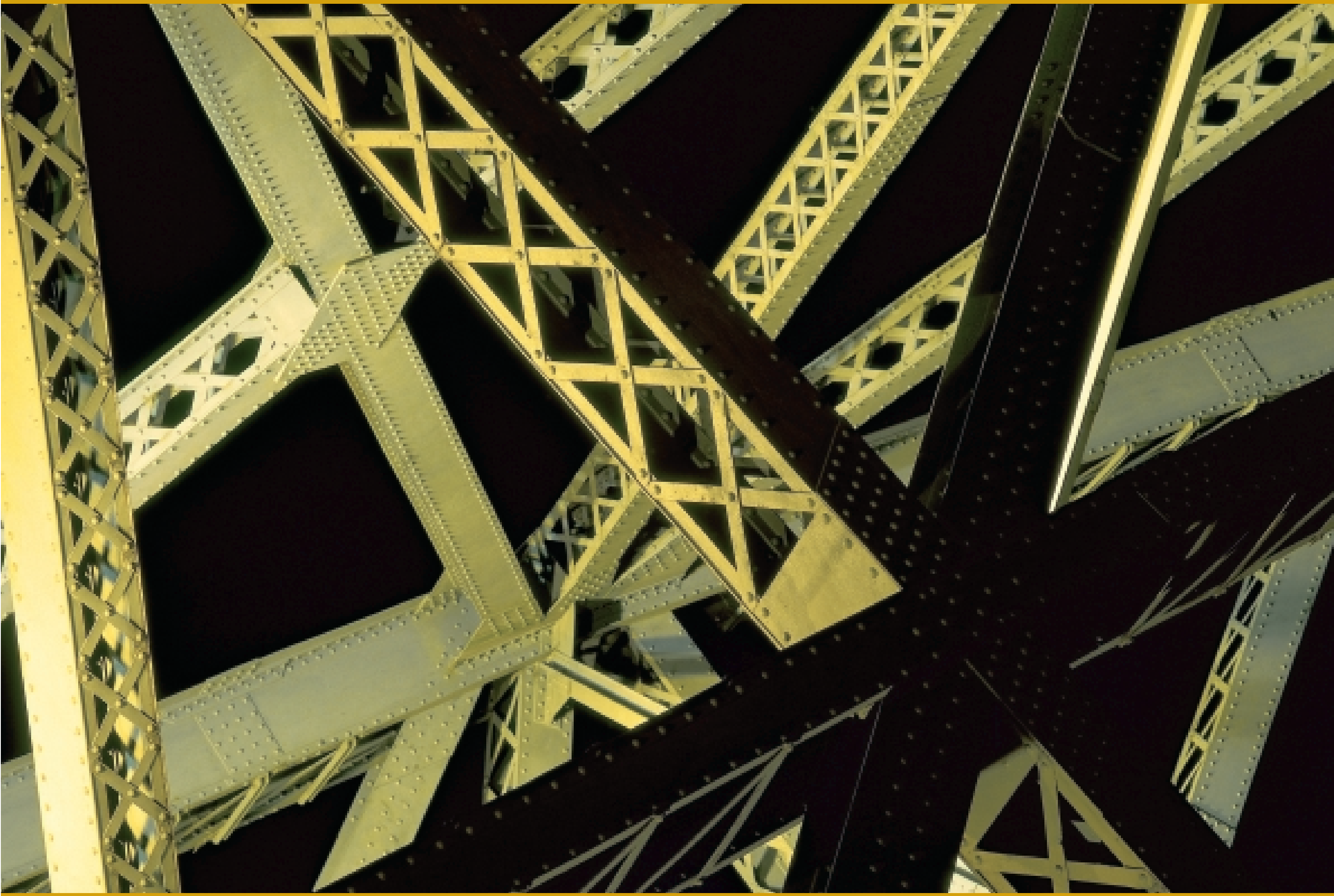
Developing Public Private Partnerships in New Europe



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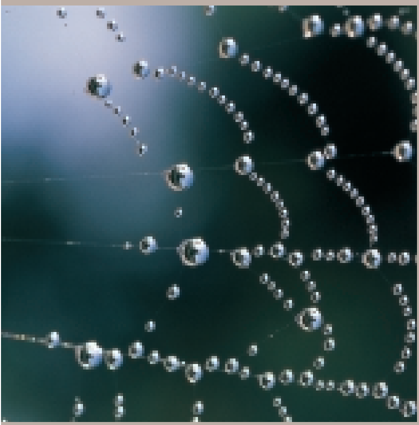


Executive Summary

The need for investment and the role of PPPs

An ‘infrastructure gap’ exists in Europe. This has a negative impact on economic growth and the prosperity of the citizens of Europe. It also affects the efforts of the EU and Member State governments to reduce the significant social and economic disparities which exist both between, and within, Member States. Governments have limited financial resources to devote to increased capital expenditure and improving public services and face restrictions (including those of the Maastricht criteria) on their ability to raise debt.

The development of PPPs is an approach which some countries have taken to procuring public infrastructure and services. The state of PPP development varies widely between the Member States, but PPPs are established as one of the tools which are available to governments.

PPPs

There is evidence that, if appropriate and properly procured, PPPs can provide significant improvements over the results that can be achieved from traditional forms of procurement. However, there should be no presumption that PPPs are a panacea or that they are appropriate in all circumstances.

PPPs are often complex and generally take longer to procure than traditional projects. Transactions costs, for both the public and private sector, also tend to be higher. There is generally a poor level of understanding of PPPs, at both the EU and Member States level. As PPPs are a new means of procurement, public sector officials do not have experience of implementing such projects. They therefore need to develop new skills and capabilities in order to undertake PPP procurements effectively. This requires an investment on behalf of the public sector.

There is a need for better sharing of knowledge and experience between different parts of the public sector. This will help to ensure efficiency in the development of PPP approaches and processes and consistency in procurement.

PPPs and the EU

Although there are a number of EU statements and reviews concerning PPPs, there is no discernable EU PPP policy. The majority of EU activity in this area has concerned TENs, where the EU has a direct interest in using PPPs to assist delivery of the network.

Little actual progress concerning the development of PPPs has been made, and there is considerable uncertainty as to how PPPs interact with EU legislation and regulations. This uncertainty has had a negative impact on the development of PPPs, especially where Member States have sought to incorporate EU requirements within their own developing PPP policies.

There have been recent developments concerning the Eurostat accounting treatment for PPPs[1] and a Green paper on PPPs and public procurement and concessions has been published. Further guidance in other areas is required and there is a need for the EU to take a more joined up approach to the PPP market.

[1] *Eurostat press release (STAT/04/18) 11 February 2004*

Combining EU funding with private finance

There are very few examples of projects which combine EU grant funding with private finance. Governments have chosen to co-finance EU grants with public funds. PPP procurements and grant funded projects have been kept separate.

Contrary to the perceptions of some governments, there appear to be no reasons why PPP approaches cannot be combined with EU grant funding; indeed the EU has stated that encouraging greater use of private sources of funding should be supported.

It appears that a mix of: uncertainty as to how such projects should be procured; the additional complexity of combining the procurement requirements of PPPs with those for grant funded projects; and the lack of precedents have all combined to make governments wary of undertaking such 'hybrid' procurements.

Accession has resulted in New Member States receiving increased levels of EU grant funding. Co-financing requirements, together with the debt restrictions which some New Member States face, may mean that some governments will need to use private finance as a source of co-financing in order to ensure that EU funds can be fully absorbed. There is a role for the EU to work alongside governments to develop appropriate project structures and procurement methods for such projects.

Developing PPPs – our recommendations

Given the actual, and potential, impact which the actions and regulations of the EU can have on the development of PPPs in the New Europe, serious consideration needs to be given as to how the EU should coordinate its activities in this area. Our recommendations are as follows:

Improving knowledge and understanding of PPPs at the EU level

The Commission should set up a cross-EU PPP Group whose role would be to coordinate EU activities which affect the PPP market and assess the impacts which EU actions, or inactions, have on the development of PPPs. This should be supported by a small Central Unit which would act as a knowledge unit and centre of excellence for PPPs within the EU.

Institutional capacity, information and training

The EU should address the poor level of information, public sector institutional capacity and knowledge about PPPs which exists within many Member States, and the EU itself. It should fund a number of initiatives, including comparative studies on the actual benefits which PPPs can deliver and the development and provision of practical training and encourage the secondment of civil servants (and advisers) to and between PPP units of Member States.

EU approach to PPP development

PPPs are hard to define and vary greatly in nature. It is therefore unlikely that developing a legislative approach to PPPs will be either practical or desirable. The approach taken by the EU should be one of interpreting and clarifying the way that existing (and future) rules and regulations interact with PPP procurements and their development. Additional legislation should be resisted.

Co-financing using private finance and PPPs

Combining PPP approaches with grant funding provides a considerable challenge. The EU should assist Member States to address the issues involved in combining EU funding and grant requirements with private sector finance and PPP approaches. A taskforce should be set up to identify and address the issues involved and the EU should assist Member States to select and implement pilot projects. The experience gained in doing so should be disseminated and practical guidelines produced so that maximum benefits are gained from the lessons learned.

Conclusions

A PPP market exists in Europe. There is evidence that properly procured PPPs can provide benefits to the governments and citizens of Member States. The EU needs to ensure that it responds appropriately to the development of this market in a proactive, rather than a reactive way. To do so the EU needs to have a better collective understanding of PPPs and the issues surrounding them. Despite a number of initiatives and reports on PPPs there has been little real progress and considerable uncertainly persists. A more holistic approach to the development of PPPs is required.

Introduction

On 1 May 2004 the European Union enlarged to 25 Member States thereby creating a market of 452 million people – a market larger than that of the United States.

As one of its founding philosophies, the EU is committed to:

> *"….achieve balanced and sustainable development, in particular through the creation of an area without internal frontiers, through the strengthening of economic and social cohesion …"[2]*

As a result, one of the key aims of the EU is to foster improved competitiveness. This is reflected, for example, in the Lisbon agenda which sets a target for the EU to become the most competitive and dynamic economy in the world by 2010. At the same time, the EU also aims to reduce economic and social disparities and enhance cohesion, although enlargement means that there are significant social and economic disparities both between, and within, Member States.

However, the ability of the EU to realise its aims is linked in part to the quantity and quality of Europe's infrastructure and public services. Although the positive contribution of public investment to the EU's competitiveness is widely recognised, the level of public investment has been falling as a share of GDP. This is seen as one of several factors which detract from the EU's rate of growth, cohesion and competitiveness.

One effect of this is that increasing attention has been given to the potential role that private finance, in the form of public private partnerships (PPPs), can play in helping to meet the investment challenge. This interest has been reflected in a growing focus on the policy issues linked to PPPs at the EU level.

The reason for this interest is that PPPs are seen as a way of bringing private sector know-how and management experience to the provision of public services and, hence, to improving value for money. Some studies have reported savings of 15-20% compared to the costs of an equivalent publicly procured project[3]. In addition, the introduction of private sector finance is seen as a way of reducing some of the effects of constraints on public finances.

Yet, despite this, the number of successful PPP projects in Europe is still small and the pattern of PPP activity across Member States is patchy. In part, this can be explained by the widespread lack of understanding of what PPPs are and where and how they can be best utilised.

[2] Source: Treaty establishing the European Community, Official Journal December 2002

[3] Further examples of efficiency savings are given in Box 1

This paper – aims and objectives

Against this background, we have sought to identify and analyse some of the major issues relevant to the development of PPPs across an enlarged EU. This is a very broad topic and we have concentrated on two areas:

- The effects which the actions, and inactions, of the EU and its institutions have on the development of PPPs in Europe;
- The ability of governments to use private finance as a means of co-financing EU grant funding, and the issues associated with developing such 'hybrid' projects.

While there has been much analysis and discussion regarding the development of PPPs in Europe, and across the rest of the world, these topics have not received much coverage to date. We hope that this paper goes towards enlightening and stimulating debate in these areas.

Our approach

Building upon our extensive experience of developing and implementing PPPs, we have:

- Examined PPP related policies, directives and legislation at the EU level;
- Reviewed EU funding instruments to determine the ways in which they can be combined with private finance;
- Examined projects financed with different types of EU grant funding (including Structural and Cohesion Funds, and ISPA[4]) to identify projects which have combined EU grant funding with private finance; and
- Reviewed a number of these projects in order to analyse how EU grant financing can be combined with a PPP approach.

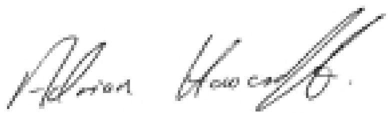
Report structure

This paper is divided into four further sections:

- A review of the need for public investment, the role of PPPs, and the level of PPP activity in Europe;
- An examination of how EU policies and regulations impact on the development of PPPs;
- An assessment of the issues involved when combining EU funds with private finance; and
- Our recommendations and conclusions.

Authors

We welcome debate and comments on this paper.
Our contact details are given at the back of the this publication.



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[4] ISPA – Pre-Accession Structural Instrument

Section 1
The need for investment and the role of PPPs

Background

From 1 May 2004 the 25 Member States of the European Union comprises a combined market of 452 million people.

Within this market there are significant disparities, both between and within the different Member States. One of the founding philosophies of the EU is to help minimise disparities and enhance cohesion in the Union. The EU's Structural and Cohesion funds, as well as other instruments of solidarity, were designed as tools to assist this process.

The challenge is great, even more so following the accession of the ten most recent Member States. There are many component parts of this challenge but one is the scale of investment which is needed to ensure that there is sufficient investment in public infrastructure and services, whether this is economic (such as transport or environmental) or social (such as health and education) infrastructure, or other areas of government services (such as prisons, IT or defence). In assessing the need for investment it is not just the quantity, but also the quality, of provision which needs to be assessed.

