CEA

Center for Economic Analyses

ONLINE TRAINING PROGRAMME:

"PPP SKILLS AND COMPETENCY DEVELOPMENT"
Final report

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Table of Contents

General information about CEA

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PPP skills and competency development training program

Background

The Center for Economic Analysis – CEA expressed interest for Public Private Partnership – PPP training to USAID. USAID sponsored the training about PPP to one participant from CEA. The training provider was the Institute for Public-Private Partnership, Inc - IP3 and the CEA trainee was its President Marjan Nikolov.

Brief description of CEA

Think tanks are playing in some transition countries an important role in supporting policy development and fostering public dialogue on key issues facing their societies. The environment in Macedonia has not yet prioritized the institutional development of think tanks. Macedonia consequently does not have robust and effective capacities to conduct macro and microeconomic analysis in either the public or private sectors.

The Center for Economic Analysis – CEA was established in 2003 to fill this void. CEA was founded by younger Macedonian economists who have received their professional education and training through studying at western universities, attending seminars and courses organized by international financial institutions and international organizations, and working in an international environment. They share a common vision of the Republic of Macedonia as an emerging economy that will integrate with regional and world markets. The Mission of CEA is to continuously research economic development and public policy in the Republic of Macedonia and to offer recommendations, suggestions and measures to the governmental and non-government organizations, including the private sector. Our goals are to establish a sustainable think tank that will be a permanent institution that provides outstanding intellectual capacities and resources to conduct analyses for government and non-government clients, and to create a demand for those services that ensures Macedonia has the capability to properly support policy analysis.

So far CEA have had around 100 projects (www.cea.org.mk see track record of CEA) and many had impact to GoM decisions. CEA won USAID three year support within unsolicited proposal for sustainability as well.

The role of Marjan Nikolov at CEA

Marjan Nikolov is the President of CEA with executive power and a founder of CEA. He has run numerous projects at CEA as analysts, team leader, initiator of projects, fund raising etc. More on his experience find at: http://www.cea.org.mk/contacts.htm.

Involvement in future PPP exercises in Macedonia

CEA has done a lot of work at sub-national level government mostly on fiscal decentralization. In the 7th issue of the CEA Bulletin – *Decentralization our goal*; the Editor points (www.cea.org.mk follow the bulletin link and then issue number 7):

> *"The challenge for Macedonia is to increase both private and public investment to support economic growth and modernize its infrastructure while maintaining a stable macro-economic environment. The LGUs and municipal companies will play a critical role in this context, as they are responsible for undertaking a substantial portion of the infrastructure investments required.*
>
> *LGU investments are well below what is required to meet EU infrastructure standards over the pre-accession period. Currently, most of local infrastructure is obsolete and a large amount of effort is required for its replacement and modernization. Services such as water, sewage and solid waste systems involve large unit costs. To increase the level of such services will require considerable investments. It is evident that large part of development, replacement, and renewal of local assets will need to be financed out of LGU budgets and /or through other alternatives.*
>
> *One alternative whereby the private sector undertakes to provide services of public nature is the Public Private Partnership – PPP experience. Best practices calls for each element of risk to be allocated to the party which is best equipped to manage it so that the risk can be minimized altogether. Of course that there are risks like confusing the value for money solution with the cheapest solution for investment project but setting a system in Macedonia could challenge the tariff reform, changes in the corporate structure, management and operations, improved legal framework, private sector participation and last but not least political acceptance."*

The reason for taking this course and expectations

CEA asked for this training to learn the world wide experience in alternative instruments to solve capital problems and to learn and than to know how to implement them in fulfilling the CIP at LSG level. PPP is important as it provides alternatives to LSG level for providing more efficiently services to citizens. It can indirectly strengthen the institutions in Macedonia as well.

The expectations are to use the knowledge and to transfer it in Macedonia, to work on projects, to transfer knowledge to the staff at CEA as well. Also, CEA can be an asset to the GoM as well in the future PPP exercises and with ambition maybe one day to be a transaction advisor.

About the training

The training period was for 6 weeks starting beginning of November and ending mid December and consisting of 6 modules: PPP concepts, rationale and contractual options, project appraisal and feasibility studies, project finance and investment analyses, procurement process, communications and stakeholder relations and contract management, monitoring and evaluation.

The course was organized in a way for participants to prepare weekly submission on content and case study requirements and to prepare an action plan on a specific project.

This document is the final report of the 6 weeks training program. It gives a brief overview on the background of the Macedonian economy and its readiness for the PPP, and then it presents the answers given to the questions from the six modules by Marjan Nikolov. Final thoughts are given at the end. Where it is possible focus was given more on local governments.

PPP – an instrument for the future: Is Macedonia ready?

Almost two years ago a Macedonian private company wanted to invest in the Capital of Macedonia – Skopje in the public bus transportation. The “negotiations” between the private company and the Mayor of Skopje was more of an exchange of public announcements in the media and at the end the initiated PPP was never realized.

Around a year ago the Mayor of Skopje wanted to go for borrowing within the EBRD to solve the acute problem of public bus transportation but he was not allowed by the Ministry of finance of Macedonia to proceed with the initiative.

The problem with the bus transportation in the city of Skopje is identified but no solution so far was implemented. Recently the GoM announced that will buy buses for the JSP (Public Bus Enterprises of the City of Skopje) while the JSP is asking for subsidies.

The story of JSP is classic example of an attempt to provide the “social peace”, to postpone the inevitable reforms as much as possible, to keep the existing employment level at JSP and all that at the cost of low quality of services, quasi fiscal costs and potential political disputes. Without an ambition to be studious (the intention of this report is not to be that) one can conclude that problems on the path to exercise PPP in Macedonia might be of a technical and social character at least. At technical level neither proper institutions are developed nor does proper level of legislation, knowledge and experience exist. The social problems could be that PPP requires strong regulatory bodies to take care of environmental and labor market issues as well as the need for efficient management of the transitional welfare costs. On the other end the private partners should be aware of their social responsibility.

Background

Macedonia as transitional country face situation where the main consumer groups should pay the full economic costs of production and supply and investment of so-called public goods so that whatever the enterprise (private or public or PPP) it should be commercially viable company that can finance its investment requirements without subsidies from the government at the one end. This will concern the relative prices between main groups of consumers and the cost pricing of goods and services provided. The viability is connected to the revenue requirements and the revenue collection.

In relation to increasing tariffs, in the communism the consumers were achieving a sizeable welfare gains from the reduction of prices in the so-called necessities. The contra weight was from the relatively high turnover taxation. This situation has caused today's problem of rebalancing the prices.

It was clear that within market economy environment, the prices of public goods/services would increase significantly to the household's consumers. But the living standard in Macedonia is not in contra balance with the relative price adjustment requirement. The result is usually a highly sensitive government to the pressure to keep down the price, revenue collection problems, not quit defined role of the public sector and status quo for the prices of some goods (recently, electricity could be good example in Macedonia where irrelevant from the independent regulatory commission, the ELEM state owned generation enterprise is not asking for higher prices even though the prices are not reflecting the long run costs. On top on that there are disputes on the institutional set up of the electricity sector which is vertically disbundled and on track of liberalization not to mention the need to discuss the energy deprivation and protection of the poor).

