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BIAC Position Paper

Towards as Set of

"OECD Guidelines on the Regulatory Framework for Public-Private Partnerships in developing countries, with an Emphasis on Infrastructure and Public Service Provision"

BIAC Task Force on Africa

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Executive Summary

- **Although the private sector has understood the significant benefits their participation in public-private partnerships can bring to social welfare in developing countries, PPPs nevertheless remain extremely risky investments.**

- **There is no general framework for the application of PPPs in place right now. Each country is left to set its own rules and regulations, where transparency and general accountability have little importance. In such an environment, the private sector is faced with too many unnecessary risks.**

- **BIAC encourages the OECD to develop a detailed but flexible set of "OECD Guidelines on the Regulatory Framework for Public Private Partnerships".**

- **To encourage the private sector to participate in PPP, OECD should address the following points in the drafting of Guidelines towards a standardised implementation process for PPPs:**

  - **The legal framework needs to enable the entrance and operation of private entities in what are often state-controlled industries;**

  - **The coordination of preparatory measures for efficient PPP start-up and implementation is necessary;**

  - **The allocation of risks through contractual agreements needs to be addressed.**

- **While considering measures to facilitate PPPs, it is important to note that project profitability is a vital prerequisite for private sector involvement, especially if the project requires long-term engagement.**

- **This BIAC contribution summarises the discussions and experience of members of the BIAC Africa Task Force and relates them to the findings of international financial institutions.**

Introduction

According to the EBRD,

> "*A PPP is a contractual agreement between a public agency (federal, state or local) and a for-profit entity. Through this agreement the skills and assets of each sector (public or private) are shared in delivering a service or facility for the use of the general public. In addition to the sharing of resources, each party shares the risks and rewards potential in the delivery of the service and/or facility.*
>
> *The agreements between the public and private entities differ in their allocation of risks and responsibilities, in the ownership of the asset and their duration; however, all involve a partnership between a public and a private entity".*

It is now public knowledge that developing and transition countries will not develop, reduce poverty and attract foreign capital without having basic infrastructures in place in transportations, power, telecommunications, water, health and education. In Sub-Saharan Africa less than 10% of the population have access to electricity, less than 40% have access to water and journeys to market are up to ten times longer than they should be. Although the importance of basic infrastructure for economic development and poverty alleviation is widely recognised, many developing countries are unable to remedy the situation. In Sub-Saharan Africa for instance, the gap between the size of investment required to rehabilitate existing facilities and develop new ones and the funds available through public borrowing and government taxation is roughly equivalent to 5.5% of the region's GDP, or alternatively, 1% of that of high income countries[1].

Public Private Partnerships (PPP) appear to be an effective tool in alleviating the situation. The core idea of PPP is that large projects are most effectively handled within the cooperation of the public initiatives and the private market system framework. These forms of partnership have been implemented in both 'hard' and 'soft' sectors, in areas ranging from transport to public health, education, public safety, waste management, water distribution and chemical plants. This paper addresses infrastructure and service provision projects in both 'hard' and 'soft' sectors of the economy. For some examples of PPPs in Africa, see Annex 1.

According to a corporate definition[2], the variety of PPPs is best described – although this is not an exhaustive list - by dividing them into three categories, varying in terms of duration, client expectations, financing requirements and degree of involvement of the private sector:

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[1] PWC, Private Sector Participation in Africa's Infrastructure: It's time to stop talking, 2004.

[2]Suez, an international industry and services company that uses PPPs in the design, implementation and operation of projects in the fields of electricity, gas, water and waste services for offering public authorities. Source: Suez website.

- Delegated Management Contracts, such as affermage, lease agreements and concessions[3].
- Services Contracts, including Operation and Maintenance (O&M) and Management Support contracts[4].
- Construction and Management Support, of which the most common are Build Operate Transfer (BOT) and Build Design Operate (BDO) contracts[5].

