PPP

PUBLIC-PRIVATE PARTNERSHIP: TRICK OR OPPORTUNITY?

STUDY MADE FOR THE CEE BANKWATCH NETWORK

CLEAN AIR ACTION GROUP
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Authors:
Erzsébet Beliczay and János Pál,
with contributions of Lázár Pavics and András Lukács

Clean Air Action Group
Pf. 1676, Budapest, HU-1465, Hungary
www.levego.hu

The Clean Air Action Group CAAG is one of the biggest independent environmental NGOs in Hungary with 129 member organisations. It was founded in 1988 for promoting sustainable development within an ecological-social market economy. The scientific activities of CAAG rely on the 8 highly qualified staff members and on the Board of Experts (104 registered experts from different fields). CAAG makes studies, prepares recommendations for decision-makers and produces materials for the media and for public education.
CAAG is a member organization of the European Environmental Bureau (EEB), Climate Action Network Europe (CAN-Europe), European Federation for Transport and Environment (T&E), World Carfree Network and other international organizations. It closely cooperates with a number of other institutions, e.g. CEE Bankwatch Network, Institute for Transportation and Development Policy (New York). It has good working relations with a number of Hungarian social NGOs, too. For further information see www.levego.hu

Abstract

Public-private partnerships (PPPs) are forms of cooperation between the public and private sector to supply the citizens with infrastructure and services which have traditionally been supplied by the public sector. PPPs are spreading all over the world. There is a growing pressure on the authorities to provide high quality services which are fundamental to the citizens' basic needs. PPPs may represent a funding alternative that can make the use of public resources more efficient. However, in many countries the true driving force behind PPPs is not the aim to increase efficiency but the ability to bypass state expenditure controls and to move public investment off the state budget and debts off the government balance sheet.

Proper design and transparent reporting are the key elements for successful PPP projects. The roots of the present failures – where the disadvantages overweigh the public benefits –are the lack of practice, too complicated and unbalanced legislation, improper preparation, and unrealistic assumptions on affordability and income growth. In some cases corruption also might play a role..

Lessons have to be learned to avoid the traps which led in many countries to projects that are neither cost-effective nor efficient and do not help to move the debts off the government balance sheet either.

Contents

Executive summary

In the case of public-private partnerships (PPPs), the private sector supplies infrastructure assets and services that traditionally have been provided by the government. As indicators of globalisation, PPPs are spreading all over the world. PPPs refer to a wide range of human and technical infrastructure projects, like the building and operation of hospitals, schools, prisons, roads, light rail networks, as well as water and sanitation plants.

This study was prepared for CEE Bankwatch Network by the Clean Air Action Group. The aim of the paper was to collect information on PPPs from the world, with special attention to cases in Hungary. As PPP projects have started recently we have to be cautious with any judgement about the PPP impacts and practices generally. Therefore we tried to describe the common characteristics of the PPP projects mostly based on the websites and other information sources of the main actors – private partners, lenders, state and local governments. While being modest with our judgments we quoted the concerns of official boards – typically that of the National Audit Offices (NAOs) – based on investigations and that of the media. There are widely spread rumours also in Hungary about corruption and about the lack of professional behaviour of the public authorities in connection with PPP projects which had never been denied officially. As PPP is a novelty both in the states with long democratic traditions and also in the emerging markets, our main conclusions are that most urgently the civil society should enforce full transparency and proper legislation with responsibilities and personal consequences to avoid further misleading PPP practices.

The state can provide public services through a long-term contract with a private company to fulfil its obligations. There are different models for public/private co-operation: outsourcing, joint venture, concession, financial lease, PPP etc. A good PPP differs from any other form of public/private co-operation on account of the private entity's integrated problem solving (design, building, financing and operation of the project) and also the risk sharing. Private partners should take most of the risk in financing and operating the project.

Those promoting PPPs argue as follows: PPPs can be attractive to both the government and the private sector. For the government, private financing can support increased infrastructure investment without immediately adding to government borrowing and debt, and – in most cases only theoretically – it can be a source of government revenue. At the same time, better management in the private sector, and its capacity to innovate, can lead to increased efficiency; this in turn should translate into a combination of better quality and lower cost services. For the private sector, PPPs present business opportunities in areas from which the private sector has previously been excluded in many cases.

Until recently, the new form, PPP, has mostly been used in the Anglo-Saxon world. It was part of a broader process of privatisation accelerated by the Thatcher government. Privatization originally referred to the transfer of state-owned enterprises to private investors. These activities (commerce, production, services for non-basic needs) have been routinely undertaken by the private sector. It is widely accepted that such enterprises should not have been run by the state in the first place. However, the privatisation of basic services for common goods is not just a simple transfer, but also a shift of public sector activities (but not the responsibilities towards citizens) to the private sector. PPPs fall under this broader category.

The provision of public goods or services through partnerships is based on two different motives. Private firms care about gaining new markets, making money by building public goods and delivering services, while governments are concerned with saving money through private participation. For these reasons, mutually beneficial partnerships between public and private sectors can be the key factor for success. The problem is that at the moment there is a lack of knowledge what determines fruitful partnerships.

It is claimed by both governments and investors that the efforts of the EU Member States and the Accession Countries to reform and upgrade their infrastructures and services have in the past benefited – and could continue to benefit potentially – from the PPP approach. However, PPPs should only be considered if it can be demonstrated that they will achieve additional value as compared to other approaches, if there is an effective implementation structure and if the objectives of all parties can be met within the partnership. Because of the very costly preparation process, PPPs can only be used in cases where the market size is large enough. Macroeconomic stability is also essential for PPPs. At times of fiscal crises, policy responses to these fiscal crises lead to cuts of public expenditure, under-maintenance of infrastructure and under-investment in new infrastructure in many sectors, including social sectors. In spite of greater needs of public services and infrastructure in low-income countries, partnerships are more common in countries with low inflation rates and higher income levels.

Inquiries made by Hungary's National Audit Office (NAO) showed that PPPs enabled the quick realisation of projects but in numerous cases they were neither economical nor even cheep. This may be true everywhere in the premature stages of PPPs. In the embryonic phase, PPPs seem not to be genuine partnerships that efficiently share risks, liabilities and profits. Rather, as new undertakings carried out off budget, they are a means for avoiding conventional contracting undertakings that are subject to standard budgeting processes. This is particularly true when the primary aim of the public authorities for private contribution's is to provide financing and to evade controls of the state expenditure.

Carrying out an activity off budget does not necessarily imply that transparency is impaired. Full transparency may be maintained for off-budget items as well. But when a government wishes to conceal a certain item from the public eye or from international institutions and the business community, it will usually prefer to implement it off budget (Sadka, 2006).

Experts generally agree that transparency is crucial in the case of PPPs. There is nothing inherent in PPPs that leads inevitably to fiscal laxity and imprudence. Civil society has to enforce the transparency of PPPs at both local and national levels in order to prevent laxity (corruption) and to accelerate the learning process. The main task for all participants is to develop into genuine partnerships for a better management of scarce public resources and an efficient sharing and managing of risks. Experts generally agree that transparency is crucial in the case of PPPs. There is nothing inherent in PPPs that leads inevitably to fiscal laxity and imprudence. Civil society has to enforce the transparency of PPPs at both local and national levels in order to prevent laxity (corruption) and to accelerate the learning process.

This paper gives a brief overview of PPPs. Part I discusses some basic features that are common to most PPP projects. Part II is an overview of PPPs from all over the world, while Part III and IV describe Hungarian PPP projects and planned developments, with special attention to motorways in Part IV.

Foreword

Sharing the responsibilities among private actors and the government has existed for a long time in our history. Let’s remember defence, education or public health in the Middle Ages. Recent years have seen a marked increase in public-private cooperation for the development and operation of infrastructures in a wide range of economic activities. Such arrangements were partly driven by limitations of public funds to cover investment needs but also by efforts to increase the quality and efficiency of public services.

The shortage of public funds has common roots in the new EU member states. Demographical trends, the ageing of society are common problems in the old member states as well but the low activity rate and the collapse of the old economy have decreased budget revenues, while from the society, businesses and also from EU institutions a pressing demand emerged for high-standard infrastructure and services.

There are several market mechanisms which are already used also in Hungary for the co-operation of the public and private sector, such as outsourcing, Public-Private Partnership (PPP) and user charging. In this study we will discuss PPP, for outsourcing had started in the middle of the nineties and is practically finished, whereas user charging will mostly just come into practice in the next few years.

What is PPP? There are several definitions for PPP. It is a kind of privatisation, a sophisticated form of joint implementation where the private partner has to tackle almost all, or at least take the bigger share, of the development’s and/or the operation’s risks. On the other hand, the public partner has to pay the costs and the profit arranged in the contract during a period of typically 15 to 30 years (in some cases even much longer).

The efforts of the Accession Countries and the Member States to reform and upgrade infrastructure and services could potentially benefit from the PPP approach. However, PPP should only be considered if it can be demonstrated that it will achieve additional value as compared to other approaches, if there is an efficient implementation structure and if the objectives of all parties can be met within the partnership.

One can find numerous websites and printed materials offering information, training, networking and other services for both public and private entities. All these are eager to attract investors by showing the bright opportunities for co-operation or to give recipes for better contracting. In most cases, the risks and obstacles are thoroughly discussed from the private investors' point of view, and the public side is presented as the main beneficiary. However, we have serious concerns about the lack of practice and skills in managing the transactions (preparation of the contracts and control the process) or about improper legislation on the national and local governmental level. But it is hard work to find facts about the "reverse of the medal", i.e. to get information about big failures or corruption, like the privatisation of the water sector in the developing countries or the motorway projects of the Czech Republic and Hungary. One gets the uneasy feeling that all these sources and web sites (either public or private) are promoted directly or in an indirect hidden manner by the lenders and investors: mostly large corporations and money lenders, which seem to have a strong interest in PPP projects.

There are also other issues which are seldom discussed.

How far should public decision makers – central or local governments – be allowed to decide about bridging the gap between demands and limited public funds? How can it be avoided that growing long-term financial obligations of the public budget bind the hands of future governments and lead to forced measures in the decades to come? Is PPP really the best solution when in fact the "user pays principle" could also be applied (e.g. for road constructions)?

The authors are far from being convinced that accelerating the development of huge technical infrastructures while neglecting investments into "human resources" (R&D, education, cultural items) would be the best policy for CEE countries and specifically for Hungary in order to fulfil the goals of the Lisbon Strategy (competitiveness and employment), not to mention the achievement of a sustainable prosperity.

I. Public-private partnership (PPP) – General overview

Over the last 20 years, in many countries the government's direct role in the economy has been diminishing.
New mechanisms have emerged, including privatisation, joint ventures, franchising and outsourcing. PPPs are distinct from these, as they represent a more sophisticated cooperation between the public and private sector. Nevertheless, PPP is not more and not less than a funding alternative that can make the use of public resources – if used correctly – more efficient.

1.1. PPPs, concessions and operating leases

PPP can be defined as the transfer to the private sector of investment projects that traditionally have been executed or financed by the public sector (see: Guidelines of the European Commission).

Concessions and operating leases are forms of PPP. In addition to (1) private execution and (2) financing of public investment, PPPs have other characteristics as (3) service provision and investment and (4) significant risk transfer from the government to the private sector.

A typical PPP takes the form of a **design-build-finance-operate (DBFO) scheme**.
The government specifies the services it wants the private sector to deliver, and then the private partner designs and builds a dedicated asset for that purpose, finances its construction, and subsequently operates the asset and provides the services deriving from it. This contrasts with traditional public investment where the government contracts with the private sector to build an asset, but the design and financing is provided by the government. In most cases the government operates the asset once it is built. The difference between these two approaches reflects a belief that giving the private sector combined responsibility for designing, building, financing and operating an asset is such source of increased efficiency in the service delivery that justifies PPPs.

PPP schemes and modalities (IMF, 2004)

Schemes	Modalities
Variants of design-build-finance-operate schemes (DBFO): Build-own-operate (BOO) Build-develop-operate (BDO) Design-construct-manage-finance (DCMF)	The private sector designs, builds, owns, develops, operates and manages an asset with no obligation to transfer ownership to the government.
Buy-build-operate (BBO) Lease-develop-operate (LDO)	The private sector buys or leases an existing asset from the government, renovates, modernises, and/or expands it, and then operates the asset, again with no obligation to transfer ownership back to the government.
Build-operate-transfer (BOT) Build-own-operate-transfer (BOOT) Build-rent-own-transfer (BROT) Build-lease-operate-transfer (BLOT) Build-transfer-operate (BTO)	The private sector designs and builds an asset, operates it, and then transfers it to the government when the operating contract ends, or at some other prespecified time. The private partner may subsequently rent or lease the asset from the government.

1.2. Which are the benefits of the PPP mechanism for the public entity?

Example: A local government intends to have a swimming pool.

Steps of a traditional public development (simplified scheme):

1. Preparation of the project.
2. Public procurement for the planning of the swimming pool.
3. Public procurement for the construction.
4. Public procurement for choosing the private operator of the swimming pool (outsourcing, concession) or establishing a public firm for the operation.
5. Controlling the object and the operation.

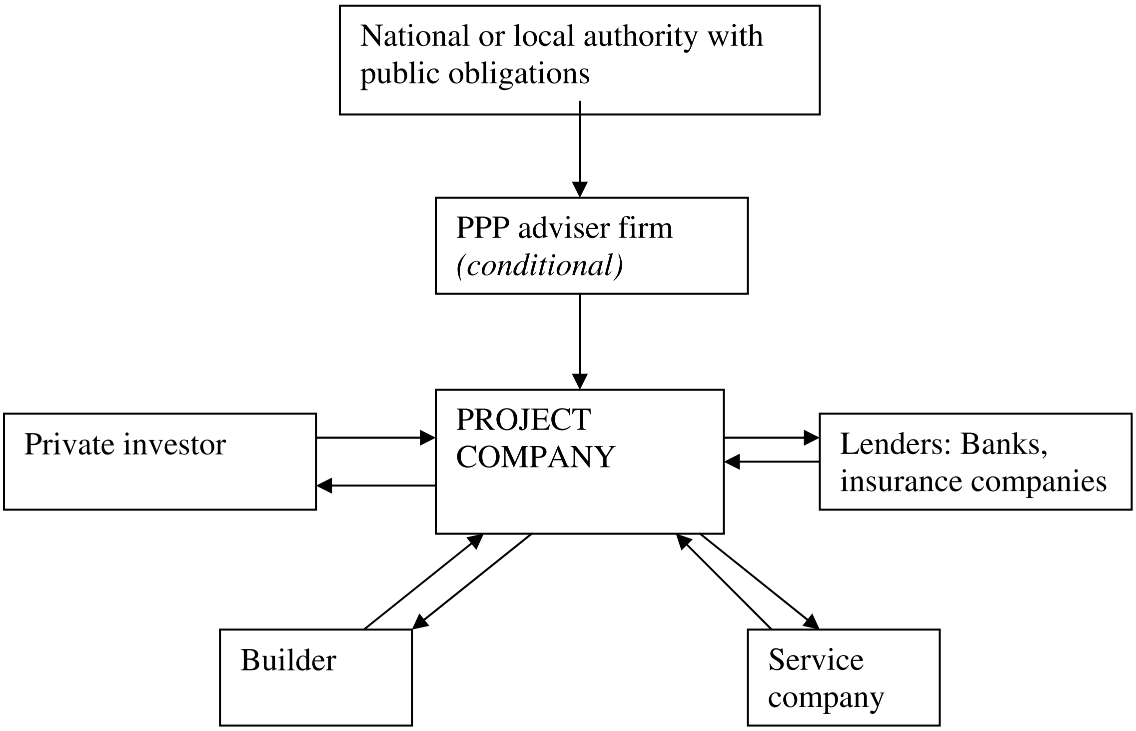
The municipality takes the risks of the design, building and operation of the object, plus it is the debtor, too.