Is PPP a solution?

The needs for capital projects, infrastructure development, satisfying EU standards and demand for quality services, cannot be met by the local/central governments. The potential financial resources needs are high and above the consolidated Macedonian budgets. Thus, the needs for the financial resources, improving efficiency, better management skills requires development of instruments at which the best from the private sector will meet the best from the public sector and jointly to achieve the objective of better provision of services.

PPP aims at that objective. But to exercise this instrument might be costly if proper legislation and institutions are not in place.

Answers to the module's questions

During the six weeks training there were six modules with a content reading material and a case study reading material. This report gives an overview of the questions and the answers given by Marjan Nikolov. The training also was asking from the trainees to prepare an Action Plan which I will send separately.

Module 1: PPP concepts, rationale and contractual options

CONTENT QUESTION: Describe a PPP that is currently in progress in your country (any sector), including the form of PPP (service contract, management contract, lease, etc.), the responsibilities of the parties, and the key risks. Why do you consider this a successful or unsuccessful PPP?

CONTENT ANSWER: In Macedonia there is a Law on concessions on power and a draft Law on concessions and other types of PPP in procedure. I don't have information at what stage is the draft Law at the moment thus, my colleagues from Macedonia might help me in that regards. The Ministry of economy is in charge of drafting the Law. At central level few concessions were issued and recently some forms of PPP were initiated and at implementation at local level like the market in Strumica. I have the impression that the local level driven PPP will occur in Macedonia at least for two reasons:

First, the LGU investments are well below what is required to meet EU infrastructure standards over the pre-accession period. Currently, most of local infrastructure is obsolete and a large amount of effort is required for its replacement and modernization. Services such as water, sewage and solid waste systems involve large unit costs. To increase the level of such services will require considerable investments. It is evident that large part of development, replacement, and renewal of local assets will need to be financed out of LGU budgets.

The EAR project on strengthening the capacity of the Ministry of environment and physical planning in Macedonia prepared estimates for meeting the capital and operational costs of the investments required to comply with European Union directives and policies in the "heavy investment" areas of environmental management. Within this project, the indicative estimates for the cost of accession in the heavy investment areas have been estimated as in the following table (for comparison Bulgaria and Romania are added):

Table. Assessment of total investments in millions of euro/per capita in euros for approximation of Macedonia, Romania and Bulgaria to EU environmental legislation

	Macedonia	Romania	Bulgaria
Urban waste water treatment, sewerage	229/113	1,385/63	2,056/267
Large combustion plants	274/136	402/18	1,627/211
Municipal waste management, landfills	80/40	NA	NA
Municipal waste management, other installations	120/59	NA	NA
IPPC-air emissions	381/187	806/36	3,261/424
TOTAL	1,084/537	10,593/475	6,944/902

Source: CEA publication on The future of local public finance: Case studies from Macedonia, Romania and Bulgaria 2006.

Second, the borrowing was allowed to LSG level starting 1st of July this year in Macedonia. Of course there will be difficulties but my estimate is that within 5 years at least 10 municipalities in Macedonia will generate public debt thus, they will be ready to assume PPP as well once the new Law is on power. There are risks like confusing the value for money solution with the cheapest solution for investment project but setting a system in Macedonia could challenge the tariff reform, changes in the corporate structure, management and operations, improved legal framework, private sector participation and last but not least political acceptance.

The latest draft Law I have, identifies the concessions and other types of PPP. It regulates the conditions, procedure, and contracts for PPP. The institutional set up can be contractual partnership and institutional partnership. The subject of contract can be construction, public services, and public goods exploitation. The procedure includes preparation actions, transfer of concessions and contracting out. The procedure is in close coordination with the tendering procedure regulation. Interesting is that the ministry of finance will manage a register of contracts. The sides will have the legal rights to appeal, to raise an administrative action in front of administrative court (not yet established in Macedonia but soon it will be. So far the Supreme Court takes the administrative cases in consideration), compensation and the right to check the documents.

CASE STUDY QUESTION: Analyze the existing situation, challenges and objectives presented in the case study and recommend the most appropriate form of PPP for improving service delivery in the water and sanitation sector in Sadcville. As part of your recommendations, please describe the form of operator's remuneration under that PPP structure, and the institutional change (if any) that will be required for implementation of the PPP.

CASE STUDY ANSWER: Afriland tolerated a large outflow of its white population, relatively high poverty (70% of its population below the poverty line) and low economic growth. The GOA is democratically elected and is dedicated to reform with priorities of poverty alleviation and creating environment for high economic growth. Recent positive developments of low inflation, increase of public funds from introducing the VAT cannot overweight the dependency upon foreign aid. Still, Afriland have big area that is relatively low populated with 22,5 inhabitants per sq km.

The urban population is growing and together with the annual population growth of 8% puts pressure to the city of Sadcville as mid sized city for its growing population as well. This situation together with its designed for less population access to potable water is creating low level of coverage and and a water with low quality and reliability. Only 30% of urban population has access to safe water which results in poor health statistics and poverty entrenchment.

The city of Sadcville will assume transfer of competency in providing water services as the GOA is planning to decentralize (devolution) the provision of potable water and sanitation. It will have to choose between the choice of publicly running the competency or to privatize it fully (the capital of Afriland will face full private sector management). However, the WB is committed to provide pumping station if the PPP is put in place for the overall management of the system. The poverty is a problem and the new tariff system must recognize this even the GOA is pushing for full cost recovery in two years. However, the latest study revealed strong WTP and informal market that captures 68% of the revenues of the sector. The most important is that GOA will establish a WRA for the sector and will get support from IFIs.

Given all that and the specific objectives for PPP of Sadcville's local council as well as the GOA's determination for thorough and careful preparation of PPP to differ from the previous controversial privatizations the city of Sadcville has to decide on the PPP option.

Decision making facility:

1. Objectives
    a. Secure funding from WB
    b. Downsize the informal sector
    c. Improved services (metering and various forms of services)
    d. Improve management (operation and financial management)
2. Constraints
    a. LSG will retain the ownership of the assets
    b. Operators will be contracted managers
    c. Gov will not allow firing of employees
    d. Strong regulator
3. Steps to of the action plan of GOA and local council-LSG – two years time horizon
    a. Establish the WRA (GOA)

b. Partnership (cooperation and coordination) between GOA and LSG. Decentralization is a major step forward and includes major institutional reform
c. Devolution finished (transfer of assets, employees, archive etc from central to local level)
d. Campaign to explain the reforms and to downsize the informal sector (GOA + LSG)
e. Talk to WB to show the determination for PPP (WB will secure funding with any form of PPP established. GOA and LSG)
f. Introducing metering will help downsizing the informal sector indirectly as it will improve the formal service providing (operator)