Inadequate infrastructure can restrict economic growth in a variety of ways:

- poor transport links increase the cost of goods and the time taken to deliver them to market;
- poor education and health care affects the economic potential of a population;
- inefficient provision of government services can burden the productive sectors of the economy and;
- poor infrastructure can restrict a region's ability to attract Foreign Direct Investment.

Membership of the EU also conveys certain responsibilities on its members, for example, complying with environmental requirements can impose a heavy investment burden on governments. The amounts estimated for implementing the environmental legislation in conformity with European standards range from €80-110 billion or around 2% of the GDP for a sustained period[5].

Public investment has been falling as a share of GDP in the EU. The investment requirements of economic growth and the increase in standards for public services, which citizens of Europe now expect, have resulted in a significant infrastructure gap in Europe. This is true across Europe and not only in the New Member States. However, some of the New Member States have additional investment requirements arising from their transition. For example, many of them have had an historic reliance on railways and their motorway networks require considerable investment. The World Bank estimated the infrastructure investment needs for the accession candidates to be €65 billion over the next 15 years. It cites Poland as the country with the highest amount of infrastructure investment needs (€21.4 billion), followed by the Czech Republic, Bulgaria, Romania, Hungary, Slovakia, Estonia, Slovenia, Lithuania and Latvia, with some 70% of these investment requirements being at municipal or regional levels of government.

[5] *Communication from the Commission on The challenge of environmental financing in the Candidate Countries, COM (2001) 304 final*

Box 1 Value for money studies for PPPs

Value for Money Drivers in PFI, UK

- A report commissioned by the Treasury Taskforce found that the average percentage estimated saving against the Public Sector Comparator was 17%.

HM Treasury research of 61 PFI projects

Key findings were:

- 89% of projects were delivered on time or early;
- All PFI projects in the HM Treasury sample were delivered within public sector budgets;
- No PFI project was found where the unitary charge had changed following contract signature – other than where user requirements changed;
- 77% of public sector managers stated that their project was meeting their initial expectations.

The First Four DBFO Road Contracts:

The National Audit Office found that the four contracts appear likely to generate net quantifiable financial savings of around £100 million (13%).

National Audit Office, UK, survey of 98 projects by the NAO in 2001 – public authorities perceptions of value for money:

- 81% believed that PFI projects are achieving satisfactory or better value for money – only 4% described value for money as 'poor';
- 75% of PFI projects were delivered on time or early, and in no case did the public sector bear the cost of construction overruns, a significant improvement on previous non-PFI experience.

The PRIME Project:

The contract is estimated to deliver savings of £560 million, 22% over 20 years.

Delfland Wastewater Treatment Project, the Netherlands:

The final project NPV achieved a saving of around 15% compared with the Public Sector Comparator, well in excess of Delfland's target of 10%.

A report published by the European Commission[6] – assessing the costs of completing the Trans-European Transport Network (TENs) – priority projects estimated costs of €600 billion until 2020. Even completing the 'quick start'[7] programme will cost €60 billion between now and 2010.

What ability do governments and the EU have to close this gap using public sector resources alone?

Governments need to address the overall size of the investment requirement for infrastructure and public services. They also need to ensure that the gap is closed in an efficient and effective way. There is a long history of publicly procured contracts being delayed and turning out to be more expensive than budgeted. This is especially so for large and complex infrastructure projects. In addition, the division of funding into separate capital and revenue accounts, which is characteristic of the public sector in many European countries, often means that even if capital projects are originally well procured these assets are then not operated and maintained in a satisfactory way.

When budgets are squeezed maintenance is frequently the first target for spending cuts, even if delaying preventative maintenance results in much higher overall costs being incurred in the future.

The public sector is often not very sophisticated in the ways that it assesses the value for money offered by bidders. In many cases evaluation is based solely, or mainly, on price with little, or no, assessment of the quality of alternative solutions and hence on the overall economic value.

While PPPs do not offer a ready-made solution to all procurement issues, and a poorly procured PPP can be as bad, or worse, than a traditionally procured project, PPP structures do address many of these problems. As Box 1 illustrates there is growing evidence (as more PPPs are procured and delivered in more countries) that PPPs can deliver significant improvements in overall value for money.

PPPs do not provide governments with a panacea. They are an approach which governments should consider using along with other forms of public procurement in tackling the investment challenges that they face.

[6] *European Commission (2003) High level group on the Trans-European Transport Network, chaired by Karel Van Miert (also referred to as the 'Van Miert report')*

[7] *Projects in the quick start programme are cross border with a strong European dimension. These are projects where, before the end of 2006, money can be committed and works can start. A European Initiative for Growth (2003)*

What are PPPs?

There is no widely accepted definition of public private partnerships, as the definitions in Box 2 show. At present the EU also has no agreed general definition of a PPP. This creates a challenge in developing legislation on PPPs, as a number of Member States are finding out. If a narrow definition is taken, this can result in legislation which only applies to a narrow range of project types or structures, which may be of limited practical value.

While there is no single definition of PPPs there are some common characteristics which are often associated with PPPs. These include contracting between the public and private sectors for infrastructure development and management where risks are shared between the parties. Risks are allocated to the party which is best able to manage, and therefore minimise, the cost of risks. The need to utilise private sector management and experience, not only the capability of raising finance, is also common.

Box 2 PPP definitions

There is no overarching definition for public-private partnerships. PPP is an umbrella notion covering a wide range of economic activity and is in constant evolution.

Source: Speech by Commissioner Frits Bolkenstein, DG Internal Market

A Public Private Partnership is a partnership between the public sector and the private sector for the purpose of delivering a project or a service traditionally provided by the public sector. PPPs come in a variety of different forms, but at the heart of every successful project is the concept that better value for money may be achieved through the exploitation of private sector competencies and the allocation of risk to the party best able to manage it.

Source: A Policy Framework for PPPs, Department of the Environment and Local Government, Ireland

A Public Private Partnership (PPP) is a partnership between the public and private sector for the purpose of delivering a project or service traditionally provided by the public sector.

Public Private Partnership recognises that both the public sector and the private sector have certain advantages relative to the other in the performance of specific tasks. By allowing each sector to do what it does best, public services and infrastructure can be provided in the most economically efficient manner.

Source: Ministry of Finance, Czech Republic

Public private partnerships (PPPs) are a generic term for the relationships formed between the private sector and public bodies often with the aim of introducing private sector resources and/or expertise in order to help provide and deliver public sector assets and services. The term PPP is used to describe a wide variety of working arrangements from loose, informal and strategic partnerships to design build finance and operate (DBFO) type service contracts and formal joint venture companies.

Source: 4Ps, UK local government procurement agency

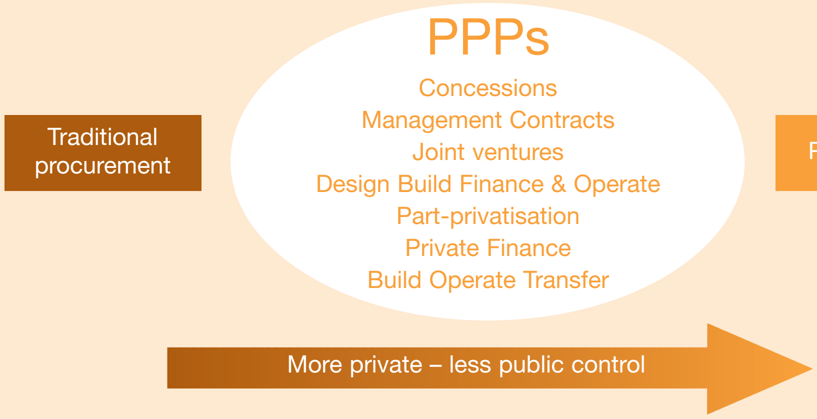
PPP brings together, for mutual benefit, a public body and a private company in a long-term joint venture for the delivery of high quality public services. Drawing on the best of the public and private sectors, PPPs provide additional resources for investment in public sectors and the efficient management of the investment. PPPs cover a wide range of different types of contractual and collaborative partnerships, including; the Private Finance Initiative (PFI); the introduction of private sector ownership into state-owned businesses; the sale of Government services into wider markets.

Source: Balfour Beatty plc

The main distinction between PPPs and alternative privatisation schemes is that the public sector plays a key role as purchaser of services. While in the case of pure privatisation (e.g., of public utilities), the clients of the private operator are private users, in the case of infrastructure building realised though PPPs, the government normally pays for the services to be supplied or has an influence in their specification. What instead distinguishes PPPs from the traditional public procurement model is the origin of the funds to accomplish the project. Instead of relying on government borrowing, most PPPs are financed through bonds issued by the private operator.

Source: Public finances in EMU, DG Economic and Financial Affairs

Figure 1 PPP structures



Source: PricewaterhouseCoopers

The term PPP covers a range of different structures which can be used to deliver a project or a service. Depending on the country and the politics of the time, the term can cover a spectrum from relatively short term management contracts (with little or no capital expenditure); through concession contracts (which may encompass the design and build of substantial capital assets along with the provision of a range of services and the financing of the entire construction and operation); to joint ventures and partial privatisations where there is a sharing of ownership between the public and private sectors. Figure 1 illustrates that PPPs fill a space between traditionally procured government projects and full privatisation, where government no longer has a direct role in ongoing operations.

Why undertake PPPs?

There are a range of reasons as to why governments undertake PPPs. The objective of achieving improved value for money, or improved services for the same amount of money as the public sector would spend to deliver a similar project, is often stated as the prime objective. But other objectives may also be important. These can include the desire to provide increased infrastructure provision and services within imposed budgetary constraints (such as the Maastricht criteria) by utilising private sources of finance via off balance sheet structures, or to accelerate delivery of projects which might otherwise have to be delayed.

> *"The decision to undertake PFI investment is taken on value for money grounds alone, and whether it is on or off balance sheet is a subsequent decision taken by independent auditors and is not relevant to the choice of procurement route. Almost 60% of PFI projects by value are on balance sheet"*[8]

It should also be borne in mind that PPPs are not just about using private finance. This is reflected in the recent development of Credit Guarantee Finance in the UK, where the public sector provides the underlying debt finance but the risk of default is guaranteed by the private sector. The setting up of the National Development Finance Agency, in Ireland, and Infrastrutture S.p.A, in Italy, also underlines the belief that it is not private sector money itself which generates value for money, but the effective transfer of risk.

In considering the appropriateness of any particular PPP structure it is important to bear in mind the competencies and capacity of the procuring entity and the environment in which the procurement is carried out.

PPPs in the Member States

While there is an interest in PPPs in all Member States, experience of the procurement of PPPs is limited. The UK stands out as having the longest and most substantial experience of PPPs. The progress of countries appears to have more to do with the interest in PPPs, and the political will to promote them shown by individual governments, than any other factor. Some countries have been reviewing the use of PPPs and developing pilot procurements for some time, but with limited results in terms of projects procured and financed. Others, which have only recently adopted PPPs as a valid method of procuring public services, have moved rapidly and have procured pilot projects within relatively short time scales.

Although we have not undertaken a detailed review of PPP activity in all Member States, Figure 2 provides a high level summary of PPP activity in Europe by country and sector.

[8] *PFI meeting the investment challenge, HM Treasury, July 2003*

Figure 2 Summary of PPPs by country and sector

	Central Accommodation	Airports	Defence	Housing	Health & Hospitals	IT	Ports	Prisons	Heavy Railway	Light Railway	Roads	Schools	Sports & Leisure	Water & Wastewater (incl solid waste)
Member States														
Austria	○	○			◔	○		○	◔		◔	○		○
Belgium		◔	○	◔					○	○	◔	○		◔
Denmark	○						◔	○	◔		◔	◔	◔	
Finland			○		◔						◔	◔		○
France	◔	◔	○		◔		◔	◔	◔	●†	●†	○		●†
Germany	◔	○	◑		○	◔		◔	◑	◑	◑	◑		◕
Greece	◔	●									◑		◑	
Ireland	○			◔	◔					◔	◕	◑		◕
Italy	○	◔		○	◑		◔	○		◑	◕		◔	◔
Luxembourg		○				◔								
Netherlands	○		○	○	○		○	○	◑		◑	◔		◑
Norway (not EU)	○		○		◔			○	○		◑	◔		
Portugal		○		○	◔	◔	○	○	○	◑	●	○		◑
Spain	○	○			◔		●			◔	●	○	○	◑
Sweden			○		○				○	◑	○			
UK	●	●	●	●	●	●		●		●	●	●	●	●
New Member States														
Cyprus		◑					◔				◔			◔
Czech Republic		○	◔	○	○				○	○	◔	○	○	◑
Estonia					○	○					○	○		
Hungary				○	◔	○		◔		○	◑	◑	◔	◑
Latvia				○							○			
Lithuania										○				
Malta				○	◔									
Poland	○	○		○			◔		○	○	◔			◑
Slovakia		○									○			○
Slovenia														◑
Applicant Countries														
Bulgaria		○									○			◑
Romania				○	◔						◑		◔	◑
Turkey		◑							○	○	○			◑

Source: PricewaterhouseCoopers

Legend

- ○ Discussions ongoing
- ◔ Projects in procurement
- ◑ Many procured projects, some projects closed
- ◕ Substantial number of closed projects
- ● Substantial number of closed projects, majority of them in operation

† Procurement activity in these sectors relates to traditional style concession contracts

Figure 3 Summary of PPP institutional development

	PPP Unit	PPP Law
Member States		
Austria	▲▲▲	–
Belgium	▲	■
Denmark	▲▲	–
Finland	–	■
France	▲	■■
Germany	▲▲	■■
Greece	▲	■■
Ireland	▲▲▲	■■■
Italy	▲▲	■
Luxembourg	–	–
Netherlands	▲▲▲	–
Norway (not EU)	▲	–
Portugal	▲▲	■■
Spain	–	■■
Sweden	–	–
UK	▲▲▲	–