The same project in PPP:

1. Preparation of the project.
2. Contracting with the project company for 15-30 years.
3. Monitoring the project for the whole contracting period.
4. Paying the fees.

In the latter case the preparation is the most costly and time-consuming part of the process. But a carefully selected and correct contract is the heart of a PPP project. (The public sector may have important lessons to learn from private companies, for example in terms of cost efficiency and risk evaluation.)

PPP scheme



Preparation of the project

(before the public procurement procedure)

- An independent advisor or expert-company has to be hired (in most cases) to work together in the project team;
- Identification of the project (assessment of the public demands etc.);
- Public Sector Comparator (PSC) analysis (The costs of an entirely public project has to be compared with an entirely private project);
- Fixing the principles of the risks evaluation;
- Risks sharing between the public and private partner (Each risk has its cost and it should be properly evaluated. The risk bearer should be that partner who can influence the risk to a certain level. E.g. modification of the local legislation is out of the competence of the private partner.);

Public Sector Comparator (PSC)

A correct PSC analysis is a guarantee for the "*value for money*" approach.
PSC is the public cost of the project (building + operating for a certain period counted with Net Present Value method) + the full cost of the risks.

"*Value for money*" principle is satisfied if $\boxed{PSC > PPP}$

The identification of the PSC has to be done at least four times during the project preparation:

- rough calculation in the project identification phase;
- detailed complex calculation for the public procurement procedure (PSC's role is crucial to adequate tender criteria);
- first control calculation based on the tenders;
- a last comparison before signing the main contract.

1.3. Financing

PPP projects can be financed in a very colourful way. Most of the capital (80-90%) comes from the lenders – banks, insurance companies. The private party (in some cases a foreign state) provides the rest (10-20%) of the total financing required. The success of the project does not really depend on the amount of the private party's capital.

Model of the revenues

Demand risk bearer	Public partner pays	User pays
Private partner	shadow toll	real fee
Public partner	disposal fee	free service

Risk sharing

Recommendation for the partners:

Not all the risks should should be taken (or refused) by one or the other of the partners. Risks which cannot be influenced by any of the partners should be shared. All actors participating in the project should take some risks.

Typical risks which can be addressed to any of the partners:

designing, building, technology, operating, availability, demand, new (local) legislation etc.

Risks which can hardly be influenced by any of the partners:

inflation, insurance, earthquake etc.

Environmental risks such as air pollution, damage to the water resources that are often effects from big infrastructure projects are not the topics of this study because these problems can occur by big public or private projects as well. However the liability is still a question: who will pay for the damages caused by the service deliverer? If the private partner had made everything according to the contract the licenses of the authorities and the standards, generally the public authority will be responsible for the damages.

The private sector can raise financing for PPP investment in a variety of ways:

When services are sold to the public community, the private sector can go to the market (**concession**) and collect the fees (e.g. toll revenue).

When the government is the main purchaser of services, **shadow tolls** are paid by the government (payments related to the demand for services), or service payments by the government under operating contracts (based on the continuity of service supply, rather than service demand) can be used.

The government may also make a **direct contribution to the project costs**. This can take the form of equity (where there is profit sharing), loan or subsidy (where social returns exceed private returns).

The government can also **guarantee private sector borrowing**.

As we can see, the preparation of a PPP project is a very costly, time-consuming and complicated process. None of the actors have long-time experiences on PPPs. The hired experts mostly care about the financial aspects and legislature. (Public procurement law is complicated everywhere in the EU; and in many aspects, PPP hardly fits into the legislation.) No wonder that considerations of sustainable development, aesthetics and diversity are often neglected.

As an example of such concerns, see the report about a discussion between the Hungarian Chamber of Architects and some ministries involved in PPP projects. The main concern of the architects was about the aesthetic quality of the projects. According to their opinion instead of the DBO mechanism (designing-building-organising package) the first step should be a call for an architectural competition. Thereafter the private partner has to build the winner's project. Of course this condition will make the project more expensive.

1.4. (Theoretical) definitions and (critical) comments

"Commercial Confidentiality"

One of the ways in which the government can avoid the freedom of information law is to classify public business as private business. To protect private interest information can be withheld from the public if its disclosure would prejudice the commercial interests of any person. Wherever the government has entered into partnership with a private company, it can argue that it would damage the company's interests if it told us what it was doing.

"Efficiency"

Under the private finance initiative (PFI), public works such as roads, bridges, schools and hospitals are built and run by private companies, and then rented back to the government. The government claims that this should be done, because private companies are more efficient than the public sector, PFI schemes cost less.

But efficiency is not an absolute term. A project can be efficient from the point of view of the investor, and at the same time be very expensive for the community and the national economy. The profitable services are done by the private partners while the burdens of growing unemployment, social problems (affordability), environmental risks, loss of diversity etc. or simply the torment of an ugly landscape are externalised – pushed to the society. (One of the key efforts of ecological economies is to internalize the external costs.) The private partner mostly has to take care of economic considerations, while the public sector remains responsible for the quality, continuity, affordability, accessibility and security of the whole range of services.

"Value for money"

The private finance initiative is supposed to allow the government to commission public services that otherwise it would not be able to afford. Private companies put up the money, build the new prisons or hospitals or underground trains we need, and run them for the next

25 or 30 years. The government pays them the rent and service charges. By this means, the Treasury claims, new money is poured into public services. As the private sector is more efficient than the public sector, they can run our public services more cheaply than the state could. (That is the principle called “value for money”.)

Advantages of the Private Finance Initiative (PFI):

- more value will be created per investment unit;
- new and effective technologies are introduced;
- the financing load of the state is elongated.

That is the theory. The practice, as innumerable studies have shown, is rather different. Instead of being led by public need, many private finance initiative projects have been designed to generate as much private profit as possible. In some cases cheap schemes, such as the renovation of a hospital, have been rejected because they are insufficiently profitable, and replaced with more lavish projects, such as demolition and rebuilding. (Monbiot, November 2004)

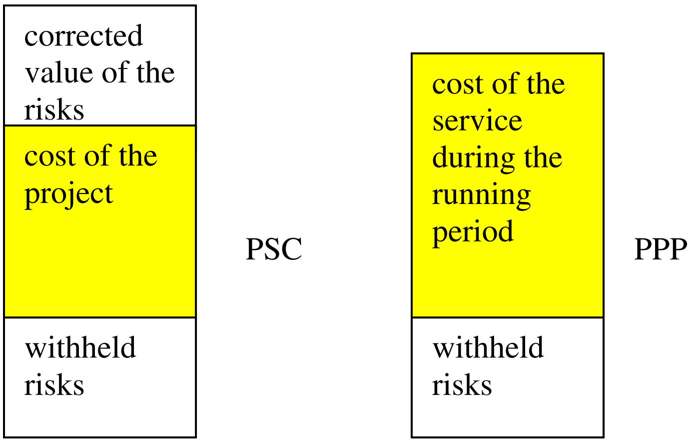
It is claimed by both governments and investors that the efforts of the EU Member States and the Accession Countries to reform and upgrade their infrastructures and services have in the past benefited – and could continue to benefit potentially – from the PPP approach.

However, PPPs should only be considered if it can be demonstrated that they will achieve additional value as compared to other approaches, if there is an effective implementation structure and if the objectives of all parties can be met within the partnership.

Inquiries made by Hungary's National Audit Office (NAO) have showed that PPPs enabled the quick realisation of projects, but they were neither cost-effective nor economical. (Báger, 2006)

A good PPP project should cost less than a traditional public development.

Comparison of Public Sector Comparator and Public-Private Partnership calculation



"Risk transfer"

Risks on the private partner's side:

- high design and preparation costs;
- longer preparation and implementation period;
- interest and currency risks because of the long running period.

Risk on the public partner's side:

- demand risk linked to less consumers than predicted
- project failure, bankruptcy

Much of the cost the companies are presumed to carry takes the form of something called "risk transfer". In principle, if traffic growth is lower than forecast, they risk losing money. ***But the risk has been massively over-estimated.*** *Even when traffic has fallen short of the companies' estimates, they have made a thumping profit. And, of course, this risk does not exist when the public sector builds a road: the government does not lose money if the volume of traffic is low. This cost, in other words, has been invented to make the private finance initiative work (Monbiot, December 2004).*

Refinancing

Refinancing means that bank loans can be renegotiated during the running period. Its background is that the risks of the project decrease after the construction is finished and the object has been operated for some time. This means that the cost of the loan can become cheaper. **The benefits of it should be shared by both the public and private partners.** It has to be put down in the general contract how the benefits of refinancing will be shared.

An example for improper contracting: The companies which built the Norfolk and Norwich University Hospital were able to extract tens of millions of pounds from the scheme through a technique called "refinancing", before the hospital had even opened (26).

Public procurement criteria

Under the procurement criteria of the European Union, EU Member States, international banks etc., international competition has to be opened in accordance with the principles of transparency, profitability, non-discrimination, common market rules etc.
All experts agree that it is mostly large corporations and international firms that can participate in the competition. They possess the skills and financial assets necessary for the tenders, as well as the stable financial background to prefinance their contributions. **Local SMEs have no chance, even if the project itself is not very large.** (Public procurement procedure is needed to choose the contributor for projects above 211,000 Euros, or 48 times the monthly sum paid by the public party for the service, according to the EU legislation.) Local authorities do not have the freedom of choice against the rigid rules of the Community legislation. Representatives of the public interest claim that a balanced approach is lacking with respect to PPPs: both the public and the private interests should be given their proper weight. The Green Paper and the PPP Guide developed by the EC rather focus on the perspective of private companies, while the challenges of public authorities do not appear to have been sufficiently taken into account.

Control and monitoring

In a PPP project, the role of the authority involved moves from delivering the service to controlling the legal, economic and technical aspects. Accepting this change of role and implementing new tools is crucial for the success of every PPP. Authorities need to ensure that private partners not only benefit from profits but also assume responsibility for any losses incurred.

Eurocities[*] Statement on PPPs and Concessions
Response to the EC Green Paper on PPPs and Community Law on Public Contracts and Concessions, 14 September 2004
(Fragments from the Statement)

Local governments are responsible for delivering a wide range of services of general interest. They are expected to guarantee that high quality services of general interest are accessible to all and are provided at a reasonable price.
Cities demand fair conditions for all market participants. Cities promote competition and economic development in the interest of citizens.

The issues of great importance to local authorities are: respect for the principle of subsidiarity; freedom of choice of local authorities as to the form of provision of services; the need for greater legal certainty… and the promotion of social, economic and territorial cohesion and sustainable development.
Political and financial aspects and the legal framework are important for the local authorities when considering the choice of a PPP or concession as a means to finance service or infrastructure.

POLITICAL ASPECTS
EUROCITIES is committed to reinforcing the rights and the responsibilities of local public authorities across the enlarged EU. A decentralised and democratic decision-making system can provide the necessary flexibility, responding to local circumstances and to the demands of citizens.

FINANCIAL ASPECTS
PPPs can offer positive economic effects for the whole society. By reducing the spending temporarily and postponing the payment of costs, however, **public authorities risk encountering unforeseen and additional costs which will limit their choices for future investments**.
Local authorities must calculate what the cost for the citizens will be in the end, whether they pay it through taxes, other redistribution schemes or through direct fees.

LEGAL FRAMEWORK
EUROCITIES does not consider any additional Community legislation on concessions, or the extension of current public procurement rules on service concessions, as desirable.
Initiatives that aim at simplifying and clarifying the use of existing legislation, as a way of reducing legal uncertainty, are supported.
Services provided “in-house” must remain exempt from Community legislation on public contracts and concessions.

1.5. Some general requirements for successful PPP projects

The NAO (National Audit Office) of the UK has prepared 47 reports about PPP until 2006. It is a forerunner in information exchange and the use of foreign experience. In their database there are more than 200 recommendations based on the control of projects, and most of these recommendations are useful for other Member State’s projects as well.

[*] EUROCITIES is an association of 120 EU cities representing 100 million inhabitants. As an interest group of local municipalities they are emphasising the importance of the subsidiarity and self governance versus free flow of goods and services throughout the EU.

1) The partners should be aware of the fact that the preparation of the contract is very costly and time-consuming. A PPP is an opportunity for larger projects or for a certain number of similar projects (e.g. swimming pools, gyms).
2) During project preparation and evaluation, the need for short-term money saving and long-term efficiency should be set in harmony. Both partners should have common interest in the project fulfilment.
3) Monitoring and flexible reaction in case of changes plus continuous evaluation are a must for the public partners. The consequences of changes in the government's development policy have to be followed with great attention. According to NAO (UK), 55 % of the contracts have been affected by such changes.
4) Cost-effectiveness is also a priority. Public procurement experts and advisors have to be educated (supplied with information) all the time. Framework financing should be preferred more often.
5) True strategic partnerships and alliances have to be formed for the long run. (Good examples can be found in the health and education sector.)
6) During the preparation, alternatives – especially different financial mechanisms – have to be worked out so as to be able to find the optimal solution for the partners.
7) For the project team involved in the preparation of the projects and contracts, high-level education and information exchange are to be provided on a continuous basis.

II. Overview of PPP practices in the world

The state can provide public services through a long term contract with a private company to fulfil its obligations. There are different models for public/private co-operation. A good PPP differs from any other form of public/private co-operation on account of the private entity's integrated problem solving (design, building, financing and operation of the project) and also the risk sharing. Private partners should take most of the risk in financing and operating the project.