4. Form of PPP – selecting the preferred option
    a. Service contract. Suitable because fits the two years program of GOA and the outsourcing can include the metering and bill collection. The assets can stay in ownership of LSG and the government can keep the status quo with the employment level. Not suitable because it will require a strong monitoring from WRA and this can be questionable as WRA will be new agency with not so much of an experience. GOA and/or LSG will do the financing of additional investment needs. Suitable as the GOA and/or LSG sector will set up the tariff.
    b. Management contract. Suitable because the operation and maintenance will be completely on the private sector. It will not require a significant change in the institutional set up as the newly established LSG Company with the devolution can contract the management personnel only. It can improve the internal management and operations of the LSG Company. Maybe not suitable for the LSG and GOA as it will require up to five years to take the effects of the expectation. The LSG can keep the current level of employment. Key performance indicators-KPI can be agreed in order to receive remunerations as well as incentive and penalties for over and under performance. LSG can go with fixed fee and incentive compensation thus, controlling the level of fee in accordance with the specifics revealed with the WTP study. GOA and/or LSG will do the financing of additional investment needs. Suitable as the GOA and/or LSG sector will set up the tariff.
    c. Lease. Suitable because it will take responsibility of working capital and upgrading required as the pumping station. Will require up to ten years contract. O&M financed by private side. Not suitable as the private sector will set up the tariff.
    d. BOT and Concessions. Not suitable as assumes risk to the private side at least for keeping the same level of employment. Also, will require private sector investment and not the WB funds.
5. Procuring the PPP, negotiating the PPP, closing the deal
    a. The private sector will accept low level of risk as the Afriland had recently gained democratic Gov dedicated to reform. It seams that

an Investor survey in this case is not needed as the GOA has set up a clear constraints to help in the form of PPP selection process. All on all, it seams that given the Gov objectives from 1. the lease and management contract are suitable forms because it will keep the current level of employment, it fits the GOA/LSG time horizon planning, will reduce low level of risk to PS, will reduce the informal sector. More, the management contract will help not only to improve the “engineering/technical” matters but the management function of the newly established public companies with the devolution as well and will provide a “flexible” tariff system with fixed fee and incentive compensation so that the GOA/LSG can control for the poverty beside the positive results from the WTP survey. A successful PPP management system will help also in changing the perception of future privatization efforts of the GOA/LSG and will not require a major institutional change. Last but not least this PPP form is with acceptable time horizon to fit the GOA ambitious planning.

Module 2: Project appraisal and feasibility studies

CONTENT QUESTION: Do you think there would ever be a case in which a PPP should be pursued even if the value for money assessment revealed that the project would be less expensive using traditional public sector procurement? Why or why not? Please explain and give an example.

CONTENT ANSWER:

I will start with academic discussion as I believe this is also an academic question with no black and white and right and wrong answer. At least the following dimensions should be considered:

1. Political environment
2. Modelling issues (model, time horizon, estimates, assumptions).
3. Internalizing externalities
4. Technical analysis

1. On the political environment. Sometimes it might be politically viable: like a "just to start with PPP" decision. Maybe out of fashion one can give an argument which of course is political decision. Another argument might be in a case of innovation in a country that is ranked in the first group given the WEF's Global competitiveness report.

2. On the modelling. The world is uncertain and we must do some modelling. it requires assumptions, the model it self and estimates. It is an empirical fact (CPB from Holland) that at least their models are wrong 50% of the time but right 50% of the time. But there are no alternatives to modelling. Models and techniques give consistency in the assessment. If it is done with a discipline and not routinely it can give nice insights. One model can give an estimate showing nice VFM results other will not. It really depends on definition which brings me to the next 3rd issue on externalities

3. The info on EU Tunnel to UK is good example as it has also symbolic importance and how can one measure "Unity in EU" or "bringing people closer". Thus, the discount rates the IRR are not that much important in making "right" decision I think in such projects.

4. From pure technical point of view, one should trust models purely and if the left hand side of the equation is not equal to the right hand side from the model then the decision is not/to invest. Also if it doesn't hurt the public, there is measurable performance in output terms and the investor gains more and vice versa it will always be Pareto efficient decision. I don't know it brings me back to Microeconomic theory, market failures and that staff.

I don't know. It was academic question I think and this is my answer: THERE IS AND WILL BE CASES ON PPP EVEN WHEN VFM ESTIMATE IS AGAINST IT JUST BECAUSE PEOPLE CANNOT ESTIMATE ALL BENEFITS.

CASE STUDY QUESTIONS:
Given the information provided in the case study, do you believe that all potential risks have been adequately addressed through the risk framework? Why or why not? Which potential risks, if any, still remain to be addressed or were not adequately addressed? How might a transaction advisor or "project officer" participated in this project?

Q1: Given the information provided in the case study, do you believe that all potential risks have been adequately addressed through the risk framework?

I don't know if they were thinking in a risk adjusted PSC framework. But I think it is well done in addressing risks.

These are more or less the risks from the materials: Oil supply and prices, seasonable bagasse, centralization project in progress in the southern part of the country, funding issues, institutional set up, project implementation strategies addresses with the WB, delays due to pricing of bagasse, funding, fiscal, centralization, electricity price, already combined coal-bagasse bad experience, no technology risk because of the automatization of shifting from bagasse to coal environmental issues conforms the base load/peak load day/night is not an issue, reduction of energy prices for the debt service period and the post-debt service period but currency risk, input price risks are solved with the indexed tariffs.

They classified the risks in three categories: construction, financial and operational but the risks at page 5/6 they were not structured. I will not do the structuring here. Here I want to mention that interesting taxonomies are provided at: From the standardized PPP risk matrix, Manual 4 PPP page 63, potential risks are structured and the PSC-Canadian best practice guide identifies at page 14 specific risks

Q2: Why or why not?

As I said. I think it is well done but maybe the risks could've been structured better.

Q3: Which potential risks, if any, still remain to be addressed or were not adequately addressed?

As it is a seasonal, the energy value of bagasse/sugar cane depends on rainy/dry season and this might have something with low density/high volume combustible. I am not an agriculture expert but this might be a risk worth looking at. Also, there is nothing about the management of the combined power plant. Also, maybe the demand for electricity might drop (I have no reasons why, but it is a demand risk).

Q4: How might a transaction advisor or "project officer" participated in this project?

Risk workshop was not organized at which they could've gained more on it. The transaction advisor and the project officer can help a lot to such workshop (page 24 Module 4 National Treasury PPP Manual).

Module 3: Project finance and investment analyses

CONTENT QUESTION: Project financing usually requires public support in the form of credit enhancements, such commitments to raise tariffs when warranted, guarantees against political risk, the use of grace periods, the use of subordinated debt, and other techniques. Apply these credit enhancements to your own country environment. Which one do you think would be most valuable to facilitating project-financing closures in your country or your infrastructure sector? Explain why. What do you think the government or public sector would need to do to enable these credit enhancement techniques?

CONTENT ANSWER: Macedonia as transitional country face situation where the main consumer groups should pay the full economic costs of production and supply and investment of so-called public goods so that whatever the enterprise (private or public or P3) should be commercially viable company that can finance its investment requirements without subsidies from the government at the one end. This will concern the relative prices between main groups of consumers and the cost pricing of goods and services provided. The viability is connected to the revenue requirements and the revenue collection.

In relation to **increasing tariffs**, in the communism the consumers were achieving a sizeable welfare gains from the reduction of prices in the so-called necessities. The contra weight was from the relatively high turnover taxation. This situation has caused today's problem of rebalancing the prices.