	PPP Unit	PPP Law
New Member States		
Cyprus	–	–
Czech Republic	▲▲	■■
Estonia	▲	–
Hungary	▲▲	■
Latvia	▲▲	■
Lithuania	–	–
Malta	▲	–
Poland	▲▲	■■
Slovakia	–	–
Slovenia	–	–
Applicant Countries		
Bulgaria	▲	■
Romania	▲	■■
Turkey	–	■■■

Source: PricewaterhouseCoopers

Key

▲	Need for PPP unit identified and some action taken (or only a regional PPP unit existing)
▲▲	PPP unit in progress (or existing but in a purely consultative capacity)
▲▲▲	PPP unit existing (actively involved in PPP promotion)
■	Legislation being proposed
■■	Comprehensive legislation being drafted / some sector specific legislation in place
■■■	Comprehensive legislation in place

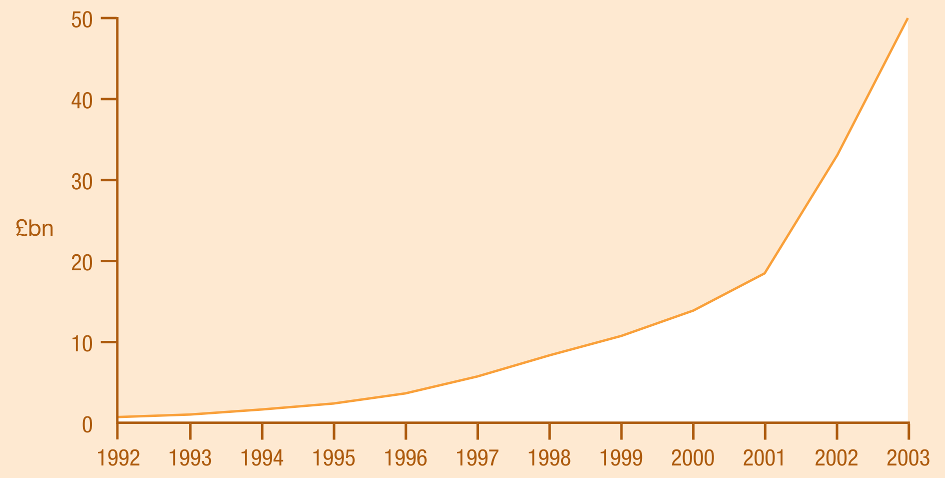
Such a high-level review inevitably simplifies the actual situation in each country with some countries not comfortably 'fitting' the categories used. Nevertheless, we believe that this provides a useful summary of the activity, or lack of it, to date.

In addition to reviewing the progress of PPPs in terms of project procurements, Figure 3 summarises two elements of institutional development which are often associated with the progression of PPPs, the setting up of one, or more, PPP units at a central government level and the promotion of generic PPP legislation. Once again there are limitations to such an approach. However, this analysis gives some insight into the efforts made by governments to develop the 'institutional capacity' and 'enabling environment' for PPPs.

Although Figures 1 and 2 do demonstrate the relatively limited progress which has been achieved in Europe to date, the use of PPPs is growing. In 2003, ninety PPP projects were financed in Europe amounting to $21.65 billion[9]. The EIB has itself provided funds of nearly €18 billion to PPP projects, a full listing of which are given in *Appendix A*.

[9] *Dealogic (2003) Global Project Finance Review*

Figure 4 The UK PFI market – cumulative capital value of deals

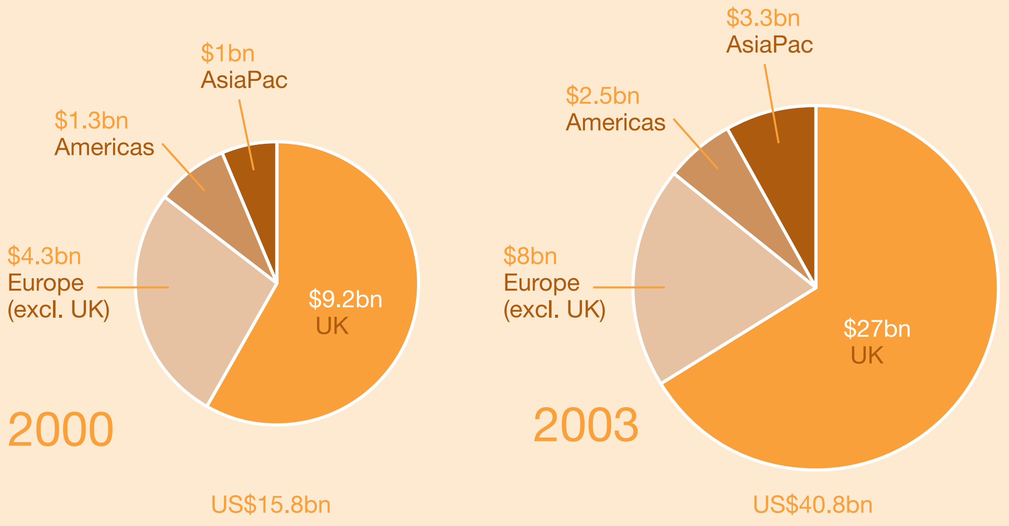


Source: Office of Government Commerce, 2003

Even where there is strong political will to develop PPPs, the complexity of individual procurements and the need to develop both an institutional capability and capacity and an ‘enabling environment’ results in progress being slow initially. Figure 4 shows that in the UK it took some time for results to come through. While other countries, which have the opportunity to learn from the experience of others, should be able to improve on this performance, this is still an important lesson for governments looking for quick results from PPPs.

Also as shown in Figure 5, it is worth considering the European PPP market in a global context. PPPs in Europe, including the UK, account for 85% of PPPs worldwide.

Figure 5 Capital value of closed deals



Source: Dealogic

A role for PPPs?

PPPs are a reality in many Member States and are an identifiable 'market' in Europe. They will become more so in the coming years.

However, PPPs are complex and difficult to procure. While there is evidence that if done well PPPs can provide significant benefits to the public sector and taxpayers, if the project is poorly procured then, given the generally long-term nature of such contracts, the public sector will suffer the consequences for many years to come.

There is an important role for PPPs in the development of public services and infrastructure in the Member States and in the implementation of EU programmes such as TENs. PPPs can be more than just a means of procuring particular projects – some of the approaches and techniques which have been developed in relation to PPP projects can be adapted and adopted for other forms of procurement, enabling governments to better procure traditional projects.

The scale of investment required, combined with the political, legal and fiscal limitations which are imposed on governments when funding these investments solely from budgetary resources, suggests that many governments will be unable to fulfil their investment programmes without some use of private sector finance.

The challenge facing governments is to ensure that they use PPPs only when it is appropriate to do so and then in an efficient and effective way. This requires upfront investment in knowledge and in public sector capacity and capability. However, PPPs are only likely to be one of a number of procurement methods used. Even in the UK, which has procured the greatest number of PPP projects across Europe, the vast majority, over 85%, of public service infrastructure investment, will continue to be conventionally procured[10].

There is a need for more coordinated and concerted action to be taken at national level. Governments need to demonstrate greater understanding and political will, develop appropriate policy and legislative frameworks where necessary, and commit resources to developing institutional capacity.

[10] *HM Treasury (2003) PFI: Meeting the Investment Challenge*

Section 2 PPPs and the EU

Introduction

In 'A European Initiative for Growth', the Commission states that it

"combines action needed to create the right regulatory, financial and administrative conditions to boost private investment and the mobilisation of Community funding with an invitation to Member States, in line with the 2003 Broad Economic Policy Guidelines, to continue refocusing public expenditure towards growth enhancing areas without increasing public budgets."[11]

The Initiative follows on from the request, at the October 2003 European Council, to the Commission and the EIB to

"explore how best to mobilise private financing support of the European Initiative for growth"

and give further consideration to a number of actions which should assist in promoting PPPs.

The Initiative is one of the more recent communications from the EU which deals with PPPs and outlines plans or actions which should benefit the development of PPPs, by way of reviewing or changing EU procedures or processes, providing new tools or initiatives, or by seeking to change Member States behaviour in certain ways.

Box 3 outlines some of the major actions or initiatives which the EU has taken in the area of PPPs.

It is noteworthy that these activities focus primarily on PPPs within the context of transport or, more specifically, the TENs programme. This may be because TENs is an EU initiative, which has its own budget line, and in which various EU institutions have a direct interest. Other areas of activity, where there is an equally important role for developing PPP approaches, are not a specific responsibility of any one part of the EU, but are delegated to Member States, or are covered under general areas of policy.

In reviewing the various EU outputs on PPPs the following themes tend to recur:

- The need for an appropriate and consistent legislative framework;
- The need to clarify the public procurement rules for PPPs;
- The interaction of PPPs with competition policy;
- The need to develop new financing instruments;
- Identifying ways of providing support at EU level;
- The identification of appropriate PPP projects; and
- The development of institutional capacity in the public sector.

Most of the studies or reviews on PPPs are narrowly defined. For example, the aim of the Kinnock report was

"to see how PPPs can contribute to achieve the objective of accelerating the implementation of the TENs network, which is vital for European competitiveness and growth."

[11] *A European Initiative for growth – investing in networks and knowledge for growth and jobs, European Commission (2003)*

Box 3 EU activities/actions concerning PPPs

Date	Action	Source
1993	White Paper on Growth, competitiveness and employment	COM(93) 700
1997	High Level Group on PPP Financing of TEN-T projects (Kinnock Report)	COM(97) 453
2000	Commission's Interpretative Communication on Concessions under Community Law	OJEC (2000/C 121/02)
2000	Proposal for a Regulation of the Council and Parliament concerning the granting of aid for the coordination of the transport by rail, road and inland waterways	COM(2000) 5
2001	White Paper on European Transport Policy for 2010: time to decide	COM(2001) 0370
2002	Building a Valuable Approach to PPPs Working session on the draft guidelines	COM(2001) 0370
2003	Guidelines for successful Public Private Partnerships – DG Regio and dissemination at a series of international conferences	DG Regional Policy
2003	A European Initiative for Growth – Investing in Networks and Knowledge for Growth and Jobs	COM(2003) 690 final
2003	Proposal for a Decision of the European Parliament and of the Council amending Decision No 1692/96/EC on Community guidelines for the development of the trans-European transport network	COM(2003) 564 Adopted on 21 April 2004
2003	Regulation amending Council Regulation (EC) No 2236/95 laying down general rules for the granting of Community financial aid in the field of trans-European networks	Adopted on 30 March 2004 – awaiting publication in OJEC COM(2003) 561
2003	Communication from the Commission: Developing the trans-European transport network: Innovative funding solutions & Proposal for a Directive on the widespread introduction and Interoperability of electronic toll collection systems	COM (2003) 132 final
2003	High level Group Report on the TEN-T network (Van Miert Report)	DG Transport
2004	Eurostat proposals on accounting treatment of PPPs	CMFB and Eurostat news release (STAT/04/18) February 2004
2004	New Procurement Directives – including introduction of Competitive Dialogue	Adopted in February and awaiting publication in OJEC
2004	Green Paper – EU consultative paper on PPPs and Community Law on Public Contracts and Concessions	COM (2004) 327 final May 2004

However, given the scope of PPPs these issues need to be addressed within a wider context, recognising that

> *"the aim of PPPs is not simply to mobilize complementary financing sources in times of constraints on public finances. It is of equal importance to improve a project's financial viability by mixing private- and public-sector skills: the public-sector experience of infrastructure management, and entrepreneurial spirit and commercial and financial skills of the private sector."*[12]

What interest does the EU have in the development of PPPs and other forms of private financing? What actions has, or is, it undertaking in these areas and how are these likely to impact on the PPP markets of Europe, some of which are relatively mature but most of which are not?

In this section we look at what we believe are some of the more important matters which are currently on the EU's agenda, and consider some of those which should be.

[12] *OJEC (98/C 129/14) Opinion of the Economic and Social Committee on 'Communication from the Commission to the Council, the European Parliament, the Economic and Social Committee and the Committee of the Regions on Public-Private Partnerships in Trans-European Transport Network projects' (also referred to as the Kinnock report)*

PPPs in an EU context

A review of the documents in Box 3 highlights that, while many EU officials describe the EU's stance on PPPs to be neutral, the EU is currently taking active steps to promote the use of PPPs in certain areas. As noted above, this is mainly in the area of TENs and transport where the EU has its own programme of projects to promote and where progress to date has been slow.

The use of PPPs does not contradict any of the fundamental principles and objectives of the EU as set out in Articles 2 and 3 of the Treaty Establishing the European Community[13].

The summary in Box 4 shows that, far from being neutral or agnostic, (as officials may claim), the EU wishes to make more use of PPPs and private financing.

How have the EU's actions matched this interest?

EU procurement rules and PPPs

This is an area of considerable complexity and uncertainty. Commissioner Frits Bolkestein (DG Internal Market), at the Third Annual PPP Summit in 2002 reflected that

> *"EU procurement law does not define public-private partnerships, nor does it provide for a specific set of rules covering the procurement of PPP projects."*

Procurement is a topic that has been highlighted as an area of concern since the Kinnock Report of 1997. PPPs have not been directly addressed in the Public Procurement Directives (the 'Classical' and 'Utilities' Directives)[14]. The Kinnock Report therefore recommended that the Commission should

> *"elaborate specific guidelines which would provide greater clarity in the procurement procedures to be followed for the award of transport infrastructure concessions."*

Since then there have been a number of amendments to directives and interpretive communications on this subject. It is debatable whether these have indeed clarified the situation or have added to the complexity of assessing which rules are to be applied in such situations. For example, the Commission's Interpretative Communication of Concessions under Community Law on Public Contracts[15] does little to enlighten anyone who is not a specialist in EU law. The net result has been a great deal of uncertainty for the public sector officials who are responsible for the procurement of PPP style contracts.