The arguments of those promoting PPPs are as follows: PPPs can be attractive to both the government and the private sector. For the government, private financing can support increased infrastructure investment without immediately adding to government borrowing and debt, and – mostly theoretically – can be a source of government revenue. At the same time, better management in the private sector, and its capacity to innovate, can lead to increased efficiency; this in turn should translate into a combination of better quality and lower cost services. For the private sector, PPPs present business opportunities in areas from which it was in many cases previously excluded (IMF FAD, 2004).

Those who are more critical of PPPs say that the initiators of PPP practices are mostly the investors looking for new safe investment opportunities. Many share the opinion that the quality of management does not depend on the ownership of an asset. Public or private entities can both operate well.

Privatization went furthest where competition was both feasible and desirable. Extensive privatization went on in the trading sector, by SMEs and large public enterprises, in some countries also in the key areas of infrastructure – electricity, gas, water utilities, and telecommunication. (This happened in some OECD countries and in Latin America. The unpopularity of privatisation in Latin America has been due to the fact that in several instances public monopolies were transformed into poorly regulated private monopolies.)
As an indicator of globalisation, PPP practices have been spreading all over the world in the last few years. **There is a trend to transform the social character of public services into a business subject to "market rules".** Beginning in the early 1990s, countries worldwide began to embrace private sector management and investment models believed as the primary paradigm for economic growth, investment and poverty alleviation. But in some CEE countries the true driving force behind PPPs may be not the aim to increase efficiency but the ability to **bypass expenditure controls and to move public investment off budget and debt off the government balance sheet.**

In particular, governments were keen to attract long-term private investment, private sector management practices and technology into a variety of sectors. While banks, investors – both branch and financial – were eager to put their money into safe long term investments with limited risks where the pay back guarantee came from the government itself. (The public partner took the risk of demand – through long term fees for the service.)

After a modest start PPPs are now flourishing all over in the world. However it is too early to draw general lessons from the experiences of these "fledging" projects.

2.1. PPP outside the EU

Until recently, the new form, PPP, has mostly been used in the Anglo-Saxon world.
In Mexico, PPPs were first used in the 1980s to finance highways and, since the mid-1990s in the energy sector. Chile has a well-established PPP program mainly used for the development of transportation, airports, prisons, and irrigation. There is strong interest for PPPs in Korea, Singapore and South Africa. There are also fledging PPP programs in Japan.
In India, transport minister Lalu Prased has recently announced that he intends to extend railways in a PPP model.
In Brazil, long-term integrated development plans form the background of the PPP projects, the main fields being rail transport, motorway building, education and regional development for strengthening international relations.
The government in Canada, Alberta has decided to implement PPP projects in the health sector.
The State of Missouri has started a USD 450 million higher education PPP project in 2006.
The Central Park in New York is also being operated as a PPP project.

Learning about PPP techniques

US companies are eager to invest their money and strengthen their influence all over the world. The Institute for Public-Private Partnerships, Inc. (IP3), established in 1994 in Washington D.C., provides global training and consulting services to governments and industries in the growing international marketplace of public-private partnership (PPP) modelling, regulation design and implementation, as well as competitive utility management. IP3's pioneering consulting and training services in PPP, infrastructure regulation and competitive utility management have resulted in ground-breaking policy and legislative reforms in dozens of countries, the completion of scores of projects/transactions and the training of thousands of government, regulatory, utility and private sector stakeholders worldwide.

New approach for financing US highways

Highway building in the US goes on as a never ending story. As a superpower possessing a flourishing economy, strong budget and plenty of land, they believe that they can afford the continuation of extensive transport development. (It seems that concerns about climate change do cause sleepless nights only for a few.) The majority of the population and most politicians share the opinion of FHWA (Federal Highway Administration) Acting Administrator Rick Capka: "…As we all know, transportation moves America and congestion can put our economy in the slow lane. …We need a new approach to keep goods and products on the move – new approaches to facilitate trade with our North American and worldwide partners." (12) However, strains are growing on traditional highway finance mechanisms. Relying primarily on the fuel tax is not the best long-term approach. Leveraging infrastructure investment through innovative financing will help tackle the most serious problem in surface transportation: congestion. Through innovative programs the states have more flexibility. Congestion pricing, tolling and other innovative forms of financing have the potential to ensure better returns on transport investments.

2.2. Water services and waste water management

Most of the experts on eco-villages and sustainable urban planning agree that key issues for the future are decentralisation, participatory setting, system design, small-scale technology, affordability on low density rural areas.

However urgent decentralised approaches in both technology and responsibility are, the present trends follow a completely different direction: the World Bank, the IMF, the WTO and related organisations, the national governments, with the US and EU at the frontline, and a few big global players are all pushing hard towards transforming water into a business subject to market rules. The four biggest corporates in this game are Suez, Vivendi, Bechtel and RWE. Bechtel is backed by the US government and right now cutting out its share of the Iraqi market. Vivendi, besides being one of the two uncontested leaders of the water market, is also among the five biggest media corporates. Vivendi and Suez are backed by the French government.

Whatever it is called: PPP, cost recovery, efficiency increase, free market, these processes end with the selling out of water resources instead of a better management. The multinationals are aiming at centralised control of huge schemes and, above all, high rates of investment return.

With WTO and the EU common market rules[1] they will have the tools to effectively oppose national environmental or social regulation.

Privatisation records are very bad until now. Resulting effects comprise:

- Problems with supply security, both in quantity and quality
- Less transparent management
- Degradation of water infrastructure
- Encouragement of high consumption instead of sustainable management
- Disadvantages for the poorer
- Environmental damages
- Stress on water resources (exhausting of water resources)

Public operation versus privatisation in the water sector

In some cases, the privatisation of global water services means billion-dollar profits for corporations, with pollution, disconnection and soaring prices for consumers. The case of the French multinational firm Suez clearly shows the power of corporations (see the case below) Many governments can be tricked not only in the third world but even among industrialized countries. It seems at the moment that no government (not even the most professional ones) can stop their ruthless tricks.

The case of water service privatisation in Georgia, US (www.theecologist.org)

In May 2002, State of Georgia's environmental protection agency issued an alert to North Buckhead residents: their tap water, the agency warned, wasn't safe to drink unless it was boiled first. A month later, another boil-water alert came. Only a couple of years earlier, United Water, a subsidiary of the giant French conglomerate Suez, had taken over the municipal system and promised to turn it into an 'international showcase' for public-private partnerships. But instead of ushering in a new era of trouble-free drinking water, Atlanta's experiment with water privatisation brought an avalanche of problems – from violations of federal drinking-water standards to major water-mains leaks that went unrepaired for

[1] *About the Janus-face of big European corporations*
In almost 400 cases the European Commission starts juridical steps against those who are reluctant to open their energy market and/or trying to hinder the international sell out of their enterprises because of national considerations. According to the Financial Times the EC called upon several big energy corporations to stop their monopolistic practice. The EC named first of all France, Italy and Spain, firms like EdF, Gaz de France and Gas Natural. Big telecommunication corporations have also been strongly criticised by the EC. – Heti Világgazdaság, HVG (Weekly World Economy) News, Hungary, 05/04/2006

weeks. (United Water, meanwhile, was insisting that the city pay it millions of dollars more for its services than had originally been agreed.) By January 2003, after a month's long investigation and threats by the mayor to cancel the contract, United had 'voluntarily' withdrawn from what had become more of an international debacle than a showcase. The debacle in Atlanta might have been a relatively trivial incident if Suez (and a handful of other private water utilities that competed for the contract) hadn't seen the city as a beachhead in their attempts to turn water delivery into a hugely profitable business in both rich northern and poor southern economies.

From Bolivia to Ghana and the Philippines, from the UK to the US and Canada, a rapidly consolidating for-profit water industry has been attempting to capture a household drinking water 'market' that, until recently, had been viewed in most parts of the world not as a cash cow for private corporations but as a public service. Multinational companies now run water systems for 7 per cent of the world's population, and analysts say that this figure could grow to 17 per cent by 2015. Private water management is estimated to be a $200 billion business.

Water management projects could be worth $1 trillion by 2021 (16). Without properly taking into account the gap between trained multinational corporations and the amateurism of poor countries, the World Bank has encouraged governments to sell off their utilities to reduce public debt. It is utmost disturbing that influential and supposedly honourable banks like EIB and WB are involved in such questionable businesses. They are posing before the public as entities with much experience, professional knowledge and responsibility, but their participation appears to be no guarantee for the success of the project.

There are extensive discussions about the privatisation techniques of public services and about concessions. It is most unlikely that those techniques should be similar to the techniques of the competitive sector.

Water supply and waste water facilities seem to be well suited to PPP techniques. PPP offers similar advantages as privatisation; however, **PPP is said to offer more guarantee for proper operation than "traditional" privatisation.** The higher risks associated with operating increasingly complex treatment processes, as well as other considerations influencing the arrangements (including regulatory and operational requirements, application of user charges, risk allocation, etc.) raise doubts about the premature use of public-private co-operation techniques in the public service sector. Social issues and affordability seem to be intentionally neglected in the preparatory phase of the negotiations. Swelling urban population and migration from rural areas caused by the lack of jobs and basic safety (wars, mosquitoes, etc.) greatly challenges the public sector's responsibility. Poverty-stricken population and budget deficits on one side and for-profit companies on the other side make the idea of co-operation an illusion.

María Amparo Lasso: Suez Packs Its Bags and Won't Be Back
Mexico City, 27th March 2006 (Tierramérica) – Extracts from the article:

The French water company Suez, the favourite villain of anti-privatisation activists, has entered the final stretch of its withdrawal from Argentina and Bolivia, where it has been packing for quite a while. And it could be a long time before it returns to Latin America. The Néstor Kirchner government in Argentina rescinded on 21st March 2006 its 30-year contract with Aguas Argentinas, a subsidiary of Suez, accused of “repeated non-compliance". The measure escalated tensions in the tortured negotiations between the Argentine authorities and the company, which have already lasted three years and have clouded diplomatic relations with France. … Suez is an energy and gas giant, with profits reaching three billion dollars in 2005, 48 percent more than in 2004, and is also one of the most powerful water companies in the world, through its Suez Environnement division. For many years now, the division has been downsizing in Latin America, while staking its bets on water concessions in less risky markets in Asia and Europe.

Suez says its water concessions in Argentina and Bolivia failed due to financial and political risks that prevented it from obtaining profits in a sector with low rates of return on investment (around five percent).

"In Argentina there was a big macroeconomic shock and the devaluation of the peso that caused the tensions on the application of some of the contractual clauses; and in Bolivia, because of political reasons, it was very difficult for the government to increase the (rates)," Jacques Labre, director of institutional relations for Suez, and participant in the 4th World Water Forum, held between 16th and 22nd March 2006 in Mexico City, said in a Tierramérica interview.

Amidst the loud hostility towards multinational water companies, private investment in this sector has been in the decline in Latin America over the past decade.

According to Labre, this trend is due to the huge investments needed in infrastructure in Latin America, which cause a big impact on rates increase, while public subsidies are not guaranteed, especially in countries where there are big tensions on the budget.

But the Bolivian authorities accuse Suez of pursuing only profits and leaving some 350,000 families without access to water. In Argentina, meanwhile, its services were described as "terrible", and there are reports that around 300,000 people are at risk due to water contaminated with nitrates.

… President Evo Morales (Bolivia) is looking towards another partner: the World Bank, an institution he described in the past as "terrorist". Minister Mamani met with Jamal Saghir, the Bank's director for energy and water, during the World Water Forum in Mexico, to explore agreements.

"In Bolivia, we would like to go to the public sector. I welcome them. But my first question is: Who can deliver efficient services to the poor at the lower cost? If you can demonstrate to me that the public sector can do it, I will finance it," Saghir told Tierramérica.

The World Bank believed in the 1990s that partnerships with the private sector were the best way to provide clean water to the poor, and invested in many companies, including Aguas del Illimani in Bolivia.

After the unfruitful search for private partners for a new concession in Argentina, Kirchner announced the creation of a state-owned company, Aguas y Saneamiento Argentinos, to replace Suez.

Public scrutiny of Kirchner and Morales's experiments in the water and sanitation sector will be intense. The challenge is not a small one: they will have to deliver water at low cost to the poor – a task they say the French multinational failed.

How many unsuccessful PPP and privatisation contracts will need to be withdrawn before gaining public benefit from the co-operation? Can mislaid projects ever be avoided in the corruption-ridden countries of the third world?

Water concession projects in Argentina (financed by EIB) were withdrawn, and the French multinational company Suez had to leave. The government has just re-nationalised the water service (Lasso, 2004).

An instructive example for public operation without privatisation

By 1993 Bogotá's public sewer and water company, Empresa de Acueducto y Alcantarillado de Bogotá (EAAB), was practically bankrupt. Staffed with political cronies who often changed with each new government, it didn't have the professional management needed to run a large utility. So, in the early 1990s, the World Bank began recommending privatisation as the solution to bad public management. What happened next rattled the foundations of World Bank policy and challenged the privatisation mantra that only big multinationals have the expertise and capital to deliver clean drinking water efficiently and at affordable prices. Convinced that water is a public resource, the city of Bogotá bucked the privatisation trend, turned its back on the World Bank's money and transformed the city's water service into the most successful in Colombia. (Ecologist, 01/03/2004: *Going it alone* by Maria Theresa Ronderos)

Public operation versus privatisation in the water sector – Water supply in the EU

According to a study of the Austrian Chamber of Economy, one third of all European households are supplied by private companies (*nol.online 21/03/2006*). But the prices and quality are the best in the Scandinavian and Central European countries where services are mostly performed by public companies.

The private water sector has a share between 79 and 87 per cent in France and in the UK. In Southern Europe, in Greece, Italy, Portugal and Spain this ratio is 33 %, while in the new EU member states it is 17 %. Among the new member states Hungary and the Czech Republic have the highest share of private companies.

According to the study titled „Privatisation of the European Water Supply", water infrastructures are of a very high quality in the above-mentioned countries and in Switzerland Germany, Austria and the Netherlands, where the portion of private ownership is between 7 and 11 per cent.

The new EU Directive on Services could accelerate the privatisation of the water sector. Once the planned Directive is introduced, large water service companies will play a major role on the European level. (*In October 2006 still under preparation.*) **The Austrian Chamber of Economy demands that water supply services should be excluded from the scope of the Directive on Services.**

Austrians say that there are limited water resources and objective technical obstacles; therefore, also the number of licenses which may be issued has its limits. The Directive will make it compulsory for settlements to announce tenders for private firms in water supply and sewage treatment. At the moment, the settlements in Austria have the right to decide between private and public services. Public services are practically exclusively in public hands, while the quality of the service is on the top of the EU level.

2.3. PPP in the EU

The EU is strongly supporting the inclusion of private funding for public infrastructure and the use of the PPP mechanism as well.