It was clear that within market economy environment, the prices of public goods/services would increase significantly to the household's consumers. But the living standard in Macedonia is not in contra balance with the relative price adjustment requirement. The result is usually a highly sensitive government to the pressure to keep down the price, revenue collection problems, not quit defined role of the public sector and status quo for some goods (recently, electricity could be good example in Macedonia where irrelevant from the independent regulatory commission the ELEM state owned generation enterprise is not asking for higher prices. There are disputes on the institutional set up of the electricity sector which is vertically disbundled and on track of liberalization instead of parallel discussing the need to increase the prices and even to discuss the energy deprivation and protection of the poor).

Another problem in Macedonia is the political risk and here I'll be short just mentioning one word – Kosovo. The recent Bear market on the Macedonian stock exchange reflects the **political risk** for the market.

Related to the **local self governments**, under the BIS-Bank of International Settlement regime, loans to the sovereign government of the same country as the bank are assigned a 0 sectoral risk weight (i.e. they are assumed to be domestically risk free) and those of private-sector firms are assigned a 1. The BIS recognizes that the relationship between the central government and sub-national governments vary from country to country and therefore allows the central bank in the respective countries to assign the appropriate risk weight. Thus, the weightings provide the central bank's opinion as to the relative risk of loans to the sub-national governmental sector in comparison to the sovereign and the private sector.

In the US, the BIS credit factors range from 0.1 for general obligations to 1 for private activity (corporate) bonds. In foreign countries, sub-national government obligations that have explicit central government guarantees have BIS ratios of 0 (which makes them tantamount to direct sovereign obligations) and those that do not, have ratios that can range up to 1 or even higher. Ratios can be changed to recognize overall changes in sectoral credit strength. This recently happened in South Africa (I was studying this in 2006), where the ratio was increased from 0.1 to 1 for sub-national governmental securities when the national government announced that it would no longer guarantee municipal and provincial debt.

Typically, in a transition economy such as Macedonia, local self governments (in Macedonia we have one tier LSG) are highly dependent on transfers from the central government. While transfers can be very volatile and untested for sustained periods of time, they form a major portion of revenues and are attractive for **interception** to cover debt service payments. **Intercepts** can have a powerful impact on local borrowers, especially small and remote municipalities. In Macedonia as far as I know the KfW was doing some credit rating testing for LSG and they were taking into account the intercepts/transfers from central government that are unconditional and substantial for some LSG.

As for the **communal sector** in Macedonia (competency of the local self governments) relevant is:

- household incomes are low
- Low level of revenue collection
- payments arrears are high
- services are not disbundled
- Subsidy system based on affordability of the consumers rather than pursuing cost recovery pricing
- underlying assets are owned by local governments, and under Macedonian legal doctrine cannot be sold, mortgaged or pledged to secure borrowing (as they are for providing public goods) as far as I understand

- Problem of requirement for invoiced VAT payments as opposed to cash collected creates hidden debt to the Public Revenue Office
- The court procedure for collecting revenues due is not properly established
- The LSG do not settle their liabilities toward the communal enterprises even though they are their founders
- The regular political disputes between the Mayor and the Council leads to a late decision or no decision made about financial accounts, prices, programs etc while the communal enterprises should operate daily and because of that regularly operate outside their legal framework
- The waste locations are far from modern facility's standards for the disposal of solid waste which is nice example that communal activity is not an environmental issue but rather a cross cutting problem with environmental issues.
- Some of the by laws of the communal enterprises are not in accordance with the separate laws that regulate the activity.
- No tariff system developed for the price of communal services
- Depreciated assets
- Still some communal enterprises in Macedonia are not re-registered properly as required after the process of decentralization started

Thus, I can say that in Macedonia as a transition country has scarce public finances and many needs thus, will require private sector funding. On the other side, as a competition to the private sector funding, we have the pre accession funds from EU, but low absorption capacity.

Anyway, the **commitments to raise tariffs when warranted and guarantees against political risk** as a public support will be required by the future public financing in order to provide high gearing ratio (communal services – water supply and solid waste management – are perfect as project finance example as assets of the communal enterprises providing the services are “special purpose” by law and cannot be used as collateral and/or sold in Macedonia).

Table. Risk matrix.

Risk	Description	Consequence	Likelihood	Seriousness	Rank	Change/ negotiation	Mitigation Actions	Cost (Euro)	Allocation
Political risk	Kosovo					Syndicating the loan with arranging bank	Guarantees against political risk		
Political risk	Lack of proper legislation						Guarantees against political risk		
Revenue risk	Affordability to pay						Commitments to raise tariffs when warranted Subsidy to poorest percentile of population Due diligence and other research		
Revenue risk	Willingness to pay						Commitments to raise tariffs when warranted Due diligence and other research		

CASE STUDY QUESTIONS:

Question 1: In the Excel spreadsheet, click on the first Worksheet '1-Inputs-Results" in order to complete the following:

1.A. Bus Fare Increases: Currently this project assumes a bus fare increase schedule for years 2007 to 2027, shown in the yellow-highlighted cells D44 to D64. These inputs would require that the percentage of MidTransit's costs covered by bus fare collections would be shown in cells E44 to E64. Remember that the Middletown City Council wants fare collections to cover at least 66% of MidTransit's total costs. <u>Insert a new schedule of bus fare increases in cells D44 to D64 that will ensure that fare collections meet theseCity Council goals (66%).</u> View the results in the graphic to the right of the input numbers.

1.B. BOO Rental Revenues: Currently, the revenues projected to be collected by the BOO developer meet neither the minimum return on equity rate of 22% (shown in cell D88), nor the lender's minimum Debt Service Coverage Ratio (DSCR) of 1.5x, shown in cell D90. The key inputs that determine these results are shown in cells D72 and D75 (the lease payments from MidTransit to the BOO for Year 1 and Year 7, respectively) and in cell D77 (the projected lease payments from private retail shop-owners). As noted above, to keep retail rents affordable at the new shopping centre, the Middletown City Council wants at least 20% of the project's revenues met by MidTransit's rental payments to the BOO. This output is show for you in cells D74 and D76. <u>Insert new proposed rentalpayments into cells D 72, D75, and D77 such that:</u>

> Retail renters do not pay for more than 80% of the average BOO projects revenues (see results in cells D74 and D76 – Remember D74 shows the percent of BOO revenues paid by MidTransit, and you will therefore want this be greater than or equal to 20%
>
> The BOO developer's return on equity is above the threshold level of 22% (as shown in cell D88); and
>
> The project lender's minimum Debt Service Coverage Ratio is above the threshold level of 1.5x (as shown in cell D90). Note that Cell D90 shows the MINIMUM DSCR, which is usually reached in the early years of a project financing. To see the DSCR for each year of the project, and to find out in which year the minimum level is reached, go to Worksheet "6-Cash Flow" Cells G22 through Z22.
>
> Note that by increasing the rental payments from MidTransit to the BOO, you have just increased MidTransit's costs. In order to maintain the City's goal of paying no more than 33% of MidTransit's costs as a subsidy, you will have to re-adjust your proposed bus fare increase schedule in cells D44 through D64. Please return to these cells and make these changes to meet the City's goals (again, as shown in cells E44 through E64).

