

TRADE UNION CHECKLIST ON PUBLIC-PRIVATE PARTNERSHIPS (PPPs)

BASED ON THE OECD PRINCIPLES FOR PUBLIC GOVERNANCE OF PUBLIC-PRIVATE PARTNERSHIPS

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Introduction

The labour movement has serious concerns about Public-Private Partnerships (PPPs) schemes for financing infrastructure and services because of the complexity of the contractual arrangements (as compared to traditional public procurement), the unequal and uncertain distribution of risks between government and private investors and, importantly, because of the threats to public services. In practice, PPPs have often proven to lead to over-priced public services as well as to situations, where gains are privatised, while losses are socialised.

Governments and citizens at large should be concerned and remain vigilant, whenever public moneys are left in private hands, or whenever a contractual arrangement would expect a for-profit operator to deliver a not-for-profit good as is the case of a PPP. This is where the OECD Principles for Public Governance of Public-Private Partnerships (hereafter “the Principles”) can have some value for trade unions engaged in policy discussions or negotiations involving a PPP scheme. The Principles surely do not reflect or relay fully the concerns by trade unions. Nevertheless, they arguably provide for a good starting point to engage in a PPP negotiation or when participating in a public debate on PPPs.

What is a PPP?

A PPP scheme is a long term contractual arrangement between a government entity and a private partner whereby the latter delivers and funds public services using a capital asset and sharing the associated risks. Under a PPP contract, the private investor is typically tasked with the design, building, financing and operation (a.k.a. 'DBFO' arrangements) of a capital asset required for service delivery as well as the delivery of a service to the government, or to the public, using that asset.

This is how the OECD defines PPPs. The definition is focussed on financing infrastructure with a clear public service objective, including transportation, water & sanitation, energy, health, education, security. The OECD Principles cover certain types of for-profit concessionary arrangements that are designed to deliver a public service. They exclude, however, other forms of concessions such as licenses to use government assets (as is often the case in the extractive industry sector). The OECD definition also excludes arrangements, where non-governmental organisations such as non-profit civil society groups, trusts, church groups etc. are involved in the development and delivery of public or semi-public services.

Importantly, the OECD definition distinguishes PPPs from 'traditional' public procurement contracts. And for a cause: PPPs are and should be treated as alternative solutions to public procurement and, as shown below, they should be compared to the latter option (as part of the "public sector comparator" testing).

About the Principles

The OECD Principles for Public Governance of Public Partnerships¹ are non-binding recommendations endorsed by the 34 member states of the OECD. To date, they constitute the only set of international guidance on PPPs.

The content of the Principles provide guidance in three areas:

Part A. on the institutional framework, including: "public awareness" on the costs, benefits and risks of PPPs and the "active consultation and engagement with stakeholders" (Principle A1), clear mandates and sufficient resources for the procuring authorities, PPP Unit, the Central Budget Authority, the Supreme Audit Institution and sector regulators (A2), transparency of regulation and reducing red tape (A3).

Part B on the selection of PPPs based on "Value for Money" principle, including: "no bias either in favour of or against PPPs" (B4), "conducting a procurement option pre-test" and "where relevant" a Public Sector Comparator (B5), "transfer the risks to those [public or private parties] that manage them best" (B6), "vigilance" of procuring authorities during the operational phase (B7), contract re-negotiation (B8) and ensuring "sufficient competition in the market" (B9).

Part C on the budget transparency and integrity of the procurement process, including: responsibility of the Central Budget Authority (most often located at the Finance Ministry / Treasury) to ensure project "affordability" (B10), transparency and disclosure of budgetary implications (B11) and anti-corruption measures (B12)

The Principles are followed by an annex background note providing a definition of PPPs and a list of "particular challenges", including: how to apply the principle of "value for money"; ensuring appropriate risk transfer; ensuring contract negotiating skills; ensuring affordability; meeting future "budget flexibility"; and considering the fiscal impact of PPPs.