Until recently, the new form, PPP, has mostly been used in the Anglo-Saxon world. Perhaps the most advanced program is the United Kingdom's Private Finance Initiative (PFI), which began in 1992. The PFI is currently responsible for about 14 percent of public investment in the UK with projects in the most key infrastructure areas.
Many EU countries now have PPP projects, although their share in total public investment is modest. 30 percent of the services provided by larger EU subnational governments (regional authorities) are delivered through PPPs (IMF FAD, 2004).

Reflecting a need for infrastructure investment on a large scale and weak fiscal positions, a number of CEE countries have embarked on PPPs. PPPs in most of these countries are dominated by road projects. The EU's European Growth Initiative (2003) envisages the use of PPP-type arrangements primarily to develop a trans-European road network.

Anglo-Saxon and continental PPP model
There are some slight differences between the Anglo-Saxon and the French (continental) PPP model. The Anglo-Saxon model is characterized by very detailed contracts and by monitoring institutions founded for controlling the project. In the continental model, local governments or their consortia and private enterprises are co-operating, while the state controls them and provides the legislation. This model is flexible, less determined.

In Germany, PPP is spreading among the regions and local municipalities. According to the Ministry for Transport, Building and Home, EUR 7 billion has been spent on the PPP mechanism in general. There are more than 300 projects under preparation; 80% of them are for public service projects. PPP projects are by 10 per cent more efficient than traditional public development.

The main reasons for the **PPP boom in the old member states are not so much the budgetary considerations, but rather the profitability, the efficiency (value for money) and the quick implementation**. In the UK there are already more than 600 projects finished but only 40% of them are qualified as off budget investments. In Germany a new law (ÖPP Beschleunigungsgesetz, February 2006) contributes to accelerating the process.

Lessons from the UK

In the UK, where the concept of PPPs is the most developed, investment through PPPs has amounted 15 to 25 per cent of total public outlays since 1995. Under the Private Finance Initiative (PFI – privately financed public project), public works such as roads, bridges, schools and hospitals are built and run by private companies, then rented back to the government.

The PFI is supposed to allow the government to commission public services it wouldn't otherwise be able to afford. That's the theory. The practice, as studies have shown, is rather different. Instead of being led by public need, many private finance initiative projects have been designed to generate as much private profit as possible. And because, for any company, profits must come before people, many of these projects offer far worse services than their publicly funded equivalents.

A scandal of secrecy and profligacy
The Skye bridge contract allowed private firms to fleece the taxpayer
George Monbiot, December 28, 2004 The Guardian
http://www.guardian.co.uk/comment/story/0,,1380095,00.html/

…On the day the bridge was opened (16th October, 1995), the government stopped the ferry service it ran between Skye and the mainland, thus granting the consortium that built the bridge a monopoly; there was no other means of getting on and off the island. The consortium was able to charge the islanders what are believed to be the highest tolls per mile of road in the world.

After massive public pressure, the Labour government gave the residents a discount, but only if they bought tickets in books of 20. The discount for books of 20 tickets was financed by the government, not the consortium.

The EIB lent a further £13m to help finance the bridge. This loan breached the bank's own investment criteria. The bank's purpose is to fund projects that boost the livelihoods of people in the less developed parts of Europe. It is legally bound to lend money only when "funds are not available from other sources on reasonable terms" and to support only those schemes that do not "distort competition". The tolls have damaged people's livelihoods by discouraging tourists. Private investors, who know a good thing when they see it, were falling over themselves to buy a stake in the project. The closure of the ferry service on the day the bridge opened did not distort competition: it eliminated it.

In some cases cheap schemes, such as the renovation of a hospital, have been rejected because they are insufficiently profitable, and replaced with more lavish projects, such as demolition and rebuilding. The Walsgrave Hospital in Coventry, for example, which was to have been refurbished at a cost of £30m, was instead knocked down and rebuilt at a cost of £330m, solely in order to make the project attractive to private companies. In other cases the contracts have been so generous that the companies have been able to extract staggering rates of return. The consortium which built Altcourse prison in Liverpool broke even two-and-a-half years into the 25-year contract: it is now enjoying 22 years of pure profit. The companies which built the Norfolk and Norwich University Hospital were able to extract tens of millions of pounds from the scheme through a technique called “refinancing”, before the hospital had even opened.

On those rare occasions when ministers condescend to answer their critics, they extract from this mess the handful of projects which appear to offer value for money. The sector they like to talk about most is highways. In 1998 the National Audit Office reported that the first four privately financed roads commissioned and built in the United Kingdom would save the taxpayer around £100 million.

But now London is going to revise PPPs (Világgazdaság, 2006). British people are especially disappointed with PPP in the healthcare sector. The expenditures of the British public health system have nearly doubled in seven years: in 1999 they amounted to GBP 40 billion, while the budget for 2006 is nearly 76 billion. A major part of this sum comes from the large hospital rehabilitations carried out in PPP model, while as a result of these transactions the institutes are managed by private boards. The PPP model was agreed by the conservative government in 1996. Since that time the private sector has operated 38 hospitals, and further 42 projects are planned in the value of GBP 12 billion.

The contracts for building and operating the hospitals are lasting for 25-40 years. During this time the hospital has to amortize the debt, while the ministry pays only for the patients therapy. According to the Le Monde of Paris, this way the hospitals have been practically privatized. Twelve thousand beds were cancelled in the last 8 years and many institutes could not be reconstructed. Cost/benefit analyses are still lacking in the case of new PPP projects.

DG REGIO – Resource Book

The European Commission’s Directorate-General for Regional Policy has undertaken a wide consultation process within the European Commission, involving the EIB, EBRD, PPP units and task forces of the Member States and Candidate Countries for the last several years. The result can be found in "Guidelines for Successful Public-Private Partnerships" published in March 2003.

As a natural follow-up and in an effort to address the knowledge gap in a practical way, DG REGIO produced (in June 2004), with the effective collaboration of the partners mentioned above, a repertory of PPP case studies across countries and across sectors, called “Resource Book”. The Resource Book was presented at the Workshop titled “Building a valuable approach to PPPs”, which took place on 5th July 2004.
The Resource Book consists of a set of case studies of PPPs in both Western and Central Europe in various sectors including water, solid waste and transport. These sectors are representative of those in which the Commission provided grant financing.
The Guidelines are conceived as a tool for assisting public sector decision-makers in evaluating the opportunity of matching public grants with private funds and funds from International Financial Institutions (IFIs) such as EIB or EBRD.

Questions about PPP and remarks about the Resource book as well as on the Guide can be sent to the mailbox with this address: regio-ppp@cec.eu.int

EIB involvement

The European Investment Bank, the European Union's long-term lending institution, finances capital investment furthering EU integration, in particular: regional development; research, development and innovation; trans-European transport, telecom and energy networks; industrial competitiveness; SMEs, and environmental protection. It also operates outside the EU within the framework of the EU's policy for co-operation and development. Owned by its Member States, the EIB raises its funds on the capital markets (AAA-rated issuer). In 2005, it borrowed EUR 50 billion and lent a total of EUR 47bn, of which EUR 42bn in the EU-25.
The EIB devotes 1/3 of its individual loans within the EU to environmental projects, which over the past 5 years, has amounted to EUR 49 billion.

By the end of 2003, loans had been signed by the Bank for PPP operations to the value of nearly EUR 15 billion. (Thomson et al., 2005)

The EIB's PPP exposure may be traced back to the loans in 1987 for Eurotunnel (France/UK), for the Orlyval project (France) in 1989 and for the Second Severn Crossing project (UK) in 1992. As the Report claims: "These projects offered the Bank the opportunity to learn a number of valuable lessons."(Resource Book, DG Regio, 2004) Project-finance lending techniques were being developed through the Bank's involvement with private-sector project finance deals in power industry in the UK and elsewhere.
Substantial growth began with loans to projects under the UK Private Finance Initiative. It has developed rapidly since 1997, and similar schemes have been adopted in many EU Member States. The Bank is now lending to PPP projects in Belgium, Denmark, Germany, Spain, France, Greece, Ireland, Italy, Netherlands, Austria, Hungary, Poland and Portugal, as well as in non-member states like China or South Africa.

The EIB has become the biggest source of international finance for projects in the countries that have joined the European Union on 1st May 2004 and in the Balkan region. Nearly half of the amount lent so far went to transport projects, including roads and railway schemes in each country. Industrial, environmental and telecommunications projects absorbed around fifteen percent each, while some 10 % was lent to energy, health and education projects. Part of these projects were realised as PPPs.

In Northern Irland, for example, EIB will provide funding alongside RBC Capital Markets and ING to the private sector partner, Dalriada Water Ltd, a special purpose company. Dalriada is owned by Kelda Water Services Ltd, a subsidiary of Kelda Group and Earth Tech. It will design, build, finance and operate four upgraded Water Treatment Works, under a 25-year contract granted by the Department for Regional Development Water Service. This is the second PPP project supported by the EIB in Northern Ireland, following the upgrade of the Westlink motorway in February 2006.

New EU member states

In the Czech Republic, Poland, Latvia and Hungary, PPPs are supported by state coordination institutions.

The forced development of technical infrastructure in the new EU member states is a great opportunity for international construction and service companies. In the EU8 countries, state investments amounted to 3% of the GDP in 2003 (Latvia being an exception with its rate of

1.5%). In 2006, this portion can grow to 3.5%, while in the EU15 state investments make up 2% of the GDP. In 2001, investments in the transport sector of the EU8 were estimated at EUR 10 billion, and environmental protection investments were estimated at EUR 47 to 49 billion.

No doubt, the PPP model offers the state free amounts of money for other developments – but only in the short run.

CEE countries and the Maastricht Criteria

PPP encourages spending to serve short-term political interests in the new Member States. The watering down of the fiscal policy has similar roots in the Visegrad Four countries:

- additional tasks of the accession (common regulation, compliance, etc.),
- slow-down of the reform of large distribution systems in the ageing societies,
- low efficiency of public authorities,
- modification of the financing scheme of local governments,
- lack of discipline on quasi fiscal sources (subsidies for enterprises, high-cost PPP investments, state loan guarantee for public institutions).

Euro Zone accession prospects of the Central and Eastern European countries in 2004

State	Officially set goal	Fiscal deficit in percentage of GDP (ref. rate: 3 %)*	Inflation rate % (ref. rate 2.4 %)**	Comment
Czech Republic	2010	-5.0	1.8	Openly undertaken policy of wait and see
Estonia	2007	0.3	2.0	Attainable owing to the strict budget policy
Poland	2009-2010	-5.6	2.5	Doubts about feasibility (political instability)
Hungary	2010	-5.5	6.5	Serious doubts about feasibility
Slovakia	2008-2009	-3.9	8.4	Speeding up after an approach of wait and see
Slovenia	2007	-2.3	4.1	Attainable owing to the disciplined economic policy

Source: "Európai Tükör", December 2005, ECB (2004) p. 23
* EC prognosis for 2004
** September 2003 – August 2004

Data about the State Budget and Growth

Hungarian state debt in % of the GDP*

1996	1998	2000	2002	2004	2006**	2008**
83	62	55	58	60	64	70

* Without the private pension's payment's correction
** Estimation
Source: HVG (Weekly World Economy, Hungary, 06/05/2006) on the basis of CEMI, Eurostat and MNB (National Bank of Hungary)

State Budget Debt Service in the CEECs in % of the GDP

Czech Rep.	Estonia	Hungary (in 2005)	Slovakia	Poland	Slovenia
1,3	0,2	4,2	1,9	2,7	2,2

(Source: CEMI, Eurostat)

The financing demand of the State Budget in % of the GDP in Hungary

1998	1999	2000	2001	2002	2003	2004	2005	2006*
6,7	5,9	4,2	5,2	8,9	8,6	8,3	9,3	10,3

*Estimation
Source: CEMI, MNB

News Release Eurostat, the Statistical Office of the European Communities[2]
139/2006 – 23/10/2006 issue

In 2005 the government deficit of both the **Euro area** and the **EU25** fell compared to 2004, while the government debt increased. In the **Euro area** the government deficit decreased from 2.8% of GDP in 2004 to 2.4% in 2005, and in the **EU25** it fell from 2.7% to 2.3%. In the **Euro area** the government debt to GDP ratio rose from 69.8% in 2004 to 70.8% in 2005, and in the **EU25** from 62.4% to 63.2%.

In 2005 the largest government deficits in percentage of GDP were recorded by **Hungary** (-6.5%), **Portugal** (-6.0%), **Greece** (-5.2%) and **Italy** (-4.1%). Another five Member States also

[2] In this News Release **Eurostat, the Statistical Office of the European Communities**, is providing government deficit and debt data based on figures reported in the second 2006 notification by EU Member States for the years 2002-2005, for the application of the excessive deficit procedure (EDP). This notification is based on the ESA95 system of national accounts. This News Release also includes data on government expenditure and revenue.
http://epp.eurostat.cec.eu.int/pls/portal/url/page/PGP_DS_GFS/PGE_DS_GFS_0

recorded a government deficit of more than 3% of GDP: the **Czech Republic** (-3.6%), the **United Kingdom** (-3.3%), **Germany** (-3.2%), **Malta** (-3.2%) and **Slovakia** (-3.1%).
Seven Member States registered a government surplus in 2005: **Denmark** (+4.9%), **Sweden** (+3.0%), **Finland** (+2.7%), **Estonia** (+2.3%), **Spain** (+1.1%), **Ireland** (+1.1%) and **Latvia** (+0.1%).
In 2005, the lowest ratios of government debt to GDP were recorded in **Estonia** (4.5%), **Luxembourg** (6.0%), **Latvia** (12.1%) and **Lithuania** (18.7%). Nine Member States had government debt ratios higher than 60% of GDP in 2005: **Greece** (107.5%), **Italy** (106.6%), **Belgium** (93.2%), **Malta** (74.2%), **Cyprus** (69.2%), **Germany** (67.9%), **France** (66.6%), **Portugal** (64.0%) and **Austria** (63.4%).
In 2005, government expenditure in the **Euro area** was equivalent to 47.5% of GDP, and government revenue to 45.1%. The figures for the **EU25** were 47.1% and 44.8% respectively.

GDP, deficit/surplus and debt

Hungary	**2002**	**2003**	**2004**	**2005**
GDP mp (million HUF)	17 203 730	18 935 672	20 712 284	22 026 763
Government deficit (-) / surplus (+) (million HUF)	-1 415 876	-1 196 247	-1 097 917	-1 434 020
% of GDP	-8.2	-6.3	-5.3	-6.5
Government expenditure % of GDP	51.2	49.1	48.8	49.9
Government revenue % of GDP	43.0	42.8	43.5	43.4
Government debt (million HUF)	9 295 829	10 570 770	11 665 421	12 714 176
% of GDP	54.0	55.8	56.3	57.7

Explanation for the Hungarian revision in deficit between the April 2006 and October 2006 EDP notification: The increase in deficit in 2005 is mainly due to new and updated source data.

