

**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS  
COMPETITION COMMITTEE**

**Working Party No. 2 on Competition and Regulation**

**SUMMARY OF DISCUSSION OF THE HEARING ON PUBLIC-PRIVATE PARTNERSHIPS**

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*This document prepared by the OECD Secretariat is a detailed summary of the discussion held during Item VIII of the 57th meeting of Working Party No. 2 on 16 June 2014.*

*More documents related to this discussion can be found at <http://www.oecd.org/daf/competition/competitionissuesinpublic-privatepartnerships.htm>*

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## HEARING ON PUBLIC-PRIVATE PARTNERSHIPS

### *Summary of Discussion*

1. **The Chairman** opened the hearing on public private partnerships (PPPs) and noted that governments increasingly turn to PPPs to provide public infrastructures and services. The **Chairman** explained that the Hearing would include five presentations. A presentation by the OECD Economics Department would set the scene by discussing an OECD Working Paper that looked at the use of PPPs in OECD countries and assessed the relevant policy frameworks then. Prof. Elisabetta Iossa from the University of Rome, Prof. Stéphane Saussier from the Sorbonne Business School and Dr Federico Antellini Russo from Cassa Depositi e Prestiti and LUISS Guido Carli University would respectively discuss the experience with PPPs in the UK, France and Italy. A presentation on the Japanese experience from the Japan Fair Trade Commission would conclude.

2. **Dr Sonia Araujo**, from the OECD Economics Department, began by explaining that in 2010 the OECD published a Working Paper ‘Public-Private Partnerships and Investment in Infrastructure’. This paper focused exclusively on PPPs in the network sectors (i.e. energy, electricity, gas, water, transport and telecommunications), due to the importance of these sectors in the OECD economies, as well as to in-house projections suggesting that these sectors would require substantial investments in the next decades.

3. Dr Araujo pointed out that participation of the private sector in the delivery of infrastructure services is attractive for a number of reasons. For example, the private sector has financial and managerial expertise that can help to better evaluate the risks entailed by complex projects, as well as to manage them more effectively. While there are specific advantages in using PPPs, these types of contracts should not be employed just to circumvent budgetary pressure or fiscal rules, as in such situations the use of PPPs may not deliver the most welfare maximising outcomes.

4. Dr Araujo moved on to discuss some specific features of PPPs. First, with respect to the decision making framework, she highlighted that it is necessary (i) to consider whether there are benefits in bundling together the construction and the operational phase of a project and (ii) to apply a robust methodology to determine whether a PPP is the appropriate investment structure. For example, when comparing PPPs with traditional procurement it should be borne in mind that inappropriate or overoptimistic demand assessment can bias the decision towards the use of PPPs. Also, net benefits of PPPs should be calculated using a whole life cycle approach. Further, the public sector should consult an independent body on the desirability of employing a PPP contract and should undertake an ex-post evaluation of each project. OECD data shows that in 2008 around half of the OECD countries consulted an independent body, and only a minority undertook an *ex post* evaluation of PPPs.

5. Second, Dr Araujo stressed that in comparison to traditional procurement, PPPs involve higher transaction costs because bundling different project phases renders the tendering process more complex and longer. This means that PPPs are generally inappropriate for low value projects.

6. Third, with respect to the tendering phase, the higher complexity of PPPs limits competition in the bidding process, which generates a risk of collusion. A way to mitigate this problem is to allow international competition or to set very transparent awarding criteria with a possibility to challenge contract award decisions in court.

7. Dr Araujo also highlighted some issues concerning contract design that have emerged from the OECD study. She explained that PPPs are generally unsuitable for sectors where technology or demand conditions change fast. With respect to contract length, this should be longer when market conditions are stable and shorter when reliable long term forecast on costs and demand are difficult to make. She insisted on the need for a stable regulatory environment, without which PPPs are difficult to manage because of the risk of opportunistic behaviours. With respect to risk sharing, governments should bear the risks that the private sector cannot control or affect through its actions.

8. Dr Araujo concluded by highlighting that PPP contracts may be affected by hold-up problems due to the incomplete nature of long term contracts that may lead to opportunistic behaviour, underinvestment and low quality of service delivery. She mentioned some of the problems and possible ways to address them. In particular, Dr Araujo focused on monitoring performance to ensure quality and on the need to ensure that at the end of the contract private contractors are compensated for the residual value of the infrastructure they contributed to build.

