PUBLIC-PRIVATE PARTNERSHIPS - SOLUTION OR VICTIM OF THE CURRENT ECONOMIC CRISIS?

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It is already a well known fact that public-private partnerships (PPPs) are considered to be a solution for world wide governments facing insufficient public budgets.
In the context of the current economic crisis, many voices promote public-private partnerships also as a solution for fighting the crisis, as PPPs help creating jobs, offer good value for money, do not have a negative impact on the public deficit, favour economic recovery.
On the other side, however, the current economic crisis affects projects which are aimed at making the public and the private sectors work together. Thus, the crisis determines a decrease of the number of private competitors and the number of financial institutions willing to get involved and finance such projects. This means lower competition and in the end higher total costs.

Keywords: public-private partnership (PPP), infrastructure investments, economic recovery, economic crisis, budgetary deficit.

JEL Classification: H44, L88

1. Introduction

Over the past decade we have witnessed a world wide growing interest for public-private partnerships (PPPs). PPPs popularity is due to the fact that governments are more and more eager to increase the quality and efficiency of public services, but in the same time they face insufficient budgetary resources to cover investment needs, coupled with public spending restrictions [1].

Public-private partnerships are not anymore a brand new concept in Romania. Several progresses have been made recently. Thus, a Central Unit for Public-Private Partnership was set up within the Ministry of Public Finance in 2005, and in 2006 and 2007 a new enabling legislation was introduced. However, there is a slow PPP deal activity to date if we look at the number of implemented projects. The reasons for the slow pace of activity include: the complexity of the PPP process in terms of preparation and awarding, not very strong, clear and long term political support, a very restrictive legislative framework (the Romanian legislation limits PPPs to service concessions and works concessions), little public sector expertise in relation to PPPs, etc.

When taking a close look into the current context for PPPs in Romania we cannot not consider the economic crisis and its` impact on the cooperation between the public and the private sectors. In this paper we focused very much on the infrastructure sector (especially the roads sector) and most of all on the PPPs opportunities which exist in this area. This particular interest is due to the fact that infrastructure development is a key determinant for economic progress and prosperity. In Romania, the infrastructure modernizing process is one of the drivers for foreign investments and also a tense item on the public agenda. Moreover, PPPs are considered to be a mechanism to fill the infrastructure "gap" which exists in many CEE countries [7] in general and in Romania in particular.

When talking about public-private partnerships in relation with the current economic crisis, two main types of attitudes emerge. On one side we have "the optimists" and on the other side we have "the pessimists".

Optimists see PPP projects as instruments for fighting the economic crisis and for economic recovery. Pessimists instead see the current economic crisis as an important obstacle in the PPPs` evolution in Romania. Therefore, the next two sections of this study are emphasizing the main arguments and counter-arguments related to PPPs as a solution for the current economic crisis. Furthermore, after presenting both arguments and counter-arguments, some objective conclusions are drawn.

2. Public-Private Partnerships, Solution for the Current Economic Crisis

PPPs may be important instruments for fighting the economic crisis and for economic recovery, and this is, as already mentioned, the optimists' approach. The arguments that support this approach are related to the ***advantages*** of PPPs: (1) PPPs may help redefining the State's direct role in the economy; (2) PPPs have positive impact on public finance; (3) PPPs may contribute to job creation; (4) there is a special fiscal treatment for PPPs (the "off balance sheet" treatment); and (5) PPPs may lead to a better absorption of EU funds.

Redefine de State's direct role in the economy

Public-private partnerships help the State to better focus on its' original functions: representing the people and managing those services that cannot be transferred to the private sector [8]. During recession periods this aspect is critical for a country's economic recovery pace. Moreover, PPPs are intended to be the recognition of the private sector's efficiency and know-how.

Multiple positive impacts on public finance

Public-private partnerships can have a significant impact on public finance by [8]: (a) generating new sources of income, new infrastructures and new services; (b) allowing new development for existing sources of revenue (public transportation, sanitation); (c) promoting industrial development and as a consequence, increasing fiscal income; and (d) better directing public budgets.

There are a lot of competing demands on the public purse which makes it difficult for governments to choose which project to finance or not. PPPs make this choice easier and help governments finance more projects than they would usually do by using traditional methods.

Public-private partnerships also contribute to reducing taxation, which is one of the primary measures governments should adopt during critical periods. Thus, the redirected resources stimulate demand and contribute to the country's wealth.