I. Recent Trends in PPP investments in developing countries

The 1990s saw some expansion of PPP projects in developing countries, but these were mostly concentrated in Latin America and East Asia[6]. Overall annual investment in infrastructure projects with private participation averaged US $ 60 billion from 1990 to 2001, with a peak of US $130 billion in 1997. Of this, developing countries only received a small fraction and by 1997 the flow of investments to developing countries, in particular to Sub Saharan Africa, had run dry. Sub Saharan Africa captured only 3% of the cumulative investment and only 7% of infrastructure projects with private participation throughout the 1990 – 2001 period. However, these figures do not reflect the number of

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[3] ***Affermage or lease agreement:*** The private operator manages the services for a period of five to fifteen years and is responsible for maintaining and renewing the facilities according to the terms of the contract. In this capacity, it takes charge of all personnel and existing assets but is not responsible for financing new facilities. It acts as counsel to the public authority on the nature and timing of investments. The public authority returns ownership of the assets as well as the responsibilities for all new investment and compliance to existing norms. The private operator invoices the end-user directly.
Concession: The Public Authority fully entrusts the private operator with management of the services and all necessary investment for a period of twenty years or more. The Private operator invoices the end-user directly, the public authority retaining strict control over service terms as well as all key decisions related to applicable rates and targets. The concession contract is the most advanced in terms of transfer of responsibility to the private operator. It features all the advantaged of a public-private cooperation, the private operator having the leeway to adopt project specifications in order to obtain the best economic performance.

[4] ***Operation and Maintenance (O&M):*** The private operator is in charge of daily maintenance of the facilities within a specific geographic area and legal framework. In this capacity, the private operator may in some cases take on the responsibility for operating the facilities. The private operator is paid for its services by the public authority according to specific and qualified performance criteria.
Management Support: The private operator supplies the public authority with human and technical resources as needed for a fee. It provides technical know-how on all operational and financial aspects of project management remaining within the jurisdiction of the public authority. Management support contracts enable the public authority to benefit from an expertise in specific areas, such as quality control and customer management.

[5] ***Build Operate Transfer (BOT):*** the public authority entrusts the private operator with the design, financing and construction and management of the major facility during a specific timeframe. In return, it charges the public authority a fee for the service. The BOT contract is particularly well-suited for projects related to specific facilities such as a water treatment plant or power plant.
Build Design Operate (BDO): The public authority entrusts the private operator for a fixed period of time with design, construction and operation of new facilities which remain the property of the public authority. The private operator assumes the risks linked to design and management of the facility. It is paid a fee by the public authority and commits to an overall cost for the facility's contraction and operation.

[6] Overview of Private Participation in Infrastructure: Trends in Developing Countries in 1990 – 2001, p1.

failed investments and the general change in mood against private involvement half way through the nineties that led to the cancellation, re-negotiation or even re-nationalisation of important projects[6].

II. Rationale for building public sector interest in private sector involvement in infrastructure investments and the provision of public services

Efforts to improve efficiency of public service provision and relieve the budgetary burden of developing countries should lead officials to turn to private involvement in the provision of public services and infrastructure. The case for private involvement is strengthened by the fact that large infrastructure projects and other forms of PPP cannot be financed by ODA alone. From a public policy point of view, the economic and social rationale for private sector participation is the following[7]:

- Partnerships with the private sector for large projects provide some important benefits to the host public sector in terms of efficiency gains in time and money. Moreover, sharing the high upfront cost of such projects with private investors can help relieve the public sector's budgetary burden and free government funds for other pressing demands, such as food provision, health and education.

- Private participation is beneficial in terms of service expansion. The private sector's technical and managerial expertise and better financial discipline enable more resources to be channeled into the expansion of service provision. Case studies of private investment in the water and telecommunication industries in Latin America and Sub Saharan Africa suggest that the entry of private companies has led to a major increase in the coverage of both services, resulting in an unprecedented rise in welfare.

- Private participation enables a more efficient provision of services than that provided by public enterprises due to strong incentives to reduce costs and increase returns on capital.

- The multiplier effect resulting from large infrastructure schemes presents considerable benefits to both the local and national community in terms of short and long term job creation in the construction and service industry. The spillover of technology and innovation are also important contributions to the creation of a skilled labour force.