¹ <http://www.oecd.org/gov/budgeting/PPP-Recommendation.pdf>

The Checklist

The checklist takes the OECD Principles as a basis and, from there, applies a trade union reading of its key recommendations, with particular attention to trade union specific concerns, including: stakeholder consultation, financial transparency and accountability.

The checklist is structured in 8 chapters, first looking at:

- Mapping out the key players and their responsibilities;
- Consultation of stakeholders;

Then, going through the key steps in the procurement process:

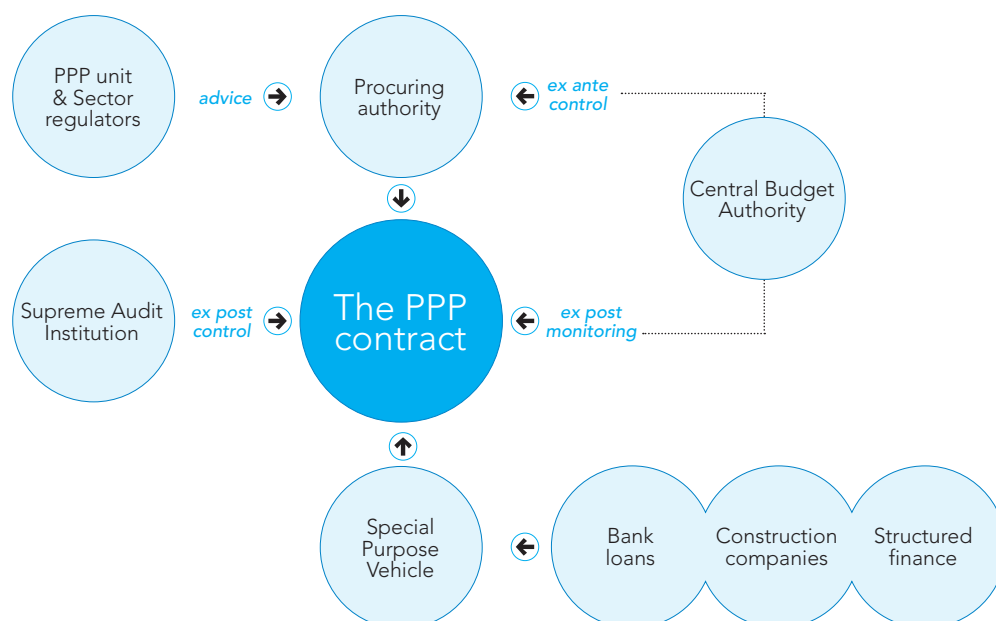
- Decision to invest and procurement option pre-test;
- Risk identification and risk transfer;
- Measuring and controlling for public sector exposure;
- Ensuring competition and responsible business conduct;
- Monitoring; and
- Contract negotiation and re-negotiation.

Mapping out the key players and their responsibilities

There are six institutions that have a role in a PPP: the procuring authority, the special purpose vehicle (representing the private operator and investor), the central budget authority, the PPP unit (government agency), the supreme audit institution and sector regulators. The chart below shows how they should interact with each other – according to the Principles – so as to ensure proper governance and monitoring of the entire process. Within that, it is important to bear in mind:

- The **advisory role of the PPP unit**: under no circumstances should the PPP unit take part in the decision process;
- The **pivotal role of the central budget authority** throughout the process;
- The importance of having the **supreme audit institution** check performance and compliance of the process in the implementation phase.