The two revised Procurement Directives have been adopted and are due to be published shortly. One of the main changes arising from these directives, which is relevant to PPPs, is the introduction of 'Competitive Dialogue'. This new approach to procurement has been much discussed over the last few years in the PPP market.

Considerable concern has been voiced as to whether this was to be an additional public procurement tool or whether it would replace the Negotiated Procedure. The Classical Directive continues to allow for both procedures. Competitive Dialogue is not available under the Utilities Directive which, given that water and transport are two of the more active PPP sectors, is puzzling. Box 5 summarises the Competitive Dialogue and Negotiated Procedure.

Competitive Dialogue may help in providing an alternative way of procuring PPPs in some instances. But it does little to address, and may well increase, the valid concerns that bidders have over the transaction costs of PPP procurements. Similarly, while a process of Competitive Dialogue may benefit the public sector in developing its requirements for a project, it does so at the potential cost of bidders losing the intellectual property contained in their proposals.

However, it is still the position that PPPs which qualify as 'public contracts' are subject to the detailed provisions of the Procurement Directives, while PPPs which qualify as 'concessions' are subject to a much lighter regime. In addition PPPs do not always easily fit within either of these two categories.

The EU has recognised that the current state of EU procurement law does not provide sufficient legal certainty in the area of PPPs and believes that

> *"the absence of a proper legal framework would hinder the development of PPP projects within the EU."*[16]

The Commission has published a consultative document, or Green paper, in May 2004.

However, as the Economic and Social Committee noted many years ago,

> *"a specific PPP directive would be difficult to formulate and even harder to apply."*[17]

We agree that the development of a comprehensive but practical procurement environment for PPPs (given that they come in many different forms) is a challenge and await the Green Paper.

[13] *Treaty establishing the European Community, Official Journal C325, December 2002*

[14] *Two revised Public Procurement Directives: Directive of the European Parliament and of the Council on the coordination of procedures for the award of public works contracts, public supply contracts and public service contracts, also known as the 'Classical Directive'and; Directive of the European Parliament and of the Council coordinating the procurement procedures of entities operating in the water, energy, transport and postal services sectors, also know as the 'Utilities Directives'*

[15] *Communication of Concessions under Community Law on Public Contracts OJEC (2000)/C 121/01)*

[16] *Speech by Commissioner Frits Bolkestein (DG Internal Market), at the Third Annual PPP Summit in 2002*

[17] *OJEC (1998/C129/14) Opinion of the Economic & Social Committee on the Kinnock report*

Box 4 EU statements and opinions on PPPs

"Given the constraints on public finance, there is an urgent need to develop real partnerships between the public and private sectors to accelerate implementation of the TEN, by making complementary finance available and improving cost effectiveness, so developing projects which are closer to financial viability. This will mean that smaller public subsidies will be needed."

Source: Communication from the Commission on PPPs in TEN-T Projects (Kinnock report)

"The use of long term contracts to provide private financing for public works is growing in several countries... such methods should be promoted and used more widely as they help States save public money".

Source: Economic and Social Committee (1997)

"The EIB largely shares the views and recommendations of the Kinnock High-Level Group on the development of PPP's in TENs and is working to incorporate them into the Bank's current strategy review. There is a clear consensus that EU institutions such as the Commission, the EIB and the EIF should actively support the PPP approach to TEN projects through the use of their existing financial resources. Where possible, the EU should reinforce PPP partnerships by co-financing and by developing these projects with other sources of risk capital finance and with the banking and capital markets so as to utilise EU financial and budgetary reserves in the most efficient manner possible."

Source: Seminar on PPPs in Transport Infrastructure Financing (1999)

"The development of PPPs is clearly seen by the Member States of the EU to be both valuable and necessary as a financing instrument because of the lack of budget resources but also because of the positive contribution to be expected from the private sector in terms of management, risk assessment, cost effectiveness and quality of service."

Source: Seminar on PPPs in Transport Infrastructure Financing (1999)

"Public Private Partnerships (PPP) are essential to tackling market failure in urban areas, and fall within the EU's objectives of the regeneration of urban areas, as well as strengthening economic and social cohesion (Article 158 of the EU Treaty) and sustainable development (Article 2)."

Source: Arlene McCarthy MEP

"While there may also have been initial resistance to PPPs on concerns about privatisation, PPPs do not necessarily involve the private sector taking partial or total ownership of the projects. The private sector can participate in the implementation and operation of capital investment programmes in other ways which can be equally valuable such as, for example, by sharing in the cost risk and/or the revenue risk or indeed other risks of projects and still fully merit being described as a PPP."

Source: A European Initiative for Growth: Investing in Networks and Knowledge for Growth and Jobs (2003)

"Public-Private Partnerships have to cope with important obstacles of a legal, economic and sometimes political nature. The Group considers it necessary to disseminate good practice and in the medium-term to update the existing legal framework in order to make them attractive for private investors in particular."

Source: High Level Group in the Trans-European Transport Network (Van Miert 2003)

"The Commission points out that the prime responsibility for infrastructure development lies with the Member States. The Commission could, however, in two ways play a more active role: to catalyse the early involvement of the private sector in project design by bringing together the key participants, particularly in cross-border projects, and to ensure that support from a range of financial instruments is provided in a coordinated way."

Source: The Opinion of the Economic and Social Committee the Kinnock Report (1998)

Box 5 Competitive Dialogue and Negotiated Procedure

Under Article 29 **Competitive Dialogue** may be used:
"in the case of particularly complex contracts,… where contracting authorities consider that the use of the open or restricted procedure will not allow for the award of the contract, (they) may make use of the competitive dialogue…"

Article 1.11 of the Classical Directive defines Competitive Dialogue as:
(c) 'Competitive dialogue' is a procedure in which any economic operator may request to participate and whereby the contracting authority conducts a dialogue with the candidates admitted to that procedure, with the aim of developing one or more suitable alternatives capable of meeting its requirements, and on the basis of which the candidates chosen are invited to tender.
For the purpose of recourse to the procedure mentioned in the first subparagraph, a public contract is considered to be 'particularly complex' where the contracting authorities

- are not objectively able to define the technical means in accordance with Article 23(3) (b), (c) or (d), capable of satisfying their needs or objectives, and/or
- are not objectively able to specify the legal and/or financial make-up of a project.

Article 30 outlines cases where, with prior publication of a contract notice, the use of the **Negotiated Procedure** is justified and sets out the specific circumstances where this is allowed, including, Article 30(b):
"in exceptional cases, when the nature of the works, supplies, or services or the risks attaching thereto do not permit overall pricing."

Article 1.11 of the Classical Directive defines Competitive Dialogue as:
(d) 'Negotiated procedures' means those procedures whereby the contracting authorities consult the economic operators of their choice and negotiate the terms of contract with one or more or these.

Source: European Commission

Accounting and statistical rules for PPPs

Another area which has been an ongoing cause of uncertainty for Member States is that of accounting and statistical rules relating to PPPs.

Uncertainty in the area of interpretation of PPPs in the European System of Accounts[18] has been high on the list of concerns for governments seeking to develop PPP programmes, both amongst New Member States and the EU 15. Although off-balance sheet treatment should not be a primary driver for procuring PPPs, uncertainty in this area is a cause of concern, especially for those governments that need, or intend in the future, to comply with the Maastricht criteria.

In February 2004, the CMFB and Eurostat published a news release outlining a new decision on the accounting treatment of PPPs.[19] The guidance provides that assets involved in a PPP can be considered as non-government assets

> *"only if there is strong evidence that the partner is bearing most of the risk attached to the specific partnership".*

This follows the 'substance over form' approach that has been used by a number of governments in developing their own accounting regulations for PPPs.

While the detailed guidance is still awaited, the release states that Eurostat is of the opinion that assessment of risk along the lines indicated

> *"would allow for a straightforward classification of the asset either 'on' or 'off' government balance sheet."*

Box 6 provides a summary of the decision.

Subject to the detailed guidance, it would therefore appear that the proposed accounting treatment of PPPs in national accounts will be less restrictive than many governments previously feared. However, it is worth noting that ESA95 only covers government accounting from an EU statistical standpoint. There is no requirement that national accounting standards (including specific public sector rules) should follow ESA95. Many Member States do not yet have clear public sector rules for dealing with PPPs, some having deferred detailed considerations until there is clearer guidance as to how Eurostat would rule in this area. In addition, International Accounting Standards covering this area are currently being drafted.

[18] *European System of Accounts ('ESA 95 Manual on Government Debt and Deficit')*

[19] *Committee on Monetary, Financial and Balance of Payments Statistics (CMFB) and Eurostat news release (STAT/04/18) February 2004*

It is therefore quite possible that a particular PPP project might have to be accounted for under up to three different sets of standards, with the real possibility that its assets could appear on different balance sheets, both, or none, depending on which sets of accounts are being looked at. Although there is still considerable potential for uncertainty and confusion in this area, the EU has made substantive efforts to clarify its rules.

State Aid issues and PPPs

The issue of State Aid and PPPs has not been a major practical issue to date. However, as discussed in Section 3, if private financing structures are to be developed as a source of co-financing EU grants, one of the four key principles of EU grant financing, is the need to

> *"ensure compatibility between PPPs and State Aid rules."*[20]

To date there has also been at least one ruling by the Commission regarding State Aid, namely in respect of the renovation and enhancement of the London Underground.

Where there is a competitive tender process, as there is with most PPPs, the scope for a referral for State Aid is limited. However, where the Negotiated Procedure is used, to the extent that there are alterations in the contracts to the bidder's advantage after the competitive phase of the tender process (i.e. after the selection of the preferred bidder but before the award of the contract) there is an increased risk of a State Aid challenge.

The Commission's decision of October 2002 in the London Underground case was that the PPP did not constitute State Aid. This appears to provide a precedent that complex infrastructure projects can be awarded after extended tender procedures involving alterations to the contracts after the appointment of a preferred bidder, without automatically resulting in State Aid. However, the Commission's ruling depended on the specific facts in this case, which has some unique features that are not likely to be relevant to many PPPs. See Box 7.

It is possible that the area of State Aid will become of increasing importance, and potential uncertainty, in the procurement of PPPs and that this uncertainty may adversely affect PPP development. If State Aid is found to have been given, the consequences can be serious. If a remuneration package paid by a Member State includes over-compensation, then the government can be ordered to reclaim the excess. Similarly any state guarantees, on which funders may be relying, may become unenforceable.

Box 6 Summary of Eurostat decision in accounting treatment for PPPs

Eurostat recommends that the assets involved in a PPP should be classified as non-government assets, and therefore be recorded off the balance sheet of the government, if both of the following conditions are met:
1. the private partner bears the construction risk, and
2. the private partner bears at least one of either availability or demand risk

The three key risks are:
1. construction risk – where a government's obligation to start making regular payments to a private partner, without taking into account the effective state of the assets, would be evidence that the government bears the majority of the risks;
2. availability risk – a government will be assumed not to bear availability risk if it is entitled to reduce significantly its periodic payments, "like any 'normal customer' could require in a normal contract"; and
3. demand risk – a government will be assumed to bear this risk where it is obliged to ensure a given level of payment to the partner, independently of the effective level of demand expressed by the final user, rendering irrelevant the fluctuations in level of demand on the partner's profitability.

It is acknowledged that in some cases, where risk analysis does not provide a clear outcome, additional elements in the partnership contract should also be taken into consideration. These could include: the nature of the partners, the importance of government financing, the effects of government guarantees, or provisions relating to the final allocation of the assets.

Source: Eurostat

[20] *Closing remarks of the then Director General of DG Regional Policy, Mr Guy Crauser,, Guidelines for successful public-private partnerships, European Commission (March 2003)*

Box 7 State Aid – the London Underground decision

A complainant alleged that after selection of a preferred bidder the level of service charge had been increased, the scope of the project had been reduced and the degree of risk to which the preferred bidder was subject had decreased.

The Commission analysis of the London Underground PPP focused on three areas:

- a review of whether the changes to the project had prejudiced the fairness of the tender process;
- an economic assessment of the changes introduced after the selection of the preferred bidder, to review the extent to which this bidder may have benefited from the changes; and
- an assessment of the proportionality of the contract terms.

The Commission found that:

- not withstanding the changes to the project the public procurement rules had been respected;
- that the maximum potential transfer of value to the bidder was reasonable in the context of contracts of this type; and
- the combination of the continuous review process to ensure that the PPP contractor acted in an economic and efficient manner, the arrangements for letting sub-contracts by competitive tender, the commercial incentives built into the contract and London Underground's audit rights all acted to limit any possibility of the compensation package drifting away from the market price in later years.

Source: Freshfields Bruckhaus Deringer

Funding initiatives

It is debatable whether there is a significant private funding constraint and therefore how much support needs to be provided by the EU in the form of additional financial instruments. While there are some concerns as to whether the debt and capital markets are able to deal with the financing requirements of some very large PPP projects, these are the exception.

The London Underground projects, which required £5.25 billion of private finance, demonstrated that if projects are appropriately structured then private finance can be raised. The development of the bond markets and monoline insurers is another example of a market response for additional sources of private finance. The bond financing of the Croatian Istrian Motorway in 2003 shows that such financing methods are not just limited to a small number of countries with sophisticated financial markets.

For many years there have been various calls for the EU to develop new funding instruments, or to encourage the introduction of new ways of funding infrastructure development.
The European Initiative for Growth listed four types of instrument which it believes are of particular relevance in this area:

- the provision of **third-party equity or quasi-equity** to projects alongside grant aids and contributions from promoters. Under the TENs Financial Regulation, provision is made for a share of the budget to be used for equity or quasi-equity investment in projects through specialised investment funds;
- **securitisation** – which can help to increase the available pool of resources from financial markets for new growth-inducing investments and to reduce the balance sheet and liquidity constraints of the banking institutions;
- mechanisms to share and spread the risk of debt provided to major projects including:
  – the EIB's **Structured Finance Facility**[21], which will contribute to increase the availability of debt finance for early, pre-construction stages of projects; and
  – a new **European Guarantee Instrument**[22] to cover specific risks to TENs projects in their post construction phase.

