SEFI

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FOR NEW PUBLIC-PRIVATE PARTNERSHIPS IN INFRASTRUCTURE & PUBLIC FACILITIES

SEFI
Association of French
International Contractors
10, rue Washington
F - 75008 Paris - FRANCE
Tel. : 33 (0) 1 58 56 44 00
Fax: 33 (0) 1 58 56 44 19
E-mail : sefi@sefifrance.fr
www.sefifrance.fr

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In November 2001, SEFI has an active membership of 15 companies, contractors of the construction and infrastructure sector, major companies specialized in design, build and management of facilities and in turnkey contracts in general, concessionaires in services.
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FOR NEW PUBLIC-PRIVATE PARTNERSHIPS IN INFRASTRUCTURE & PUBLIC FACILITIES

The Contractors and large Engineering Companies of SEFI (Les Entrepreneurs Français Internationaux - Association of French International Contractors) intend to make here a conceptual contribution to the development of public private partnership projects in infrastructure and public facilities, on the basis of their experience in various countries. Their approach is pragmatic and is based on recognized concepts and proven instruments, with full awareness of the needs, possibilities and constraints of today's economies. They want to help establish the general principles, rules (guidelines) and tools to allow for a new orientation of private capital for infrastructure. This is the purpose of this new brochure.

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EXECUTIVE SUMMARY

CONTEXT

Public private partnerships, an instrument for sustainable development and growth

The necessity of sustainable development, allowing access for all to public facilities, is now an acknowledged goal pursued by all parties involved in development (the State and public authorities, citizens/consumers, public and private operators, international and multilateral institutions). A second consensus has also appeared as to the necessity of infrastructure for development. In industrialized countries, the quality of infrastructure is now undoubtedly one of the necessary conditions not just for sustainable growth but also for the well-being of citizens, and is therefore demanded by the latter.

As to the means, it is now generally agreed that **such projects can rarely be handled within an "all public" framework,** for various reasons including:
- the preservation of public resources: public deficits and the national debt must be reduced, particularly by redirecting spending to the State's core responsibilities. Delegating the management of some infrastructures to a well-chosen private partner can free up public resources for needs, which only the public authority can address;
- management efficiency: within a framework regulated by the State or the public authority, bringing in professionals can help optimize management. Most bilateral and multilateral development organizations are heading toward this direction, even for services other than infrastructure.

However, it is just as clear for public authorities, private operators and multilateral organizations that **"all private" market systems are not operative either**. Project financing techniques have served their purpose for projects, which involve socio-economic utility. Quality public service requires that the State or public authority maintain its responsibility and oversight role. This is not a question of ideology but rather a simple observation, based on the current difficulties in developing, industrialized and emerging countries.

Public private partnerships (PPP) appear today to be much more than a simple budget tool, but rather a real instrument for co-development[1], and an operational contribution to socio-economic growth in general. When properly conceived from the outset, PPP optimize the satisfaction of the three fundamental actors involved (i.e. the State/public authority, citizens/consumers and private operators).

In addition to its positive impact on the management of the project (as already mentioned above), PPP is **a virtuous process** in that:
- its very nature requires, from the outset, a long-term view of the project;
- by taking into account (as of the financial planning stage) the long-term net socio-economic benefits generated by the project, the decision to invest can be made on a rational economic and social basis;
- the public authority can optimize its spending by including in the investment the notion of creation of value for the community.
All of these criteria can help avoid questionable or hasty decisions.

The actual use of such formulae has unfortunately declined.

PPP yesterday and today

Public Private Partnership (PPP), by many names, has a long history, especially in France and in the United Kingdom. In 1985-90, there was increased interest in it with the BOT formula (Build, Operate, Transfer, in French: Construction, Exploitation, Transfert - CET). This appeared to be one of the possible solutions to the consequences of the 1980's debt crisis in emerging countries, and was thus widely used.

1."Co-development : towards a new system of Partnering in the public and private sectors in the execution of major infrastructure projects", International Business Law Journal, n° 2, 1999, French-English.

PPP also had success in industrialized countries. There was an upturn in PPP projects at the beginning of the 1990's, which peaked in 1997 but then dropped off sharply with the Asian, Russian and Brazilian crises (Volume cut by half in 1999 with respect to 1997). The rise of the concept of "Shareholder Value" also intensified the phenomenon. Today, PPP projects are in a rut.

However, the needs for infrastructure are now greater than ever, both in emerging and developing countries (about two thousand billion dollars over the next fifteen years) and also in industrialized countries (for example in Europe, various figures are provided but the approximate financing deficit amounts to a minimum 50 billion Euros over the next ten years, for European networks alone).
Both States and multilateral organizations are recommending and trying to apply these types of projects, for the above-mentioned reasons of good management, and also because of the absolute necessity of fostering access to all basic services.
Private money is also available for long-term projects.

> *Some key figures for the year 2000: multilateral financing represented about 80 billion dollars[2], public bilateral development aid 42, that of the European Union 9, that of United Nations agencies 5, that of Non Governmental Organization's 6.5 (not including public contributions), private capital for developing countries was 257 billion dollars, including 178 in direct investment to a fairly concentrated geographic area, compared to 1000 billion in total direct foreign investment, with world trade exports of 6180 billion dollars.*

Why is the number of PPP projects declining? Why this discrepancy between announced desires and actual projects?

It seems that existing needs are not fully expressed, due to the **growing inadequacy of the existing systems.** Traditional project financing techniques require intrinsically profitable projects (i.e. profitable solely with the collected fees), which are now almost non-existent. **Today's problem is not so much finding financing, but rather guaranteeing it for lenders and investors. This could be done through systems measuring the socio-economic utility (net positive externalities) and the financing mechanisms including them**. If nothing changes, private partners will no longer be able to bear the much greater risks and constraints which they are facing, and will abandon these projects, which are useful for the community and essential for development and growth.

All people involved are aware that suitable conceptual tools must be found urgently.
For Europe, the 1997 Kinnock Report suggested pragmatic approaches for public private partnerships. Since then however, more and more sophisticated formulae have appeared, leading to unconvincing theoretical debates rather than to concrete projects.