What are your observations from these inputs and changes that you have made?

Question 2: Credit Enhancements: What if the selected BOO developer argues that MidTransit is not a creditworthy party that is able to meet its rental payment obligations for the entire 20 year term, and therefore argues that the City Council should guarantee all payments to be made by MidTransit? Do you think the City Council of Middletown should be prepared to provide such a guarantee? Explain why or why not. Secondly, what if Middletown City Council itself is not determined to be creditworthy enough to provide such a guarantee to the private BOO developer and it lenders? Should the National Government of Azanialand consider providing a back-up guarantee to the BOO developer that if both MidTransit AND the Middletown City Council are unable to make the agreed rental payments, then the National Government of Azanialand will pay the developer? Explain why or why not. Please post your responses under Module III in the Discussion Board.

<u>Advanced Level Questions:</u>
For those of you who are looking to sharpen your understanding of PPP project financing and spreadsheet modelling skills, an extra advanced level question is provided:

One the key determinants of the size of rental payments required from MidTransit, and therefore of the bus fares required from Middletown's riders, are the interest rates on the funds borrowed by the BOO developer and the BOO developer's own required return on equity. According to the survey of commercial lenders conducted by the PPP feasibility study team, the BOO developer could likely be expected to pay and interest rate of 16% per year on the funds borrowed for this project. What if this interest rate could be reduced to 13% IF the City Council of Middletown would provide the developer with a guarantee minimum level of retail commercial rental payments for the shopping centre/marketplace equal to 80% of projected retail rental payments? In other words, IF the BOO developer is only able to rent out 50% of the space of in the shopping centre/marketplace then the developer (and its lenders) can expect to be paid an amount equal to the 30% of rental payments it is missing from the City of Council of Middletown. Please answer these two questions:

> What is the impact of this lower interest rate on the average rental payments from both MidTransit and from Middletown's retail shop-owners? By how much would this reduce the average cost of this project to MidTransit and to Middletown's retail shop-owners?
>
> Do you think the City of Council of Middletown should try to provide such a guarantee? Is this a good form of PPP risk allocation? Explain why or why not.

One of the other key determinants of the affordability of this project is efficiency of the management of MidTransit. You have probably already seen the projected 10% annual increase in all of MidTransit requires that bus fares be increased by 5 – 10 cents every 3-4 years, just to keep pace with MidTransit's rising operating costs. What if, in addition to this BOO for the new Bus Terminal, a management contract for MidTransit could structured that required the contractor to achieve:

1. A 90% collection rate from MidTransit's riders (instead of the projected 75%) Go to "1-Inputs-Results" Cell D67

2. Operating costs could only increase at 7% per year (instead of 10% per year currently) Go to "1-Inputs-Results" Cell D68

3. MidTransit would still need to recover 66% of its own costs from fare collections, as shown in "1-Inputs-Results" Cells D45 through D64

Do you think that Middletown City Council, therefore should try to pursue a management contract along these lines for the management of MidTransit? Explain why or why not as well as identify what any obstacles or challenges might be to your recommendation.

One member of the Middletown City Council has argued that this PPP project is actually more affordable for Middletown than this feasibility seems to show. Because this new BOO Bus Terminal & shopping centre would pay the City an estimated $200,000 per year (as shown in "1-Inputs-Results" Cell D82, this effectively reduced the cost to the City of the project. In fact this Council member recommends that the full $200,000 per year in property tax payments should be paid directly to MidTransit, thereby reducing the amount of subsidy required by the City. Do you agree with this reasoning? Given what you know about the background to this project and its needs, are there other priorities that this City tax revenue should be spent on first? Explain.
We really hope you try to tackle these more advanced questions and look forward to your responses. Again, post your responses under Module III in the Discussion Board.

CASE STUDY ANSWERS:

Background

The Azanialand looks like regular transition country after the breaking of Berlin Wall. Thus, I suppose it is something like Poland, Czech Republik with a difference that they started earlier with the empowering the local governments and that Azanialand is not EU member but still the general socio-economic and political environment to me is similar thus, I am not expecting that much of political instability.

The Middletown on the other side looks like in developing country burdened with the pressures from globalization and “growing urbanization” (migration of people to urban places).

They want to solve: housing, water supply and local transportation. There exists public owned city bus company but with changing environment and possible as a result of corruption, bad management, hidden employment, subsidies etc the result is 53,3 passengers per bus trip (international peer indicator is 35 to 40 passengers per bus trip). Thus, the overdemand created unregulated private mini-bus transportation. On the one side this company provides meeting the demand but on the other side there are negative externalities mostly on safety mostly.

Finally there is a political will to do something with whatever existing assets of the public bus company but the public representatives, that is the local government, have no financial resources. Basically they would like not only new investment but better management and expanding the activity as well.

Current situation

- Annual operating costs 1mln $US
- Fees collection 465,000 $US
- Subsidy 535,000 $US
- Bus fare so far 0.15 $US per passenger per day
- Expected increase of costs for BOO 35% to 60%
- Free riders 50%
- Target collection rate 75%

Targets:

- Improve fees collection
- Investment in new busses
- Better and new bus routes
- P3
- Increase of bus fare
- Subsidy 33% (gradual declining from 53.5%)
- Operating costs coverage 67%
- Bus fares indexed to inflation and increase number of busses
- 20 years P3 contract
- As far as I understand there is a potential requirements for kind of cross-subsidy to the own local shop-owners
- Gradual approach as:
    - phase 1 - 25 bus berths up to the 7th year, phase 2 – 35 bus berths up to the 20th year

  - bus fleet from 25 to 50 when new bus terminal and shopping center ready and up to 80 after the 8th year
- Rents up to 70% to 80 % from private shops and 20% to 30 % from project's revenues

Advice to Middletown,

1.A. Bus fare increases.

Bus fares are indexed to inflation and increase number of busses (and other variables implicitly) thus, directly we can simulate by changing the two variables. On the other side the inflation is a matter of the Central Banking authorities and the number of busses are agreed to increase from 25 to 50 when new bus terminal and shopping center ready and up to 80 after the 8th year.

From this, I conclude that keeping inflation 10% all over the project life is not realistic as I am expecting that this government will do fine with macroeconomic stability (maybe one would expect Ballasa Samuelson effect and price pressure) and I will simulate with a 7 % inflation rate as an unweighted average for the period.

Technically this is done in the excel model by replacing 10% with 7% in the Income statement G39 cell. The result is exactly what I need i.e. 67% cost coverage.

If one needs to achieve the same goal it can do it by changing the bus fares in the cells from D44 to D64. A 68% can be achieved by increasing the price from 0,7$US in 2016 to 0,75$US in 2017.