In addition, there have been recent proposals for the EIB's Structural Finance Facility to be increased from €500 million to €1,500 million and for a new EIB TENs Investment Facility[23] of up to €50 billion. A regulation amending the TEN Financial Regulation was adopted on 30 March 2004, which allowed for the total amount of funding from the TENs budget line to increase from 10% to 20% of relevant project costs.

However, it was noted in the 1998 Economic and Social Committee Report that

> *"Funding is not the sole or core issue re the development of TENs – issues are often the poor preparatory work, synchronicity of timetable, cross-border issues, status etc."*

Therefore while additional funding instruments may assist in the development of the PPP market their effect may only be marginal.

[21] The Structured Finance Facility was established by the EIB board of governors in 2001 and extended the EIB's financing through the provision of senior loans and guarantees (incorporating pre-completion and early operations risks), subordinated loans and guarantees and mezzanine finance

[22] The Commission is developing a proposal for the creation of a European Guarantee Instrument to provide support for post construction risks associated with TEN-Transport projects

[23] The EIB is prepared to commit €50 billion under a TENS Investment Facility in support of TENS priority projects

Private financing is generally available for well structured projects, with appropriate risk allocations and payment structures. While financing is an important factor the focus of effort should be on the economics of the projects, whether they are 'affordable' from a public sector standpoint (where public sector contributions are required to make the project commercially viable) and ensuring that the structuring of the project is appropriate for the private sector to become involved in a manner which provides overall value for money.

The role of the EIB

The EIB is the only EU institution which has substantial practical experience of PPP projects and their procurement. As *Appendix A* shows, the EIB has been a major provider of debt finance to European PPP projects. The EIB has played a major role in the development of the European infrastructure and PPP funding markets and has contributed towards developing good industry practice. The EIB has increasingly been involved in assisting the Commission with a number of developments and initiatives such as the European Guarantee Instrument. It is also used by the EU to provide expert advice regarding individual projects (such as the renegotiation of grant applications where PPPs are involved – see Box 12.) It was also represented on the Task Force looking at the accounting treatment for PPPs and is represented on the Informal PPP Exchange Group for TENs which has recently been formed.

However, the EIB's function is to act as the lending bank for the EU and its role is not in itself to develop policy.

The need for a joined up approach to the PPP market in Europe

There have been significant recent developments in the areas of accounting treatment and procurement. The recent publication of the Green Paper on PPPs, and the expected publication of the detailed Eurostat guidance should be helpful in furthering debate and providing guidance on these areas.

However, the EU's approach to the development of PPPs is largely compartmentalised and uncoordinated. This reflects the organisational structure of the EU and its institutions with different organisations having responsibilities for different sectors or areas of activity. In this the EU is no different from many Member State governments, where responsibilities relating to PPPs are split between different ministries and agencies.

An approach which a number of governments have taken, both in Europe and elsewhere, has been to develop a centre of knowledge and excellence in PPPs, often referred to as a 'PPP Unit' or 'Knowledge Centre'. The roles played by these units, and the importance which they have in actively promoting the development of PPPs, varies from country to country. However, we consider that such entities, if properly constituted, empowered and resourced, an have a substantial positive effect in promoting PPPs.

PPPs are complex, in concept, in design and in implementation. They are also difficult to define. Therefore it is difficult to

> *"create the right regulatory, financial and administrative conditions"*[24]

in which they can be promoted.

There is now a general realisation that PPPs need to be considered in more detail at the EU level with a requirement

> *"for initiatives to promote PPPs".*[25]

However, the actions which have been undertaken to date in this area have been of limited scope, and progress has been slow. If the EU believes that it needs to clarify the position of PPPs within an EU context (or even to take a more proactive role and actively promote the use of PPPs) then it needs to take an active and holistic approach.

[24] *European Commission (2003) A European Initiative for growth – investing in networks and knowledge for growth and jobs*

[25] *High level group on the Trans-European Transport Network (2003) Van Miert report*

Section 3 Combining EU funding with private finance

Introduction

Considerable uncertainty has been expressed as to whether, or how, private financing can be used as a means of co-financing funds provided by the EU under its various grant schemes.

These schemes have been in place for many years, but few, if any, examples of PPP projects with EU grant funding appear to exist. The accession of the New Member States, bringing them increased levels of EU funding, together with the associated co-financing requirements, has increased the importance of this area.

Funding for regional development and for strengthening economic and social cohesion is the second largest part of the EU budget. In the current Financial Perspective (2000 to 2006), EU grant funding amounts to some €240 billion. This funding takes a number of different forms. Those most relevant to the provision of infrastructure and government services are; the Structural Funds (particularly the European Regional Development Fund and the European Social Fund) and the Cohesion Fund for Member States, and PHARE and ISPA for Accession and Candidate Countries. *Appendix B* provides short summaries of these funding types.

Prior to the accession of the New Member States in May 2004, only four countries (Greece, Ireland, Portugal and Spain) were eligible for the Cohesion Fund, which provides project based assistance for transport and environmental infrastructure investment where a country's per capita GDP is below 90% of the Community average. Since 31 December 2003, Ireland no longer qualifies. On accession, the New Member States became eligible for Cohesion Fund financing, which replaces the pre-accession ISPA programme. All New Member States will also benefit from Structural Funds.

As Figure 6 shows, accession provides a significant increase in the amount of funding which becomes available for the CEE Member States (New Member States less Cyprus and Malta). This reflects the significant needs which these countries have, in terms of economic development and cohesion if they are to achieve comparability with the EU 15[26] within a manageable timescale.

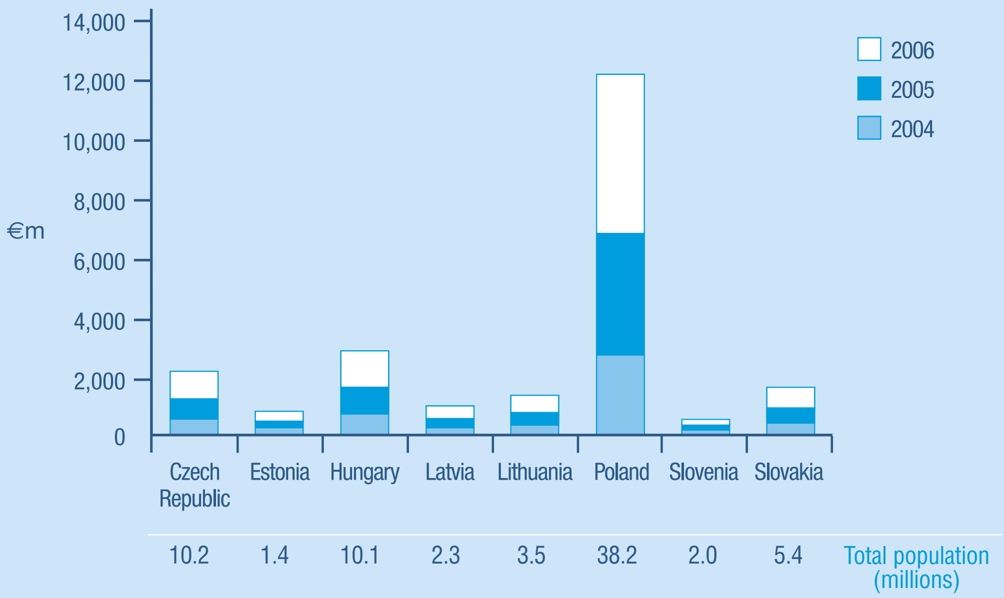
Both Cohesion and Structural funding require co-financing, with EU funding normally being limited to a maximum of 85% and 75% of eligible costs respectively. Therefore, while this significant increase in funding is a great benefit to the New Member States, it does bring with it a considerable co-financing commitment. This comes at a time when there are great pressures on governments to reduce government deficits and public sector debt, both generally and, for those who plan to join the Euro, as required by the Maastricht criteria.

[26] *See glossary for EU 15*

As Figure 7 shows, in the case of Poland (which receives about 50% of the total funding for the CEE Member States) the co-financing requirement is significant. Even if projects and programmes receive the maximum grant funding levels, the estimated co-financing requirements will amount to €5 billion over this period.

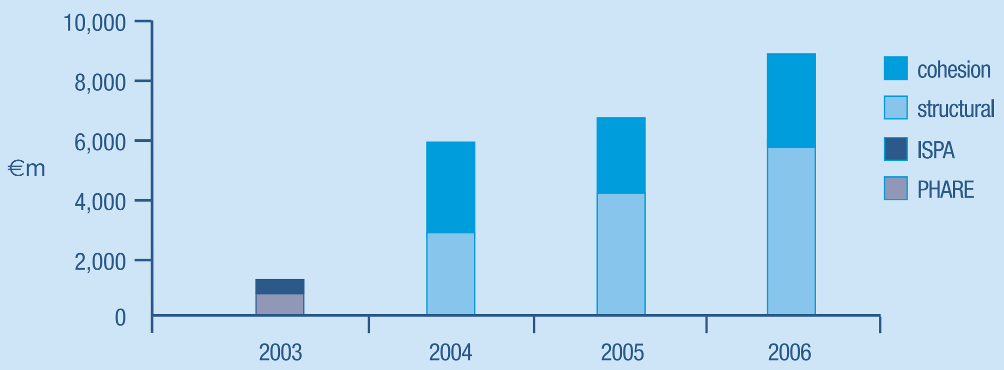
In this section we examine the concept of private finance being utilised as a source of co-finance. In doing so we have looked at the experience to date of the original four Cohesion Fund Countries (Greece, Ireland, Portugal and Spain) and three of the CEE New Member States (Czech Republic, Hungary and Poland) prior to their accession (regarding ISPA) in using private finance in this way. We have also reviewed the success of Member States in utilising past levels of EU funding.

Figure 6 Annual EU Funds to CEE Member States (€m)



Source: InfoBASE Europe, European Commission and PwC calculations

Figure 7 Structural and Cohesion Funds, CEE Member States, 2004 - 2006



Source: InfoBASE Europe, European Commission and PwC calculations

Review of co-financing using private funding

In undertaking this review we have assembled a comprehensive list of projects funded by the Cohesion Fund (between 1999 and 2000) in Greece, Ireland, Portugal and Spain and projects funded by ISPA (between 2000 and 2002) in the Czech Republic, Hungary and Poland. We sought to validate these lists with the co-ordinators for ISPA and the Cohesion Fund at the European Commission, our aim being to establish how many projects might be classified as PPPs or have included private finance. The results are summarised in Figure 8.

We also sought to validate the project lists with the ISPA and Cohesion fund contacts in the Member States, but were only partially successful due in part to recent changes in government in several of these countries and a reluctance of some governments to disclose information.

Figure 8 Summary of Cohesion Fund and ISPA projects with private finance

Country	Project name	Year	Sector	Type of EU grant	Grant (€m)
Greece†	Athens International Airport	1976-2001	Transport	Cohesion Fund	223,139,000
Greece†	Athens Ring Road	1992-2000	Transport	Cohesion Fund	–
Ireland	Limerick main drainage (stage III)	1999-2004	Environment	Cohesion Fund	107,000,000
Ireland	Cork main drainage (stage III)	2000-2004	Environment	Cohesion Fund	44,700,000
Ireland	Dublin region waste water treatment	1999-2003	Environment	Cohesion Fund	133,300,000
Ireland	Dublin region solid waste management infrastructures	2001-expected 2005/6	Environment	Cohesion Fund	6,900,000
Ireland	M1 Drogheda by-pass	1999-2003	Transport	Cohesion Fund	52,180,000
Portugal	Tagus bridge	1993-1998	Transport	Cohesion Fund	311,000,000
Spain	Planta desaladora de Almería	1997	Environment	Cohesion Fund	32,472,942
Spain	Planta desaladora de Cartagena	1997	Environment	Cohesion Fund	35,435,590
Spain	Planta desaladora de Alicante	1997	Environment	Cohesion Fund	35,342,878
Spain	Residuos A Coruña	2000	Environment	Cohesion Fund	12,271,586
Czech Republic	No projects reported				
Hungary	No projects reported				
Poland	No projects reported				

† Projects for Greece not confirmed with the European Commission

Source: European Commission/PricewaterhouseCoopers

Boxes 8, Tagus Bridge, and 9, Athens International Airport, summarise two of the projects cited in Figure 8. Box 12 looks in more detail at the Drogheda by-pass PPP in Ireland.

The results show that there have been very few projects which have combined these forms of EU funding with sources of private finance or PPPs. We have not undertaken a comprehensive review of Structural Funds, as most programmes do not have a significant infrastructure or public services element to them. In addition, Structural Fund projects tend to be of a smaller size which, given the transaction costs associated with PPPs, suggests they would be less appropriate as PPP projects. However, the 'Actnow' project, a PPP designed to promote broadband communications in the far South West of England, shows that PPPs can, and have been, used with Structural funding. Box 10 contains a short summary of this project.

Box 8 Tagus Bridge

This project involved the construction of an 18km bridge across the river Tagus which enables north-south traffic to bypass the Portuguese capital Lisbon. The 30-year concession includes the operation and maintenance of two river crossings, including the existing '25th of April bridge'.

It was one of the first important public works concession projects financed by limited recourse in Portugal, and the international tender, the negotiations and the post-adjudication monitoring were complex.

Project financing:
Total cost: €897m, including a European Union grant of €319m(35%); an EIB loan (with bank guarantees) of €299m (33%) and; a Government grant of €218m (25%).