For a drastic change in mentalities and behavior

Beyond rules and techniques, a drastic change in mentalities and behavior is clearly needed if PPP is to emerge as a real procedure and a philosophy for partnership. PPP is based on transparency; a lack of understanding and its resulting opacity are major obstacles, as they pave the way for irrationality, arbitrariness and the destruction of value. The oversight responsibility granted to the private partner cannot coexist with sometimes archaic rules, based on a rigid public/private dichotomy and suspicion, by which the provision of public service is almost exclusively bestowed upon public agents and the delegation to the private sector is considered as an exception. Such a position has indeed some grounds, but may lead to a misunderstanding of all of the costs and contributions of infrastructure. The success of the partnership philosophy promoted by multilateral institutions depends on a minimum level of mutual confidence, based on firm obligations imposed on each party.

How to bring wishes and reality back into phase?
This is the purpose of our brochure, with no bias whatsoever and regardless of the origin and type of regulation considered, with a pragmatic and non-ideological approach.

2. With about 30 for the European Investment Bank and 29 for the World Bank.

SUMMARIES OF CHAPTERS

PPP can be used for new projects and for rehabilitation or maintenance projects. The facilities involved may be major infrastructure sites (transport, sewage treatment, construction), or, especially for rehabilitation-maintenance, complete existing infrastructure networks.

Economy of a PPP project and the decision to undertake it

Prior to any legal formalization, the decision to undertake a PPP project must be based on a serious economic approach, relying on a certain number of criteria, varying according to the nature of the infrastructure. The structuring of the financing will reflect this.
Among these criteria is the use of socio-economic benefits, or positive externalities, assuming that they can be identified and measured. There are now adequate instruments for this. This phase includes consultation and consideration for the opinions of civil society.
Once this first step has been achieved, taking into account possible nuisances, and the positive contribution of the private sector has been demonstrated, the latter can participate in the project following a competitive process. Otherwise, the project does not go forward.
The public authority, with the required know-how, is in charge of making the preliminary choice and the final decision of whether to undertake the project.

The essential role of the State and public authorities

In a PPP project, the State provides initiative and oversight. This constitutes the essential difference between Public-Private Patnership and privatization (in which assets and service are transferred to the private party).
In a PPP, the State appears as both the regulatory authority and the concession-granting authority. The State as regulator must set out a public service policy, with a clear will and concerns for the final interest of both the consumer and the community. It establishes the necessary legal, fiscal, accounting and financial framework in order to ensure this.
In order to fulfill these functions with PPP, experience has proven that there is a need for a specific regulatory authority, with powers granted by law and subject to political, administrative and judicial supervision. greater than the one that could be provided by the public sector shall be the goal and the justification for calling on a private company. **The concession-granting authority considers that a value added (or quality for the cost) greater than the one offered by the public sector should be the goal and the justification for calling on the private sector.** It defines the objectives and performances to be reached and leaves to the concessionaire the freedom of methods and means, in accordance with his obligations under the concession contract.
In both of its roles, the State must have the necessary authority to establish a balanced, stable and clear framework, with legal rules and an adequate financing system. It sets strict goals for the private sector, with which it can share the profits generated by the project, according to the initial agreements, while it can also sanction it if the goals are not met.
The setting-up of a suitable and attractive PPP framework will undeniably become a competition factor between States, in the same way that they compete for foreign direct investments made by international industrial and commercial companies.

Private partners

Private partners are diverse by nature: companies, financiers (banks, insurance companies), and operators. They must have the capacity to carry out and manage complex projects, allocate their corresponding equity capital and, thanks to their expertise, provide a facility and/or service of quality, which meets the specifications of the delegation contract, throughout the life of the project, at a price and within a time frame below that of the public sector.

In exchange for the obligations and potential sanctions, which they agreed on, and in return of their investment, they must receive a reasonable financial profitability, according to an acceptable timetable and the expectations of their shareholders and the financial markets. The private party requires the public partner to ensure transparency, for example by providing technical data enabling it to improve its projections and to reduce the overall cost of the project.
Since the low and deferred profitability of the projects is one of the causes of the decreasing number of projects undertaken, a new financing approach must be found. When the fee from the user does not reflect the real market price, the financing structure must integrate some of the socio-economic benefits, which would not exist without the project.
The resources for financing this contribution may be found today on financial markets, with the help of the multilateral organizations for emerging countries, through securitization of the future flows of socio-economic benefits generated by the project.
A specific legal entity must allow this without increasing State spending or indebtedness.

The role of institutions, agencies and international and multilateral organizations

The triple role of multilateral organizations as project "facilitators" is irreplaceable. Their "capacity building" action is essential in helping to establish complete, clear, adapted, stable but flexible and safe institutional systems, which provide security for foreign and local private investment.
Their consulting role helps identify, validate and prioritize projects.
They fulfill an essential function, which should be developed, of an indirect support for project financing, by providing financial and political risk guarantee mechanisms. The extension by multilateral organizations of the guarantee programs offered by States and the development of new instruments for the private sector is a step in the right direction.
Only multilateral organizations can attract investors and mobilize financial markets and/or banks. If after studies and dialogue with all parties involved, multilateral and bilateral organizations were assuming a share of the residual risks which none of the direct actors can cover, and ensuring proper execution of the financing, some projects which are not viable in the current context could go forward. This remark also applies to bilateral projects, which are sometimes blocked due to a lack of guarantees.
In order to quickly reach such goals, these institutions should establish a special transversal and multi-purpose tool, regional and/or worldwide, dedicated exclusively to the development of PPP.

Reduction of uncertainties through risk allocation

The basic principle of PPP consists in the transfer of each category of identified and quantified risks to partners who can assume those risks most efficiently and at the lowest cost. This requires transparent information and dialogue between the parties, so that each of them has a good knowledge of all costs, whether direct, indirect, visible or hidden. A risk matrix will be made and its analysis will eliminate those which can be eliminated, while reducing the others. An accurate appraisal of the risks run by each of the partners will optimize the sharing.
Uncertainty, and thus risk, are also reduced by the search for quality and the use of appropriate techniques, such as Partnering and Alliancing for relationships between partners, and Contract Bonds to ensure the completion of the project.
The diversity of the types of contracts reflects the possibilities for risk allocation. They range from Design-Build-Lease projects (DBL) in which risk taking is reduced, to BOOT concessions in which the risk taking is maximal, and also Design-Build-Lease-Maintenance, or the British DBFO.

Selection and competition

The selection of the contractor must be swift, efficient and above all pragmatic. In complex projects, two points must receive particular attention: prior selection of the most qualified contractors and protection of innovation. It is also wise to limit the duration of negotiations and the number of participants, as it generates useless costs.