9. The **Chairman** clarified that the term PPP can refer to two types of contracts: one where the State and the private sector each finances a part of the project, and second where only the private sector finances the project. The **Chairman** then invited Prof. Iossa to talk about the competition issues raised by PPP contracts.

10. **Prof. Elisabetta Iossa** started by explaining that there is no single definition of PPP, but that the term PPP typically refers to contracts that present the following four characteristics: (i) a bundling of different phases of a project in a single contract; (ii) private finance; (iii) typically long-term contracting, and (iv) a high level of risk transfer to the private sector compared to traditional procurement. Prof. Iossa then questioned various advantages usually ascribed to PPPs relative to traditional procurement, in particular that PPPs are more efficient, that private financing is cheaper and that PPPs do not affect the level of governments spending. She concluded that there is only one reason for using PPPs: by bundling together design, building, finance and operation in a single contract it is possible to create a single point of responsibility for all the aspects of the project. If coupled with appropriate risk transfers, this can create the correct incentives for the contractor to undertake choices that will ensure that the costs are minimised for the whole life of the project and that high quality infrastructures are delivered.

11. Prof. Iossa noted that PPPs raise competition concerns. First, PPP contracts tend to be rather complex, because of the bundling of various project phases (i.e. design, building, operation, maintenance). This complexity may lead to limited participation in the tender, especially by SMEs, and thus favour anticompetitive agreements among the few potential players. Public authorities should collect information on the number and type of firms participating in the bidding for PPP contracts. Particular attention should be paid to PPP markets with few bidders and limited participation of SMEs and foreign firms.

12. Second, bundling and long term contracting can lead to market foreclosure. Prof. Iossa argues that ancillary services (i.e. those services that are non-core) should be excluded from PPP contracts, as there is no clear benefit from bundling these activities and from having long-term contracts. These services should be contracted out separately and for shorter durations, thus facilitating competition from small and medium size firms that can deliver them but not the core PPP activities.

13. Prof. Iossa also suggested that the design of procedures for the so-called unsolicited proposals should warrant careful consideration. Unsolicited proposals are those that are not submitted as part of a tender, but are put forward autonomously by the private sector. Various countries have created institutional mechanisms to encourage the private sector to come forward with potentially beneficial project concepts. All these systems grant an advantage to the original project proponent in the bidding procedure. While this may be useful in promoting new ideas and encouraging active participation from the private sector, it may also result in a lack of transparency and a reduction in competitive pressure in tenders.

14. Prof. Iossa pointed to the problem of the lack of harmonisation of PPP legislation that leads to low cross-border participation of firms. Finally, she discussed renegotiations and highlighted that: (i) they weaken the incentives of the contractor to perform, and (ii) they may create serious distortions at tender stage, giving incentives to bidders to act strategically.

15. Prof. Iossa concluded by recommending that attention should focus on the implementation phase, and not just on the tender. She suggested that, in order to effectively control the implementation phase, standardised contracts should be designed centrally by a national authority and imposed locally.

16. The **Chairman** referred to Prof Iossa's presentation and confirmed that renegotiations are indeed problematic; on the one hand they can be essential to successful implementation of a PPP contract, on the other they can be very opaque and lead to uncertainty and financial losses for the government. The **Chairman** then referred to concerns about the risk of collusion and noted that the number of competitors is not in itself a measure of the probability of collusion: the risk of collusion depends on various circumstances of which the number of bidders is just one. He then gave the floor to Prof. Stéphane Saussier.

17. **Prof. Stéphane Saussier** started by explaining that his presentation would focus on PPPs in France, and in particular on one specific type of PPPs, namely private finance initiative (PFI) contracts. PFI is a procurement method where public authorities – and not service users - are paying annual fees directly to private companies that are providing services. The presentation focused in particular on the efficiency and the future of PFIs in France. First, Prof. Saussier noted that PFI contracts account only for a small part of public investments both in France (around 8 to 9 % in 2011) and at the European level. Yet, they are very important because they allow the financing of public infrastructures that could hardly be financed through concession-like contracts.