Source: PricewaterhouseCoopers

Box 9 Athens International Airport

This project involved the development of Athens' second international airport. Work included the construction of a runway and taxiway systems for handling up to 65 aircraft movements per hour. The airport had an existing capacity for 16 million passengers a year, increasing to 50 million passengers a year after development, giving it a leading position in air transport.

Project structure:
The Hellenic Republic and a private consortium created a private company, Athens International Airport SA (SPV), which owns and operates the airport. The construction project was undertaken as a joint venture between a group of Greek and foreign companies led by the firm Hochtief.

Ownership structure:

Hellenic Republic	55%
Hochtief AG holds	45%

Project financing:
Total cost: €2.155 billion, including an EIB loan (46%), EU grant (12%) and state subsidy from the Hellenic Republic (7%)

Source: PricewaterhouseCoopers

Box 10 Actnow Broadband Communications

Actnow (Access for Cornwall through Telecommunications to New Opportunities Worldwide) is an example of how Structural funding is being used to leverage private investment to exploit new technology and regenerate the county's economy.

Actnow is a PPP between BT (the dominant telecoms provider in the UK) and a number of public sector entities: Cornwall Enterprise (a wholly owned subsidiary of Cornwall Country Council), the South West Regional Development Agency, Business Link and Cornwall College. It started in April 2002 and will run until March 2005. It is expected to create more than 1,000 jobs in Cornwall.

Actnow's goals include:

- Bringing broadband and its benefits to businesses throughout Cornwall;
- Improving the competitiveness of existing Cornish businesses on a national and worldwide stage;
- Stimulating the growth of new SME's within the county;
- Increasing the opportunities for external companies to do business in the county; and
- Improving local SME's understanding of the benefits of Information & Communications Technologies.

Under the contract BT will upgrade 13 telephone exchanges to deliver ADSL broadband services at significantly lower levels of demand than normally required to justify deployment of the technology. BT is also responsible for putting together a set of subsidised hardware and software packages to help businesses make the best of the opportunities created by broadband. Business advisory and training services are also provided.

Of the total project cost of €20 million, €8.4 million came from ERDF and BT contributed €4.8 million.

Actnow has been identified by the IST project Best eEurope Practices, which is responsible for establishing benchmarks for the introduction of ebusiness in Europe, as an example of best practice in using PPPs to deliver the commercial benefits of broadband services to small businesses in remote areas.

Source: PricewaterhouseCoopers

Review of absorption levels

One of the fundamental challenges to the New Member States will be whether they are able to absorb the levels of EU funding for which they are eligible. There are many reasons why funds may not be fully absorbed, which can include limited public sector capability or capacity or unforeseen delays in project implementation. One additional factor which, given the substantial increase in levels of funding for CEE Member States, may also be relevant is a government's ability to co-finance EU funds. Figure 9 provides a summary of the historic absorption rates for the Cohesion Fund for Greece, Ireland, Portugal and Spain and for PHARE for the New Member States. Equivalent figures for ISPA are not available on a comparable basis.

Due to the complexities of the way in which EU budgeting procedures distinguish between 'commitment appropriations' and 'payment appropriations'[27] absorption rates have to be interpreted carefully. However, it is clear that levels of grant funding, where the time periods in both cases are sufficiently long to mitigate the effect of a time delay of project start-ups' accounting for limited payment appropriations within the period, are not being fully absorbed.

Should the CEE Member States only achieve similar levels of absorption for Structural and Cohesion Fund allocations, they will lose substantial amounts of assistance, a loss which these economies can ill afford. While these countries have the benefit of the institutional capacity which has developed during the implementation of ISPA, in many ways they are less prepared to absorb these levels of funding than are the Cohesion Fund Countries (who have developed capacity over the longer period of time that they have been eligible for Cohesion Funds).

[27] *Payment appropriations are a guide to likely disbursements in a given year, while commitment appropriations are a guide to the total amount of funds committed to a policy area or project over a number of years*

Figure 9 Summary of absorption rates – Cohesion and PHARE

Cohesion funding by country 1993-1999 (€ million)

Country	Commitments	Payments	Payments as % Commitments
Greece	549.7	247.6	45%
Spain	1757.6	941.7	54%
Ireland	271.9	190.4	70%
Portugal	549.7	331.9	60%
Total	3128.9	1711.5	55%

PHARE funding by country 1990-2002 (€ million)

Country	Commitments	Payments	Payments as % Commitments
Czech Republic	767	490	64%
Estonia	286	195	68%
Hungary	1,317	969	74%
Latvia	355	249	70%
Lithuania	673	330	49%
Poland	3,420	2,099	61%
Slovakia	594	344	58%
Slovenia	296	196	66%
Bulgaria	1,310	828	63%
Romania	2,007	1,085	54%
Multi-country projects	2,711	1,707	63%
Total:†	14,000	8,749	63%

† *includes €265 million in commitments and €258 million in payments in the former Czechoslovakia and former East Germany.*

Source: European Commission/PricewaterhouseCoopers

The use of private finance as a means of co-financing

Given that the Cohesion Fund Countries have all undertaken some PPPs and that the EU does not prevent the use of private financing as a means to co-financing infrastructure development, it is surprising that there have been so few projects which have combined these two sources of finance.

It appears that there is a perception gap between the views of Member States, (where there is scepticism as to whether the EU is willing to see EU grants and private sector funding combined) and the EU where the Commission has stated that private co-financing is acceptable, so long as various requirements are satisfied.

A review of the fundamental principles and objectives of the EU, as set out in the Treaty of the European Union and other EU documents (including the Guidelines for Successful PPPs) shows that there are no fundamental contradictions between these and the utilisation of PPP approaches, or the use of private finance, as a means of co-financing EU funded projects. This is supported by discussions which we have had with Commission officials and the EIB and the contents of Box 11.

Given this, why has there been such limited use of private finance as a means of co-financing EU funded projects?

Box 11 EU Grant Regulations and PPPs

"The new Structural Funds Regulations stress the need to achieve the best leverage from operations funded from the Community budget by favouring as far as possible recourse to private sources of financing, notably risk and venture capital and Public-Private Partnerships (PPPs), as a means both of increasing the resources available for investment and also of ensuring that private sector expertise is brought to bear on the way in which schemes are run."

Source: The structural funds and their coordination with the cohesion fund Guidelines for programmes in the period 2000-06 (1999)

"...in order to strengthen the leverage effect of Community resources by favouring as far as possible recourse to private sources of financing and to take better account of the profitability of the projects, the forms of assistance available from the Structural Funds should be diversified and the rates of assistance differentiated with a view to promoting the Community interest, encouraging the use of a wide range of financial resources and limiting the contribution of the Funds..."

Source: Council Regulation (EC) No 1260/1999 of 21 June 1999 laying down general provisions on the Structural Funds Official Journal of the European Communities

"...the Commission shall support beneficiary Member States' efforts to maximise the leverage of Fund resources by encouraging greater use of private sources of funding."

Source: Proposal for a Council Regulation establishing a Cohesion Fund (2003)

"...while the principle of a high level of assistance is retained, the search for other sources of finance, in particular the beneficiary Member States effort to maximise the leverage of Fund resources by encouraging greater use of private sources of funding should be supported by the Commission."

Council Regulation (EC) No 1264/1999 of 21 June 1999 amending Regulation (EC) No 1164/94 establishing a Cohesion Fund Official Journal of the European Communities

The Cohesion Fund Regulation already stipulates that *"the Commission shall support beneficiary Member States' efforts to maximise the leverage of Fund resources by encouraging greater use of private sources of funding."*

Source: COM 2003_0132 – page 15

"...the rates of assistance provided from the Community under ISPA should be set in order to strengthen the leverage effect of resources, promote co-financing and the use of private sources of finance and to take account of the capacity of measures to generate substantial net revenue."

Source: Council Regulation (EC) No 1267/1999 of 21 June 1999 establishing an Instrument for Structural Policies for Pre-accession (ISPA)

Practical issues of co-financing EU funded projects with private funding

Some of the issues outlined in Section 2 have a bearing on why PPPs have not developed in this area, but consultation with the Commission, the EIB, the European Bank for Reconstruction and Development and representatives of governments of the four Cohesion Countries and the CEE Member States confirm that additional specific reasons include:

- A lack of understanding of:
  - PPPs generally;
  - whether PPP approaches can be combined with EU funding;
  - where practical guidance and advice can be sought; and
  - the need for a public sector capacity and capability to tackle the complex project structuring and procurement requirements which are necessary;
- The lack of precedents and availability of information on the limited number of precedents that there are; and
- The sheer complexity of combining the separate (if not contradictory) requirements of PPPs and EU funding in one project structure and procurement within the context of national public sector procurement requirements.

Individually we do not see that any of these issues form a fundamental obstacle to the development of structures which combine private finance with EU funding. However, when combined, in all but a small number of circumstances, these obstacles have in practice presented a challenge which few governments have been prepared to take up.

In addition, for CEE Member States, the need to absorb current funding levels, and the time that it is likely to take to procure the first PPP projects, may restrict the use of private co-financing for projects in the current Financial Perspective.

The four Cohesion Countries have, in most cases, been able to adequately co-finance projects from domestic budgetary resources. Given this, there has not been a strong incentive to take up such a challenge. A good example of this is the approach that the government and the National Roads Authority in Ireland have taken to the development of road infrastructure. This has been to develop a pool of projects to be undertaken using Cohesion funding (combined with public co-financing), and a separate pool of roads to be procured under a PPP programme. These separate 'pools' have been combined in only one instance and this was not initially intended (See Box 12 for further details).

Box 12 Irish roads programme

Road improvement:
Sources of financing 1994- 2006 (€ millions)

Funding source	1994-1999	2000-2006
Cohesion funds	569	231
ERDF	562	530
Exchequer	720	3,555
PPP	-	1,270
	1,851	5,586

Source: National Roads Authoity

The Irish Government has set a target of securing €1.27 billion of private finance for a programme of 11 national roads, 23% of the total road investment programme. Without this injection of private finance "the roads programme would be substantially incomplete and current deficiencies, which threaten regional development and economic growth, would fail to be addressed."

Source: PricewaterhouseCoopers

The PPP road schemes will be carried out on the basis of DBFO contracts with a long-term concession period (of not less than 30 years). During the contract term, the concessionaire will recoup construction and on-going operation costs through the collection of tolls, along with a public subsidy, where necessary.

A large proportion of the Cohesion Funds used to fund 34 (1994-99) and 4 (2000-04) projects was utilised for project preparation, and planning and design work.

Initial planning and pre-construction work for the M1 Drogheda Bypass (which forms part of the Dublin-Belfast TENs route) was originally funded from the Cohesion Fund. At the time of the original grant decision the NRA had no plans to toll the project. However, during implementation, a decision was taken to toll the motorway in the context of granting a concession to operate the toll and build a further section of the M1 as a PPP. This resulted in NRA having to renegotiate a reduced level of Cohesion Fund support for the Drogheda Bypass.

The challenge of combining PPPs with grant financing have been outlined in the Guidelines for Successful PPPs. These summarise the key issues which should be taken into account when developing and procuring projects:

- ensuring open market access and competition;
- protecting the public interest;
- ensuring full compatibility between PPP arrangements and State Aid;
- defining the right level of grant contribution;
- selection of the most suitable PPP type;
- ensuring active partnership – requiring a degree of flexibility from both the public and private sides;
- timing – involvement of all parties (including the Commission) at an early stage;
- ensuring recognition of EU grant financing objectives and ensuring the best use of grant financing; and
- the need to develop institutional capacity in the public sector and develop private sector investment facilitation mechanisms.

The Guidelines for Successful PPPs give limited assistance in demonstrating how these issues can be accommodated by developing appropriate project structures and PPP approaches. However, we believe that all of these issues can be satisfactorily addressed by a PPP approach which is properly developed and procured.

It is apparent that addressing all of these issues requires considerable effort and expertise, over and above that which would be required for a PPP procurement without EU funding involved, and considerably more so than for a traditional public sector procurement. This we believe is the main reason why so few projects combining grant funding with PPPs or private finance (which we define as 'hybrid') have actually been undertaken to date. If there is not a sufficient incentive to undertake such procurements (such as a lack of co-financing resources), and nothing is done to reduce the effort required (by providing knowledge, assistance and pilot projects with can be used as precedents), then this situation is unlikely to change.

Given the longer procurement timetables which are associated with PPPs, it may not be appropriate for New Member States to seek to use private financing as a means to co-finance projects in the current financial perspective. However, there is concern, both within CEE Member States and the EU over the capacity of these countries to fully absorb and co-finance these funds. If private co-financing is to be seriously considered for future projects then, given the complexity of the issues involved, all parties need to start their preparation now.

The Challenge

Given the difficulties of combining grant funding requirements and PPPs, why should governments, or the EU, seek to promote such hybrid procurements?

Undoubtedly PPPs can provide a variety of benefits and governments need to consider these and assess whether these benefits are likely to outweigh the costs of developing and implementing hybrid procurement structures. Benefits might include:

- achieving greater additionality of grant funding by funding more projects at a lower average rate of grant contribution;
- the utilisation of private finance, thereby increasing the overall level of funds available with which to undertake investment in infrastructure and public services;
- being able to utilise the wider benefits which PPPs can realise, including the use of private sector management and expertise in developing, constructing and operating such projects and generating enhanced value for money in the area of public infrastructure and services; and
- reducing the crowding out effect which significant levels of 'free' grant finance has so far had on the private financing of infrastructure projects, with the associated limited development of debt and capital markets, which are often associated with PPP programmes.

The wider economic benefits of infrastructure development do not directly benefit the private sector and it is therefore unreasonable to expect the private sector to expend significant effort in structuring such hybrid projects. It is the responsibility of Member States (aided by the EU) to do so in the interests of Europe's citizens to enhance growth.