The enormous costs for companies for bids and development could be reduced through mutualization. The losing bidders could then receive compensation.
Alongside or within the standard attribution systems, the partnering technique should be developed, as it promotes innovation as well as competitive and transparent dialogue, in order then to jointly set out the means for reaching the objectives defined.
Lastly, if we want to promote the emergence of innovative ideas from companies, these innovations must be protected through a special law on the protection of ideas in infrastructure projects.

Proposals to promote the emergence of PPP projects

Normative measures

- Enactment, updating or reconsideration of legal and regulatory provisions and legal codes: budget and public accounting rules, administrative and contract law.
- Establishment of specific regulatory authorities with broad powers granted by law and with an ad hoc budget. This regulatory authority will calculate, oversee and publish the commitments for allocation of the socio-economic benefits made by the State.
- Establishment of tax depreciation mechanisms and specific accounting norms for these projects. A special system for concessions should be studied on the occasion of the shift to the IAS norms scheduled for 2005.
- Transposition and development in Civil Law Countries of techniques and the practice of "Partnering/Alliancing".
- Establishing a specific right of protection of ideas and innovation in infrastructure projects (confirmation of submission of innovative offers).
- Encouraging multilateral organizations to establish an overall ad hoc structure dedicated to the promotion, development and management of PPP.

Project approach

- Establishment of ad hoc organizations granted with the necessary powers, concrete organization and realistic, efficient and credible procedures to identify, collect and transfer socio-economic benefits, allowing for recourse to financial markets, with guarantees from multilateral organizations in some cases.
- Rules for project selection and financing structures, resulting from an analysis of the value and the socio-economic optimum.
- Allocation of risks and public contributions, allowing for a reasonable level of equity capital funding, and for acceptable earnings on equity capital within reasonable time frames.
- Rigorous pre-selection of competitors, on a multi-criteria basis.
- Competition procedures allowing for contributions to competitors' development costs.
- Structuring and mutualization of consulting expenses, supplying by the concession-granting authority of more substantial information.

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1 ECONOMY OF A PPP PROJECT AND THE DECISION TO UNDERTAKE IT

Necessity of a prior economic approach
With criteria which are not just financial
Taking the nature of the infrastructure into account
The structure of the financing will be based on this approach
Using the notion of socio-economic benefits or positive externalities
Better identification of them and use of appropriate measurement instruments
Consulting civil society
The decision of whether or not to undertake the project will depend on this analysis
Economic rationality helps avoid deceiving appearances

1.1 Problem

Necessity of a prior economic approach

The approach of the various PPP formulae has been examined in many studies, which focused mainly on their legal aspects. There are various forms of public-private association for infrastructure projects, classified schematically according to the degree of transfer or delegation of the public authority to the private partner, such as pure privatization (transfer), DBL (Design-Build-Lease), concessions, BOT (Build-Operate-Transfer), BOOT (Build-Operate-Own-Transfer), DBFO (Design-Build-Finance-Operate), BLT (Build-Lease-Transfer), etc.
Before concentrating on these legal definitions, the planning for a PPP project should normally be done according to an economic approach, which takes into account the project duration from the outset. As such an approach is unfortunately often absent or neglected, we can only hope that economic and financial analysis for PPP projects will be more systematically done.

Only a preliminary economic analysis, assessing whether the project should be pursued or not can ensure the viability of the project over time. It is also politically sound because the various participants in the project are thereby involved from the outset. A great many operations, whether for new projects or management, maintenance and/or the rehabilitation of existing projects, now abandoned, could have been viable with a long-term approach seeking to optimize the value (quality and overall profitability) and the appropriate financing planned from the beginning.

Problem and search for solutions

In the private sphere and with unregulated prices, the sales price of products normally reflects all of the costs plus the company's profit. This is not the case for all infrastructures when, for social reasons for example, the service is provided free of change, or users consider that they have already paid for the service through their taxes. In such cases, the fee, in the broad sense, does not reflect the real cost, due to:
- the public service mission (notion of universal public service);
- public and/or private subsidies (urban public transport tickets);
- payment only for the direct service which the consumer receives (a highway toll represents, at best, only the value of the time, and the fuel and maintenance savings). The other services provided by the infrastructure do not have identified buyers: the community benefits from them free of charge, and the State receives all of the positive externalities (or socio-economic benefits) produced.

Some States want to make tolls or fee the only source of financing for this type of infrastructure. This desire is not based on a solid economic or financial reality. The necessity of substantially increasing a toll or fee does not take into account the consequences:
- the level of traffic or use would diminish as the price increases;
- the concessionaire's income would decrease, threatening the financial equilibrium sought;
- the socio-economic benefits would not be optimal.

■ **In most cases, especially for roads, the concessionaire's economic and financial criteria cannot really be the sole basis for the setting up of the fee for the use of public facilities. It must take into account not just the political and social dimensions of the project, but also the level and the nature of the socio-economic effects it will generate. With such criteria, it would therefore be rare that the concessionaire's optimum is also that of the community.**
This is not the case for infrastructures, for which the service is provided at market prices (air terminal, energy, telecommunications, etc.) and that is why these have been the favored targets for privatization. In such cases however, especially but not only in emerging countries, there are problems of redistribution to the poorest categories of the population. In order for them to have access to these services, multilateral organizations can then provide upstream financing of the State subsidies granted for the project (e.g. World Bank Loan to Vietnam for the financing of subsidies for electrification).

■ **Infrastructures can be divided into three categories** depending on whether the public service:
- is delivered without a direct fee from the user. The concessionaire's returns depend almost totally on the payment from the State. The concessionaire must ensure that the State can honor its commitments in the long run, and may seek to cover the risk of an interruption in payments through multilateral, bilateral or private insurers;
- involves a mixed payment, i.e. tolls plus support from the State;
- is provided in market conditions without any financial intervention from the State, which simply makes certain that the service is provided in accordance with the provisions of the concession contract.

■ **The financing will be structured accordingly, depending on:**
- the social or productive nature of the infrastructure;
- the collection or non-collection of a right of use;
- the commercial or non-commercial nature of the toll or fee;
- the extent of and the sharing of the savings resulting from the private sector's providing of the public service;
- the possibility or impossibility of building the conceded infrastructure in several phases;
- the conservation of the toll or fee by the State or its delegation to the concessionaire;
- the nature and extent of the externalities, the capacity of the State to evaluate and include them in the project.