While the main argument for PPP is the "*value for money*" principle, in some of the new member states of the EU PPP is preferred because of the opportunity to bypass controls of state expenditure and to move public investment off budget and debt off the government balance sheet, by exploiting loopholes in current fiscal accounting and reporting conventions. Local governments' PPPs are not subjects of the government balance sheet.

IMF experts are warning the debt ridden countries because of the long term financial obligations. (Even if the projects are classified as off budget projects.)

Eurostat Decision on the Treatment of PPPs

The Eurostat decision covers long-term contracts in areas where the private partner builds an asset and delivers services mainly to the government.
Eurostat recommends that assets involved in PPPs should be classified as non-governmental assets, and therefore recorded off balance sheet for government, **if both of the following conditions are met (1) the private partner bears the construction risk and (2) the private partner bears one of either availability or demand risk.**
An accompanying opinion of the Committee on Monetary, Financial and Balance of Payments Statistics indicates that these conditions refer the private partner **bearing "most of the risk" concerned**.
Construction risk covers events such as late delivery, low standards, additional costs, technical deficiency, and external negative effects. If the government makes payments to the private partner irrespective of the state of the asset, this indicates that the government bears most construction risk.
Demand risk covers the impact of the business cycle, market trends, competition, and technological progress on the continued need for service. Government payments to the private partner that are independent of demand indicate that the government bears the demand risk. Changes in demand due to changes in government policy are excluded.

It is the responsibility of national statistical offices to implement the Eurostat decision, based on information that is judged to be easily obtained from PPP contracts. However, where a clear classification is difficult to make, other contract provisions can be taken into account. In particular, if the government has an obligation to buy the asset at the end of the contract at a predetermined price, this would indicate that the government bears most PPP risk when other considerations are unclear.

Eurostat 2004

III. General Hungarian Experience about PPP*

As part of the transition into market economy, more and more state obligations have been covered by private capital. Governments and political parties have been eager to hide the fact that these new institutions and mechanism are often much less cost-effective than the old

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* The Hungarian motorway projects are discussed in the IV. Part.

public patterns were, and that in the end they have to be financed from taxpayers' money. (The modified state budget deficit was 8% of the GDP in June 2006. For the full year it is expected to be 10,1%. Each Hungarian citizen has about Euro 50 000 state debt.)

3.1. Institutional framework

Hungarian public authorities highly appreciate the British experience. They have built up connections to the Treasury and to the National Audit Office (NAO) for many years. They take over the methods, regulations and good practices in order to improve Hungarian PPPs.

State coordination institutions help promote PPP on intersectoral and sectoral levels. Hungary only has practice in concession contracts. There are a number of open questions with respect to the PPP mechanism: how to calculate the Public Sector Comparator (PSC), risk calculation and allocation, regulatory and operational requirements, refinancing, profit sharing, etc. There are only a few expert firms and advisors with limited practice on this field.

The PPP Interdepartmental Committee (IC) was established in 2003. Its members are the Ministry of Economy and Transport, the Ministry of Finance, the Ministry of Justice, the Prime Minister's Office and the Central Statistical Office. The main tasks of the PPP IC are to promote the flow of information and to provide the legal background. They also perform the professional evaluation of PPP projects for decision-makers: the Economic Cabinet of the Government and the Economic Committee the Parliament (above a project value of HUF 50 billion). The Secretariat of Public and Private Sector Partnership within the Ministry of Economy and Transport supports the work of the PPP IC. They have published the Hungarian PPP Sourcebook and they are working on model contracts similar to the British method. As nearly half of the development sources (EUR 6.5 billion) for 2007-2013 will come from the EU Funds, also **the connection between PPP and the EU Funds has to be cleared**. Within the PPP mechanism, the Hungarian Treasury is an important actor, registering state obligations and loans.

3.2. The first PPP projects

Although most of the literature dates the PPP projects from 2001 in the Resource Book on PPP Case Studies of the DG Regional Policy two early PPP projects are described from Debrecen and Szolnok from the beginning of the nineties. "… *successful modernisation of*

MSWM [municipal solid waste management] without any initial EU or central government support, but through creation of joint ventures with foreign strategic investors. The two companies fulfilled a pioneering role in modernizing municipal waste management in Hungary through private investment and management." (DG Regio, Resource Book 2004)

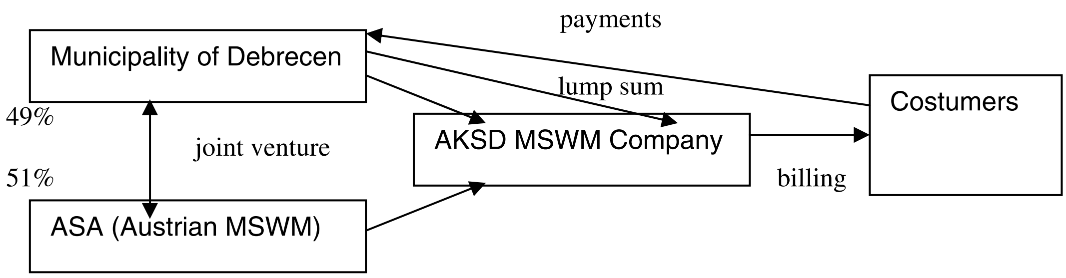
The description of the two joint venture companies as PPP projects shows that the definition of the PPP is very flexible. From the cases below we can see that in the early stage PPP was only used in the case of emergency or lack of funds. All possible errors were in fact made: these projects could not prevent imposing a burden on the budget and increasing the deficit and the debt rates; they were not cost-effective; at the same time the state provided total profit guarantee for the private capital.

The structure of the companies are similar to the general scheme of PPP in Part I.

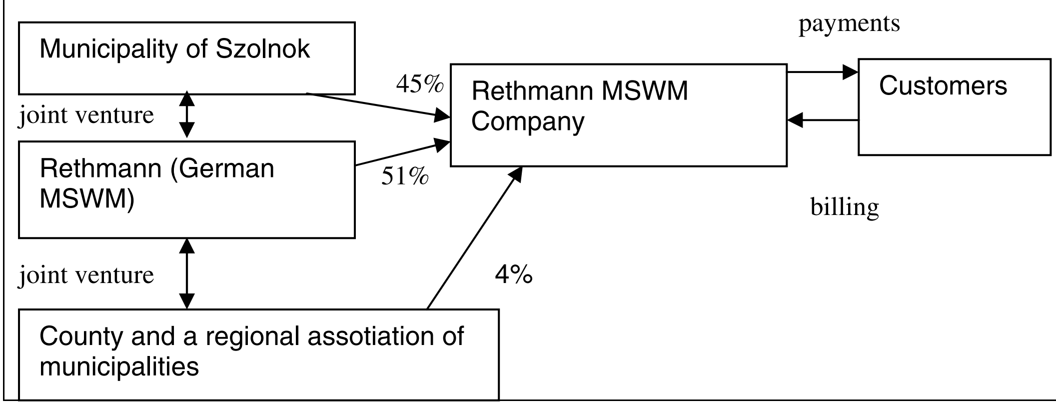
Lessons Learned

- Joint venture deals in MSWM can be financially viable and sustainable, without central government support, and can effectively contribute in MSWM regionalisation,
- Direct negotiations and competitive tendering can both result in a positive outcome, but a professionally conducted competitive tendering process has major advantages, including possible long term cost savings,
- Pricing and risk sharing can be resolved in different ways, but it is risky to base contracts on loosely founded expectations regarding income growth.

PPP Structure of Debrecen MSWM



PPP Structure of Szolnok MSWM



Budapest Sport Arena (BSA)

The old BSA collapsed in a night fire several years ago. At first it was planned to have a new one built by a private company which would have financed at least half of the project and would also have operated it. The state had promised to pay service fee over twenty years. After that period it would have become state property. The state was unable to assume twenty years' obligation at that time and the project was built under different conditions. The winner, a French company, could contribute only with a sum less than 10% and the rest had been covered by a state loan of 12 years duration – which, of course, had increased the state deficit and debt. Since that time, the BSA has become an almost 100% state property, and its operation is carried out by a subsidiary of the owner (state) company. The operator pays the owner a rent and a so-called asset replacement contribution.

The NAO investigated the whole project in 2003. Their most relevant critical finding was that although the project was financed in 90 per cent by a bank loan (with 100% state guarantee) and in 4 per cent from the state budget, with private contribution representing only 6 per cent in the joint venture founded at the beginning of the project, the private partner had a 75 per cent share while the state only a 25 per cent share. The state had only a 25 per cent decision-making right during the whole decision-making and contracting period. The private capital may have speeded up the building of the project, but the criteria of effectiveness and the sparing use of public funds were not met.

Palace of Arts

The Palace of Arts was an early PPP project. The government had the intention to carry out the project as a PPP because of the shortage of available budget funds. According to the original contract, the investor had to assume the whole risk – from licensing to financing –, while the state undertook to cover the costs in ten years, with the payback starting after the opening of the Palace. But this would be a typical financial leasing kind of a loan. The mechanism did not fulfil the three principles of PPP investments: the risks of building, availability and operation have to be taken fully or at least in 2/3 part by the private investor. Therefore the contract had to be remediate: 99% of the operational costs' risk could be shifted to the investor. The investor will operate the Palace for 30 years, it will finance all the costs of repair and maintenance, while the state will pay an availability charge. In spite of the remediation of the contract, Eurostat qualified the project as a state project, which meant that between 2002 and 2004, in the investment period, the construction costs of HUF 32 billion had to be accounted as state expenditures, and at the same time this amount had to be added to the state debt.

3.3. The EBRD strategy for Hungary

The Bank's activities in Hungary will be based on the following operational objectives (EBRD Report 15/11/ 2005):

- Continue to work closely with local financial intermediaries on providing funding to the SME sector.
- Provide higher risk products such as equity and structured debt for local corporations to fund their growth, in particular in the context of cross border expansion. Support foreign direct investment by medium sized companies in the less developed regions by providing higher risk products not offered by the private sector.
- Work on a limited number of high quality public private partnerships in the infrastructure sector, including in cooperation with EU structural and cohesion funds (SFs, CFs).
- Identify and fund energy savings projects and renewable energy projects.

Strategic orientation

The Bank will explore how to assist best the Government's recently relaunched railways restructuring efforts as well as its renewable energy/energy efficiency programme.

The Bank will build on its good relationship with local authorities to find appropriate solutions for the efficient use of EU SFs and CFs to implement infrastructure and environmental projects including through PPP structures. The sector faces substantial challenges related to the implementation of infrastructure and environmental projects co-financed from the EU funds. When co-financing is not available from the central budget, there is scope for private sector involvement through PPPs but there is little experience, both at the levels of central and local governments, in implementing municipal PPP projects. In addition, many investments will go beyond one municipality and there will be a need for regional cooperation. Besides the necessity of meeting EU environmental standards, Hungarian municipalities will face the challenge of upgrading their agening housing stock, local healthcare and education facilities, as well as roads and urban transport systems.

3.4. Other IFI's and the EU

European Union (EU)

Hungary has allocated EU Structural and Cohesion Funds in excess of EUR 1,99 billion (SF) and EUR 1,1,billion (CF) for 2004-2006. In the next 6 years period Hungary will get about EUR 22-24 billion (CF + SF). There are no data about how much will be spent on PPP and the conditions are not determined either.

European Investment Bank (EIB)

Since 1990 the EIB has lent in excess of EUR 5,5 billion in Hungary. The most recent projects include support for the 4th underground line in Budapest, the Budapest Central Waste Water Treatment Plant, a student loan scheme, loans for the construction of the Budapest Ring Road M0, the rehabilitation of the railway line connecting Budapest with the Romanian border and for financing of smaller projects mainly implemented by SME's and municipalities by means of EIB Global Loans extended to local banks. None of these big projects were realised in PPP construction.

International Monetary Fund (IMF)

Hungary has been a member of the IMF since 1982. The last stand-by agreement with IMF expired in 1998.

World Bank

Hungary has been a member of the WB since 1982. The aggregate World Bank's commitments to Hungary exceeded USD 4 billion for around 40 operations. The latest ongoing project for municipal waste water treatment in Budapest and Dunaújváros will be completed by the end of 2006.

International Finance Corporation (IFC)

Hungary has been a member of the IFC since 1985. The most recent project in Hungary, supporting financing of SME's, was approved in 2003.

3.5. PPP projects in the Hungarian state budget of 2006

At the moment, PPP projects in the amount of EUR 3.5 billion (approx. HUF 900 billion) are planned. (The real sum is rather uncertain. Professional papers have published different data.) The PPP mechanism intends to spread the costs (the budget burden) of new infrastructures over a period of 15 to 30 years. In 2006, PPP projects will cost the state budget HUF 35 billion, whereas following year almost HUF 60 billion.

The value of those PPP projects which have already started or have been decided about amounts to nearly HUF 700 billion (at estimated present value) (Table 1). This represents about 3 per cent of the GDP in 2006 and 9 per cent of the aggregate sum of state budget expenditures, which means a considerable accumulating burden and obligation on the next year's budget. Nevertheless, not even this growing load would exceed 2% of the GDP in 2008.

The Hungarian Television (MTV) headquarters would cost HUF 78 billion (22). The largest project which is totally uncertain as yet is the motorway project of a value of HUF 600 billion. Until 2007, road sections in the value of approximately HUF 250 billion will be constructed. Seventy-five per cent of all costs are made up by the costs of the M5 and M6 motorways (20 years' availability charge).

Prisons

There is a real need for new prisons in Hungary. There are nearly 20 thousand prisoners, while the capacity of the prisons is 12 thousand. There is also strong demand for higher standards because of Hungary's EU membership. The goal of ensuring better prison conditions could only have been attained in co-operation with the private sector. The government took the decision about the PPP construction in 2004. The preparations for building two new prisons in Szombathely and Tiszalök started far earlier than the regulation. According to the NAO audit about PPP projects between 2001 and 2004, the preparation of the prisons had borne high risks in many areas.

There were neither coordination institutions nor proper theoretical and legal guidelines available during the preparation of the first pilot-projects.

The methodology for calculating and modelling the long-term payment obligations has only been published in 2005. The calculation of the Public Sector Comparator (PSC) is one of the hardest tasks of the preparation: it has to be proved that the PPP model is more cost-effective than a state investment.

Student Dormitory and Hostel of the Debrecen University

In the higher education sector, a sum of HUF 57 billion is planned for the construction and renovation of training facilities and dormitories until 2020-2025. This is an easier field from the aspect of benchmarking and performing proper assessments of effectiveness, since these kinds of projects are closer to the competitive sector.

