

IMPACT OF LEGISLATION ON INFRASTRUCTURE FINANCING BY PUBLIC-PRIVATE PARTNERSHIP CONCEPT

UDC 334.752 338.49:336.13

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Abstract. *The introduction and development of public-private partnership as a funding concept is becoming essential for the development and implementation of infrastructure projects. Even though infrastructure financing is a sector which traditionally relied on budgetary resources, the economic crisis and limited economic growth and development require new ways of funding. Therefore, there is growing interest of the public sector to introduce new financial instruments intended for financing of infrastructure projects, which requires creation of political, economic and legal framework that will allow it. Private investors are becoming more and more interested in creating conditions that will allow a more efficient and regulated implementation of the public-private partnership concept, with appropriate regulations. This paper aims to point to potential opportunities and guidelines that should be incorporated into the public-private partnership law, which is expected to provide the financial resources intended for construction and development of infrastructure in Serbia.*

Key Words: *infrastructure financing, public-private partnership, legislation*

1. INTRODUCTION

Important factors for the private sector to decide to form a partnership with the public sector in the construction of infrastructure projects are national and local legal regulations and laws in the host country. Therefore, it is important to ensure development of efficient laws and regulations before the start of public-private partnership. In some European countries, especially in common law countries, public-private partnerships are treated as different Government procurements which do not require special legal regulations.

At the same time, in civil law countries, public-private partnerships are most often regulated by special legal framework intended exclusively for that type of arrangement,

Received December 11, 2011 / Accepted December 19, 2011

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just like the Concession Law is defined by a special law. Both common and civil laws have many advantages and disadvantages, which are reflected in the time needed to obtain various permits, clarity of procurement procedures, supervision of design and construction of an infrastructure project, project company ownership restrictions and the like.

Regardless of which country the law comes from, it is certain that the contents of the project contract, as well as the way its stipulations are implemented are vital for the success or failure of the infrastructure project implementation.

2. APPLICATION OF PUBLIC-PRIVATE PARTNERSHIP IN THE EU COUNTRIES

At the European Union level there are special rules that regulate public-private partnership relationships. Any act, whether it be contractual or unilateral, whereby a public entity entrusts the provision of an economic activity to a third party must be examined in the light of the rules and principles, particularly as regards the principles of freedom of establishment and freedom to provide services, which encompass in particular the principles of transparency, equality of treatment, proportionality and mutual recognition. [3]

At the moment, European law has two valid procurement directives that refer to public-private partnerships. Those are the Utilities Directive (2004/17/ES) coordinating the procurement procedures of entities operating in the water, energy, transport and postal services sectors, and the Public Sector Directive (2004/18/ES) which refers to procedures for the award of public works contracts, public supply contracts and public service contracts. At the same time, all contracts that include wider community also have to contain legislation that defines the business laws within the community, regardless if it is a public-private partnership law or not, and it also has to include principles of transparency, equal treatment, proportionality and mutual recognition. [5]

The definition of 'public-private partnership' is not uniform in the EU legislation, so it can be said that it is a type of cooperation between a public sector authority and representatives of the private sector for financing, revitalization, management and maintenance of infrastructure, which results in certain revenue for the service provided. The latest analysis of PPP was given in 2008 through EU Commission guidelines [2], in the Green Paper on public-private partnerships and community law on public procurement and concessions, which precisely interprets this type of partnership.

The Green Paper does not contain concrete proposals, nor it favors a partnership model, but it emphasizes that PPPs contribute to quality improvement of public services and supports economic growth in the EU. It deals with PPPs created on the contractual basis only and those that include joint participation of a public and private partner in a legal person, in mixed ownership. The Green Paper defines the basic elements immanent for PPP, such are duration of the partner relationship of the public and private sectors, project financing model, role of public authorities and the private entrepreneur (investor) in defining goals, as well as risk distribution. [2]

Even though the definition of public-private partnership is not uniform in the EU legislation, all the definitions have some common characteristics: (1) public-private partnership always refers to cooperation between two or more participants (where at least one participant is public), (2) each participant is a principal, (3) the relationship is enduring, stable and based on mutual or complementary benefits, (4) each of the participants trans-

fers material or immaterial resources to the partnership, and (5) risk and responsibility are shared among all partners. [1] Therefore the participants, their relations, resources, allocation and continuity of business that comes out of the partnership represent the most important elements of a PPP contract.

3. CONTRACTS ON PPP-FINANCED INFRASTRUCTURE

Public-private partnerships include numerous participants, and therefore also the appropriate number of contractual arrangements that regulate relationships among the participants in the project financing, distribution of rights and obligations, as well as risk allocation. Finance contracts follow the planning, construction and management of the infrastructure project, as well as its financial aspects.

PPP contracts belong to the category of 'incomplete contracts', since it is impossible for the contract to predict all the possible events in the future. The more complex the contract is, and the longer its duration, the less complete the Contract itself is. That means that only the projects which are expected to be long-term and stable, such is construction of roads and road infrastructure, are suitable for implementation of the PPP concept. In accordance with that, analysis of the legislation that follows PPP contracts is based on the analysis and study of individual contracts with the immanent project finance concept, as well as the elements that are essential for closing the contract.