18. Prof. Saussier explained that in order to evaluate the efficiency of PFI contracts, he and his co-authors had sent questionnaires to French public authorities that had signed PFI contracts. The study was carried out in 2012 when more than 150 PFI contracts had been signed. It had focused on those projects that were already in the operational phase, i.e. those where the infrastructures have already been provided. Of the 150 signed contracts, 46 projects were in operational phases and the information that was collected concerned 30 of them (16 local authorities refused to answer the questionnaire). The questionnaire included questions concerning the construction as well as the operational phase of the project. With respect to the construction phase, 90 % of the French public authorities in the sample had reported that they were satisfied with the outcome, and that the budget was respected. 77 % responded that the deadline was met, and 67 % that the projects met the quality targets. With respect to the operational phase, 80 % of public authorities said that the budget was met. In terms of quality, 50 % of them reported that they were satisfied and the other 50 % were only partly satisfied. The overall assessment varied between 4.5 and 5.3 out of 6, depending on the sector, indicating overall a rather good result. However, Prof. Saussier warned that there may be a risk that public authorities may have provided incorrect information when answering the questionnaire.

19. Prof. Saussier pointed out that it is always necessary to perform a value for money assessment before the contract is signed. However, he admitted that it is very difficult to make such an assessment. Moreover, the capacity building of the municipalities in terms of managing competitive dialogue and innovation in such contracts is very limited. Therefore, to benefit from PPPs it is necessary to invest in the award procedure, in the negotiation procedure, in the competitive dialogue, as well as in the renegotiation procedure while ensuring transparency and accountability.

20. **The Chairman** asked Prof. Saussier what was the average size of the 30 PFI projects that had been studied.

21. Prof. Saussier replied that the average amount of the deals was EUR 25 million for the PFI contracts signed at the local level and EUR 250 million for the PFIs signed by the State.

22. **Dr Federico Antellini Russo** started his presentation by explaining three premises relevant for understanding the operation of PPPs in Italy. First, while the Italian PPPs market is not mature, in the last ten years there has been a constant increase in terms of both the total number and the total value of PPP contracts. Second, while building contracts only account for 19.5 % of the number of PPP contracts, they represent the most important type by value (44.2 %). Third, there is a high mortality of projects as only 30-40 % of the projects arrived to the operational stage. The reasons behind all these failures are insufficient preliminary analysis, late involvement of banks, lack of technical capacity of the contracting authorities, as well as frequent post award changes.

23. Dr Antellini Russo observed that the market can be divided into two segments. The first one is dominated mainly by contracts concerning non-complex projects with low demand risks that are generally awarded by municipalities. The second segment involves more complex contracts, typically above 15 million Euros that are awarded by government agencies or regions. In 2013, the first segment accounted for 97 % of all tender notices.

24. Dr Antellini Russo pointed out that municipalities are subject to an internal stability pact that strongly constraints their ability to indebt themselves, hence they have incentive to outsource the financing of as many projects as possible in order to reduce current expenditures. He also explained that in Italy the level of SMEs participation in PPP tenders is not an issue because, given the small value of the projects, the first segment is unsurprisingly dominated by small firms. However, problems may arise with respect to renegotiations; first, there is no supervision mechanism below 15 million Euros and second, there is no *ex post* value for money assessment.

25. Dr Antellini Russo explained that in the second segment, which includes all projects above 15 million Euros, the award is often made on the preliminary blueprint. The problem with the award on the preliminary blueprint is that it requires additional (and not obvious) bureaucratic steps, which creates considerable uncertainty with respect to the duration and the costs of the project.

26. Dr Antellini Russo concluded by supporting the recommendation made earlier by Prof. Iossa and Prof. Saussier that it could be useful (i) to create a standardised benchmark for some elements of PPP contracts; (ii) to create a real benchmark on how PPPs could work; and (iii) to try to group similar projects to ensure the skills required to write complex projects.

27. **The Chairman** thanked Dr Antellini Russo and gave the floor to Japan.

28. The delegate from **Japan** remarked that the presentation would focus on the PFI, since in Japan this type of contracts is more popular than PPPs. In Japan, PFI contracts are implemented in accordance with the PFI Act, which was enacted in 1999. The delegate explained that PFI contracts have three merits. First, PFIs can help provide public services of better quality and at lower costs. Second, involvement of

private enterprises in the building and operation of public facilities is expected to lead to an appropriate and efficient division of work between the public and the private sector. Third, PFIs are expected to create business opportunities for the private sector, thereby contributing to the revitalisation of economy.