- In countries with governance and transparency problems, private partnership could help improve the situation in the utilities/infrastructure industry because of the private sector's incentive to reduce costs and eliminate leakages to benefit returns.

[7] World Bank working Papers N.5, Private Participation in Infrastructure in Developing Countries: Trends, Impacts and Policy Lessons, 2003.

- Private partnership can help improve revenue collection in the utilities industry. As mentioned earlier, the private sector's incentive to reduce costs and eliminate leakages to benefit returns, helps reduce distortions arising from fabricated meter readings and billings. Moreover, the use of contract-bonded PPPs, and the high level of budgetary transparency these contracts entail, reduces possibilities for bribing public officials and unproductive expenditures.

Some critics argue that the private provision of public services will raise prices to the point of excluding entire segments of the population. **However, studies find that improved efficiency has led to the expansion of service provision to remote areas as well as substantial gains in welfare. In cases where affordability was an issue, subsidy/cross-subsidy schemes have been enacted to ensure those segments could afford the basic services.**

***PPPs and service provision for the poor: Jakarta Water Concessions*[8]**

In Jakarta in 1996, water service coverage was 41%, non-revenue water stood at 57%, and groundwater was used extensively. In most areas without a network for water provision, the poor would buy their water from tanker drivers. The latter would buy it at $0.04 per m³ and sell it to consumers for $1.50. Vendors would then carry 20L containers of water by handcart to other consumers and increase the price to $5 per m³. With an average water consumption of 20m³, expenditure on water averaged out to $100 per month.

In 1997, PAM Jaya, the public agency responsible for water provision entered in a concession with two subsidiary service providers: Ondeo Services (Suez) and Thames RWE. The contract gave the providers exclusive rights over water provision but also specified a high technical standard, to guarantee the potability of water throughout the concession, and an expansion in service coverage of 75% in year ten and 98% in year 20.

Although the concession agreement did not include specific provisions to service the urban poor, and the cost of connecting them was high due to the required technical standard, the distribution network was extended to low income areas by using flexible connection fees and installment periods. A connection fee payable in 12 installments of $0.71 was charged, leading to an average monthly bill, including connection fees and other fixed charges of $1.50 a month.

The number of poor served in West Jakarta through this operation increased by 143% from February 1998 to December 2000. Consumption increased 12 to 15 times while the monthly water bill was reduced by a third. This case study illustrates how "classic" PPPs that do not pay specific attention to the poor, nevertheless benefit them by reforming services and providing better quality at lower prices

[8] "Beyond Boundaries: Extending Services to the Urban Poor" Asian Development Bank

III. What went wrong so far?

The following points summarise what BIAC members consider to be the key elements that have inhibited the proper implementation of PPPs over the past twenty years. These findings are based on a World Bank/IFC study by F. Sader (2000) concerning the difficulties of attracting foreign direct investment into infrastructure. According to business, the major inhibiting factor remains the inadequacy of existing systems to protect lenders and investors from the risks of investing in developing countries.

- ***Lack of a transparent legal framework at a national level and/or regional level***. Legal uncertainty due to inexistent and partial legal frameworks can impede successful project implementation as the private operator's ability to operate freely and efficiently is denied. This leads to stalled projects, delays in implementation and suboptimal results and ultimately deters future investors.

- ***Lack of an international standard framework for PPP investments and a regionally harmonised framework for PPP in many countries:*** The absence of an overreaching policy framework on investment initiatives in developing countries has led to the development of a multitude of overlapping legislative frameworks, arranged on an *ad hoc* basis and often of questionable credibility. As a result of this situation, investments are unprotected as no existing framework has legitimacy over any other.

- ***Problematic financial feasibility due to poorly-run risk assessments:*** The range of risks that could possibly jeopardise a project's feasibility is amplified when investing in developing countries because of the uncertainty linked to unpredictable political, economic and environmental shocks. In all too many cases, investors refuse to get involved realising the tremendous risk involved and the time and effort needed to get legislation changed during the preparation of a given project.