1.2 Identification and measurement of externalities (socio-economic benefits)

Identification of externalities

The public authority, possibly with the assistance of outside consultants, must mobilize the necessary skills in order to carry out preliminary studies to ascertain the direct and indirect costs, as well as the apparent and hidden financial, economic, environmental and social risks of the project. It must also identify, quantify and allocate the positive balance of the externalities.

■ **An accurate assessment of the project must distinguish, from the outset, the economic and social benefits (or externalities) from the financial profitability.** The purpose of the former is to evaluate the benefit of a project for the community. The latter, when applicable, involves only the precise feasibility conditions for a project delegated to the private sector. Only the public authority can have a global view of the externalities of a project, which take into account factors such as:
- giving more people access to basic services;
- improving access to a region and promoting its economic development;
- the induced increase in employment;
- the improvement in transport safety, public health, living conditions, and the re-appropriation and development of urban areas;
- the decrease in pollution, improvement of the environment, etc;
- all taxes and levies directly generated by the project.

■ **Such identification presupposes prior consultation with and consideration of the opinions of civil society, according to special procedures defined by the rules of each State.**

Measurement of externalities

The development of financial and econometric techniques and knowledge of data for projects already completed allow us to go beyond the purely subjective aspects of the concept of externality and enable us to demonstrate its reality, and then to quantify it. This approach will include human data resulting from the consultations. It will then be possible to:
- assess the socio-economic reactions of direct users and public opinion to the principle and amount of the toll or fee requested, to the costs and advantages of the projects, to its contribution to the improvement of transportation and to city life, as well as the consequences for the environment and public health;
- draw demand curves with corresponding elasticity;
- decide whether or not to carry out the project based on rational criteria;
- then, on this basis, determine the breakdown of the proceeds between tolls or fees and the contribution of the community to the project (facility and/or equilibrium subsidy, total or partial reimbursement of advances, etc.);
- have political authorities set up a satisfactory average rate, using the concessionaire's know-how to optimize the rate policy.

> An analysis of recent projects leads us to a surprising conclusion. While many of them generate a socio-economic Internal Rate of Return which is well above the Rate of Return on Investment of private companies for the same project, and despite the new very long-term financing possibilities offered by financial markets, States do not finance them, or only very few, or put in concession only a few projects with acceptable conditions, as they give priority to operational indebtedness to the detriment of investment spending. **States act as if the socio-economic benefits did not exist.** They block the development of infrastructure and its positive contribution to the economy, although they have the means to make this possible under better conditions than in the past.

The combined use of concepts, values and instruments for:
- the measurement and optimization of the socio-economic benefits;
- the setting up of an optimum fee or toll;
- the "commercial" price for the service provided;
- the extent and price level of the associated commercial services;
- financial cost effectiveness;
- the assessment of the degree of certainty of the traffic or use forecasts;
- cost savings;

will allow for rational decisions based on tangible and measurable realities.

1.3 Appearances and economic rationality - Real toll and shadow toll

The economic approach allows us to go beyond deceiving appearances. For example, a free service is not necessarily an obstacle to its privatization, as clearly demonstrated by the shadow tolls used in the European PPP. However, it does require from public authorities to be willing and able to compare the costs of the two systems at the origin of the quality for price (value for money) and to make payment to the concessionaire over the long term, possibly with deferment, from their general budget.

It should be noted however that the **shadow toll mechanism, for which the total financing is backed by the payment of the State to the concessionaire, is only a budgetary tool, which does not lead to an additional net financing contribution through the fees** paid by the users of the infrastructure. This technique therefore "consumes" externalities without taking them into account, without the socio-economic contribution of combining a real toll and repayment of externalities. The economic rationality of shadow tolls projects is generally not as deep as those of real tolls. As the real economic surplus provided by the project is not precisely known, it is therefore more difficult for the public authority to justify the decision to undertake it. As for the concessionaire, its influence and its role in the life of the project, its adaptation to demand and its improvement are less important in a project with a shadow toll than in concessions with a real toll.
The shadow toll is primarily a tool for lowering public spending and not a development aid tool

2 THE ESSENTIAL ROLE OF THE STATE AND PUBLIC AUTHORITIES

The double nature of the State, Regulatory authority and Concession-granting authority
The necessity of a clear political will, based on the final interest of the consumer and the community
A legal framework to be reviewed or established
The need for specific PPP institutions
An overall approach applied to the various types of PPP
Initiative and oversight are the State's responsibility

2.1 The double nature of the State

In a PPP project, the State is both the regulatory authority and the concession-granting authority (itself or through de-concentrated, decentralized or autonomous public authorities such as Federal State, Region, Province, Department, City, regional or national public institution, Chamber of Commerce, etc[3]). In both cases, the State takes the initiative.

The State, regulatory authority

It is the role of the State to define and apply a long-term public service policy based on **a clear will and on the final interests of both the consumer and the community**. The PPP concept, which involves a long-term approach, can become one of the key systems, through a general regulatory authority or a specific one for each category of infrastructure.

When a State decides to undertake PPP projects, and once it has set the objectives, it must have an **overall approach to the various types of PPP.** It must set up the corresponding legal, fiscal, accounting and financial framework. These are long or very long-term projects, which cannot be handled like public works contracts. In order to be effective, the partnership requires a radically different outlook, with priority given to a balanced sharing of roles, risks and financing throughout the life of the concession.

Experience has shown that controlling this process requires a special PPP organization, both in industrialized and emerging countries. The United Kingdom and very recently the Netherlands have established such bodies. The English mixed entity (PUK) even relies on financial markets to invest in such projects. Serious thinking on this issue is underway in some emerging countries as well.

> We consider it essential that there be a regulatory authority with the capacity granted by law to organize a framework in which PPP will be used and which will then be involved in monitoring and overseeing it. It must develop PPP, based on the general economic and social objectives determined by the authorities, and must train the various representatives of the public powers involved as well as the potential licensors (ministries, regions, public establishments, etc.).
>
> This authority shall be subject to special budget rules, outside of the general budget, adapted to the characteristics of the projects and their duration, as well as to the social priorities set by the State. The authority will make sure that externalities are identified and used properly. It will handle oversight and accounting. The law will grant it regulatory control and arbitration power to achieve this within a collegial framework involving members of the private sector and civil society. It shall be subject to political, administrative and judicial control.

