

THE ANALYSIS OF OPPORTUNITIES OF PUBLIC PRIVATE PARTNERSHIP IMPLEMENTATION IN LITHUANIAN TRANSPORT SECTOR

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Annotation

The goals of this article are to introduce the PPP model because the PPP model is not yet prevalent in Lithuania. The model including principles, structure and process is briefly described in this article. Also this article develops arguments for the choice of various Public Private Partnership arrangements taking into account various factors that affect the balance between costs and benefits of each alternative of public service provision and infrastructure development. The factors derived from the premises of the new institutional economics and theories of public finance are the nature of goods provided, positive externalities, transaction costs, management costs, risk costs, and interest rates. In the last part of the article the legal environment for PPP implementation as well as obstacles and opportunities for successful PPP projects in Lithuania are discussed.

Key words: public private partnership, infrastructure, transport development.

Introduction

In the last two decades various countries of the world have shown a growing interest in Public Private Partnerships. A Public Private Partnership (PPP) is a partnership between the public and private sector for the purpose of delivering a project or service traditionally provided by the public sector.

The goals of this article are to introduce the PPP model because the PPP model is not yet prevalent in Lithuania. The model including principles, structure and process is briefly described in this article. Also this article develops arguments for the choice of various Public Private Partnership arrangements taking into account various factors that affect the balance between costs and benefits of each alternative of public service provision and infrastructure development. The factors derived of premises of the new institutional economics and theories of public finance are the nature of good provided, positive externalities, transaction costs, management costs, risk costs, and interest rates. In the last part of the article the legal environment for PPP implementation as well as obstacles and opportunities for successful PPP projects in Lithuania are discussed.

Energy and transport infrastructure facilities are seen as playing a central role reducing poverty in developing member countries (DMCs) by providing direct access to critical services and stimulating economic growth. Public Private Partnerships (PPP) support the development of infrastructure by improving DMCs ability to access resources to develop facilities at competitive costs.

1. Theoretical Justification of PPPs

PPPs came out of the commercialization and privatization processes initiated in the 1980s in countries such as the United Kingdom, where increased private sector participation was seen as beneficial for the following reasons:

- It removed conflicts of interest between the Government's role of defining policies, regulating industries, and providing outputs;
- Allowed the private sector to provide outputs in competitive markets as it has strong incentives to perform due to the profit motive;
- It reduced the Government's expenditure commitments which helped support macroeconomic stability, and allowed public expenditure to be reallocated towards high priority outputs in sectors such as health and education.

Governments pursued this program by separating policy, regulatory and service delivery functions that were present within vertically integrated monopolies administered by public sector agencies. Policy functions such as planning sector reforms and designing regulations were transferred to Ministries, and responsibility for administering regulations assigned to special purpose, and in many cases independent, regulators. Service delivery functions were transferred to commercialized state owned enterprises (SOEs) and where markets were competitive, these firms were privatized. In many cases, particularly in infrastructure sectors, it became apparent that competition was not always feasible due to problems with economies of scale that offset the benefits of competition due to efficiency costs, and sunk costs that discouraged private investment. These issues led to the development of intermediate solutions such as PPPs that could be used to both regulate private sector providers and encourage them to commit capital for long term investment. PPPs provide a means of preserving economies of scale by allowing the private sector to compete for the market over time, rather than compete within the market. PPP contracts also provide a mechanism to ensure that risks are efficiently allocated between the public and private sectors, and there is a reasonable degree of certainty on the tariff mechanism and private sector return on investment (Freig, 2008).

PPPs differ in terms of what resources they provide and the way in which they manage risks over time. Sources of resources and allocation of risks under the various PPP options are as follows:

Table 1. Sources of Resources and allocation of Risks under Various PPP Options

PPP Option	Labor	Financing	Contract duration	Output risk	Investment risk
Service contract	Private	NA	1 - 2 years	Public	Public
Mgt. Contract	Private	Public	3 -5 years	Public	Public
Operating Lease to Private Sector	Private	Public	5 - 15 years	Public	Public
DBFO	Private	Private	15-25 years	Public	Private
BOOT	Private	Private	15-25 years	Private	Private

Source: Operations Evaluation Department.