- ***Lack of ODA use as leverage rather than as an alternative to FDI; lack of project-focused development of financial instruments***: ODA could facilitate FDI by helping developing countries to control and protect the outcomes of FDI investments in their countries. In terms of PPPs, ODA could be used to improve the local skills base to better meet the demands of foreign investors by educating and training civil servants in risk mitigation and efficient project monitoring.

- ***Corruption and lack of transparency:*** The more important the project and the more local and international communities it involves, the easier it is for corrupt practices to go unnoticed. The escalation of such practices can jeopardise the long run financial feasibility of the project.

- ***Lack of cooperation and coordination of work and responsibilities between investors and the local community: Government, civil servants and other civil organisations to facilitate project implementation:*** Informal practices, such as the black market, informal employment, service provision and housing, are core characteristics of developing countries that shape the way things are done in these countries. For a project to be successful in such an environment, the private operator must have a clear understanding of the informal frameworks it will be operating in and how these frameworks will be affected by and possibly affect the implementation of the project. Because informal practices are difficult to document and change, the private operator must cooperate with local entities, that are knowledgeable of, and have contacts within the system to ensure project feasibility. In many cases, these realities have been overlooked and projects have been stalled and even cancelled in the first stages of the concession.

- ***The insufficiency of a predictable judicial system capable of dealing with disputes amongst foreign investors and host country governments.***

IV. How to regain investors' trust

An improvement in the investment environment and investors' trust will only occur through a concerted and coordinated effort on behalf of the public sector, private investors, international financial institutions (IFIs) and banks. There is a clear role for multilateral organisations, institutions and agencies as facilitators in the investment process. Their capacity building action is essential to help establish clear, stable and safe institutional systems that provide security for foreign and local private investments. What investors need most urgently is a set of Guidelines determining the regulatory framework that would enable all the different parties involved in PPP projects to coordinate their efforts in a clear and logical fashion.

BIAC encourages the OECD to develop a set of "OECD Guidelines on the Regulatory Framework for Public Private Partnerships" leaving sufficient flexibility for a case-by-case approach. BIAC volunteers to participate in such an exercise.

a. Constitutional, legislative and institutional framework

Business believes the following themes are essential for the good practice of Public-Private Partnerships and should be addressed in the OECD Guidelines. These Guidelines should be recommended to non-OECD countries receiving private investment and ODA, as a guide to good PPP practice.

- **Basic Principles**

BIAC trusts that transparency, predictability and fairness in legislative frameworks are essential for a successful partnership needing predictability because of the length of the concession and investment size. The host country's legislative framework must state clear and objective laws and administrative procedures to promote confidence in the country's infrastructure development project and avoid arbitrary or improper actions on behalf of the contracting authority. Due to possible conflicting interests between the various entities involved in the project (Government, public services, authority agencies and private partner), the legal framework must also clearly state the rights and obligations of each party taking into account that disputes might bring foreign investors in confrontation with host country governments. Independent and competent judicial and arbitration procedures are a crucial element of an investor friendly policy in cases where conflicts arise. The signing of bilateral investment treaties with investor's home states should be encouraged.

- **National and industry-specific legislation**

When existing, and implemented, legal framework must be reviewed to identify all possible restrictions to the full execution of PPPs. In the Guidelines must figure a law allowing the involvement of foreign private entities in domestic infrastructure programmes, another allowing private ownership of property and certain means of production, and a final one confirming the suitability of the given sector to privately financed projects.

- **Coordination of Preparatory Measures**

A public authority agency should be included in the preliminary assessment of the project's feasibility. The assessment should include an economic and financial analysis of the project's estimated cost and potential returns, as well as an advance budgeting calculation to ensure the public authorities can meet financial commitments extending throughout the entire concession period.

The framework should include an arrangement that guarantees the issuance of all necessary licences and permits required for the project prior to the commencement of the investment. Missing licences or permits can cause serious delays in bringing a project into operation and can have repercussions on its cost, the price paid by users and consequently on returns to the private entity.