The process started with a two-round negotiation. PSC calculations were used for deciding about the winner. Before the PSC, thorough risk assessments were carried out. The risks of the services are almost all borne by the investor, but the demand risk during 10 months of the year is borne by the University. The project was carried out in a DBFO model (Design-Build-Finance-Operate). The building was opened in 2005. Half of it serves as a dormitory and the other half as a hostel with market-based prices. Fifty-five per cent of the dormitory fees are paid by the University, and the remaining part by the students. The profit of the hostel will be shared between the public and private partners. The operation of the service units, the revenues and risks thereof, as well as the profit from refinancing belong to the private partner.

Table 1.

Key data of PPP projects

Ministry	Project	Short description	Statutes*	(Expected) starting date	Expected duration of the project (years)	Estimated present value of the project (million HUF) *Total*	Budget expenditures (million HUF) *2006*	*2007*	*2008*
Ministry of Economy and Transport	Section I of M5	Operation and maintenance	2336/2003 (XII.23.), 2036/2004 (II.19.); Parliament decision No. 90/2004 (IX.23.)	March 2004	27				
	Section II of M5			July 2004	27				
	Section III of M5		1124/2004 (XI.17.)	February 2005	26	246 000	23 125	28 188	28 188
	Section I of M6	Design-Build-Finance-Operate (DBFO)	2336/2003 (XII.23.), Parliament decision No. 92/2004 (IX.28.)	October 2004	22	117 235	9 564	12 284	12 583
Ministry of Justice	Prisons	Establishment of 2 penitentiary facilities in DBFO model	2126/2004 (VI.28)	November 2005 – January 2006	18	71 732	731	4 020	5 848
Prime Minister's Office	Hungarian Television (MTV) headquarters	Design-Build-Finance-Operate (DBFO)	Act No. XXVI of 2005	2005	20	78 000	393	516	699
National Sports Office	"Sports Facility Development Programme No. XXI"	Design-Build-Finance-Operate (DBFO); training swimming pool, gymnasium	1055/2004 (VI.8.) 2039/2005 (III.23.) 2146/2005 (VII.15.)	From 2006	15-17	n.a.	0	6 268	6 400
Ministry of Education	Dormitory accommodation or training infrastructures	Design-Build-Finance-Operate (DBFO)	2207/2004 (VII.27.)	From 2004	establishment + 20 years' operation	155 788	1 116	6 500	10 000
Total						**668 755**	**34 939**	**57 776**	**63 717**
in percentage of GDP						*2.9*	*0.1*	*0.2*	*0.2*
in percentage of the aggregate sum of expenditures of the state budget of 2006						*8.9*	*0.5*	*0.8*	*0.8*

Source: Hungarian State Budget of 2006

* Besides an Act of Parliament and two Parliament decisions, the other statutes are Government decisions

Training Swimming Pool Programme in sub-regions of Hungary

Many of the towns and sub-regions have no swimming pool at all in Hungary. As part of the "Sports Facility Development Programme No. XXI", the Ministry for Children, Youth and Sports announced a competition for building and operating swimming pools in PPP arrangement, according to the DBFO model. These pools will serve the teaching and training tasks of primary and secondary schools in the sub-regions. Financing of the facilities will be shared by the Ministry and the local governments, while the risks of the building and operation will remain with the private partner. In the first round, local governments or their partnership will be chosen for the project. In the second round, the decision will be made about the private partner. The Programme is based on a Government decision (No. 1055/2004 (VI. 8.)). The announcement of the competition reflects a significant improvement in the knowledge and management of PPPs on the authorities' side (www.gyism.hu). (The same ministry mismanaged the BSA several years earlier.) The project reckoned with 50 facilities until the end of 2006. It seems that there are delays in the realisation.

3.6. Further PPP projects planned for the next years

Budapest Seed Programme

The Podmaniczky Programme is Budapest's Urban Development Programme (2005-2013), harmonised with the Structural Fund Conditions of the Second National Development Plan. It was adopted by the General Assembly in June 2005. The Assembly specified the so-called Budapest Seed Program, the list of absolutely necessary developments, the total costs of which are about HUF 2100 bn (EUR 7.65 bn). Many international real estate development firms are already interested in the development opportunities offered by the Programme. The Hungarian capital can spend – inclusive of loans – HUF 110-140 billion for these projects. Half of the funds should come from private investors; additionally, they reckon with support from the EU and the state, and also with the financial contribution of the districts of Budapest. Seven development sectors with 134 projects are specified in the Programme for the reconstruction of the transport system, the environment, the building stock and the institutional network of the Hungarian capital. According to Imre Ikvai-Szabó, deputy mayor of Budapest, they will attract investors while keeping an eye on the city’s plans and interests. This is similar to the real estate development practice of other European cities.

Main projects of the Podmaniczky Programme:

- City Hall project
- Cultural Centre, Budapest, Erzsébet Square
- Complex development of the Jewish quarter
- Utilization of the old Public Warehouse buildings for cultural purposes
- Utilization of the Óbuda Gas Factory sites for a Technical Museum
- Preparatory development for establishing residential areas (Csepel, Mocsáros wetland)
- Development of an international ferry station on the Danube
- Brownfield reclamation (EXPO, Ganz, Rákosrendező railway station)

Healthcare sector

There are continuous debates in Hungary about further privatisation in the healthcare sector. The outsourcing of capital-intensive equipments (CT laboratories, mammography, X-ray centres) and the privatisation of healthcare networks, surgeries, clinics, dental surgeries and family doctor networks are no exceptions. Some services are paid for by the Social Security Fund, while others (e.g. certain dental services, naturopathy) are financed directly by the patients. At present you can choose between expensive private clinics and more affordable back payment (a kind of bribe) hoping for better services, shorter waiting lists or just buying confidence. Everybody agrees that the existing healthcare system is not effective, and neither the patients nor the doctors are cost-sensitive in general. Those who advocate further privatisation (among others PPP projects) hope to reclaim the healthcare system, make it more effective and offer more choices for those who are willing to pay more. The other opinion is that privatisation would split the solidarity-based system into high-quality and poor services.

The opinion of István Győrfi, representative of the government in charge on healthcare issues about PPP in the healthcare sector (Virág, 2003) was the following:
Consolidation of the healthcare sector means the consolidation of (the capital) financing and cash flow. Healthcare institutions have to be reshaped in order to eliminate the causes of debts. According to recent inquiries, the main reason is usually the behaviour of the municipal or state owners. The management is also crucial factor. Hospitals with annual budgets of HUF

5 to 6 billion cannot be economically managed as traditional public institutions financed from the state budget.

In the healthcare sector, in spite of new economic conditions, fiscal accounting analyses or other modern management tools are not being used. In recent years, there have been no developments of tangible assets.

The NAO has audited many municipal, state and church-run hospitals. One of the main findings of these investigations is that development and investment resources are lacking, and that the procurement of equipments and instruments is also unsolved. Approximately HUF 1500 billion would be needed for 10 years in order to ensure good physical conditions. But the government cannot afford to spend such amounts, therefore we need private investors. We do not want to sell the institutions; we will rather implement privatisation with increase of capital. The previous health government intended to divide the institutions into subcontractors. There is no decision made by the present government. The services should be financed at a „European standard" (generously), including depreciation. This is first of all for the good of private investors. A depreciation of HUF 40 to 50 billion is also included in the present system for asset replacement, but it is disintegrated and depends on the decision of the maintaining entity.

The legislation guarantees regulated long-term investment opportunities. Earlier, investors had chosen the better financed parts, like CT, laboratory and dialysis, but the new regulations will ensure the innovation of the whole institution. PPP makes it possible to fulfil state obligations in time. The state will pay in 15 to 20 years the instalments to the financial investors. In 2003, the HUF 2 billion earmarked for the procurement of instruments will also be spent on the instalments. This system is more expensive than the issue of state bonds, but private investments are by 20 per cent cheaper than state investments, and the operational costs are also less by 10 to 12 per cent. An example for the latter is the outsourcing of catering, laundry and cleaning. The government's programme will accelerate capital investment also by lifting investment barriers. The deliverers cannot become owners but stockholders under certain conditions.

The National Health Insurance Fund contracted with 11 thousand private firms, mostly with family doctors, dentists and welfare officers. The amount of their investments cannot be compared with the huge sums invested by private firms to run sophisticated diagnostic or dialyser stations. Ninety per cent of all Hungarian patients suffering from renal diseases are treated in these private places. The largest firm, Fresenius Medical Care invested HUF 14 billion in 12 years. (Világgazdaság, 2006)

3.7. Lessons learned from the PPPs

Immature PPP – NAO report about Hungarian PPPs between 2001 and 2004 (Báger, 2006)

The conclusions were based on the experience collected by auditing the investments of the Budapest Sport Arena, as well as the M3 and M7 motorways:

- PPP is considered too often as the only way to solve the problem because of the delayed obligation to pay. **PPP should only be chosen if it is the best alternative.** The "value for money" examination (calculation) has to be carried out for all possible alternatives.
- The fees of the engaged advisers are still too high. But the costs will diminish with the accelerated spreading of knowledge.
  - A databank is needed to store the lessons learned from earlier PPP objects. A risk register is also necessary to collect data for a better calculation of risks.
  - Authorities and advisers have to be aware of the fact that if they take market structures with all their tensions and complications into public financing in a complex way, the "value for money" principle will be weakened.
  - **Today it is still impossible to see whether the return on the capital invested by the private sector is in proportion or not with the risks of the specific project concerned.**
  - If the tender does not attract an adequate number of interested parties, it has to be thought over and repeated. **PPP must not be implemented without competition.** A market assessment helps finding interest for the project.
  - As the costs of the financing (interest rates of the bank loans) are crucial factors, one has to make sure that the involvement of private capital is indeed the best alternative.
  - There is no proof that the PPP projects were the most effective in comparison to traditional public projects. Although in most cases benchmarking is not possible, one should **only decide for PPP if it has obvious advantages**.

3.8. Investments and the National Strategic Reference Framework 2007-2013

The ratio between consuming and accumulating is 76:24 at present. Accumulation should rise to 28-30% of the GDP – mostly private developments. Hungary will get 6-6,5 thousand billion HUF (22-24 billion Euro) EU Funds during the next 6 years period. Because of the serious state debt the consuming should slightly grow while accumulation should take the form of business investments. The state should provide only the minimum sum of co-financing EU sources. No state and bigger municipal developments should be started before fulfilment of the Maastricht Criteria.

Infrastructure monsters

Because of the weak performance of private enterprises, especially the lack of capital at the SMEs, the growth of GDP had slow down. To hide the weaknesses of the business sector motorways, huge "environmental pyramids" (regional waste dumps with enormous transport need, sewage water plants with never ending drain network) had been built from public money. Maintenance of the existing roads, prevention of waste generation, or support of local small scale investments were not on the agenda. In most cases the explanation for the big infrastructure investments was an EU obligation. We took over the main parts of the EU legislation while did not care about the local characteristics which would need specific regulation.

High debts

Because of the debt burden the government intends to reduce the costs of the state further on. Controversially high expenses occur by the skilful preparation and proper monitoring of the PPPs because civil servant-experts on this field are rare and therefore have to be hired from private firms. For good PPPs strong national and local government and public professionalism is absolutely necessary.

Holes in the legislation

Law enforcement can prevent further increasing of debts both of the state and the municipalities and also the unlimited privatisation of public goods and services. Transparency and clear personal liability is also a must.

Privatisation in Hungary has been completed much further than in most of the old and new EU member states. Improper regulation and control and the empty state treasury have led in the public service sector to serious social tensions. PPPs at present stage seem to deepen the tension instead of reducing it.

Conclusion: Any form of PPP should play inferior role in Hungary at least until 2010-2012 because of the debt burden.

IV. The PPP model of motorway constructions in Hungary – theory and practice

4.1. General overview of the situation

Prior to the change of regime, in the years of the communist era, the high-speed road network and individual transport in general was rather underdeveloped in Hungary as compared to Western Europe. The last fifteen years have seen a very rapid development of motorization in Hungary: in 1990 there were only 187 cars per 1000 inhabitants, and the total length of motorways or expressways reached 349 km (out of which 267 km were motorways), whereas in 2005 the number of cars per 1000 inhabitants increased to 287, the high-speed road network extended to 780 km (out of which 642 km were motorways) according to the data of the Hungarian Central Statistical Office (KSH) and the Road Management and Coordination Directorate (UKIG).

The above data can also be compared with EU figures. In the European Union in 1996 1000 inhabitants had 412 cars, and in the 1990s the length of motorways per 1000 persons (depending on individual countries) was in the range of 100 to 150 m (at present, this value is about 65 metres in Hungary).

As regards motorway constructions, the prevailing opinion of the majority of Hungarian decision-makers is truly reflected by the following few sentences taken from a description of the importance of road network development posted in the website of the Ministry of Economy and Transport: „There are no economic surveys at all which do not come at the conclusion that the development of the road network, and within that motorway constructions in particular, have a very favourable impact on the economic advancement of the regions concerned. […] Naturally, the development of the high-speed road network exercises the strongest positive influence on the progress of any given region."

As a consequence of the often misleading political PR activities, the majority of the Hungarian population believes that the road leading to economic prosperity can only be accessed through motorway constructions.

In Hungary, a key issue of debate during the parliamentary elections of 2002 was which one of the competing political parties would undertake the construction of longer motorway sections. While the Fidesz Hungarian Civic Union (member of the European People's Party) promised 600 kilometres of motorways in the spring of 2002, the Hungarian Socialist Party

(MSZP, which later on could form the following Hungarian Government) was not satisfied with that much: their promise, modified and explained on several occasions, was not less than 800 kilometres of motorways. According to some experts, this length of motorways was not only an absolutely unfeasible idea as regards Hungary's financial possibilities and the time required for the implementation of such plans, but even from the aspect of the actual short-term need for motorways in Hungary (Dudás, 2005).

Thereafter, the construction and planning of motorways was significantly accelerated (see Table 1). Even for the population, this topic has become a key issue for the possibility of economic advancement. High-cost motorway constructions went on at an increased pace despite Hungary's large state budget deficit. (By the end of May 2005, Hungary reached 81.9 per cent of the total state budget deficit projected for the entire year. In November 2006, the state deficit expected for the whole year totalled 10.1% of the GDP, by far the highest in the EU.)

State budget problems had already appeared earlier, so Hungary **was the first in the region** to undertake motorway construction by one of the most discussed and controversial types of private sector involvement, **concession financing** (Szabó, 1999).