The most important is Project Contract which defines the framework of the project. According to Yescombe[9] there are two main models of this contract:

- contracts with predetermined buying conditions for project products/services, and
- concession contract.

The contracts where the buying conditions for project products/services are predetermined are contracts signed between a project company and the buyer of the final product of the project and they define conditions of buying a product/service. According to this contract, the private partner designs, constructs, finances and manages the investment project, and, after that, sells the product/service (e. g. electric energy) to the buyer (e. g. the company that distributes electric energy) under the conditions in the contract. With this contract the buyer ensures the supply of the needed product, and the private investor in the public sector ensures the sale of his products in advance, which enables him to plan his income more easily and, in that way, it significantly decreases possible risks in the sale of his products.

Concession, in the sense of this law, is the right to use natural resources and goods in general use or conduct business of general concern which the grantor cedes to a domestic or foreign person (concessionaire) for a period of time, under the conditions defined by law, for a concession fee. Concession contract is signed by the Government in the name and on behalf of the state and the concessionaire. If the concession was granted to multiple persons, the concession contract is signed by each of the concessionaires or the person authorized by the concessionaires, with special proxy. When the subject of concession is construction of municipal facilities for municipal activities, the contract is signed by the concessionaire and the authorized organ of local government, in the name and benefit of the local government, with previous written consent by the Government. [10] The contract identifies project risks that are allocated between the grantor and concessionaire, and

specifies the role of the state, supervision and procedure in the case of unforeseen circumstances.

Concessions are used more in the service sector than the product sector. Concession Contract can be signed between a project company and the Government of the host country, local government, government agencies, public companies or special companies founded for the needs of the concession.

The second group of project contracts are ancillary contracts that regulate rights and obligations between a project company and companies working on special tasks important for the infrastructure project. This group of contracts is made of [9]:

- construction contract,
- operation and maintenance contract,
- fuel or other input supply contract,
- permits,
- government support agreement, with the Government of the host country.

Construction contract is a contract that is signed between a project company and contractors on the project. This contract has to contain a detailed description of the tasks needed to complete the project, the cost of the whole project, as well as certain activities, construction and delivery deadlines, bonuses for completion of the project before the deadline, or penalties for delay, as well as conditions for hiring and payment to all sub-contractors and equipment suppliers.

Operation and maintenance contract is a contract signed between a project company and the company hired to lead and maintain the project. The operator can be an independent company or a project leader, i.e. sponsor. The project company has a long-term contract relationship with the company hired for the job and the contract specifies the jobs in connection with maintenance and management for the investment project. The contract defines fixed compensation, as well as additional compensation. The contract secures fixed operational costs and maintenance costs, as well as risk allocation between the project company and the operator.

Fuel or other input supply contract is a contract signed between a project company and key suppliers on the supply of material, fuel and other necessary inputs. The contract defines obligations, conditions and price for which the supplier needs to provide the project company with the appropriate products/services.

Permits are not considered a part of project contracts, but they are needed for project implementation. In that sense, special attention should be paid to permits necessary for construction and operation of the project and financing and investment permits.

Government support agreement is the agreement signed by a project company and representatives of the host Government. This contract is signed when there is a contract which predetermines the conditions for purchase of project products/services with a state-owned company, or a concession contract that was not signed with the Government but with another public sector entity. This type of contract provides political support, which is especially important in the countries where there is no legal framework for public-private financing and where the financial market is not developed.

Consideration of contract documents should aim at: [7]

- Protection of public interest.
- Contract equity.

- Promoting efficient arrangement and supervision.
- Provision of contract flexibility in order to follow changes in circumstances.

It is of key importance that these documents be prepared in a transparent way, as well as that their provisions are completely understood by all interested parties.

4. POSITIVE INFLUENCE OF LEGAL PROVISIONS ON PUBLIC-PRIVATE PARTNERSHIP

Contracts between the public and private sectors are created under various special circumstances, so it cannot be said that there is a generic or best model in all cases. Public-private partnership is a contract relationship between government authorities and private investors, i.e. entrepreneurs interested in a job, or a project of general benefit. Each subject contributes to the contract relationship with certain resources, according to their abilities and participates in planning and decision-making. The goal is a higher level of efficiency, easier access to capital, allocation of financial risks, and, at the same time, provision of high standards of environment protection and work safety.

In the countries that have an organized set of legal regulations in PPPs private investors are more motivated to invest capital in infrastructure projects. Legal provisions that support participation of private capital in construction of infrastructure projects are, according to Finnerty [6], based on:

- Provisions that allow a private entity to find, choose and suggest projects they will participate in, and which are financially viable for them.
- Provisions that refer to Government support in the process of planning, obtaining permits, acquiring land and resolving intergovernmental and interagency dispute.
- Provisions that refer to possibility of use of partial or complete public sector studies of land and environment.
- Provisions that enable Government or public administration loans for capital costs, which improves financial feasibility of a project and reduces the amount of private financing that is needed.
- Provisions that refer to additional securities of employee safety during construction of airports and highways, where government services can provide those services on a contractual basis, instead of the private sector representatives, which is beneficial for the private investors.
- Provisions that refer to defining differences between state and local taxes and their deferral. By tax deferral the government can invest in a project without investing funds directly.
- Provisions that introduce certain tax relief or exemption, in connection with use of certain construction supplies, since that too is a type of infrastructure financing owned by the government and local authorities.
- Provisions that refer to definition of limitations of tort liability, since the Government, as part of its sovereign immunity, enjoys a higher level of tort liability protection than private entities do.
- Provisions that refer to providing use, lease or sale of land to private investors.
- Provisions that refer to approval of the commercial aspect of the project.