Governance map of a PPP



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| Consultation of stakeholders | <ul style="list-style-type: none"> Trade unions, NGOs and local communities are consulted (reference to OECD Principle A1). Consultation covers any change in the working conditions, the “culture of the work place and opportunities for advancement”, other social and environmental consequences, impact on the rights of minority groups (A1) as well as any transfer of risks onto workers and local communities (B5). End-users are consulted in defining the project and its output specification and in monitoring service quality once the project is operational (A1). |
| Access to information and transparency | <ul style="list-style-type: none"> The cost-benefit evaluations and the ranking of different projects of a tendering process are made public (B4). All costs and contingent liabilities – including public guarantees on private financing – and the payment stream from government (“what and when the government will pay”) are made public (C11). Any re-negotiation of a PPP contract that “substantially alters” the original agreement is made public (B8). |
| Decision to invest & procurement option pre-test | <ul style="list-style-type: none"> The decision by the Procuring Authority to invest is separate from how to procure and finance the project (B4). The PPP Unit should not decide on whether the PPP should move forward (A2). The Central Budget Authority assures that the investment is aligned with the government’s short and medium term macroeconomic stability targets (A2). Once decision is taken, the Procuring Authority conducts a “procurement option pre-test”. “If relevant”, the PPP project should be benchmarked with a “public sector comparator” (B5). There should be no institutional, procedural or accounting bias either in favour of or against PPPs (B4), including in the design of the public sector comparator (Background note). |
| Risk identification and risk transfer | <ul style="list-style-type: none"> The risks of the project are clearly defined, identified and measured (B5). Risk categories include commercial (demand), project (operational) and credit risks, as well as: policy, technology, risks of stakeholders, including workers and local communities (B5 & background note). Risks associated with statutory responsibilities to maintain services cannot be transferred to the private investors (B6). |
| Measuring and controlling for public sector exposure | <ul style="list-style-type: none"> Risks of failure and the associated costs for the public sector are identified (B5). The Central Budget Authority (and not the Procuring Authority) ensures that the project is affordable for public finance (C10). Consideration is given to imposing upper limits on annual stocks and flows of PPPs to help contain fiscal costs and overall public sector long-term commitments (C10). Any implicit or explicit central government guarantees to sub-national government levels and state-owned enterprises is controlled through rules on PPP stocks and flows (C11) |
| Ensuring competition and responsible business conduct | <ul style="list-style-type: none"> There is sufficient competition in the market to ensure a competitive tender process or, at the least, to allow non-incumbent operators to enter the market (B9). The selected investors have a track record of good service delivery and responsible business conduct as defined by the OECD Guidelines for Multinational Enterprises (B5 & B7). |
| Monitoring | <ul style="list-style-type: none"> The Procuring Authority is prepared for the operational phase and devotes the “same intensity” as that necessary during the pre-operational phase (B7). The Procuring Authority ensures that the private investor acts according to the norms of responsible business conduct defined by the OECD Guidelines for Multinational Enterprises (B7). End-users are involved in the monitoring (A1). There is an independent public oversight of the implementation of project in order to ensure greater accountability and “social control” (A1). The Supreme Audit Institution audits and assesses the PPP ex-post, reports to Parliament and, to that end, maintains sufficient capacity (A2). |
| Contract negotiation & re-negotiation | <ul style="list-style-type: none"> The allocation of risks between the public sector and the private investor and the method to apportion these risks if they materialise are defined under specific contractual terms (B6). Only if conditions change due to discretionary public policy actions does the government consider compensating the private sector (B8). The realisation of a risk does not qualify as a genuine unforeseen change in circumstances that would allow for private investor compensation (B8). |

Annotations

Key players and responsibilities

While responsibilities and roles differ between them, as shown below, the Principles stress the need for all parties to “retain the appropriate level of ownership regarding the project and that “particular attention should be paid to contractual arrangements and monitoring capacity at later stages of a project so as to ensure that incentives do not deteriorate as the cost of non-compliance falls” (B7).

The **Procuring authority** (incl. central administration department, local or regional municipality, public agency, other institutions at arm’s length of central government) is the institution that is “ultimately responsible for the project” (A2) on behalf of the public party – although, and as noted below, the central budget authority should have the final say on the decision regarding the long term liabilities for the public budget.

The **Special Purpose Vehicle (SPV)** is the private sector counterparty with whom the procuring authority engages the PPP contract. The SPV is responsible for undertaking the PPP project. It is often composed of a consortium of private sector companies for the construction and service delivery and of banks and institutional investors (including workers’ pension funds), as well as state-owned and regional development banks.