- **Conditions for operation**

The extent to which PPPs can help improve welfare in the region is directly related to how efficiently the companies involved in the partnership are allowed to operate, in other words, to what extent they are allowed to operate at a profit-maximising level. The more barriers there are inhibiting companies from operating at efficient levels, the lower or more dissipated the benefits to welfare. Therefore the laws should try to eliminate all factors that could inhibit the concessionaire from collecting tariffs or user fees for the services it provides. The concessionaire should be able to decide on a user fee that allows it to profit maximise and any difference in demand for the service at this price should be take in charge of by the contracting authority.

b. Risk allocation, mitigation and contractual agreements

- **Risk allocation and mitigation**

Risk allocation refers to the determination of which parties should bear the consequences of the occurrence of events identified as project risks. Risk mitigation is the use of preventive methods to minimise the likelihood of such risks occurring. The legislative text should include a clear framework for risk allocation based on the principle that risks should be allocated to the party best able to assess, control and manage them. The main categories of risks that should be addressed in the legal framework are political, construction and operational, commercial, financial, and force majeure.

The contracting authority or public entity should bear the consequences of all political risks as well as those arising from extraneous events such as war and natural disasters and commercial risks. The project company should assume commercial and technical risks related to infrastructure development and operation.

c. Guarantees provided by Government

As part of the strategy to mitigate risk, the OECD Guidelines should address the benefits of various forms of host government support.

- **Public loans and loan guarantees**

As a means of attracting more foreign investors for PPPs, the legislative framework could authorise the host country to extend low interest rate loans as well as guarantees of loans taken by the private entity as a means of lowering financial cost and reassuring lenders by protecting them against default by the project company.

- **Sovereign guarantees**

The legislation should include a guarantee against the breach of obligations assumed both parties under the project agreement. For example, the project agreement must guarantee the right of the private investor to repatriate profits and capital throughout the concession period.

- **Performance guarantees**

The State could provide a protection, either off-take guarantees, supply guarantees or general guarantees depending on the nature of payment, against the possibility of default on behalf of the contracting authority.

- **Political risk guarantees**

The legislation should include guarantees against non-cooperation of other authorities of the host country that could affect the rights of the project company, such as foreign exchange guarantees and guarantees against expropriation/nationalisation of the company.

d. Guarantees provided by International Financial Institutions and Export Credit Agencies

Such institutions play crucial roles in mitigating risk by assisting developing countries in designing institutional reforms for reduction in regulatory risk and by providing further financial backing for PPP projects to minimise the risk of default on sovereign contractual obligations and long-maturity loans. These guarantees are usually backed by counter-guarantees from the host government.

IMF conditionality must be flexible enough to allow a sound PPP project to be set up with a sovereign guarantee.

ANNEX 1

A few more concrete examples of PPPs in "soft" sectors (not infrastructure related)

The distinction between "hard" and "soft" sectors is a vague one. However, the following examples may be seen as taking place in "soft" sectors.

HIV-Aids; several multinational companies operating in Africa (e.g. BMW, Heineken, and many others) have set up comprehensive programs, in close cooperation with local authorities and foreign donors, to fight the spread and the negative effects of HIV-Aids. To some extent such programs are concentrating on their employees and their families, but they also have important spin-off effects to much wider groups within society.

Agriculture; several multinational companies have developed programs for the wider cultivation of organic crops (e.g. coffee) in close cooperation with local organisations of farmers, local authorities and also with NGOs. The business partners' direct interest is the supply of organically cultivated produce to their distribution networks, apart from the positive spin-off effects on the environment, etc.

For example; Unilever has set up a PPP in West Africa to develop the extraction, for the first time on a commercial scale, of edible oils from the seeds of the Allanblackia tree. Partners in the PPP include, among others, the World Conversation Union, the Netherlands Development Organisation and the World Agroforestry Centre. The oils will be used for the manufacture of products such as soap and margarine.

Finance; a large international bank is developing a guarantee fund to finance local financial intermediaries which are extending loans to local coffee growers. The risks of the guarantee fund are shared with a bilateral donor. Other banks are involved in developing systems to set up micro-credit institutions in close collaboration with local partners.