Table 1: High-speed road section constructions started under each of the successive Hungarian governments (Dudás, 2005)

Government cycle	Total	Constructed road / Length (km)	Total length
1990-1994 (right-wing)	37	M0 / 14, M1 / 23	37
1994-1998 (left-wing)	156	M1 / 42, M3 / 44, M5 / 70	155
1998-2002 (right-wing)	96	M0 / 3, M3 / 64, M30 / 9, M7 / 20 + renovation	96 + renovation
2002-2006 (left-wing)	431	M0 / 13, M3 / 75, M30 / 25, M35 / 48, M5 /63, M6 / 70, M7 / 86, M70 / 21, M8 / 10, M9 / 20	431

Increased motorway constructions do not only impose a burden on Hungary's present economy (and, in the case of various cost deferral tricks, on the country's longer-term economic situation), but they also cause problems by siphoning off resources from the maintenance of the currently existing transport network (railways, and regional and/or local public roads), which is very much required. More than fifty per cent of all national main roads and secondary roads do not meet the criteria of professional technical and user expectations (load-bearing capacity, uneven surfaces, wheel track troughs). It is characteristic of the road surfaces of the Hungarian public road network that in the road qualification system 24% of the network does not even fulfil the current load-bearing requirements (which are less strict than the standards permitted in the European Union), and a further 10 per cent of the roads belong to the „poor" load-bearing category (Holnapy, 2006).

The government did not only break records in the construction of motorways, but also in the continual modification and adjustment of the financing of these mega-investments. The relevant concept has been changed at least four times just during twelve months. In December 2005, the Hungarian Parliament amended for the third time Motorway Act's passage related to financing, but MPs belonging both to the government and the opposition think (in unusually harmonious agreement) that the government did not yet find (not even this time) the real solution for the problem (Mink, 2005).

By autumn 2003, during the term of the government headed by Péter Medgyessy, the current Motorway Act was passed (Act No. CXXVIII of 2003). The real strength of this rule of law (which was voted for by the opposition as well) is that it specified in detail which road sections and when are to be opened, and it also ensured the budgetary financing means for these tasks by earmarking predetermined amounts of billions of HUF for the constructions in the budgets of the following years. The Act also declared that the high-speed road network development programme is to be considered as a programme of public interest. This doubtful definition made even more difficult the situation of stakeholders fighting against the large-scale motorway investment project (environmentalists, towns, villages and farmers unfavourably affected by the developments).

As regards financing, the situation already changed less than a year after that: following a change of government (but with the same ruling parties), János Kóka, the new Minister of Economy and Transport presented the PPP model, with motorways being constructed in the cooperation of public funds and private capital. The government stresses as one of the benefits of this scheme that it enables constructions by spreading payments over a longer period, imposing less burden on the state budget at the moment. However, Fidesz claimed that this was just the hypothecation of the future, and also raised the question**: how can the government say that it builds motorways when the price of these constructions will have to be actually paid by the following governments** (Dudás, 2005).

The government modified the Motorway Act with Act No. CLX of 2005. Thereby it wanted to outsource from the state budget all road sections under construction: the operating rights of the completed motorways would have been given to the Állami Autópályakezelő Zrt. (State Motorway Management Co., ÁAK) in exchange for bonds issued. The road section under construction would not have been paid for by the government, but they would rather have been built in PPP model, i.e. they would have been implemented by using public and private funds. It was planned that the state would pay availability charges to ÁAK for about thirty years, and that ÁAK would have arranged these capital expenditures through the issue of bonds. This means that on one side the state sells the operating rights, and on the other side it pays in a deferred manner. According to the original plans, bond issues in the value of HUF 750 billion would have been arranged.

However, Eurostat, the European Union's Statistical Office, did not accept this accounting trick. In the case of motorways which reached a completion status of more than 50 per cent by the end of 2005, the PPP solution cannot be applied. So the government had to modify the value of the budget deficit. In the aggregate, expenditures which could not be taken out from the budget have substantially increased the state budget deficit: the actual resulting figure in proportion of the GDP in 2005 became 6.1 per cent instead of the earlier presented 4.7 per cent. The state budget deficit is modified (corrected) so often in Hungary, because of the governments campaigning for popularity (F. Szabó, 2006).

The motorway programme planned to be financed by the bond issue of ÁAK (which has been removed from the budgetary sector) would have managed to pick and combine the worst individual features of developments implemented by the public and the private sector, namely:

- It would have been extremely expensive. ÁAK may only issue corporate bonds, which have significantly higher costs than government bonds.
- The state nevertheless would have kept the control in its hand; therefore, there would have been hardly any hope that in the future the Hungarian motorways (which are being constructed at very high costs in international comparison) will be built in a more rational manner, i.e. with less corruption costs.
- The budget deficit figures would remain the same. The fact that Eurostat reclassified ÁAK into the budgetary sector, made all the disadvantages undertaken as part of this model futile. The Hungarian Ministry of Finance already beforehand has made preparations for such situation by elaborating the state budget deficit projections with an uncertainty range of HUF 250 to 300 billion on account of "methodological risks" (Madár, 2006).
- Earlier Hungarian estimates have shown that the motorways constructed from foreign loans or in concession are by some 30 to 40 per cent more expensive than the ones which are directly financed by the state.

Finally, in September 2006 the plan was dropped as it became clear that the proposed arrangement would not be accepted by Eurostat, i.e. the sum anyway would have to be counted as part of the state debt.

In 2006, road issues are already operated in a new system which is considered by stakeholders to be more transparent. The Ministry of Economy and Transport is responsible for the strategy, and practically it will be the initiator of new ideas. At the top level of execution, however, UKIG will appear as a regulatory organ. Nemzeti Autópálya Zrt. (National. Motorway Co. Ltd., NA Zrt.) will be responsible for developments, while the task of operation and maintenance will belong to Magyar Közút Kht. (Hungarian Road Management Public Company) and ÁAK. More funds will be left for road maintenance: in the period between 2007 and 2013 subsidies worth HUF 1800 to 2000 billion may be expected from the European Union (F. Szabó, 2006).

After the adjustment of financing, the Ministry of Economy and Transport turned its attention to identifying possible savings. János Kóka, Minister of Economy, thinks that by implementing a more modest technical content (but without endangering safety), for instance by making narrower the stopping lanes, as much as 23 per cent, i.e. HUF 300 million can be saved per kilometre.

Hungarian PPP projects have been evaluated by Hirschhausen (2005) as follows:

- There is a high impact of Hungarian policy on the PPP projects.
- The risk transfer to the state is too high, there is extensive granting for motor- and expressway network.
- There has been a multiple overestimation of the willingness-to-pay.
- The availability payments have led to high cost charging in future.

4.2. Motorway M6 (financed by EBRD and other banks)

The motorway M6 is part of Helsinki Corridor No. V/C. An approximately 252 km long section between Budapest and the Hungarian-Croatian border is to be built in 2 phases: the first phase between Budapest and Dunaújváros (54 km) by 2006; the second phase between Dunaújváros and the Croatian border (198 km) by 2007.

4.2.1. First phase of M6 (Budapest–Dunaújváros)

The M6 from Érd to Dunaújváros was announced for a concession tender in respect of the design, building, financing, operation and maintenance of the 58 km long stretch under a Public Private Partnership scheme for 22 years. The starting date of the concession period was October 2004. The competition during the tendering process was intense (5-6 bidders), and the process was accomplished within six months. The concession agreement of the EUR 470 million project was signed in October 2004 by Bilfinger Berger BOT, Porr Infrastruktur GmbH and Swietelsky International Baugeselleschaft mbH. The concessionaire will receive an availability payment during the operation phase (Hirschhausen, 2005).

Even in international comparison, the M6 motorway was among the quickest concluded PPP projects – and perhaps it was the quickest concluded PPP project ever.

The net present value of the basic availability charge payable during 22 years is EUR 513 million (this means nearly EUR 10 thousand per km). In 2006, this charge is expected to amount to EUR 36.4 million. In 2007, in the first full year of operation, this sum is EUR 48.8 million, whereas in 2025, in the last full year of operation it is EUR 64.8 million. The actually payable availability charge may slightly differ from the basic availability charge as a function of lane closings, road quality and accident indicators.

By virtue of the modified concession agreement, the constructor also undertook to build into the motorway some 2.5 million m^3 of metallurgical slag (which is classified as hazardous waste).

4.2.2. Second phase of M6 (Dunaújváros – Croatian border)

The second phase of the M6 will be constructed in smaller parts. The M6 motorway's 47.9 km long section between Szekszárd and Bóly, as well as the 10 km long 2x2 lane section of the M60 expressway between Bóly and Pécs may also be constructed in a PPP scheme by the end of 2007. János Kóka, Minister of Economy and Transport announced that under favourable circumstances, the PPP contract of a term of 20 to 30 years may be signed with the successful tenderer in the first half of 2006, and so the two road sections mentioned are expected to be opened to the traffic by the end of 2007 (Anonymus, 2006).

4.3. Motorway M5 (financed by EBRD and other banks)

The M5 motorway is part of Helsinki Corridor No. IV (E75). In 2006, it was completed from Budapest to the country border.

The history of its construction and the content of the concession contract has become the source of a series of scandals. The Hungarian State concluded a contract in 1994 with the Bouygues-Bau Holding-MOL-EGIS-SCREG consortium (later on: AKA Rt.) for the construction/reconstruction of the M5 motorway's 97 km section between Budapest and Kiskunfélegyháza, as well as for its 35-year operation and maintenance. In fact, the first 27 km had already been built by the state earlier, AKA Rt. only had to renovate it. The next 30 km had been half-built (only 2 lanes) by the state, so AKA Rt. had to build only the other 2 lanes.

Simultaneously with the signing of the credit contract, in 1995, with the modification of the concession contract, the state undertook a guarantee for a partial replacement of losses of revenues owing to traffic volumes not reaching the planned levels.

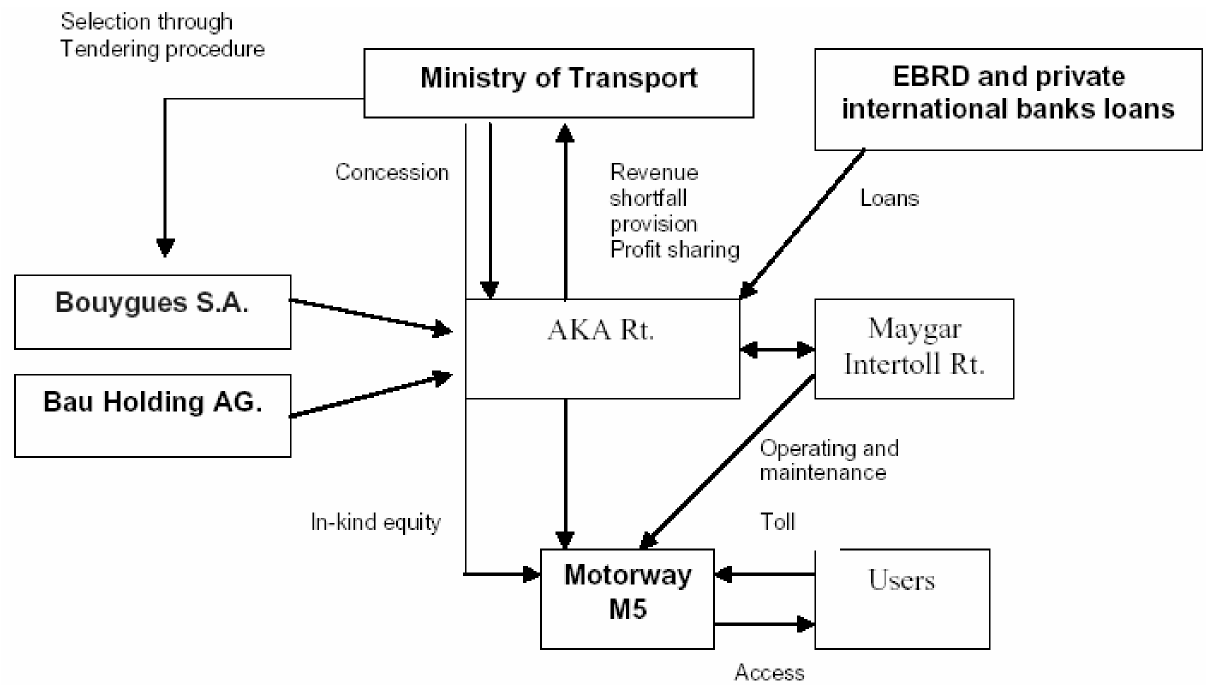
On 1st January 1996, the construction and reconstruction started, and by the end of the year the section between Budapest and Kecskemét was completed. In 1997, motorway tolls were introduced, the level of which was disproportionately high. Due to the high tariffs on the motorway, most of the cars and especially the trucks used main road No. 5 parallel to M5. It is notable that the toll was introduced not only on the completely new section, but also on the old section constructed by the government. This meant that because of the high tolls most of the traffic was diverted even from this section (i.e. not only the completely new section) to the parallel roads going through towns and villages. All this resulted in permanent protests from the local communities, including street demonstrations and petitions to the government.

The revenues from the motorway tolls had to cover the maintenance and repair works, and the repayment of the loans.

The section up to Kiskunfélegyháza was completed in 1998. From that time onwards, unfruitful negotiation attempts were taking place between AKA Rt. and the competent ministry and/or its agent, MFB Rt. (Hungarian Development Bank) about a possible further construction, about joining the national vignette system and about replenishing the reserve accounts.

In February 2004, it was announced that the Hungarian Government, through ÁAK Rt., purchases for EUR 83 million 40% of the shares of AKA Rt., the high toll on the motorway was abolished, and the national vignette toll collection system was introduced on the motorway in March. For refinancing the construction of phase I (Budapest – Kiskunfélegyháza), as well as for the construction of phase II, and for the maintenance, operation and renovation of the entire motorway, AKA Rt. receives from the state a so-called availability charge. The availability charges are paid on a monthly basis, and they vary according to the degree of meeting the performance requirements specified by the state, and the degree of accessibility of the motorway ensured for motorists.

Figure 1: PPP structure of the M5 tolled motorway (EC, 2004)



In September 2004, the concession contract was modified. Pursuant to that, for the construction of the 46 km long section between Kiskunfélegyháza and Szeged, and for the maintenance of the entire 147 km long road section the Hungarian state will pay EUR 92.5 million annually from 2006 to 2030. Calculated at present value (EUR 840.5 million), this amount is 2.3 times the original cost (EUR 365 million – data refer to 2004). Consequently, the construction of the 47 km long motorway section means a cost of nearly EUR 8 million per motorway-km, whereas the 25-year maintenance and the financing scheme for the entire 147 km long section results in a cost of EUR 3.24 million per motorway-km at 2005 present value.

Concurrently with the modification of contract, AKA Rt. and the consortium, made up by four financial institutions lending to the company, also signed a credit contract of EUR 750 million (HUF 190 billion), which put an end to the Hungarian state's guarantee of EUR 500 million in force with respect to the loan contracted back in the middle of the 1990s for financing the construction of the M5's first section.

For the construction of the 47 km long section from Kiskunfélegyháza to Szeged, the government contracted loans from the EBRD. The private company AKA Rt. holds the concession to finance, build, maintain and operate the M5 motorway from Budapest to the state border (157 km).