The **Central Budget Authority** is the administration within government that has overall responsibility for the budget and public debt financing. Its prime role is to monitor each phase of a PPP, from decision to invest, down to the effective operation of a PPP. However, and importantly, it should also “assure” that the capital investments of a PPP are “aligned with the government’s short and medium term macroeconomic stability targets” (A2) and “ensure that the project is affordable and the overall investment envelope is sustainable” (C10). While the procuring authority is ultimately responsible for the PPP, the central budget authority should have the final say on the decision to invest.

The **PPP unit** can fill gaps in terms of specific skills, a lack of coordination or high transaction costs” (A2). It has a pure advisory role: “while responsible authorities should draw on expertise from the PPP unit where necessary, it should be emphasised that they remain ultimately responsible for the project” (A2). The PPP unit “should not decide on whether the PPP should move forward. This green-lighting process should be anchored in the Central Budget Authority” (A2). In practice, PPP units may be prone to a biased view of PPP, mixing technical expertise with outright promotion of PPPs. That is why the OECD principles stress the need for “the role of the PPP Unit [to be] clear and without conflicts of interest” (A2).

The **Supreme Audit Institution** has an important role in examining whether the risks involved in PPPs are managed effectively (A2). It should audit and assess the PPP ex-post, report to Parliament and to that end it “should maintain sufficient capacity” (A2).

Sector-specific regulatory agencies should be consulted in the project design and subsequently monitor compliance with regulated service standards, including with regard to service quality, profitability, tariffs and prices (A2).

Consultation of stakeholders

According to the Principles, given the “complexity and long-term scope” of PPPs, there should be “active consultation and engagement with stakeholders and end-users in defining the [PPP] project and subsequently in monitoring service quality” (A1). Consultation should cover three stakeholder groups: (i) trade unions, (ii) NGOs and local communities and (iii) end-users.

Trade unions and their workers represent “a key stakeholder group” that can be substantially affected by the usage of PPPs and accordingly should be “actively involved”.

Regarding the content of “consultation”, the Procuring Authority should among others identify “any transfer of risks onto other stakeholders, including workers and local communities” (B5):

- For workers and labour unions, such transfer of risks would cover “working conditions, the culture of the work place and opportunities for advancement” (A1);
- For NGOs and local communities, risks would include “social and environmental consequences and impact on the rights of minority groups” (A1); and
- End-users should be involved in “defining the project and its output specification” and subsequently in “monitoring service quality” once the project is operational (A1), not least because the PPP project can lead end-user charges to be levied.

Consultation does not end with the ignition of the project but is required throughout the project. According to Principle B7, it is “the responsibility of the procuring agency to ensure that the private partner acts according to the norms of responsible business conduct as mentioned in the OECD Guidelines for Multinational Enterprises”. These guidelines prescribe a number of consultation rights to stakeholders, including workers and local communities.

Access to information and transparency

The Principles stress the need for a legal and institutional framework that “fosters competition and helps minimising the risk of conflicts of interest, regulatory capture, corruption, and unethical behaviour” (A3). To that end, the government should adhere to principles of “open government”. Access to information and the decision-making process should be “open and equitable” (A3).

Regarding individual PPP projects, public disclosure should cover:

- The cost-benefit evaluations and the ranking of different projects (B4);
- All costs and “contingent liabilities”, the payment stream from government under the PPP contract (“what and when the government will pay”) and “full details” of [public] guarantees on private financing (C11);
- Any re-negotiation of a PPP contract that “substantially alters the original agreement” (B8).

The government should guard against “waste and corruption” by ensuring the integrity of the procurement process. The necessary procurement skills and powers should be made available to the relevant authorities (C12). The procurement process should observe the requirements laid down in the 2008 OECD Principles for Enhancing Integrity in Public Procurement (C12).

Decision to invest & procurement option pre-test

The initial decision to invest should be separate from how to procure and finance the project – be it by way of a PPP or through conventional procurement routes (B4). PPP and public procurement are means to an end, not ends themselves.

Once the decision to invest is taken, the procuring authority should conduct a “procurement option pre-test” (B5), comparing the PPP option with other options. In doing so:

- There should be no institutional, procedural or accounting bias either in favour of or against PPP (B4);
- “Value for money should be the only test” in comparing options and “should be based on a whole of life, present value, approach” (B4);
- Comparison should cover costs of (a) finance (b) construction (c) operation, as calculated over the whole lifetime of the project, in each alternative mode of procurement (B5).