These options involve increasing levels of financial risk being assumed by the private sector service provider and increasing regulatory risk for the Government (mainly in terms of potential for monopoly).

Service contracts are short term and in the context of infrastructure relates to services such as project design, or construction. Management contracts only provide private sector management expertise and no capital, and therefore they are primarily used where the Government wants to access private sector skills and technology to operate facilities. Operating leases provide private sector management expertise and no capital, and are used when the Government does not wish to sell an asset, but it is not concerned about the outputs produced by the asset (Freig, 2008; Gudelis, 2004).

2. PPP Model

Design Build Finance Operate (DBFO) concessions are a primary form of PPP and they are used where the Government directly purchases the outputs, often through a stand-alone fund, using a fixed annuity payment plus a performance bonus, such as in the road sector. This type of PPP is relatively new in emerging economies, but it is becoming increasingly important in countries such as India.

Build Own Operate Transfer (BOOT) concessions are the other main form of PPP and they are used where the Government does not directly purchase the outputs, but tariffs are typically set by a regulator, such as in the power sector. In some cases, quasi commercial SOEs may act as the offtaker for BOOT concessions. BOOTs are the most common form of PPP used in emerging economies to date.

DBFOs and BOOT concessions are largely synonymous with the term PPP, and are the focus of the SES. DBFOs are used where it is difficult to manage demand risks and directly charge revenue from the public, and the Government procures the outputs from the private sector concessionaire. DBFOs are common in:

- transport, particularly for secondary roads, or urban transit systems where the Government does not wish to allow the concessionaire to charge users the full costs of service;
- schools and hospitals, where the Government wishes to continue to provide services, but procures the infrastructure from the private sector. Increasingly, DBFOs are being used in countries such as the UK, Australia, and India (EC, 2003).

BOOT concession agreements have commonly been used in Asia to supplement capacity in:

- the transport sector for air and seaports, and roads with high traffic volumes;
- electricity and gas sectors for generation, distribution, and transmission;
- water in a small number of cases.

International experience shows that the application of a PPP model in which design, build, maintenance and financing are tendered as one task, results in better overall economy, greater innovation and better risk and responsibility allocation between the public and private parties (COM, 2005; Torton, 2006).

To support the realisation of the potential benefits, it is crucial that:

- the PPP tender provides as much freedom as possible with regard to design, choice of materials and execution methods. Consequently, a PPP tender will as far as possible be based on output specifications.
- the project risk allocation is based on an assessment of which party is better qualified to handle the individual risks. The proposed risk allocation is therefore based on an analysis of the public and private parties' ability to influence the individual risk elements (Amos, 2005).

3. Market Survey

A significant contribution to the PPP evaluation has been a market survey among some domestic and foreign financial institutions and contractors. Some important input derived from the market survey:

- That foreign players appear very interested in participating in the project, and that it would be an advantage if they participate in cooperation with Danish players who possess knowledge about local contract and market conditions.
- That all players focus on generating more PPP projects to create a foundation of business to support investment in PPP competencies.
- That the opportunity to optimise and control the project's design, construction and operating stages implies a potential cost saving of 10-15 % in addition to a reduction in the construction time of approximately one year.
- That the contemplated risk allocation appears appropriate and transparent.
- That the project is considered realistic and serious, not the least because the planning process is well under way and well documented.

A financial analysis has been performed to clarify whether the application of a PPP model is expected to create economic advantages for county (Amos, 2005).

The following key inputs were included in the assessment of expected variations between a traditional and a PPP model:

- cost differences, including transaction, construction and operating costs;
- differences in regards to time, at both the planning and construction stages;
- differences in risk allocation, including the risks of exceeding the construction and operating costs budgets, as well as risks related to the construction period;
- financing (Amos, 2005; EC, 2003).

4. Analysis of PPP implementation experience in Lithuania

The implementation of public private partnership (PPP) to financing the transport infrastructure is provided in the long-lasting strategy of the development of the Lithuanian transport system (to 2025). The sector of transport, in the strategy document of the EU transport policy is separated as one of the common, in which this principle is successfully implemented, and especially accents the importance of this principle to realize the projects of Trans-European transport network (TEN-T). In the European level it is accepted, that indraft of the private capital can forward the implement of the Trans-European transport network, which these days, is very late. The main reason of this lateness is the deficit of finance.