According to the statement of István Csillag, previous Minister of Economy and Transport, the M5 project will thus be relocated under the influence of the private sector, and a new era is commenced in the history of the motorway (PPP), which is favourable for the taxpayers, and also ensures the road's further construction. But in fact, the construction, maintenance and operation of the M5 in the above described manner cost the taxpayer substantially more than as if the construction had been directly financed by the state budget, without any PPP – even if we do not take into account the enormous damages caused by the diversion of traffic to the parallel roads.

4.4. Other motorways or expressways

The M1-M15 motorways lie on the Helsinki Corridor No. IV (E60-E65), and they connect three capitals: Budapest, Vienna and Bratislava. The length of the concession sections is 43 km on M1 (between the city of Győr and the Austrian border), and 14 km on M15 (between the city of Mosonmagyaróvár and the Slovakian border). After two years of construction, the concession section of the M1 motorway was opened in January 1996, and the M15 section was opened in June 1998 (Szabó, 1999). As the level of state debt did not permit public financing, a PPP approach was considered necessary for the realisation of non-recourse financing of 57 km of new motorway (European Commission, DG Regional Policy, 2004).

The history of M1/M15 motorway was the following (Hirschhausen, 2005):

1993 Concession agreement (BROT, 30 years). Concessionaire: Első Magyar Koncessziós Autópálya Rt. (ELMKA) established by Strabag and Transroute.

1996 M1 is opened to traffic. The traffic in 1996 and 1997 represented only 56% of the estimated amount in the traffic study and 49% of the toll revenue forecast was achieved.

A large part of the cars and most of the trucks continued to use the old parallel road in order to evade the toll.

1996 Legal actions started against ELMKA on the ground that the charged high toll rates were contrary to Hungarian law.

1996 Lenders suspended disbursement for completion of the M15 section looking for negotiations on restructuring the project.

1997 The Hungarian Government and project sponsors agreed to provide guarantees for those disbursements.

1998 There were national elections and change of government. The new government opposed toll motorways and provision of national capital assets through the use of private finance.

1998 The M15 was completed. ELMKA continued to lose money.

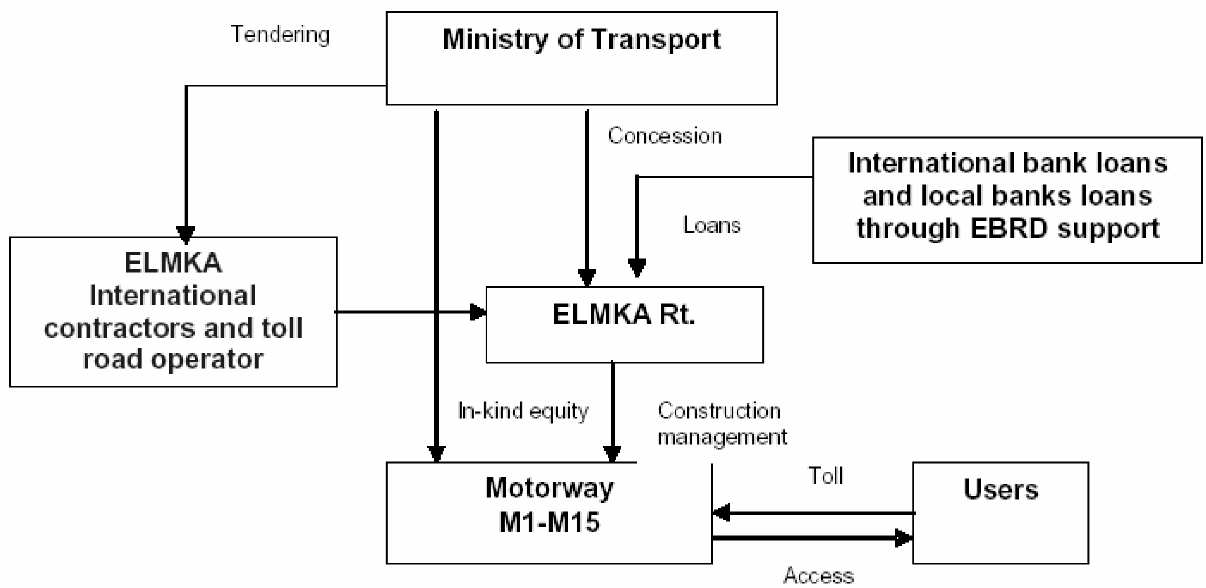
1998 The liquidation of ELMKA started and was subsequently completed.

1999 The project was re-nationalized, i.e. the taxpayers had to buy it back. The toll was abolished and the motorway section was integrated in the national motorway vignette system.

Besides EMLKA, the participants of the PPP were the Hungarian Ministry of Economy and Transport, the EBRD and other financing banks. According to the report of the European Commission (2004), the strengths of the project included: „attempts to achieve private sector efficiencies and incentives for the design, construction and operation of the motorway", whereas its weaknesses were the „overestimated traffic forecasts and inadequate tender criteria". The project consisted of the design, financing, building, operation and transfer (35 years after effectiveness of the Concession Agreement) of 43 km of motorway from Győr to the Austrian border (M1) and 14 km of motorway linking the M1 to Bratislava (M15).

The private party provided 19% of the total financing required in the form of equity and shareholder funds. In addition, lenders were involved for EUR 329 million arranged by Banque Nationale de Paris (BNP), co-arranged with the EBRD, and syndicated to 11 commercial banks. The loan maturity was 14 years. At the time this was the longest maturity secured by a Hungarian public or private borrower. Hungarian Forint financing amounted to HUF 12,000 million, arranged and provided by the EBRD and Hungarian commercial banks and insurance companies, together providing 81% of total financing (European Commission, DG REGIO).

Figure 2: PPP structure of the M1-15 tolled motorway
(European Commission, DG Regional Policy, 2004)



Motorway M3 as PPP project (to be financed by EIB)

The project comprises the construction of 73 km of new motorway to connect the M3 motorway (TEN Corridor No. V) to Debrecen (36 km) and to bypass around Debrecen (13 km) and Nyíregyháza (24 km). The main aim of this programme according to the government is to improve the accessibility to the less developed regions and hence to contribute to a more balanced regional development of the country.

The proposed EIB finance was up to EUR 320 million, the total cost was estimated at EUR 640 million. The project to be financed by the Bank has been opened to international competition under the principles of transparency, economy and non-discrimination, in accordance with the Bank's procurement criteria. This project was approved by the Bank in May 2005 (EIB, 2006).

Public participation in motorway projects

The Aarhus Convention on Access to Information, Public Participation in Decision-making and Access to Justice in Environmental Matters was declared by law in Hungary in 2001. A number of other laws and decrees also guarantee public participation.

However, in practice these rules are often not observed. In many cases citizens and their organisations are not consulted or not properly consulted before decisions are taken on transport infrastructure development. Even if they are consulted, their proposals are often neglected by the authorities without giving any explanation why these proposals had not been accepted.

The so-called Motorway Act even reduced the rights of citizens and environmental NGOs concerning public participation, and especially their access to justice.

The government is propagating motorway constructions by all means, practically there is no day without some politician or government official speaking in favour of more motorway construction. This is echoed by the press. The government never initiated any public discussion on the possible advantages and disadvantages of its motorway construction program, and it is constantly giving a very one-sided information to the public. Those who question the sense of motorway construction have little chance of getting into the media (or if, yes, only as people opposing progress). This situation makes meaningful public participation almost impossible.

The government only after a long time and only partially took into account even the strong protests by local governments and citizens who pointed out that the tolling of motorways causes serious environmental, health and traffic problems in their towns and villages. Even the Hungarian Automobile Club, the largest organisation of car-owners in Hungary did not receive permission to see the concession agreements on the construction and operation of the new motorways, although this has been financed with public money.

Often the lack of capacity and expertise also makes it difficult for citizens and NGOs to participate in the decision-making process. The revenues of non-profit organisations are significantly less than those of their counterparts in the old EU member states. People in Western Europe and the United States recognise and appreciate the work done by non-profit organisations by granting them money. This is not a well-established practice yet in Hungary.

4.5. Conclusion of Part IV

The speedy and extremely expensive motorway constructions – while giving some economic and transport advantages in certain regions for certain people and certain enterprises – have detrimental effects on the state budget, the national economy, the society and the environment in Hungary. There are already a number of studies showing that motorway constructions in Hungary are too expensive not only for the environment, but also from economic and social aspects. (Lukács, 2003)

The state budget in Hungary has a huge debt burden. It is highly questionable that instead of reducing the budget deficit and debt, the government increases both by taking loans or using PPP for motorway constructions.

General Conclusions and Recommendations

The governments' direct role in the economy in many countries has been altered and also weakened over the last 20 years. For the countries which were earlier beneficiaries of the social market economy and also for the emerging markets the transfer of competences and of ownership has unidentified fiscal, social and environmental traps. The privatisation demands new professional behaviour from the national and local authorities. This is the fact also concerning PPPs which should be a new sophisticated mechanism of partnership for delivering public services by private bodies for the common good.

However the rules at present are almost entirely dominated by business interests. This – also as a result of a marginal representation of the public interest – does not ensure balanced decision making.

The idea that there are (civil) groups wishing to participate in the whole life cycle of the PPP project not because of their own interest, but for the good of the society, has not yet been sufficiently understood.

There is another crucial problem which has been seldom discussed: how should be the social aspects handled? There is an antagonistic conflict between profit and humanism. The many hundred years old achievements of solidarity based services (health care, education, basic physical infrastructure) could disappear when profit-oriented firms are running the projects. Public authorities are able to provide basic public services for all members of the community. That is one reason why many rich and democratic countries are reluctant to privatize their public services. (Controversially the same public firms are eager to participate in the privatisation in other countries.)

The state builds a social protecting network for the poor but no system is perfect. Loopholes cannot be bridged in case of a for-profit partner. When the object is run or the service is delivered by the public nobody will object some exemptions to solve an urgent need. A for-profit company on the other hand will not deliver something for free, and it will not be generous if this will jeopardise its profit.

CAAG recommends the revision of the whole mechanism (including public procurement) by which the European Commission and the member countries would deal with the regulation of PPP for example on the following issues:

- How the Public Procurement procedure has to be revised to guarantee meaningful protection of the environment on both local and global level,
- How the mandates should be distributed (civil control) in order to give clear indication regarding the contents of the PPP project,
- How effective participation of stakeholders representing the public interests in the evaluation and monitoring process can be implemented (as this is a precondition for the legitimacy of the PPPs),
- How the projects should be checked and publicly rejected in case they do not meet the essential requirements of the environment and good fiscal management.

The PPP contracting process needs to change so as to ensure transparency – fair and equal rights for commercial and non-commercial interests (e.g. to give a vote to NGOs when it comes to the final approval in the decision-making process or to enforce consensus) .
Apart from gearing up the PPP process for balanced representation of public interest, the participation of stakeholders representing the public interest also requires the availability of financial resources.

A central data bank is needed to collect the data for benchmarking the projects (ex-ante and ex-post calculations) and to avoid mistakes repeatedly (case studies, contract-patterns, standards etc.).

There are further environmental problems such as air pollution, loss of natural resources, fragmentation etc. which are common with many PPP projects. The victims of the losses and other negative impacts are always the public – the present and the future generations. Therefore the public authorities should take the risks and the responsibilities above all. (Of course they can sue the private operators or builders.)

To mitigate the number and the negative impact of mislaid projects the main decision-makers have to take personal responsibility for their judgements.

Strong legislation and enforcement is needed to prevent running into future debt of national and local communities.

Hungary is at the moment the most debt-ridden country among the EU25. Therefore we recommend that any form of PPP should play inferior role in Hungary at least until 2010-2012.

Only a strong state can tackle the risks of PPPs in a post-industrial society

Based on the experiences of the premature PPP projects in Hungary we recommend first of all a broad discussion about the role of the state in the post-industrial society.

Many people believe and the neo-liberals claim that the role (and responsibility) of the state will be less and less in the post-industrial area. However the success of the Nordic countries on one hand and the upsetting situation in the new EU member states (Slovakia, Czech Republic, Hungary) on the other show that the state's role is not decreasing but it is transforming from active economical participation into controlling and initiating. This also means that the state will have as many if not more obligations in the future than it had in the industrial period. This also means that a small but inefficient public sector is riskier than a bigger one. It is especially important to have highly qualified and devoted several devoted civil servants.

Here is an example from the Hungarian building sector.

Strict controlling networks existed for both planning and constructing of any new objects in the period before 1989. These have been falling apart step by step after the transition. In the summer of 2006 – realising the negative impact on both quality and efficiency – the state planned to decided to enlarge the building authority of the State Office of Housing and Building (OLÉH) from 18 part time employees to 180-200 full time civil servants. However the old/new government in August 2006 reorganised the building departments and decreased the size of OLÉH from 83 to 23 employees. There are no lauds any more about strong building authorities.

The practices of different countries and also the inquiries of the National Audit Offices show that the performance of any service or institution is ownership-neutral. State owned institutions can be as efficient as any private firm. However the probability (and risk) of market failures and disturbances are much greater in transitional societies than in states with long democratic traditions and strong civil society.

In case of high state budget deficit and decreasing public expenditures for the operation of the existing public infrastructure, public expenses for PPPs are questionable. They often worsen the financial situation of the country, especially in the long run. When a new object has to be financed by the users it is better to leave to the market the decision about the investments.

Transparency

The costs of the preparation and monitoring of PPP projects are very high. The experts' fees reflect to the market positions of the few consultants with the necessary skills to meet the rigid and formal requirements. The public partner has much less assets than the private partner (e.g. to hire well paid solicitors). Therefore they often fail to protect the public interest, The fact that the public partners have no long term experiences on PPPs makes things even worse. Transparency can help to meet the "value for money" principle and to keep the costs both of the investment and of the operation optimal. The spending of any amount of public money should be public – this is so in Hungary according to the "Clean Hand" law. However this is not the practice at the moment. Both the private participants and the public partners insist to hide the details at least temporarily. In other cases documents are only available in English and it is nearly impossible for civil volunteers to find out the relevant data among the many thousand pages of documents. A certain sum of the preparation costs should therefore be earmarked for independent expert control in case of doubts raised by the public partners.

PPP is neither "The Solution" for good quality of public services and for cost-effectiveness nor is the "devil's manipulation". It is simply an alternative for more sophisticated (indirect) privatisation and financing. The success of PPP is depends on the level of the democracy (transparency, corruption) and the professionalism of the public sector. Therefore we cannot say which projects are good for PPP and which are not. Better regulation, more experiences, less corruption and skilled public sector are the basic conditions. But only long term solvency of the public and stable state budget can avoid financial difficulties of the public during the contracting period.

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