“If relevant, further analysis regarding using a PPP should be based on input from a prudent public sector comparator” (B5). The public sector comparator consists in

comparing (i) the net present cost of bids for the PPP project against (ii) “the most efficient form of delivery according to conventional public sector means (the so-called reference project)”. As noted in the background note to the Principles, the “starting point for [measuring value for money of a PPP option] is the public sector comparator”.

The background note also alerts to the risk of a biased comparison: the public sector comparator can indeed “be open to manipulation with the purpose of either strengthening or weakening the case for public-private partnerships (e.g. much depends on the discount rate chosen or on the value attributed to a risk transferred)”.

Risk identification and risk transfer

In a PPP agreement the service delivery objectives of the government are intended to be aligned with the profit objectives of the private investor. The effectiveness of the alignment depends on (i) a proper identification of the project risks and, from there, (ii) an allocation of the risks respectively to the public and the private parties. The procurement option pre-test should, hence, cover a number of comparative information on the risk identification and allocations to the public and private parties respectively. Principles B5 & B6 provide for useful guidance in this regard. Among others, it sets the following conditions:

- The risks of the project are clearly defined, identified and measured (B5);
- Particular attention should be paid to policy and technology risks (in a rapidly changing environment); as well as to:
 - the demand risk, particularly if end-user charges are levied and accordingly the demand risk increases (i.e. insufficient demand over the lifetime of the project);
 - “any transfer of risks onto other stakeholders, including workers and local communities”.
- Risk should be allocated the party that can manage them best. By ‘best’ managed is meant the party for whom it costs the least to prevent the risk from realising, or for whom it costs the least to deal with the consequence of realised risk (B6).

Risk should not be transferred to the private partner at any price for the sake of transferring risk alone or to achieve a desirable accounting treatment. Governments and public authorities cannot transfer to the private sector the risks associated with statutory responsibilities to maintain services (B6).

Measuring and controlling for public sector exposure

The decision process and the procurement option pre-test should pay particular attention to the long term implications of a PPP project on public budget. The Procuring authority should among other ensure that:

- risks, cost, contingent liabilities and “quality trade-offs” can be quantified and managed by the public sector (B5); and
- risks of project failure and associated costs for the public sector are identified (B5).

In doing so, it is the Central Budget authority (and not the procuring authority) that has a leading role in ensuring that the project is “affordable”: an investment project is considered affordable if the expenditure and contingent liabilities it entails for the government can be accommodated within current levels of government expenditure and revenue and if it can also be assumed that such levels will be and can be sustained into the future.

Accordingly, the Central Budget Authority should:

- ensure that the project is affordable and the overall investment envelope is sustainable (C10);
- consider imposing upper “limits on stocks and flows of PPP” to help contain fiscal costs and overall public sector long-term commitments (C10).

PPPs are financial schemes that are difficult to integrate in the annual government budgetary process. They are even more so, when there is a mismatch between (i) the contractual allocation of risks between the procuring authority and the private investors' SPV and (ii) the legal status of the SPV. When the SPV is treated as a purely private entity, but still benefits from some form of public guarantees, the PPP is, wrongly so, recorded off-budget. As noted in the Principles, "in many countries, most of these SPVs are created and organised in a way that allows them to be classified outside the central, general, or even the public sector as a whole, jeopardising [government] fiscal monitoring and control".

Another challenge for the transparent use of PPPs is with procuring authorities located outside the realm of central government including local government and state owned enterprises. PPP liabilities generated by a local government institution or a state-owned enterprise may not be included in the definition of public debt and accordingly may not be properly monitored by the central government (C11). The text does not dwell too much on the specific context and challenges associated with local government use of PPP, other than a general requirement that the Principles should be "institutionally maintained" at sub-national level (A2) and with the exception of the management of liabilities:

- Implicit or explicit central government guarantees to sub-national government levels and state-owned enterprises should be "controlled through rules on PPP stocks and flows" (C11); and
- The Ministry of Finance should retain an up-to-date overview of all PPP liabilities relevant for central government (C11).