Since amount of the state budget and European Union financing is still not enough to improve state road network, protractedly maintained under conditions of insufficient financing, in the shortest possible time, it is necessary to attract additional funds. One of the possible solutions for improvement of state infrastructure objects is to attract private financial resources by signing a contract between government and private company or investor (hereafter – PPP).

If we want to implement effectively the financial support of EU in the plans of transport sector and make the investment plan of Lithuanian transport infrastructure modernization we must essentially implement the PPP in the development of transport infrastructure, because the cost of transport infrastructure works has suddenly increased during the last years. This principle is widely implemented in France, the Netherlands, Germany, and also in the new members of the EU – Hungary, Poland, Slovakia, Czechia.

The partnership of public and private sector is widely implemented in the world countries. PPP is implemented in the EU and other countries very often not only in the projects which are related with modernization of transport infrastructure but also and in the activity of different areas.

For example, considering into account limited financing in road sector and reposing on pace of state economic growth and expected increase of road users paying capacity, the Ministry of Transport of the Republic of Latvia has accepted application of PPP projects in implementation of several projects. In compliance with the strategy of the Ministry of Transport of the Republic of Latvia for the time period until 2013 it is decided to begin work on implementation of three projects, by applying DBFM (design-build-finance-maintain) principles, signing long-term service contracts un attracting financing of private investor: road E 77 section Riga bypass - Senite (pilot project); road E 67 section A4 Riga bypass (Baltezers - Saulkalne); road E 67 Kekava bypass. After 2013 it is planned to implement the following projects: road E22 section Priedaine - Sloka; road E77 section Riga - Jelgava; road E22 section Riga bypass - Koknese.

The experience of many world countries shows us that the partnership of public and private sectors can give benefit for the society and the country because the private sector during the project realization period can give public service, improve this quality or create, innovate and effectively manage the capital which is needed for this service lend. Many different models, which are implemented to solve the specifically tasks in different countries are known. The type of PPP project can be differently reliant on this size, repartition of the risk and structure of financing. In the EU policy it can not be indicated or the public authority institution must do the economical activity themselves or give it to the third part. The European Commission notes, that it is advisable to develop the PPP forms and accents that the members of the EU inform about the variable PPP forms and their problems. The policy of the EU unregulated implementation of the specific PPP form. The European Commission notes, that all PPP are reputed as public procurement or concession, and it is not necessary to create the new law instrument for all PPP agreement/contract.

In recent years, the Private finance initiative has become the most important. This is the model, when the private sector during 3-5 years has invested the main sum in the object whereas the public sector has invested some part of the sum for the long time (25-30 years). In this situation the private sector assumes the responsibility and all the risk to lend the public service according to pre-establish specification. Such investment of the

private sector, when PFI contract is used concerns 10-15 percent of all investment in the public sector in the EU.

In Lithuania, only one PPP form – concession is regulated, but not directly in this field we can also assign the public procurement law. The forms are not regulated or regulated only in the common law instrument but incompletely. The typical procedure and rule of PPP can not be formulated. The coordination and maintenance of PPP projects are not performed, the information about the realization of PPP project in Lithuania and in other countries is not collected, not systemized and not analyzed.

At the moment, the implementation of PPP principle is not devolved in Lithuania. The PPP projects are realized only in the municipality level. Only several ministries are prosecuting the PPP projects implementation (Ministry of Finance, Ministry of Economics and Ministry of Transport and Communications). The interest of the implementation opportunities of PPP principle are noted in the government institution.

The PPP principles are widely implemented in the projects of the transport sector modernization in the EU. The principal interference of implementation of PPP principle in the development of the transport infrastructure is not performed in the Lithuania. Lithuania must quickly use the model of PPP in realizing the project of transport infrastructure modernization if it wants to reach the main goals which are to formulate in the long-lasting strategy of development of Lithuanian transport system (to 2025). If we want widely implement the PPP the political purpose is necessary. So much attention should be given for wide and systematic information of the society because such situation shows us, that business representatives get no information about opportunities to participate in the PPP projects, procedures, benefits.

As the experience of another country shows, to reach the effective implementation of PPP principle we must start with neither big nor difficult projects.