29. The delegate noted that the number of and expenditure for PFI projects have been growing annually. Education and culture (i.e. schools and libraries) account for the largest number of PFIs, followed by housing and environment projects (i.e. hospitals and waste disposal facilities). Three fourth of PFI projects are undertaken by local governments. The delegate also explained the standard process for the award of PFI contracts. First, the competent authority starts with the planning of the project, it then selects the qualified project and carries out a feasibility study to find out the merits of implementing such a project through a PFI contract. The subsequent step consists in selecting a business operator to perform the project and, finally, the contract and the project are implemented.

30. The selection of the business operator is based on 'competitive bidding with a comprehensive evaluation method', which consists in choosing the winning bidder by comprehensively considering not only the price but also other elements (e.g. the service standard of maintenance/operation, technical capability, etc.) within the bound of the predetermined price. This type of evaluation is expected to render potential collusion among bid riggers less likely as it is difficult to predict the final evaluation score. However, if bid rigging happens, the Antimonopoly Act will be applied.

31. The delegate also explained that there are mainly four types of PFI projects in Japan. First, there are PFI contracts involving a deferred payment, which at the end of September 2013 accounted for about three fourth of all PFIs. In this type of contracts business operators initially incur the cost of building and managing the facilities, and subsequently they receive a payment from the government. However, there are also other types of PFIs: concession PFIs, utilising commercial facilities PFIs and pure PPPs. These other types are used less frequently and they imply a lower financial burden on the government.

32. The delegate then described a case study concerning a PFI that utilises a commercial facility, namely the contract for a city sewage facility and in-house power generation facility using biomass energy from the sewage in Kurobe city (district of Toyama), and explained how such projects can reduce the financial burden of cities.

33. The delegate remarked that most of the past PFI projects in Japan involved deferred payment with 100 % of the cost covered by public money. However, in order to reduce the financial burden on the public sector, Japan is seeking to increase recourse to other types of PFI, such as concession PFI where part of the costs are paid by the projects' fee revenues.

34. The **Chairman** then gave the floor to **BIAC**. BIAC delegate stressed that the difficulty of ensuring a level playing field in of the award of PPPs results from some of the specificities that have been mentioned earlier, such as the length of the project and the fact that the return on investment is not imminent. This means that there are usually only few large bidders. Therefore, it is important to make sure that tenders for PPP projects are as open as possible to international competition. Another feature of PPPs is that they are vulnerable to changing political influences during the life of the project. BIAC has often observed that public priorities change during the long duration of the contract, in particular if one considers that a large proportion of the projects involve local governments as opposed to national governments. Therefore, it is important that some form of harmonisation of the regulatory framework is achieved and this is where OECD has an important role to play. In particular, the OECD should promote a clear definition of the term 'value for money'. Second, it should encourage governments to give due consideration to the general interest economic constraints that are imposed on the contractors. Third, it should contribute to the development of robust governance frameworks to monitor the implementation of projects.

35. Prof. Saussier noted that issues raised by BIAC are very complicated, in particular the issue of favouritism and the lack of foreign bidders. He also argued that, given the length of PPP contracts, it is useful to allow some discretionary margin to public authorities with respect to choosing the contractor with whom they will cooperate, though without allowing undue favouritism. Prof. Saussier asserted that the only way to address these issues is to put in place governance best practices. Although they are very costly, they are needed for the proper supervision of the bidding as well as for the renegotiating procedures of PPP contracts. They would facilitate collection of data necessary to assess the performance of PPP contracts. This, in turn, would permit to hold public authorities accountable for their choices, which unfortunately is still not the case.

36. **The Chairman** stressed the importance of the lack of data necessary to carry out controls as well as the difficulty distinguishing between undue favouritism and competition. With respect to renegotiations the **Chairman** observed that while they are necessary, there is no instrument of control that would allow determining whether all of them are really necessary.

37. Prof. Iossa added that she would like to stress the importance of using standardised contracts at the bidding stage. With standardised contracts designed centrally for each sector the bidding process could become more transparent and would allow a more level playing field.

38. Dr Araujo remarked that while most OECD countries actually perform some kind of value for money assessment, in most of them demand risks tend to be underestimated. There is therefore a scope for harmonisation and for designing best practices for the ‘value for money’ definition.

39. The **Chairman** concluded the session by summarising some of the main points that were raised by the participants of the roundtable. First, PPPs contracts are far too expensive than they should be and second, they should not always include ancillary services. Third, standardised contracts could help in running award procedures. Fourth, he noted that all PPP projects should entail some risk: however, only the risk that the private partner can control should be shifted to the private sector.