Nutrition; a major food company is to test market a branded salt containing iodine and iron in West Africa in partnership with UNICEF, the global NGO, Micronutrient Initiative, and local salt producers. Iodised salt is a key ingredient to combat iodine deficiency disorders.
The same company is also working with UNICEF and the Kenyan Government on a micronutrient education campaign in schools.

An Intiative of the Dutch Ministry of Development Cooperation

In November 2003 the Dutch ministry of Development Cooperation launched a "call for PPPs for Sustainable Development". This concentrates on the MDGs and the results of the WSSD (Johannesburg 2002) and focuses on the themes Water and Sanitation, Energy, Health, Agriculture, and Biodiversity, preferably in sub-Saharan Africa. Private sector partners have to contribute 50% of private capital to the total budget. No funds will be allocated for large-scale investment in infrastructure. Public money cannot be used to protect partners from normal commercial risks.

The initiative received a massive response, not least because the program is not restricted to Dutch companies. A number of PPPs are now being set up, several of these in agriculture, water and sanitation, and energy. The initiative is a good example of how public-private partnership can be stimulated in a creative way.

ANNEX 2

DaimlerChrysler South Africa / PPP HIV/AIDS Workplace Project 2001-2003

Synopsis

- It is estimated that 6 million South Africans are infected with HIV (13 – 15% prevalence).
- Average HIV prevalence in DaimlerChrysler South Africa (DCSA) in 2001 was 9% (10% East London, 6% Zwartkop, 13% Pinetown).
- HIV/AIDS mortality in DCSA was expected to peak in 2006 without further successful interventions.
- A phased approach to the implementation of the DCSA / PPP HIV/AIDS Workplace Project was adopted consisting of four components:
    - Education, Awareness and Advocacy
    - Integrated Health Care
    - Risk Management
    - Community Involvement
- An appropriate management system, including comprehensive monitoring and evaluation, was established to ensure that the activities of HIV/AIDS Workplace Project are integrated as core business in DCSA.
- The DCSA / PPP HIV/AIDS Workplace Project cost approximately R500.00 per employee per annum spent on prevention, care and support initiatives at all business locations and in immediate communities.
- HIV/AIDS treatment costs (including costs of anti-retroviral drugs) currently average at R17,000.00 per infected employee or family member per annum.
- The DCSA / PPP HIV/AIDS Workplace Project, supported by GTZ, concluded in December 2003 was successful in ensuring:
    - A sound workplace programme management system
    - Services for voluntary HIV/AIDS counselling and testing with good uptake
    - Improved HIV/AIDS, sexually transmitted infection and tuberculosis treatment services
    - Human resources and employee benefit management processes designed to meet the impact of an increasing HIV prevalence
    - A solid information, education, communication and advocacy framework
    - A platform for meaningful community involvement

Key Outcomes

- 75% of employees had an HIV test to determine their HIV status, with 40% using the DCSA on-site HIV Voluntary Counselling and Testing (VCT) services.
- The survival rate of DCSA employees and family members on anti-retroviral treatment is equivalent to the experiences of North America and Europe with a 48-month survival rate of more than 90%.
- No children of DCSA mothers, utilising the prevention of mother to child transmission treatment services offered by the DCSA medical aid scheme, were infected with HIV.
- During the project period the tuberculosis cure rate improved from 40% to 100% amongst patients using the services of on-site DOTS (Directly Observed Treatment – Short Course).

- The incidence of sexually transmitted infections (STI's) decreased by 50% amongst employees utilising the on-site Occupational Health Services (Syndromic Approach to STI Treatment).
- A 56% reduction in HIV/AIDS mortality (deaths from AIDS) was achieved during the project period.

Future Developments

- The DCSA HIV/AIDS Workplace Programme will be extended to a range of small and medium enterprises in the Eastern Cape Province of South Africa.
- A global uniform HIV/AIDS strategy will be implemented in DaimlerChrysler AG (DCAG) locations based on international guidelines and lessons learned in DCSA.

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