3. Herein referred to as the "State" or the "concession-granting authority" for the sake of simplicity.

The State, concession-granting authority

In a PPP project, the public authority should **define the goals and performances** to be sought for:
- optimum use of public funds;
- the best satisfaction of consumer needs at the lowest cost.

However, it must **leave to the concessionaire the choice of the methods and means** for reaching and optimizing this result. It achieves this through a balanced and more or less substantial transfer of risks to the private sector.
The key criteria involved are:
- the priority of the project;
- its social and cultural acceptability on a national or local level;
- the creation of long-term value;
- the economic and financial value of the investment made, in terms of the benefit for the community, private investors (professionals and pure financiers) and lenders.

The quality for the price, or value-added, is one of the fundamental principles of PPP. This notion includes:
- rapid completion of projects;
- a high level of quality and services;
- effective management over time.

The concession-granting authority must study and quantify all direct and indirect costs of the project, in order to compare purely public to purely private functioning. Given identical service, the value above and beyond that which the public sector would provide must be used as the objective and justification for involving a private company.

Privatization and PPP

The concession-granting authority is the main initiator of the PPP process. It externalizes project management and also the work itself. PPP implies the delegation of certain public service tasks and missions, but with **final control by the public authority**. **This essential difference distinguishes PPP from privatization, by which not only assets but rather the entire corresponding public service is totally transferred to the private party.**

The public authority must therefore participate and become involved in the planning and carrying out of the project, in varying degrees depending on each phase. When the public authority does not have all of the necessary expertise, outside consultants and/or multilateral organizations should also be involved in order to help in the planning and execution of the project.

2.2 The role of the State (or public authority)

The State must provide for a stable, balanced framework

The public regulatory authority must identify and decide which public services will be delegated to private companies and must define the extent of this delegation. This initial conceptual and voluntary step cannot be taken without the prior definition of principles and guidelines, and then the adaptation or establishment of codes and regulations allowing PPP to exist and develop.

■ The authority must **simply and operationally create, update or reconsider the applicable legal** (public law and private law), fiscal, financial, accounting and environmental frameworks, with a special emphasis on the following points:

- budgetary rules, public accounting and a long-term approach: multi-year budgets, modification of budgetary allocation procedures, use of deferred payment and equalization mechanisms; adaptation of public accounting rules in order to better evaluate externalities;

- accounting and fiscal aspects: re-examining depreciation rules for public facilities, which tend not to be subject to obsolescence and which have very long working lives;

- public domain law and public function: possibility of abandoning or modifying the status of some assets in the public domain, for the purpose of helping to finance new projects or to rehabilitate already existing ones; conditions for transfer of employments from the public to the private sector;

- innovative budget mechanisms allowing for the sharing of the savings generated by the know-how of the private partner, and allocating to the latter a share of the socio-economic benefits, with a maximized security and at the lowest cost. In emerging countries, the intervention of multilateral organizations can ensure that this mechanism functions properly;

- contract law: establishment of committees for oversight and multi-party adaptation, with sufficient powers, especially for rapid resolution of conflicts; safe and simple procedures for compensating the concessionaire; organization of periodic meetings for monitored flexibility;

- protection of intellectual property: an appropriate and efficient legal system tailored to protect innovation;

- legal framework for competition, in order to attract only experienced professionals and to limit the cost of project planning and development borne by the public sector and by private competitors.

…and efficient application

When the private sector is asked **to carry out a public service mission in the same conditions as the State**, it is neither shocking nor illegitimate to re-establish, in other forms, the economic and financial equilibrium in favor of the concessionaire (which was formerly the State's responsibility).Therefore, the State must set a toll compatible with the socio-economic optima and include in the financing plan a part of the externalities to make the project financially viable, **as long as the final socio-economic cost effectiveness remains positive.**

■ **The State must have the will** to provide the necessary skills, instruments and means of measurement for this.

It must be stressed once again that **only a long-term approach, based on quality and efficiency, can ensure correct understanding of a project.** From a practical standpoint, this quality approach implies the obligation for the private company to ensure that the service shall be made available at the agreed level, if it is to receive the corresponding proceeds.

The concession-granting authority must:
- request to be provided with reliable and reasonable guarantees from the private partner;
- oversee the proper execution of the work and service;
- make sure that the qualitative and quantitative results provided for in the contract are obtained;
- punish, without despoilment, the concessionaire's shortcomings.

Full delegation to the private sector therefore leads the concession-granting public authority to oversee and sanction the private sector when it does not strictly observe all the specifications.

3 PRIVATE PARTNERS

The various types of private partners
Rigorous and controlled obligations
Offering reasonable profitability with an acceptable time frame to stop the fall in the number of these projects
The need for a new financial approach
An ad hoc public entity
Sharing of the profits made
Reciprocal transparency of information.

3.1 The nature of the private partners and their fundamental obligations

Private partners are essentially: **companies, as natural sponsors for transport infrastructure** because of the technical risks associated with construction, pure financiers (i.e. banks and/or insurance companies), and operators.

The private partners must:
- have the capacity to undertake complex, long-term projects;
- allocate the corresponding equity capital, convince lenders and insurers, and provide them with certain guarantees;
- on the basis of their expertise, offer a facility and/or a service of quality which meets the specifications of the delegation contract throughout the period of the concession, at a price and within a time period less than those of the public sector.

In return for their obligations and their investment, they receive a reasonable financial profitability, within an acceptable time frame, and in accordance with the expectations of both their shareholders and the financial markets.

3.2 The search for reasonable profitability

Obtaining this profitability within an acceptable time frame is absolutely essential if there is to be any hope of attracting investors and increasing the number of undertaken projects. Infrastructure requires substantial capital and time for development. Given the structure of their balance sheets and the requirements of their shareholders, for whom value creation is imperative, companies do not have capital which they can tie up for long periods of time, while awaiting deferred results.
The low and deferred profitability of these projects constitutes one of the main causes of the current contraction. The time for companies' return on investments is very long, as much as 15 years for some sectors!

> The capital levels required from private companies are too high. It is not rare to find capital of 40% of the total amount of the investment. The distribution of the socio-economic benefits from these projects between the concession-granting authority and the concessionaire is often very unbalanced to the detriment of the latter.**The income received by the concessionaire as a return on its investment is insufficient.** Given the prudential ratios required by lenders, the financing plan can only be balanced through a substantial injection of capital, which would be very unlikely to find acceptable remuneration and which investors would not be willing to provide.