1.B. BOO rental services

I entered the schedule

BOO Revenues from MidTransit Rental Payment (Years 1)	$ per year	$650.000
MidTransit Rental Payment Inflation Rate	%/Year	10%
Average Percent of BOO Project Revenues from MidTransit (Years 1- 6)	%/Year	25%
BOO Revenues from MidTransit Rental Payments for Phase II (Year 7)	$ per year	$1.000.000
Average Percent of BOO Project Revenues from MidTransit (Years 7 - 20)	%/Year	22%
BOO Rental Revenues from Private Retail Tenants (Yr. 1)	$ per year	$2.000.000
Private Retail Tenant Rental Inflation Rate	$ per year	10%

And of course the costs to Mid Transit increased. Thus, by readjusting the bus fares I get the following schedule and achieving the target of operating cost revenue coverage of 67%:

Year	MidTransit Bus Fares	Percent of MidTransit Cost covered by Fare Collections
2007	$0,15	35%
2008	$0,30	68%
2009	$0,30	65%
2010	$0,30	61%
2011	$0,40	65%
2012	$0,40	62%
2013	$0,40	59%
2014	$0,40	58%
2015	$0,50	69%
2016	$0,50	66%
2017	$0,50	67%
2018	$0,60	76%
2019	$0,60	72%
2020	$0,70	78%
2021	$0,70	80%
2022	$0,70	75%
2023	$0,80	79%
2024	$0,80	74%
2025	$0,80	69%
2026	$0,80	64%
2027	$0,90	67%

Well, we can see that all variables are connected as it is in the real world that is in the modeling as well. With a bit practice one can test and simulate the correlation between the variables and their elasticity.

Answer to Question 2.

There are two situations. One is the perception of the private partner and of course the argument and the negotiation. I think that local self government was paying subsidies for years to MidTransit anyway and that giving guarantees for less amount of money should be granted to the private partner. A separate discussion can be that the private partner will go for a BOO and the rental part is lease PPP. Thus, the LSG can argue that with the lease part the private partner assumes les risk thus, no need for guarantees. All on all, it really depends on the arguments for what kind of risk the private partner is assuming to ask for guarantees.

The second situation is if the LSG assembly itself does not trust its creditworthiness. Of course the central government should not go for a guarantee because of the moral hazard reasons and the hard budget constraints benefits.

Advanced level questions and answers:

1. If the LSG assembly provides guarantees the interest rate will now be 13% (cells D35 and D39) and will affect the total debt service (lowering it). As far as I can see there is no impact on the average rental payments. From this I think that the city should not provide such a guarantee as the rental space risk is commercial risk up to the private partner (the way I see it).
2. For sure the collection rate up to 90% will decrease the costs of the project and the bus fares can be lower thus, more affordable to people and in expectation of less free riding. On top, if the O&M decline by 7% this is additional incentive for affordability to consumers.
3. From this exercise it seams that the project is highly sensitive to the collection rates and the O&M and it is recommendable for the city assembly to consider negotiating a management contract with the private partner.
4. With the management contract there is no need for significant institutional change and it is less risky for the private investor.
5. I don’t agree with the city councilor as all the calculations were based on some risks assumed including the subsidy. On the other side it also depends on the system of financing and how revenues are linked to expenditures in that city.

New proposed bus fares schedule after lower interest rate to 13% and O&M decline by 7%.

Year	MidTransit Bus Fares	Percent of MidTransit Cost covered by Fare Collections
2007	$0,15	35%
2008	$0,20	55%
2009	$0,20	53%
2010	$0,20	51%
2011	$0,30	61%
2012	$0,30	59%
2013	$0,30	57%
2014	$0,30	58%
2015	$0,35	65%
2016	$0,35	63%
2017	$0,35	66%
2018	$0,35	63%
2019	$0,35	60%
2020	$0,40	66%

2021	$0,40	70%
2022	$0,40	66%
2023	$0,40	62%
2024	$0,50	74%
2025	$0,50	70%
2026	$0,50	66%
2027	$0,55	69%

Module 4: Procurement process,

CONTENT QUESTION: Please, provide one example of a PPP that would be best procured using sole sourcing, one that would be best procured using competitive negotiations, and one using competitive biding. Explain your rationale.

CONTENT ANSWER: From what I see there is a trade off among and often diametrically opposite conditions to be satisfied in relation to money, time and specialization.

The longer the procedures are the higher are the costs and the loner is the time for preparing all well. The higher the specialization requirements are the more the need for direct selection is. The more time resources available in general the better the competitive biding to choose.

No, by looking at the content reading material one can use the conditions to analyses case by case studies. I was looking at the regional and sectoral review optional reading material (with the excel spreadsheets) and I can see that for a decade staring 1990 the PPPs are structured in energy, telecommunication, transport and communal area. Each of these sectors can classify in each choice of procurement process I think.

It would be interesting to see a cross table by type of PPP and choice of procurement which I could’ve not find and if anyone of you can please do share it with us.

For the colleagues I choose the following table:

Figure 1.4 Annual Investment in Infrastructure Projects with Private Participation, by Sector, 1990-2001 2001 US$ billion						
Period 1990 - 2001	**Telecommunications**	**Electricity**	**Natural gas transmission and distribution**	**Transport**	**Water and sewerage**	**Total**
	331,4	213,2	34,5	135,3	39,8	754,1

CASE STUDY QUESTION: In the case of TICTS, local involvement in the consortium came about as a result of the efforts of HIL, a local Tanzanian company. How might a government, such as the Government of Tanzania, take a more proactive approach (both in terms of the design of the procurement process and RFP documents, and the provisions of the Lease contract) to encouraging the involvement of local companies and/or investors in the bidding consortia, particularly given the lack of local financing available?

CASE STUDY ANSWER:

Background

- African ports – state monopoly
- Low productivity, low investment, low quality of services
- High maritime transport costs
- Low competitiveness
- PPP experience since 1990
- Strong pressure for hard budget constraint from IFIs
- New environment of competition and technological change and lack of financial resources
- PPP proved as efficient instrument in African ports for better quantifiable results
- Fears from transfer from state to private monopoly
- GoT developed a privatization policy in 1992 and created the parastatal sector reform commission – PSRC
- PSRC objectives: operational efficiency, loss making of GoT budget and bigger role of the private sector

Current situation

- The THA was established in 1977 and also DSCT operates as a part
- In 2000 it become TITCS following the capitalization lease
- The lease is for 10 years and now spending its fourth year
- In 1996 utilities and infrastructure become part of the privatization agenda for them being subject to management performance contarcts
- Due to huge resource requirements GoT asked the welcomed the sector to contribute to the cost of rehabilitation and modernization
- Thus, objectives for privatizing THA were
    - o Efficiency
    - o Quality of source
    - o Higher competitiveness
    - o Higher profitability
- CT enters in the second phase

- The first phase started 1994 with the performance contract between the GoT and THA
- Originally GoT was owner and private sector involvement by concessions and lease
- CT to be privatized as it was profitable
- THA case in 1997 was again proved for privatization
- Market risk increased, low rating from customers and average technical services
- Three scenarios:
    - Minimum commercialization
    - Mid level commercialization
    - Full commercialization
- Scenario two was recommended even though the scenario 3 was closer to the adopted form and by management contract
- Factors to decide were
    - Importance of the unit to THA
    - The need for change
    - The easy (difficulty) to change
- Comparative advantage of CT: core activity and strategic implications
- Employment not that a problem but services with low quality

Procurement:

- Procurement process followed the WB procedures
- The process was mainly handled by the transaction advisor
- Procurement started in 1998 with advertising the opportunity
- There were 17 EOIs, 5 prequalified (they received RFP) and 2 bidders selected
- The RFP included the draft lease contract
- Pre bid meeting held, data room available
- Two stage bid procedure was performed (technical and then financial bid)
- The two bidders were send the revised lease contract, revised the bidders and finalized
- The highest lease fee seams to gained the highest score (in order to gain time during negotiations)
- Bidders were asked to sign the lease contract within two weeks
- The wining bidder was asked for 4 months mobilization period
- At the end lease contract was awarded and the local investors increased their share from 25% to 30%

Answer:

For me this was difficult question but this is my answer:

1. I think that the RFQ could've have statement of requirement to use local labor
2. Maybe the public announcement should have start earlier domestically and latter domestically and internationally
3. The background information in the RFP could have more info on local economy and a clear statement that the GoT encourages domestic financiers

Module 5: Communications and stakeholder relations

CONTENT QUESTION: To what degree to you believe stakeholders should be involved in the PPP process? Should they be consulted and when should consultations occur? Should they be represented on a project steering committee? Should they be able to vote on key aspects of the PPP? Finally, if stakeholders to not agree with a proposed PPP, or some aspect thereof, when should government stop trying to build consensus and simply move ahead?

CONTENT ANSWER:

1. **should stakeholders be consulted**

Stakeholders should be addressed in order for the whole PPP process to be sold to as much as possible parties. It will give credibility to the process, increase transparency and some considerations can be looked at and internalized in an earlier stage before the PPP is underway. It is shown in the study from Campbell-White and Bhatia that out of 15 impediments to economic reform the majority relates to weak communication and a lack of public understanding and consensus about privatization. Also, the cultural context is important as stressed in the content reading material about the AIDS and the SAR. Stakeholders should be also consulted in order not to make the mistake to think that the less information the fewer risks will be involved (as explained in the building support for privatization reading material.)

2. **when they should be consulted**

After stakeholders are properly identified as for their interests and needs and after they are segmented into a target groups i.e. after properly developed and implemented communication strategy.

3. **should they be represented on the steering committee**

Indeed, as this instrument can facilitate better coordination and will strengthen the management of the programs. Those not represented can always be informed from the assigned communication officer.

4. **should they be able to vote on they aspects of P3**

If the best practices justify it yes, they should be able to vote. However, the best is to stick to the legal requirements for public participation prepared by MIGA or

EBRD for example. The rules of the game should be followed without exceptions as if there are exceptions it will undermine the credibility of the process it self. I present case study from EBRD annual meeting held in Kazan this year which I attended (for those interested to read the whole report from the Kazan event see the attachment).

BOX: Case study

One interesting case study is the Tbilisi water supply improvement project. The ministry of healthcare, labor and social protection is planning to give each family per annum 30 US$ for communal services. The water fee per person is 1.2 US$ thus, for a 4 members family is almost 10 US$ per month or 120 US$ per annum. The monthly salary for a teacher is about 60 US$ or 720 US$ per annum and according to studies the affordable level of combined water and waste services should not exceed 4 % of average household income (thus, 29 US$ or almost 60 $ per annum if both parents are earning the same income). Thus, the subsidy from the state of Georgia is covering only 1/4 of the sum of 120 US$. Taking into account that in Georgia around 50 % of the people live under poverty line it is a high chance that a large part of the population will be without drinking water.

The point of the above case study was also supported by the Legal seminar: “Fostering transition through PPP”. Honestly, I was present only part of the seminar but the PPP to me has two obstacles to be introduced in Macedonia as well as in Georgia. First, the PPP is recognized by the politicians as downloading the complete risk of the investment to the private investor while keeping the turf of power and second, the return for the investment cannot be reached (return over the discount rate) given the quasi-fiscal burden and risk for subsidizing the poverty (that should be government concern). This is the biggest threat to the PPP in the transition countries as Macedonia and Georgia apart from the usual threats of lack of legal requirements, risk analysis, capital investment planning etc. Downloading the redistribution responsibility from the government to the investors is not a PPP but more of a perverse quasi fiscal burden to the potential investor that will create further conflicts in a society.

Similar transparency and disclosure problems regarding PPP one can find regarding the project of the planned motorway – the Western High Speed Diameter as a part of the IX Pan-European transport corridor linking St. Petersburg with Scandinavia. The Save Yuntolovo Public Environment Movement is blaming the EBRD being too easy on the procedures related to proper preparation and disclosure of the EIA for this investment.

The CEE Bankwatch Network’s newsletter makes an analysis of the double standards and the adverse role of the EBRD beside their responsibility related to the environmental impacts and issues in relation to the projects they sponsor. The case study shows how the EBRD withdrawal from the Sakhalin II project is a right decision but for the wrong reasons. Namely, EBRD decided to halt its consideration of Sakhalin II after Gazprom agreed with SEIC shareholders to acquire the controlling stake in the project. This followed months of saber-rattling by the Russian environmental prosecutor. Ironically the EBRD didn't withdrawn its considerations for Sakhalin II years ago when it was clear that the project was in violation of the bank's environmental policy instead they were crying crocodile tears after take over from Gazprom. Now, the banks and the SEIC shareholders are praising again Gazprom with the new Area of Mutual Interest-AMI announcement by Shell.

The story supports my view that the foreign investors are going beyond the classical risk assessment and are weighting the future cash flows against the risk at higher levels given the potential of the Russian endowments. The stakes are at such level that the environmental issues are anticipated as a luxury that should be worked over. The weak government institutions and captured regulatory bodies and a public that is near the poverty line are too weak to correct the behavior. The same story holds for Macedonia except for the fact that the situation is even worse given that the NGO sector is much weaker and the public creators (mostly journalists) are willing to pay attention only to the daily political issues. In an environment such as in Macedonia where journalists wants to be politicians and politicians wanting to be journalists environmental issues are at the list of lower priorities.

5. **if difficult to achieve consensus when the Gov. should move ahead and give up in building consensus**

NO. The Gov. should always keep to PPP to be fair, equitable, transparent, and competitive and to think in a sustainable growth environment. Short term gains often create long term welfare loses.

CASE STUDY QUESTION: The PC spent a tremendous amount of effort in engaging the Union and employees. Do you consider their efforts to be a success? Why or why not? What might the PC have done differently? Do you think that adequate attention was paid to the Board and Management? Why or why not, and what might the PC have done differently? Finally, do you think that the PC's approach to managing labour stakeholders is transferable to other PPPs in the SADC region? Why or why not?

CASE STUDY ANSWER:

Background

PPP to achieve:
- efficiency increased in the economy
- reduce monopolies and increase competition
- enhance participation in public enterprises
- raise revenues for the GoM

Communication strategy:

- ad hoc
- press releases
- case stories

Result: increasing opposition to PPP and negative media coverage.

Was the invested time and effort a success?

I think yes from all the info I have. Of course, one should've calculate the risks and losses of not being successful with time and effort being invested and to make judgment (i.e. I need the evaluation part of the strategy so that I can be sure of saying it is a success).

What might've been done differently?

Take-away messages strategy should've been done thoroughly in the very beginning. Or ISPE methodology or to employ specialists in the area. They lost considerable time from 1996 to 2001 to finally get aware of the need for a firm strategy.