Developing hybrid procurement and funding structures

What would such hybrids look like if they were to be developed?

The development of innovative hybrid structures will require strong political will (on behalf of the procuring entity, the national government and the EU) and an investment of time and effort to identify pilot projects. In the UK PPP structures have evolved to meet changing requirements. In addition to DBFO style concessions new structures such as the Local Improvement Finance Trust initiative (LIFT), Diagnostic Treatment Centres (DTCs) in the health sector, and 'Partnerships for Schools' in education have been developed in response to changing requirements. Hybrid pilot project structures and payment mechanisms should be kept relatively simple and it should be possible to define clear allocations of risks and rewards between the parties.

Pilot projects will need to be able to satisfy the EU's main criteria of grant financing:

- protecting the public interest, ensuring value for money and avoiding windfall profits for the private sector;
- ensuring an open market and transparent public procurement procedures;
- ensuring efficient grant contribution by defining the right level of grant contribution, appropriate project specification and maximising the use of limited funds; and
- adhering to the principles governing State Aid and ensuring no over-compensation for the private sector.

Therefore, greenfield projects, prior to any grant application or project structuring being undertaken, are likely to be the most appropriate pilots. In this case the project scope, structure and procurement can be designed from the start in accordance with the objectives and constraints relevant to such a hybrid project.

Given that many infrastructure projects are not commercially viable (they do not generate sufficient revenue from users of the facilities to repay the project costs), even if they may be economically viable (their overall benefits, including wider economic and social benefits outweigh the costs), there is a need to find a method whereby this gap can be closed. In many PPP projects this is done by providing a public sector contribution to the project cashflows. Where governments are able to make funding commitments over the entire term of the project, these can be made in terms of annual (often availability) payments. In the case of the EU, given the current form of EU grants, (where each Financial Perspective is for a fixed period of 7 years), such long term commitments cannot be entered into for grant financing. However, the approach of using grant funding to provide a capital contribution (paid out on the achievement of required milestones) to reduce the overall cost of construction (and hence the need to raise debt finance to fund the construction) is appropriate.

Box 13 Use of public sector capital contribution in the N4 Kilcock – Kinnegad road project

The N4 Kilcock to Kinnegad road was the first of the 11 roads in the Irish PPP programme to reach financial close in 2003. It involves the construction of 39 km of motorway. Eurolink, the winning consortia, are required to: complete the detailed design; construct all works; maintain all aspects of the road, including providing winter maintenance; operate the road and the tolling system; reinvest to ensure all facilities have the required residual life at handback; and raise the required finances for the scheme.

Payments from the NRA to Eurolink:
payments, of €146 million over the construction period (released on satisfactory completion of milestones) and €6 million during the operation period, are fixed.

Payments from Eurolink to the NRA:
a share of the toll revenues collected (dependent on traffic levels). The NRA anticipates that this "revenue share will be a very substantial amount of money that will part repay the subvention payments that the NRA will have made and will be payable during the period of the concession."

Project financing:
€232 million of private financing was raised (for the infrastructure excluding land and preparatory costs – incurred by the Government) and Eurolink is responsible for the repayment of all debts.

Source: PricewaterhouseCoopers

This is an approach which has been used by governments in traditional PPP procurements where the size of the required capital contribution is a variable on which bidders are evaluated. For example, this approach, together with limited operations period payments, was used on the first PPP road project to reach financial close in Ireland (Box 13).

It should be recognised that, for some of these hybrid pilot projects, maximising overall value for money may not be the prime objective. More important will be the role such projects have in proving that such an approach is possible, in providing learning opportunities and acting as precedents. However, it will be important for governments to show that such pilot projects demonstrate that, when compared with alternative means of procurement, such project structures can deliver similar, or better, value for money in overall economic terms.

Preparedness of Member States to develop PPP projects

Due to their increased complexity, PPP projects normally require a higher level of project preparation than traditionally procured projects in that they often require more financial and commercial preparation, especially in the early stages. There are doubts as to whether governments, especially in New Member States, have dedicated sufficient resources to the preparation of projects. This applies to traditionally procured, as well as PPP projects.

New Member States face a challenge in preparing sufficient projects to utilise the significantly greater levels of EU grant funding post accession. If they decide to co-finance some of these projects with private funds they will need to ensure that they allocate enough dedicated resource to this area and that they have the necessary mix of skills and experience to ensure that such projects can be effectively procured.

The public sector also needs to have a realistic understanding as to the risks which the private sector will undertake, and therefore do not have unrealistic expectations as to the percentage of funding which needs to be provided by the public sector.

Support requirements

The development of project structures and procurements of a hybrid nature will need to be undertaken within a wider enabling environment. Therefore the issues outlined in Section 2, relating to the role of the EU in the development of PPP markets, need to be addressed, as will many domestic issues.

It would be an advantage if countries had an established track record of successfully procuring standard PPPs, before moving on to developing and procuring more complex hybrid projects. Whether or not this is a realistic approach will depend on the co-financing needs and resources of individual Member States and their progress with developing standard PPP procurements.

In addition to having the necessary public sector institutional capacity and capability to undertake PPPs, the development of hybrid projects will require high levels of cooperation between the EU, national governments and the procuring entities.

At least for initial projects, it will be important that sufficient resources are dedicated to the design and procurement of such projects. This will require inputs from relevant PPP units, EU grant specialists (at national and EU level) and private sector specialists, in addition to properly resourced and experienced project management teams, to undertake the procurements. All of this will cost money and the EU, if it wants to enable such approaches to be developed, should ensure that grant funding is available to cover these increased public sector transaction costs.

The cost to the EU of building the necessary institutional capacity to procure the pilot projects will be immaterial relative to the overall level of grant funding and the actual, and political costs, of any non-absorption of these funds, and the consequential effects on the citizens of the CEE Member States.

It will also be necessary for all parties to recognise that they will need to demonstrate some flexibility in the way in which such transactions are procured. It is our belief that such projects can be undertaken within the principles of the EU, both generally and as they relate to grant funding. However, relevant rules will need to be interpreted reasonably and parties should be open to innovative solutions which may need to be developed in order to overcome the challenges and hurdles that such projects will encounter.

It should also be borne in mind that in the majority of cases, the use of a PPP or hybrid approach to procurement may **not** be appropriate. A PPP approach should only be used and developed for those situations where PPPs provide an improved outcome from that which would be achieved in a traditional procurement.

Section 4 Recommendations and conclusions

This review of the development of PPPs in New Europe has discussed how PPPs are complex and difficult to define, design, structure and implement.

For PPPs to be undertaken, and for programmes of PPPs to develop in an efficient and effective way, a number of conditions should be present:

- Demonstrable, strong, clear, long-term political will;
- A good understanding at a political, and policy level, of what PPPs are, where they are appropriate and how to use them;
- An understanding, at all relevant levels of government (national, regional and local) and, where relevant, at the EU, of how PPPs should be structured and procured;
- An appropriate level of public sector institutional capability and capacity to be able to develop and undertake complex projects and procurements;
- A suitable 'enabling environment' or 'framework' in the following areas:
  – legislative;
  – regulatory;
  – commercial; and
  – financial.

PPPs will not happen all of their own. It is up to the governments of the Member States to decide what use they wish to make of PPPs, to identify appropriate PPP projects and to ensure that they have the capabilities to procure them in an efficient and effective way.

However, while the prime responsibility for the development of PPP policies and procurements is that of the Member States, we believe that there is a role for the EU to play in assisting Member States in developing and procuring PPPs. In addition the EU has its own interests in PPPs as a means of delivering the TENs network, both in partnership with Member States and in rare instances (as with the Galileo project) as a contractual party.

Recommendations for promoting the development of PPPs

We have seen that the EU both influences the development of PPP markets through its actions (or inactions), and is interested in the development of PPPs. The EIB is the only EU organisation which has significant practical experience of PPPs. Other EU institutions have specific interests in PPPs, or in areas which overlap or impact on PPPs, but have little practical knowledge or experience of PPPs and the issues relating to their design, structuring and procurement. Most have a narrow interest in, and therefore approach to, PPPs.

Given the importance which PPPs have for the EU and the impact that the EU can have on the development of PPP markets (both positive and negative) we consider that the EU should be taking a more structured and comprehensive approach to the development of PPPs, and combining private finance and PPPs with EU grants. We make the following recommendations:

Improving knowledge and understanding of PPPs in the EU Institutions

There is a need to improve the knowledge and coordination of EU Institutions in the area of PPPs. Currently there are a number of initiatives which go some way to addressing this issue. There are a number of working groups considering specific issues. An 'Informal PPP Exchange' group has also recently been set up which includes representatives from national PPP task forces, the EIB, relevant DGs and other public sector organisations, but this deals only with TENs transport matters. More is needed.

We recommend that:

The Commission should set up a cross-EU PPP Group, whose role would include:

- assessing the impact of EU decisions and actions on the PPP market;
- acting as a centre of knowledge in PPPs for the EU;
- coordinating requests for information and assistance, from both within and outside the EU Institutions; and
- act as a reference point in supporting other parts of the EU in their involvement in areas relevant to PPPs.

This Group would have an overall EU role regarding PPPs and their development. Other parts of the EU would liaise, and work with, the Group on issues which could impact on PPPs and their development.

The Group should be supported by a Central Unit which would act as a centre of knowledge and excellence on PPPs.

However, we do not consider that it is either desirable or appropriate to set up a large bureaucracy which would be involved in the detail of all matters in the EU which affect PPPs. It is the responsibility of Member States to develop PPP projects and programmes. The EU role should be one of support to Member States, especially regarding the promotion of pilot hybrid projects. The cross-EU PPP Group would have an overall policy-related responsibility supported by the Central Unit who would assist it as necessary.

As policy should not be developed in isolation, we recommend that the members of the Group and Unit should have relevant practical experience of PPP procurement.

An appropriate model to look to would be that which has been adopted by a number of Member States, where central PPP units have been set up, often with additional units in specific ministries or agencies which are responsible for the implementation of PPP programmes. These units tend to be small, and are often staffed by a mixture of civil servants and individuals seconded from the private sector, who bring specific skills and experience which is not normally found in the public sector.

Institutional capacity, information and training

There is a lack of institutional capacity in many Member States. This needs to be addressed if PPPs are to be properly developed, procured and implemented.

There is a lack of research and studies into the actual outcome of PPP projects and programmes. This hampers both the development of evidence-based policy and the ability to undertake a proper public debate on PPPs.

While there are a large number of conferences and seminars which are held on PPPs, there is a need for detailed training courses which will help develop the necessary skills, and disseminate the information and experience, which public sector officials responsible for the development and implementation of PPPs need.

We recommend that:

- EU funding should be made available to support appropriate public sector institutional development and capacity in Member States. This should include the development of PPP units, the secondment of civil servants (and/or advisers) between Member States, and from the private sector to the public sector;
- the EU should sponsor high quality comparative studies of the outcomes of PPPs and research in other relevant areas; and
- the EU funds the development and provision of practical training in this area.

EU approach to PPP development

The development of PPPs relies, to a considerable extent, on the 'market' responding to public sector needs in an innovative and effective way. PPPs are difficult to define and vary greatly in nature. We therefore consider that it is neither appropriate, nor desirable, for the EU to seek to regulate this 'virtual' market in the way that it does in some other areas.

As has been outlined in this paper, PPPs fit within the aims, objectives and principles of the EU. This is not a market where there is a need for new legislation or rules, neither is it one which would respond well to them.

We recommend that:

The focus of EU activity should be on the clarification of how current legislation, rules and procedures interact with the development and implementation of PPPs. A case of interpreting existing rules, not one of developing new rules.

Such an approach would reduce the significant levels of uncertainty as to how a variety of EU legislation and rules impact on PPPs. This would both stimulate PPP activity (where this is appropriate) and reduce the transaction costs associated with PPP procurements. While PPPs should happen within a general framework which is conducive to their procurement, in most cases PPP projects are regulated by the contracts which all parties sign, and not by a separate regulatory organisation or process. This approach should be adopted as the way that the EU should promote PPP development.

Co-financing using private finance and PPPs

Combining PPP approaches with the requirements of EU grant funding provides a considerable challenge. It is up to Member States to decide whether this is a challenge which they wish to take up, or not. However, the EU has stated that it believes that private finance can be a useful form of co-financing and that it should be encouraged. It is therefore incumbent on the EU to ensure that this can be done and to support Member States which wish to undertake projects on such a basis.

We recommend that:

The EU assists Member States to tackle the issues involved in integrating EU funding and grant requirements with private sector finance and PPP approaches. Given the difficulty of developing and implementing such hybrid structures, Member States will be reluctant to take on this challenge without demonstrable support from the EU. As many of the issues and their solutions will be generic, and not specific to any one country, it may be more efficient for these to be developed collectively rather than by individual governments.

A central taskforce, with clear terms of reference, should be set up and resourced to:

- identify and investigate the issues and challenges relating to the procurement of such projects from a practical standpoint;
- address these issues and develop project structures and procurement routes which will satisfy the requirements of the EU, governments and the private sector, and enable such projects to be procured;
- assist Member States in selecting a number of pilot projects;
- provide substantial support and assistance (including contributing to the funding of feasibility studies and the advisory and transactions costs of the public sector) to the procurement of these pilot projects so that they will provide good practical examples of how to procure such projects and act as precedents for future projects;
- ensure that the learning and the experience gained is collated and made available to others (as well as provide inputs to guidelines for the procurement of such projects going forward); and
- develop practical guidelines and principles (including, if appropriate standardisation of processes and documents) which can be used by Member States to assist in the development and implementation of such hybrid projects.

The selection of the pilot projects should be based on practical considerations as to what would make good pilot projects and should be selected on their technical, financial and commercial merits and not on national or political priorities or criteria.