This situation does not favor the broad development of PPP. In addition, during the crucial first years of the project, the deferred depreciation and tax rules have a negative impact on the externalization of the results of the project company to its shareholders. The diluting nature of these rules is a strong deterrent for private investors. The application of rules for depreciation of industrial and commercial assets to public facilities, which tend not to be subject to obsolescence and have very long working lives, must be re-examined.

In the future, if the conditions for such profitability are not met, more and more companies will probably be only interested in projects ensuring a "market" level remuneration, or will alternatively focus on acquiring new market shares through external growth, abandoning their participation in projects held as too hazardous. Projects that are nonetheless undertaken will not attract financial investors other than in exceptional cases, leaving the companies, with their limited capacities, to make the initial capital investment alone.

3.3 For a new financial approach

The financing of public infrastructure can no longer be structured by simply transposing project-financing techniques used for standard market investments. The financing of infrastructure projects between private investors and the concession-granting authority must be redistributed and balanced. **A new financing approach, which mobilizes future social benefits, must be fostered.**

The contribution of private partners

Every time the fee or toll requested from the client does not reflect a real market price, the structure of the financing must **include some of the socio-economic benefits, which would not exist without the project.** The experience of our companies demonstrates that, on average, road concession projects generate for the community annual socio-economic benefits from 20 to 25% of the amount of the initial investment.

A new analysis of the distribution of the externalities between the concession-granting authority and the concessionaire, as well as the undertaking by the concession-granting authority of part of the uncertainty related to use and traffic forecasts, should allow for:
- a significantly lower level of private capital, close to the levels generally observed in the United Kingdom (between 5 and 10%);
- an associated debt much lower than what is generally requested for most projects, allowing for higher prudential ratios, justifying financing which is really without recourse to the shareholders of the project company.

Guarantees will be given by the concessionaire to the lenders and the concession-granting authority, drawn up in strong language, covering the "price, deadline and quality" triad for construction, as well as for operation/maintenance, in accordance with the strict conditions of the concession contract.

The contribution of the public sector

The concession-granting authority will provide complementary financing. The resources for financing this contribution may be found today on financial markets, with the help of the multilateral organizations for emerging countries, through **securitization of the future flow of the socio-economic benefits** generated by the project. **A specific legal entity must permit this without increasing State spending or deficits.** This financing could be raised by an autonomous public entity, to which the State would allocate some of the externalities created by the project after having first identified and collected them. In order to reassure lenders, the identification, monetization and allocation of the balance of the externalities shall be **separated from the general budget of the State, and covered by reliable guarantees.**

On such bases, it is not unrealistic to hope that the project could generate, within an acceptable time frame, a level of profitability from 12 to 20%, covering the cost of capital of the investor as well as the project and country risks. Should the profitability ceiling agreed on by the parties be surpassed, a profit-sharing mechanism would allow the concession-granting authority to benefit from the favorable changes occurring during the concession period (increase in traffic beyond forecasted level, efficiency of operation/maintenance, future improvements in financing terms, etc.), without making it bear the negative changes. This mechanism is justified by the concession-granting authority's participation in the financing of the project and the **forecasts uncertainty.**

In this respect, transparent and reciprocal information must be one of the bases for proper functioning of PPP. The use of existing databases concerning traffic, the number and quality of which have improved, allows for better use of calculation and probability analysis tools. Greater precision in the forecasts for future flows of income allows for:
- improvement of lending conditions through a decrease in the level of the prudential ratios and the risk premium;
- more precise allocation of the necessary public support;
- optimization of the amount of capital;
- financing of a larger number of projects.

4 THE ROLE OF INTERNATIONAL AND MULTILATERAL INSTITUTIONS, AGENCIES AND ORGANIZATIONS

The essential role of multilateral organizations
"Capacity building"
The consulting role
The role of facilitating financing
Investment guarantee instruments to be developed
A specific system for PPP to be established

International institutions, the European Union and multilateral organizations have an irreplaceable role as "facilitator" of PPP projects, with a long-term view, taking into account the major stakes for a region. Their attitude and incentives should lead emerging countries to establish and structure appropriate policies and to allocate the corresponding means thereto.

4.1 Establishing clear frameworks

As already stated above, the first condition for the success of PPP projects is the establishment of guidelines applied within a comprehensive, clear, suitable, stable but adaptable, and dependable institutional structure. International organizations should help in the setting-up of clear principles and rules, an appropriate legal framework, and corresponding institutions. Within the scope of their role of advising and disseminating successful past experiences (e.g. role of the Knowledge Bank, developed by the World Bank), they can help by calling on private sector specialists. In conjunction with the States and their administrations, the latter, will handle the analysis, definition and application of new procedures and/or their necessary adaptation. This is precisely the purpose of the "capacity building" program being undertaken by the World Bank and the WTO.

4.2 Identifying and validating projects

Multilateral organizations can then, through direct advising or by financing specialized consulting firms, encourage and help States to **identify, validate and prioritize** projects of all sizes and natures, which will have a very significant impact on their development. Their role is essential in this long and costly process. The contribution of international institutions and multilateral organizations to an overall approach to PPP economy in emerging countries, the improvement of knowledge of costs, and the contributions of infrastructure enable States to carry out concrete poverty reduction projects.

4.3 Orienting private financing to PPP projects

Capital is not lacking, even for emerging countries.
The security offered to participants is inadequate. The private insurance market is growing considerably but multilateral organizations, through their indirect support for project financing, and especially with their financial guarantees and political risk mechanisms (MIGA-type), existing or now being improved, are the only ones who can attract investors and mobilize financial markets and/or banks.

The contribution of multilateral organizations

Multilateral organizations compensate for the insufficiency of purely national capital by helping with the development and rise of local capital markets, as well as for the difficulty or impossibility of these States to gain access to international banks or financial markets (weakness of ratings given by specialized agencies, hedging of foreign exchange risks). They make the final risk acceptable to investors, lenders and insurers.
These remarks also apply for bilateral projects, which sometimes cannot be undertaken due to a lack of guarantees.

■ **If, following studies and dialogue with all parties involved, multilateral and bilateral organizations assume a share of the residual risks which none of the direct actors can cover, and also ensure the proper execution of the financing, some projects which have not been viable in the current context could then go forward.**
At the same time, the concept of zero loss underwriting used by private monoline insurers would allow multilateral organizations to very substantially reduce the risks related to the granting of their guarantees. The absence of loss is due largely to:
- the value of the institutional framework;
- the reasonable nature of the planned repayments;
- the quality and independence of the organizations involved;
- the credibility of the procedures, particularly the measurement instruments and the State's effective capacity for repayment of externalities, under the control of the regulatory authority.