Job creation

Public-private partnerships are source of jobs on the medium and long-term and the key of the anti-crisis programs. For example, the 900 billion dollars plan for revigorating the American economy adopted in 2009 is aimed at saving 2,5 million jobs in the next two years through public-private partnership infrastructure projects: roads , bridges, schools, ecological technologies, etc. [9].

The Eurostat treatment for PPPs/ the "off balance sheet" treatment

The fiscal treatment of public-private partnerships is one of the main drivers for such projects in the new European Union member states. Thus, accordingly to the EU state budget and public finance rules, PPPs can benefit of the "off balance sheet" treatment if: the construction risk and either the demand risk or availability risk is accepted by the private company.

In other words, the Eurostat treatment for PPPs establishes the minimum level of risk the private sector has to assume in order to degrevate the public budget of that project (the assets involved in a PPP project will not be registered in the government's balance sheet).

The private company assumes the construction risk if the public sector pays only when the results obtained match the agreed parameters.

The private partner assumes the demand risk if he is totally responsible for the demands' variability compared to the moment when the contract was signed.

The private company bears the availability risk if the public authority applies penalties when the concessionaire's performance is poor, meaning that he was not able to reach the stated quality standards.

In the context of the current economic crisis, it is in the state's interest to keep investment in public infrastructure off the balance sheet so that it does not add to the national budgetary deficit.

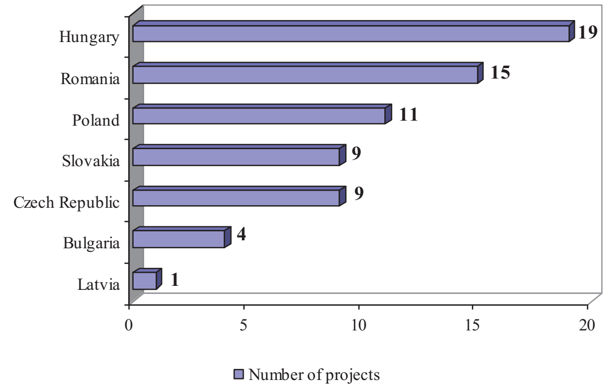
Absorption of EU funds

Public-private partnerships assure a better absorption of the EU grants. PPPs which blend public and private finance with EU funds are called hybrid PPP. Optimists think that EU money will protect PPPs from the negative effects of the financial crisis.

Grant financing has three principal impacts on public-private partnerships [2]: (a) an immediate impact on the project' financial viability by reducing costs (or increasing revenues); (b) an impact on local authorities budgets by reducing demand on funds and allowing budget transfer to other requirements; and (c) an impact on the private sector contractor's perception of the project viability.

Figure 1 shows a series of infrastructure development opportunities in Central and Eastern European countries that are expected to be developed on a PPP basis during 2007-2013. Romania ranks second in this top.

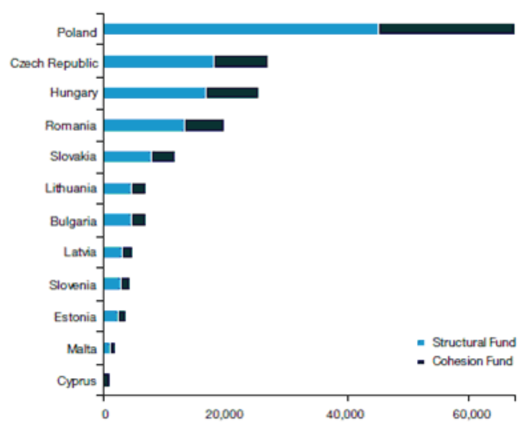
Figure 1 Major infrastructure development opportunities by country



(*Source:* PricewaterhouseCoopers, 2008)

However, the allocations of EU funds for CEE countries for 2007-2013, as shown in Figure 2, ranks Romania on the fourth position. This indicates two important aspects. First it highlights that there is a real interest for PPPs and that things are starting to move forward. Second, this situation is the consequence of the historic underinvestment in infrastructure in Romania, which caused an infrastructure "gap" by comparison with other CEE countries.

Figure 2 Allocations of EU funds in CEE countries in 2007-2013 (€m)



(*Source:* PricewaterhouseCoopers, 2008)

3. Public-Private Partnerships, Victim of the Current Economic Crisis

The current economic crisis may be an important obstacle in the PPPs` evolution in Romania, and this is the pessimists' approach. Most of them fear that big infrastructure projects, like Comarnic-Brasov highway or the Bucharest ring road will be affected by the current macroeconomic context (Table 1). The arguments that support this approach are: (1) tighter lending conditions; (2) decrease in the investor's confidence; (3) weaker external demand; and (4) difficulties in blending PPPs with EU grants.