Ensuring competition and responsible business conduct

A central concern of PPPs, particularly in the developing countries, is the lack of competition in the bidding process. Accordingly,

- There should be sufficient competition in the [PPP] market to ensure a competitive tender process" or, at the least, to allow "non-incumbent operators" to "enter the market" (B9).

The Procuring authority should also take care of the "track record of good service delivery, responsible business conduct and PPP experience" as well as the "risk appetite" of the potential private-sector partners (B5 & B7). Regarding responsible business conduct, the principles makes explicit mention of the OECD Guidelines for Multinational Enterprises:

- The selected investors have a track record of good service delivery and responsible business conduct as defined by the OECD Guidelines for Multinational Enterprises (B5 & B7).

The Principles do not elaborate further on the notion of "risk appetite" however. Given the long term nature of PPPs and the potential illiquidity risk associated with financing infrastructure at large, it could be assumed that by "risk appetite" the Principles would in fact bring attention to the need for a long term perspective by the private investor.

Monitoring

There is a danger that once a PPP contract is signed, the attention from the Procuring Authority and of other public sector decision-makers is substantially reduced. Other key players, including the PPP Unit, the Central Budget Authority, the Supreme Audit Institution and sector-specific regulators should "play their part and retain the appropriate level of ownership regarding the project" (B7). Accordingly:

- The Procuring Authority should be prepared for the operational phase and should devote the same "intensity" as that necessary during the pre-operational phase" (B7).

Monitoring should also cover the responsible business conduct of the investor, because it is "the responsibility of the procuring agency to ensure that the private partner acts

according to the norms of responsible business conduct as mentioned in the OECD Guidelines for Multinational Enterprises”:

- The Procuring Authority ensures that the private investor acts according to the norms of responsible business conduct defined by the OECD Guidelines for Multinational Enterprises (B7).

The Principles also suggest a role for civil society and end-users in the monitoring process. Involving end-users in both the design and the monitoring increases the likelihood of the effort being perceived as legitimate, fair and understandable:

- End-users are involved in the monitoring (A1).
- There is an independent public oversight of the implementation of project in order to ensure greater accountability and “social control” (A1).

The Supreme Audit Institution has an important role in examining whether the risks involved in PPPs are managed effectively:

- The Supreme Audit Institution should audit and assess the PPP ex post, report to Parliament and to that end it “should maintain sufficient capacity” (A2).

Contract negotiation et re-negotiation

The ability to write and negotiate PPP contracts is an important public sector capacity requirement, especially given the long-term nature and complexity of PPPs. An essential question is whether the risks of the project can be defined, identified and measured for the purpose of contractual agreement. The less this is the case, the more room there is for conflict over the contract’s terms in the course of the implementation of the project:

- There should be clear methods in the contract by which risks can be apportioned when they materialise (B6);
- The allocation of risk between the public sector and the private investor is defined under specific contract terms (B6).

The Principles’ discussion on contract negotiation also brings particular attention to the risks associated with re-negotiations during the implementation of the PPP. Beyond ensuring a “predictable and transparent rules for dispute resolution” embedded in the initial contract, the Principles recommend:

- Any re-negotiation that substantially alters the original agreement should be made public (B8).

Regarding compensation of investors for changes in commercial conditions, they should be explicitly negotiated within the contract. Only if conditions change due to discretionary public policy actions should the government consider compensating the private sector. Even if the current project outcome differs from what the private partner expected, it may just be a realisation of the risk that it carried. Both parties should distinguish between the realisation of risk and a genuine unforeseen change in circumstances. Care should be taken to make sure that the standards, to which the private-sector contractor operates, are not eroded without compensation to the public-sector authority:

- Only if conditions change due to discretionary public policy actions does the government considers compensating the private sector (B8);
- The realisation of a risk does not qualify as a genuine unforeseen change in circumstances that would allow for private investor compensation (B8).



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