■ The strengthening of the guarantee programs offered to States by multilateral organizations, and the development of new instruments for the private sector are steps in the right direction. The extension of the externality collection mechanism to projects of sub-sovereign entities is the beginning of a solution with respect to the intervention of multilateral organizations in their favor.

A special tool for the economic approach to and the development of PPP projects

In order to reach such objectives, these institutions should rapidly establish **a special transversal and multi-purpose structure**, regional and/or worldwide, **exclusively dedicated to the development of PPP**.

5 REDUCTION OF UNCERTAINTIES THROUGH RISK ALLOCATION

Through transparent information and dialogue between actors
Through accurate identification of risks, using simple matrices
By seeking quality
Through cost/benefit analysis
Through the use of appropriate and well-proven techniques…
Partnering and Alliancing
The Contract Bond
Formulae based on the risk taking

The basic principle of PPP lies in the transfer of each category of identified and quantified risks to partners who can assume them in the most efficient manner and at the lowest cost. This assumes that each party has a good knowledge of these direct and indirect, visible and hidden costs.

5.1 Reduction of uncertainties

The transparent establishment and provision of data, through teamwork between the concession-granting authority and each of the competitors, is indispensable. These would constitute reliable statistics and information concerning the risks involved in each step and with each party, from government agencies, insurers, multilateral institutions or private parties. Accurate assessment of the risks taken by each of the partners will allow for an optimized sharing.
In return, competitors must agree to work with the public partner in a straightforward and open manner, to the extent that confidentiality is guaranteed and ideas are protected. Part of this process requires taking into account the concerns of Civil Society (Non Governmental Organizations, users' associations, neighbors, etc.). The savings resulting from such transparency will be shared between the parties, in ways to be determined on a case-by-case basis. Based on these principles, the parties must jointly establish risk matrices.

Risk matrices

- Public risk: both political and administrative, along with a list, as of the date of the allocation, of the laws and regulations affecting the concession.

- Economic and financial risk:
. free rate setting / administered rate, providing of service at a "market" price, extent of the public service mission assigned to the company (notion of universal public service), socio-economic acceptability of the toll or fee, inflation, devaluation;
. returns from and support for the project: tolls, rents, fees, temporary or permanent public contributions, paid or free, and the compensation paid by the concession-granting authority to the concessionaire (reimbursement of advances, incentives, etc.);
. changes in financial markets - volume, rate - due diligence, fulfillment of preceding conditions.

- Traffic risk: economic change in the region, absence of competing projects, new or rehabilitated, offered free of charge without compensation from the concessionaire;

- Construction risk: proper completion, hazards, geology, force majeure (act of God).

- Operation and maintenance risk

- Environmental risk.

Analysis and use of the matrix

This phase allows for the **removal of risks which can be easily eliminated**, such as decision uncertainties due to political and administrative authorities, so that only real risks remain: political, natural, economic, financial or socio-cultural;
It leads to the **minimizing of risks** through the search for quality and efficiency from the outset.
The cost/benefit analysis allows for an objective evaluation of the risks borne by each party. It facilitates the sharing and assignment of risks at the lowest cost, avoiding useless coverage costs.

Proven techniques

Two techniques can be cited: "Partnering", valuable for enhancing transparency during the negotiation phase of the project, and the "Contract Bond", which guarantees fulfillment. The risks associated with each step are thus minimized.

"Partnering[4] " is a relationship between parties, which favors in-depth dialogue between them from the outset of the project. By promoting information transparency to jointly determine the means for reaching the objectives, it reduces the risks for all partners.

A Contract Bond is granted by the Guarantor prior to the tender offer, based on the technical and financial capacity of the company, its experience, the quality of its management and its capacity to fulfill the particular contract. As the contractual obligations are included in the Bond, the Guarantor must step in and fulfill the obligations of the main Contract if the Contractor defaults. This tool is a remarkable instrument for enhancing contractual security and transparency.

5.2 The various types of risk allocation

The wide range of contract types reflects the possibilities for risk allocation. They range from Design-Build-Lease projects (DBL), in which risk taking is reduced, to BOOT concessions, in which the risk taking is maximal, and also Design-Build-Lease-Maintenance, or the British DBFO.

In this latter hypothesis, the concessionaire's remuneration is only marginally based on the real use of the facilities. It results mostly from its availability and the performance of the concessionaire (maintenance, security).

6 SELECTION AND COMPETITION

Principle of pragmatism
Limiting the duration of negotiations and the number of participants
Decreasing the cost of bids and development, compensating competitors for this
Classic attribution procedures
A technique to be developed: Partnering/Alliancing
Protecting innovation

4.See page 21 ("Selection and competition").

6.1 The utility of pragmatism

The selection of the contractor must be swift, efficient and above all pragmatic.

The negotiation time must be reduced. Multiplying the number of participants leads to substantial study and consulting costs, which put increasing burdens on contractors. Project development and preparation costs can amount up to $10 to 15 million per contractor and project.

A large part of these expenses, dedicated to outside consulting, results from inadequate procedures. Such consulting costs, borne by each of the competitors, can be limited through better pooling of the used data and through the provision of more substantial information by the concession-granting authority.

The total or partial reimbursement of expenses for all or certain bidders should be allowed, as it is sometimes the case for the attribution of the concession project, although this could be applied more widely. The resources covering such expenses would result from the savings generated by the partnership with the private sector.

6.2 Attribution procedures

The usual attribution procedures are:
- tender offers, open or limited with a prior call for candidates, according to the size and complexity of the project;
- competitive negotiation, generally subject to threshold or specificity rules.

In complex projects however, two points require special attention: prior selection of the most qualified candidates and protection of innovation.

A technique to be developed: Partnering/Alliancing

The main differences between this procedure and other forms of collaboration lie in the method for selection of the private partner, and in the fact that the "Partnering" or "Alliancing" technique requires from the public authority to be an active participant. It favors in-depth dialogue between the parties from the outset and facilitates a win-win approach for all of the partners. It is useful in PPP projects, and could be broadly used for them.