Was an adequate attention paid to the board and the management?

I think yes. They were at least twice addressed and informed and they were also a key part of the steering committee responsible for overseeing the transaction itself.

What might've been done differently?

NA.

Was the approach to deal with the labor stakeholders replicable to other countries?

Yes it is. As the labor unrest can be a result of workers not being meaningfully involved in the PPP by not being informed of the objectives and the rationale for privatization. As for Macedonia let me tell you that the privatization process is deal done and not successful. This is why this government now in Macedonia invests a lot in PR in order to sell the further reforms to its citizens (voters).

Module 6: Contract management, monitoring and evaluation

CONTENT QUESTION: Please provide an example of a PPP from and tell us whether it is regulated by contract or by independent regulation. Describe

the strengths and weaknesses of whichever approach has been taken and include any recommendations you have for improving the approach to regulation.

CONTENT ANSWER:

First of all let me tell you that I read this and I understand it all but this is a knowledge that is worth only if implemented in practice. Thus, I have no practical knowledge on this one.

I was in Croatia for a study tour to see how municipalities there exercise their borrowing power and have seen that some municipalities there went into PPP with regulation by contract.

Interesting for me was that in few of the municipalities we visited all of them were using the services of one man who holds PhD from UK and whom they all contracted for him to prepare the PPP contract that will regulate the relationship between the municipality and the private partner in the area of education services mostly. We have been told that the contract is complex, confidential and that it regulates each detail up to the point of changing the toilet paper in the toilet.

By reading this content material I see the scale of this exercise of contract management and regulation and understand much better what the Croatian colleagues where telling us.

One example I have though is the privatization of the electricity distribution in Macedonia. First the deregulation started and the company was vertically disintegrated. The transmission is at government ownership as it is the generation. The distribution was sold to the Austrian partner.

Now, by my opinion there were few problems:

1. The financial settlement was not regulated properly and thus, the private distribution company was collecting the revenues but was not transferring money to the generation company.
2. The same practice was followed by the transmission company to whom the generation was obliged to sell at regulated prices
3. In Macedonia we have an independent regulatory energy commission
4. The energy law provides for the distribution company a monopoly as it is stated that only one distribution license can be issued on the whole territory of Macedonia
5. The generation company is subsidizing the households as the government is not ready to go for and asking for increasing the electricity price for this type of consumers (or for a dynamic efficiency economic regulation as stated in the content material from the IP3 training material).

6. The direct consumers (high voltage) are receiving a subsidized price from importing electricity from the transmission company and are now pushed by the government from 1st of January next year for them to provide electricity on the market on their own and not to wait for the transmission company to import and transmit them electricity in order to close the energy balance.
7. Thus, the situation results in a not sustainable generation company that will be soon become insolvent towards its creditors
8. Rumors has it that this was done with a purpose from the previous government so that the company can soon lose its value and can be easily sold to the private distribution company under the story of “inevitable vertical integration character of the business in the long run”.
9. An argument to bullet 8 is that the distribution company is persisting for the generation company to recognize 24% distribution losses (I think that is around 15% of the total generation capacity of the country) which is way above the international practice.
10. Now, the new government amends the energy law and provides for the generation company to receive a license to import and sell electricity as well and is pushing the private distribution company to fulfill its obligation as per the contract and to make the agreed investment and to increase the revenue collection rate as it was expected.
11. The privatization contract was kept confidential for a year and is now available to the public and I haven’t seen it yet (but I’ll do that for sure).
12. Interesting is that the previous government signed the contract with a clause that goes something like this: if the independent audit finds out that the balance sheets were not properly done by the government before the privatization than the government must pay penalty to the private company (I thing in amount of around 5% of what was paid for the distribution).

Thus, from what I read in the content material and the reading material from Sanford Berg, there are few problems that I will outline them in general (I have no ambition to go for taxonomy in order to structure the listed problems):

1. the government is still sensitive to the social tensions and is not moving to ask for economic price of electricity for low voltage consumers
2. the government is not giving enough transition time to high voltage consumers to start to buy electricity on the market on their own and there is not a detailed schedule on what type of consumers when can enter the market
3. the regulatory commission is working upon a ROR methodology to set up prices for energy but is reacting only when an operator asks for price changes
4. there is an indication that during the design of the electricity market it was intentionally left for the generation company to went insolvent so that it can be easily sold to the distribution company

5. the proper financial settlement for the electricity consumed is not on place
6. governments in Macedonia are still not matured in a way to send a message that the time horizon for a policy extends beyond the next election
7. as for the regulatory governance, the communication was not in accordance with the best practice as the contract was holding information that should've been available to the public in the very first beginning. In addition, the process was not transparent as the openness to the stakeholders was not on proper level thus not providing legitimacy and I think that is why the government now is challenging the distribution company
8. last but not least, I can see now that maybe either the government at that time new about this and have done it in purpose or they were not aware of the things mentioned in the reading materials from module 6

Well, my colleagues you can create your own opinion upon this example and I would like to read your comments.

CASE STUDY QUESTION: Why do you think Nepal has taken steps to attract private investors to the power sector during a national political and military crisis? Why has investment continued to flow into the power sector, notwithstanding uncertainties?

CASE STUDY ANSWER:

Background

- Political instability
- Stable demand for electricity (mostly urban) and even underestimated with the policy paper
- Only 1,5% of economically viable capacity potential is utilized thus, who enters first the market will gain the profits
- Underdeveloped and Thomas Malthus type of stress on land
- Vertically integrated, high losses, deteriorated financial position
- However, clear power sector reform objectives
- As His Majesty is the ruler his policy paper in which it is clearly stated that He see Nepal's economy based on hydropower
- Clear effort to create independent regulatory authority
- This authority set tariffs, control market entry and require minimum standards
- Under the contract there can be no unilateral changes
- Interesting is that the WECS is not asking for conditions under a basin water use plan
- License documents are developed by DOED
- Public consultations is required but not EIA

- WB enters with a credit to increase access to electricity for population in rural areas
- Power development fund established with WB help under IDA (favorable conditions)
- Expectations are that the new legislation will be enacted once the political crises is over thus, opportunities for profit will increase

Nepal took the step to develop the hydropower sector as they recognize the fact that it is the only resource that they can account on which ground economy can be build. The human resources are scarce as the population is too young thus, not educated and without skills. It is a rural mountainous place that can build tourism as well.

I think that investors are attracted mostly because of the expectations for profit opportunities in near future, to be first in the growing market, because they can use the WB credits under subsidized IDA conditions, the water resources regulation is not that clear yet and there are no requirements for EIA I think.

Final thoughts

PPP can be an efficient instrument to provide better services for citizens at best value if properly designed. It requires proper legislation and institutions in place, accountable and transparent government and proper knowledge and capacity building. Trainings like this one sponsored by the USAID are more than welcomed and it should continue in the future.

The training provider IP3 was professional and on top on their task. Possible improvements could be to introduce more PPP examples from Europe and to stress more explicitly what are the shortcomings of the PPP. Of special importance was also the Microsoft Excel spreadsheet that gave nice hands-on-work in finances and investment decision-making.