Tighter lending conditions

Given the actual financial crisis it is likely that a single bank will not be capable to finance a one billion euros PPP infrastructure project, like Comarnic-Brasov. Such an investment will require the participation of at least ten banks. Also, more time will be needed in order to obtain the necessary loans and the negotiation conditions will be for sure tougher. At the moment banks do not have enough financial resources and as a consequence they will tend to be very selective when it comes to getting involved in a major infrastructure project [4].

Decrease in the investors' confidence

The tough lending conditions will force investors to be very careful with their money. Moreover, the banks restrictive attitude will force private partners to increase their equity contribution. This means investors will get involved in a PPP deal only if the project proves to be very feasible. In other words, the bankability and viability of projects will be very much affected. Bankability refers to the private sector's interest in participating in a public-private partnership, while viability measures the project's capacity to generate positive cash-flows.

Weaker external demand

The fragile economic situation will generate a decrease in the number of tenders interested in participating at PPPs bidding processes. This comes as a natural consequence if we think about the costs private partners have to bear in order to make a proposal: pre-feasibility and feasibility study expenses, consultancy, negotiation costs, etc. Less tenders mean less competitive price for PPPs and higher prices are translated into lower efficiency, which in the end means less value for money.

Difficulties in blending PPPs with EU grants

During 2007-2013 the European Union allocated for Romania 13.1 billion euros from the Structural Fund and also 6.6 billion euros were allocated from the Cohesion Fund. Although the absorption of EU grants is extremely appealing for PPPs as it offers the cheapest financing, there are several financial, legal and organisational incompatibilities that make it difficult to insert EU grants within public-private agreements. Thus there is a difference in the timing of payments: EU funds are available for a much shorter period of time (7 years) than public-private agreements, which are long-term contracts (20-25 years), based on constant availability payments. Pessimists consider that PPPs are not going to attract as much EU funds as predicted due to this inconveniences.

Table 1 Ongoing and upcoming infrastructure PPP projects (road sector)

Project	**Status**	**Procurer**	**Project details**	**Project size (€m)**	**Likely timetable**
Comarnic-Brasov highway	Ongoing project	Romanian National Company of Motorways and National Roads (CNADNR)	Twelve tenders have been already submitted for the competitive dialogue procedure relating to the concession contract.	995	2008-2011
Sibiu-Pitesti highway	Upcoming project	CNADNR	The length of the concession highway will be around 120km. The feasibility study is under development.	1,260	2009-2012
Brasov-Ploiesti highway	Upcoming project	CNADNR	The length of the concession highway will be around 111km.	2,051	2009-2013
Focsani-Brasov highway	Upcoming project	CNADNR	No further details about the project have been announced yet.	n/a	n/a
Targu Mures-Iasi highway	Upcoming project	CNADNR	The length of the concession highway will be around 300km.	1,050	2009-2013
Bucharest ring road	Upcoming project	CNADNR	The length of the concession highway will be around 164km.	1,000	2009-2013

(*Source:* PricewaterhouseCoopers, 2008)

If for instance we take a look at the Comarnic-Brasov highway which today has a six years delay compared to its initial deadline (2003) we will notice that it would have been more advantageous for the Romanian state to close the negotiations in 2003, when the prices were lower compared to 2009. If instead we analyse Hungary's experience we can clearly see that although its M1-M15 motorway PPP contract was considered to be unsuccessful at that time (2003) (due to unrealistic traffic forecasts which led to several renegotiations of the contract and in the end to the re-nationalisation of the project), today is thought to be a major achievement, which attracts foreign investors and boosts economic development, compensating the high price paid from the public purse in order to build it.

4. Conclusions

Romania is starting to implement major infrastructure projects with a PPP component in an extremely delicate macroeconomic context, when financial institutions are becoming very selective because of their low financing capabilities. This gives us two main alternatives: either to continue, or temporary give up our infrastructure plans, until the economic situation will improve.

Optimists' opinion is to continue PPPs plans because PPPs bring along a series of advantages that can compensate the negative impact of the economic crisis and can help achieve economic recovery faster.

On the other side, pessimists suggest to postpone infrastructure PPPs as they tend to be more expensive today than they will be once the recession ends. However such a rationale does not take into consideration our past experience or the PPP lessons learned by other Central-Eastern European countries.
We may conclude that it is better to finance infrastructure PPP projects today than tomorrow. Although today it may be more expensive due to the "credit crunch" generated by the financial crisis, tomorrow it will not be cheaper because prices always tend to grow up and because the renegotiation process is very expensive too.

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