Functioning

Starting with an initial selection based on a set of multiple skill criteria with an emphasis on the experience of the competitors, their technical and financial capacity to handle the design, building and operation/maintenance of complex projects in the long-term, teams are formed and become real partners of the concession-granting authority. The **establishment of targets** (time, quality, costs, transfer of know-how etc.) and the possibility of **sharing the resulting benefits** lead to real cooperation.
The offer creating the greatest value is then selected. The determination of this value will take into account innovations such as "benchmarking" techniques, referencing or the pooling of ideas, overall offers and contracts with maintenance.

Value

With "Partnering/Alliancing", the public authority reduces the risk associated with the companies' capacity. This approach is the opposite of solitary, arbitrary and theoretical determination of characteristics, functionality, services etc., which the concessionaire must carry out without really using its creativity. **On the contrary, "Partnering/Alliancing" promotes innovation, and competitive and transparent dialogue,** in order to jointly determine the means to fulfill these objectives.
The authority gains detailed knowledge of each company throughout the project definition phase and is therefore provided with the necessary information to assess the risks associated with the concerned companies. It can also break its ties with the companies at any time on predefined terms.

"Partnering/Alliancing" is a transparent and competitive mode for defining and attributing projects, which allows for real competition between the various parties. For complex projects it is the best system to:
- clearly express the concept of value and to promote innovation;
- efficiently help with optimum risk allocation;
- demonstrate that the **performance of the public service mission by the private sector produces quality and lowers costs.**

■ As this notion is a Common Law notion, it should be adapted in Civil Law countries. This could be the purpose of a European action.

■ Protecting innovation

One aspect of the search for value is innovation. For many States, this represents a key factor in the PPP process (e.g. Ireland, South Africa, California, etc.). Innovation is promoted not just during the project-planning phase but also and especially during the competition phase. However, innovation, like any intellectual work, must be protected. Builders will not be motivated to seek innovative approaches if their ideas are taken by others during the contract attribution.

■ **Particular rights should be granted for the protection of ideas in infrastructure projects** (recognition of submission of innovative bids) and actual commitments to protect and compensate for violations by the concession-granting authority and/or the other competitors should be included in the specifications for the tender offers.

7 LIST OF PROPOSALS TO PROMOTE MORE PPP PROJECTS

7.1. Normative measures

- Enactment, updating or reconsideration of legal and regulatory provisions and legal codes: budget and public accounting rules, administrative and contract law.
- Establishment of specific regulatory authorities with broad powers granted by law and with an ad hoc budget. This regulatory authority will calculate, oversee and publish the commitments for allocation of the socio-economic benefits made by the State.
- Establishment of tax depreciation mechanisms and specific accounting norms for these projects. A special system for concessions should be studied on the occasion of the shift to the IAS norms scheduled for 2005.
- Transposition and development in Civil Law Countries of techniques and the practice of "Partnering/Alliancing".
- Establishing a specific right of protection of ideas and innovation in infrastructure projects (confirmation of submission of innovative offers).
- Encouraging multilateral organizations to establish an overall ad hoc structure dedicated to the promotion, development and management of PPP.

7.2. Project approach

- Establishment of ad hoc organizations granted with the necessary powers, concrete organization and realistic, efficient and credible procedures to identify, collect and transfer socio-economic benefits, allowing for recourse to financial markets, with guarantees from multilateral organizations in some cases.
- Rules for project selection and financing structures, resulting from an analysis of the value and the socio-economic optimum.
- Allocation of risks and public contributions, allowing for a reasonable level of equity capital funding, and for acceptable earnings on equity capital within reasonable time frames.
- Rigorous pre-selection of competitors, on a multi-criteria basis.
- Competition procedures allowing for contributions to competitors' development costs.
- Structuring and mutualization of consulting expenses, supplying by the concession-granting authority of more substantial information.

GENERAL CONCLUSION

It is now more than ever necessary to reduce poverty in developing countries and, both in these countries and in industrialized countries, to foster or revive economic growth. The construction of infrastructure and public facilities is one of the best ways to achieve this goal. Many needs in this area are not met, due to the difficulty in reconciling the constraints of the parties involved in standard financing systems.

Public private partnership can provide the optimum for each of the three main PPP participants:

- the socio-economic optimum for **the State**;
- financial profitability for **the investor**;
- an acceptable toll for the **consumer**.

If PPP is to emerge as a real mode of operations and a philosophy for partnership, a drastic change in mentalities and behavior, more than in techniques, is clearly needed. PPP is based on transparency, and a lack of understanding of it and its opacity are major obstacles, leading to irrationality, arbitrariness and the destruction of value.

A distinction must be made between industrialized countries and developing countries.

In the former, the law exists but the rules and principles of PPP are either absent or rigid, and no longer correspond to the intrinsic needs of the community and requirements of the projects.
These countries must abandon their rigid public/private dichotomy, which triggers suspicions and which, by nature, gives public agents a near exclusivity on providing public service, making delegation to the private sector an exception. The reason for such an excessively rigid position is to be found in the ignorance of all of the costs and contributions of infrastructure.

For the latter, the diagnosis is the same but the problem is even worse. If nothing changes, private partners will no longer be able to bear the disproportionate risks and constraints they are increasingly facing. These essential actors of the development of their countries may, in the end, chose to focus on markets in industrialized countries, where project opportunities exist and external growth possibilities are substantial.
Unless new policies and means are established to keep and/or attract private partners, the forced withdrawal of companies and investors will hinder the growth of these countries. What is needed, on the contrary, is support for a real co-development approach.

All of the industrialized and emerging countries must adopt modes of functioning and techniques which favor partnership and transparency, **respecting the decisions of the States, which remain in control of the whole process and which can stop it at any time.** Structural reforms leading to the establishment of flexible and suitable PPP organizations are thus essential. The international and multilateral institutions for these countries are aware of this, and some of them have already reached the planning phase.

An association of private sector operators and civil society, sharing a constructive, non-corporatist and non-ideological view, would make a contribution in terms of the efficiency, rapidity and understanding of these mechanisms. It would also demonstrate that the delegation of public service missions to the private sector does not lead to an increase in service costs and a degradation of quality, contrary to what is still often and wrongly stated. Past failures should not be viewed as a signal to abandon PPP, but rather as an incentive to approach it with appropriate rules.

PPP is a virtuous, "win/win" process for all parties involved, which promotes transparency, efficiency and sustainable development at all stages. This process must be structured and all of the parties involved must have the will to make all of the necessary changes rapidly.

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