Conclusions

A PPP market already exists in many Member States and Member States will continue to develop their own PPP programmes. Some may also decide to take up the challenge of combining PPP structures with EU grant funding.

The EU will continue to need to react to developments in PPPs and determine how these relate to, and interact with, its legislation, regulations and rules. To the extent that the rate of development in the PPP market outstrips the EU's ability to react to these changes, there will be uncertainty and confusion. This will add to the overall risks, of both the public and private sectors, of undertaking PPP projects. Increased risk and uncertainty inevitably results in higher costs. These will ultimately be paid for by the populations of Member States (either as consumers or as taxpayers).

It is therefore important that the EU addresses the whole area of PPPs and their development in a proactive, rather than in a reactive manner. Given the potential importance and scope of PPPs in a new Europe it is vital that it does so from a position of knowledge and understanding.

Evidence from the UK and the Netherlands shows that, if well executed, it is possible to achieve efficiency savings in the region of 15% with PPP projects. This supports the view that, where appropriate, Member States should consider and promote the use of PPPs, although PPPs are likely to be an appropriate procurement method for a proportion of public sector projects.

There has not been much progress since the Commission launched a consultation process in 1995 aimed at encouraging the development of PPPs. In the transport sector we have seen the Kinnock and Van Miert High Level Groups grapple with many of the same issues, which are still to be resolved. The Procurement Directives have been revised many times and yet only recently has the EU issued a consultative document on the procurement of PPPs.

To continue with a piecemeal and uncoordinated approach to the development of PPPs will not provide the progress needed. What is required is a more holistic approach by the EU and its institutions to the development of PPPs.

The EU has advocated the use of PPPs in the areas of transport and as co-financing for grant funded projects. In the Galileo project, it is currently involved in sponsoring a €3.6 billion PPP project, one of the largest PPP projects to be proposed in Europe to date. It is surely appropriate that the EU invests the necessary time, money and effort in ensuring that the development of PPPs in the New Europe is encouraged.

PPP procurements face a great many hurdles. In comparison with traditional procurements the playing field for PPPs is not a level one. If the EU does believe, as it has stated, that PPPs should be a viable alternative to more traditional forms of procurement, and can offer enhanced value for money, then it should take appropriate actions.

The EU needs to recognise that PPPs are a reality for many Member States, and soon will be a reality for many more. Given the difficulties which governments face in developing and implementing effective PPPs, the EU must work towards facilitating their development in a way which maximises the benefits for all.

Appendix A

EIB funded PPP projects by country and sector

(total projects funded to March 2004)

Country	Project name	Sector	Amount (€million)
Austria	GRAZER FRACHT TERMINAL (PPP) A&B	Transport	40.0
Denmark	GREAT BELT LINK 2 A	Transport	2,498.2
Denmark	ORESUND LINK	Transport	1,042.5
Germany	ELBE TUNNEL FOURTH TUBE HAMBURG A B 2 C	Transport	355.5
Germany	ENGELBERGBASISTUNNEL PPP A B	Transport	172.4
Germany	WARNOWQUERUNG ROSTOCK A	Transport	104.9
Germany	WESER TUNNEL A B	Transport	98.2
Greece	ATHENS INTERNATIONAL AIRPORT	Transport	465.0
Greece	NEW ATHENS INTERNATIONAL AIRPORT D E	Transport	534.3
Greece	ESSI MOTORWAY	Transport	1,027.4
Greece	RION-ANTIRION BRIDGE A B C	Transport	370
Ireland	M1 DUNDALK PPP MOTORWAY (IRELAND)	Transport	65.0
Ireland	M4 PPP TOLL MOTORWAY	Transport	78.0
Ireland	IRISH SCHOOLS PPP	Health, Education	38.3
Ireland	NATIONAL MARITIME COLLEGE PPP	Health, Education	29.2
Netherlands	HSL ZUID PPP (TEN)	Transport	400.0
Netherlands	DELFLAND PPP WASTEWATER TREATMENT	Water, Sewerage	125.0
Portugal	CHAVES MOTORWAY	Transport	450.0
Portugal	COSTA DE PRATA MOTORWAY	Transport	190.0
Portugal	LEIRIA MOTORWAY	Transport	208.9
Portugal	SCUT ALGARVE	Transport	130.0
Portugal	SCUT BEIRA INTERIOR A	Transport	358.3
Portugal	SCUT BEIRA LITORAL/BEIRA ALTA	Transport	470.0
Portugal	SCUT GRANDE PORTO	Transport	300.0
Portugal	SCUT INTERIOR NORTE	Transport	324.3
Portugal	SD TEJO RD BRIDGE(BEI/ED)(PTE) (DEM1) (PTE2)	Transport	305.9
Portugal	AGUAS DE SANTA MARIA DA FEIRA	Water, Sewerage	80.0
Spain	AUTOPISTA LEON ASTORGA	Transport	42.0
Spain	AUTOPISTA M-45 A&B	Transport	149.3
Spain	AUTOPISTAS A6 Y AVILA	Transport	100.0
Spain	AUTOVIA DEL NOROESTE - MURCIA A	Transport	12.5
Spain	AUTOVIA PAMPLONA LOGRONO (DBFO)	Transport	175.0
Spain	METRO DE SEVILLA DBFO-AFI - A	Transport	50.0
Spain	METRO SUR MADRID (PPP) A B C	Transport	1,000.0
Spain	RADIAL 2 DE MADRID (DBFO A B (CAJA MAD)	Transport	120.0
Spain	RADIAL 4 DE MADRID (DBFO)	Transport	360.0
Spain	RADIALES 3 Y 5 DE MADRID (DBFO) - A & B	Transport	300.0
Spain	TRANVIA BARCELONA BAIX LLOBREGAT(DBFO)	Transport	136.1
Spain	TRANVIA BARCELONA GLORIES - BESOS DBFO	Transport	125.1
Spain	TUNELES DE ARTXANDA A	Transport	40.0
Spain	AGUAS DE SEVILLA (PPP)	Water, Sewerage	60.0
Sweden	OERESUND LINK	Transport	722.2
UK	A13 DBFO ROAD	Transport	150.4
UK	A1 DBFO MOTORWAY	Transport	167.2
UK	A1 - M1 DBFO ROAD	Transport	106.2
UK	A1(M) & A 417/419 DBFO ROAD	Transport	131.0
UK	AAE EUROPEAN RAIL FREIGHT WAGONS	Transport	135.0
UK	CHANNEL TUNNEL RAIL LINK	Transport	408.7
UK	LONDON UNDERGROUND PPP (BCV) (SSL)	Transport	1,339.2
UK	M6 DBFO ROAD	Transport	121.9
UK	MANCHESTER METROLINK PHASE 2	Transport	14.9
UK	MIDLAND METRO LINE 1 A	Transport	47.9
UK	PORTERBROOK - NIFT I SECURITISATION	Transport	172.1
UK	SECOND SEVERN CROSSING 2 3 4	Transport	176.1
UK	SKYE BRIDGE	Transport	16.9
UK	WELSH DBFO ROADS - A55	Transport	81.2
UK	BLACKBURN HOSPITAL PPP	Health, Education	72.1
UK	DUDLEY GROUP OF HOSPITALS PPP	Health, Education	113.0
UK	EDINBURGH SCHOOLS PPP	Health, Education	58.8
UK	FALKIRK SCHOOLS (SCOTLAND)	Health, Education	56.3
UK	GLASGOW SCHOOLS PPP	Health, Education	166.1
UK	HBOS PPP FRAMEWORK LOAN	Health, Education	146.1
UK	KIRKLEES SCHOOLS PPP	Health, Education	40.4
UK	LONDON UNDERGROUND POWER	Energy	187.2
UK	NORTH EAST LONDON HOSPITALS PPP	Health, Education	141.9
UK	ROTHERHAM SCHOOLS PPP	Health, Education	69.5
UK	SEEBOARD POWERLINK	Energy	71.1
UK	SHEFFIELD SCHOOLS PPP	Health, Education	46.5
TOTAL			17,890.4

Appendix B

EU funding relevant to infrastructure development

Cohesion Fund

General principles: the cohesion fund was established in 1993 to help the four countries qualifying for its assistance, Spain, Portugal, Ireland and Greece, to meet the convergence criteria for economic and monetary union and at the same time continue to invest in infrastructure. The Cohesion Fund finances projects designed to improve the environment and develop transport infrastructure in Member States where per capita GNP is below 90% of the Community average.

Qualifying countries: the Member States qualifying for the period 1993-99 and 2000-06 included Ireland, Greece, Spain and Portugal, progress made by each country was reviewed at the end of 2003, as a result of the review, Ireland no longer qualifies for Cohesion Fund assistance. Since May 2004, the 10 New Member States also qualify for Cohesion Fund assistance.

Projects financed: projects financed must be for either environment or transport infrastructure. The funds are split 50-50 between the two categories.

Grant financing: 80% to 85% of the total cost

Total budget available: €18 billion (2000-2006)

Source: European Commission

ISPA – Instrument for Structural Policies for Pre-Accession

General principles: ISPA is one of the three financial instruments (others are PHARE and SAPARD) available to assist the candidate countries to prepare for accession.

Qualifying countries: until 1st May 2004, the ISPA programme provided assistance to Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovenia and Slovakia (these countries no longer qualify for ISPA, assistance is now provided through the Cohesion Fund). The candidate countries Bulgaria and Romania, expected to join the EU in 2007, still qualify for ISPA.

Projects financed: projects financed must be for either environment (to ensure countries comply with the 'acquis communautaire' and 'investment heavy' directives such as drinking water and air pollution) or transport infrastructure (funding for the building and repair of transport infrastructure, including expanding the TENs to provide connections between the EU and accession countries)

Grant financing: 75% of the total cost

Total budget available: €7 billion (2000-2006)

Source: European Commission

PHARE

General principles: PHARE is one of the three pre-accession financial instruments (others are ISPA and SAPARD) financed by the EU to assist the applicant countries of central Europe in their preparations for joining the European Union. The PHARE programme has funded modernisation programmes in the CEE countries for more than ten years.

Qualifying countries: until 1st May 2004, the PHARE programme provided assistance to Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovenia and Slovakia (these countries no longer qualify for PHARE, assistance is now provided through the Structural Funds). Until 2000 the countries of the Western Balkans were also beneficiaries of PHARE. However, as of 2001 the CARDS programme (Community Assistance to Reconstruction, Development and Stability in the Balkans) has provided financial assistance to the Western Balkans. The candidate countries, Bulgaria and Romania, expected to join the EU in 2007, still qualify for PHARE.

Projects financed: finance provided for a range of projects including economic development, administrative change, social development and legislative work, to enable candidate countries meet the criteria for membership of the EU.

Grant financing: 100%

Total budget available: €1 billion (2000-2006)

Source: European Commission

The Structural Funds

General principles: four different types of Structural Funds have been established by the European Union for granting financial assistance to support structural economic and social development. Two types of Structural Fund, the European Development Fund (ERDF) and the European Social Fund (ESF) are relevant to PPP projects.

Qualifying countries: all EU member states qualify for some type of structural funding.

Projects financed: The ERDF mainly finances the development of infrastructure and small or medium-sized enterprises. ERDF resources are mainly used to cofinance: productive investment leading to the creation or maintenance of jobs; infrastructure; local development initiatives and the business activities of small and medium-sized enterprises. The ESF funds programmes to develop or regenerate the employability of people in eligible regions and local employment initiatives giving assistance to individuals through vocational training, education and careers advice, also through social skills development.

Grant financing: variable, depends on the wealth of the region where the investment is made.

Total budget available: €195 billion (period 2000-2006)

Source: European Commission

Glossary

Accession Countries	The 10 New Member States prior to their accession on 1 May 2004
CEE	Central and Eastern Europe
CEE Member States	The Accession Countries, less Cyprus and Malta
Candidate Countries	Bulgaria and Romania
CMFB	Committee on Monetary, Financial and Balance of Payments Statistics
Cohesion Fund Countries	The four Member States which were eligible for Cohesion Funding prior to 1 May 2004 – Greece, Portugal and Spain and Ireland up to 31 December 2003
Competitive Dialogue	as defined in Article 1.11 (c) of the Classical Directive TENs: Trans-European Networks
DBFO	Design Build Finance and Operate
EBRD	European Bank for Reconstruction and Development
EIB	European Investment Bank
ERDF	European Regional Development Fund (part of Structural Funds)
ESA95	European System of Accounts
EU 15	The Member States of the EU prior to the accession of the New Member States on 1 May 2004 - Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, United Kingdom.
Eurostat	The Statistical Office of the European Communities
Galileo project	An EU sponsored project to develop a satellite radionavigation system for civil use
Green Paper	EU Consultative document on PPPs and Community Law on Public Procurement and Concessions
ISPA	Instrument for Structural Policies for Pre-Accession (See Appendix B)
Member States	The 25 member states of the EU – Austria, Belgium, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Slovakia, Slovenia, Spain, Sweden, United Kingdom.
Negotiated Procedure	as defined in Article 1. 11. (d) of the Classical Directive
New Member States	The 10 new member countries which joined the EU on 1 May 2004 – Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia, Slovenia.
Open Procedure	as defined in Article 1. 11. (a) of the Classical Directive – "Open procedures means those procedures whereby any interested economic operator may submit a tender"
PFI	The Private Finance Initiative – a particular form of PPP in the UK
PHARE	One of the three pre-accession financial instruments (see Appendix B)
PPP	Public Private Partnership
Restricted Procedure	as defined in Article 1. 11. (b) of the Classical Directive – 'Restricted procedure' means those procedures in which any economic operator may request to participate and whereby only those economic operators invited by the contracting authority may submit a tender
State Aid	as defined in Article 87 of the Treaty establishing the European Community
TENs	Trans-European Networks

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