We can identify the common problem, that the implementation of the PPP principle to realize the project especially the project of transport infrastructure is not widely promoted:

1. Not prepared strategy of partnership of private and public sector.
2. The absence of the institution, which can be responsible for the implementation of private and public partnership sector development. This institution must select, analyze and spread the information about the realization of PPP projects in Lithuania and other countries, lend the methodical support about PPP project.
3. Lithuania doesn't have the institution which implements the public and private expertise of PPP projects.
4. There is no clear repartition of competences between institution of public administration and agency, also there is no institution, which gives consulting and methodical support, prepares the typical form of partnership agreement, creates the method of the project preparation and the method of risk evaluation and division between the members of the project.
5. The absence of the typical procedure of PPP and no formulation of the mechanism of processes stimulation.
6. The existing base of law only partially shows the PPP forms, opportunities, processes and etc.
7. The information does not reach the society.

Conclusion

The fundamental principle of a PPP model is to tender design, financing, construction, operation and maintenance as one task. International experience shows the following benefits of the PPP model:

1. PPP is based on an overall assessment of how to resolve a task in the most efficient manner - for example by linking together design, construction and operation.
2. PPP allows greater innovation than conventional tenders at all stages of the project.
3. PPP implies focus on an appropriate risk allocation and optimisation of the public and private competencies so that these complement each other in the best possible way.
4. PPP can help improve the quality of the service provided by offering the private partner financial incentives to control the delivery of the agreed service through the entire contract period.

Experience from abroad shows that these benefits can contribute to higher public service quality without increasing the service price.

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The Analysis of Opportunities of Public Private Partnership Implementation in Lithuanian Transport Sector

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Summary

PPP is implemented in the EU and other countries very often not only in the projects which are related with modernization of transport infrastructure but also and in the activity of different areas. The experience of many world countries shows us that the partnership of public and private sectors can give benefit for the society and the country because the private sector during the project

realization period can give public service, improve this quality or create, innovate and effectively manage the capital which is needed for this service lend.

Many different models, which are implemented to solve the specifically tasks in different countries are known. The type of PPP project can be differently reliant on this size, repartition of the risk and structure of financing. In the EU policy it can not be indicated or the public authority institution must do the economical activity themselves or give it to the third part. The European Commission notes, that it is advisable to develop the PPP forms and accents that the members of the EU inform about the variable PPP forms and their problems.

The policy of the EU unregulated implementation of the specific PPP form. The European Commission notes, that all PPP are reputed as public procurement or concession, and it is not necessary to create the new law instrument for all PPP agreement/contract.

Privataus ir viešojo sektoriaus bendradarbiavimo galimybių vertinimo analizė Lietuvos transporto sektoriuje

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Santrauka

Siekdamos užtikrinti tinkamą paslaugų teikimą, valstybinės valdžios institucijos vis labiau domisi galimybe bendradarbiauti su privačiuoju sektoriumi. Partnerystės galimybės (viešojo ir privataus sektoriaus partnerystė) valstybinės valdžios institucijos suinteresuotos, nes nori iš privataus sektoriaus pasisemti praktinės patirties. Kita vertus, šis interesas susijęs su valstybės biudžeto ribotumu.

Privataus ir viešojo sektoriaus partnerystės terminas ES Komunikate nėra aiškiai apibrėžtas. Komunikate pažymima, kad visos viešojo ir privataus sektoriaus sritys (jeigu atitinka Europos Bendrijos steigimo sutarties taikymo sritį) siejamos su viešaisiais pirkimais arba koncesijomis.

Paprastai šis terminas reiškia viešojo ir privataus sektoriaus lėšų skyrimą infrastruktūros objektams finansuoti, statyboms, renovacijoms ar objektų priežiūrai. Viešojo ir privataus sektoriaus partnerystę charakterizuoja: ilgai trunkantis viešojo ir privataus sektoriaus bendradarbiavimas, pagrįstas aiškiai suformuluotomis sutarčių sąlygomis, apibrėžiančiomis kiekvienos dalyvaujančios šalies atsakomybę bei rizikos laipsnį.

Reikšminiai žodžiai: privataus ir viešojo sektoriaus bendradarbiavimas, infrastruktūra, transporto plėtra.

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