For these partnerships it is understood that each party has certain advantages over the other party when it comes to completion of specific tasks, so each partner should do what they are best at. Contracts in the area of long-term cooperation between the public and the private sector include financing, design, implementation and operationalization activities of infrastructure and public services projects. An appropriate partnership structure depends on specific project demands, as well as responsibility and risks.

5. NEGATIVE INFLUENCE OF LEGAL PROVISIONS ON PUBLIC-PRIVATE PARTNERSHIP

Most project finance models are based on the leading role of private entrepreneurs in project planning, design and management. Private entrepreneurs invest their assets in the project, are exposed to great risk of return on assets, and therefore they are most interested to ensure legal protection through clearly defined, but not overly bureaucratic legal environment in the host country.

Decision of the private sector to participate in infrastructure projects largely depends on the complexity of economic, legal, social, ecological and other conditions in the host country. For private companies that want to protect their investment it is very important how and in what way a country regulates the questions of ownership rights, expropriation, land law, how they regulate founding and business of economic subjects, questions of bankruptcy, taxation, customs relief, how the securities market is regulated and the like. If legal provisions regulate inadequate risk allocation, legal environment where it is difficult to conduct business and where private entrepreneurs cannot receive an adequate yield rate for their investment will not have the initiative and be ready to participate in projects of public (general) importance.

Legal provisions that have a negative effect on the private capital flow in infrastructure projects, and in which the private sector has the leading role are based on [6]:

- Inability to modify the contract in the course of the project.
- Requirements from the developer to provide financing by posting excessive bonds or to acquire excessive amounts of private insurance.
- Exposing a public-private facility to certain risks, such is the change of the political structure, and, with them, changes of legal provisions that lead to unexpected competition which can decrease the future revenue of the private investor.
- Demands for monetary regulation in case of unforeseen problems.
- Readiness and ability of local government to provide some degree of financial support for the project, as well as political support.
- Private investor demands for the most cost-effective public procurement methods.
- Government requirements for approval of detailed design specifications before construction can begin.

It can be concluded that PPP is an infrastructure financing concept that is far more applied in the countries that have highly developed institutional and legislative framework. According to that, the technique of application of this concept of infrastructure financing is at a higher level, so PPP is present in various sectors significant for quality of life within the borders of a country. Also, public administration plays an active role here in promoting PPP as a concept of infrastructure financing.

6. LEGISLATION FRAMEWORK OF PUBLIC-PRIVATE PARTNERSHIP IN SERBIA

In the past few decades the needs for infrastructure development in Serbia were much bigger than the resources needed for their implementation, which is the reason why Serbia is still not developed enough in this area. Even though in the last few years there has been some improvement in infrastructure development, the reform of this sector is still one of the main priorities of the Government of the Republic of Serbia. So the National Economic Development Strategy of the Republic of Serbia, adopted at the beginning of 2007, anticipates infrastructure investments of 18 billion euros between 2008 and 2012, with the biggest share allocated to the sectors of traffic, energetics, telecommunication, ecology and water supply [7].

Still, inclusion of the private sector in the improvement of infrastructure and municipal service quality in Serbia is slow. There is no Public-Private Partnership Law or an Agency for Public-Private Partnership which is a central national entity for implementation of the Public-Private Partnership Law.

There are also no regulations that regulate PPP, and local governments are not obliged to apply tenders that encourage competition. Direct negotiations are allowed only in special cases. [4] More precisely, in the area of infrastructure Serbia has mostly relied on the budget, which is, naturally, not sufficient, then credit lines obtained from international financial institutions, as well as EU development funds and IPA funds. The biggest consequences are felt by local governments that reached their loan limits at financial institutions, and are quite incompetent to attract private partners interested in making profit by investing into local infrastructure.

The existing legal framework in Serbia allows different forms of PPP, such are joint ventures, but no law or bylaw defines precisely and in detail the procedures of this partnership in all its phases. Since Serbia is still not a member of the EU, its PPP regulations are not applicable; therefore, the contracts between the public and the private sector rely solely on domestic regulations.

Most regulations in this area do not strictly refer to PPPs, but only anticipate the possibility of application of PPP in the public sector. The most important laws are [8]:

- Concession Law ('Official Gazette RS' No. 55/03);
- Local Self-Government Law ('Official Gazette RS' No. 129/07);
- Law on Public Enterprises and Engagement in a Business of General Concern ('Official Gazette RS' No. 25/00, 25/02, 107/05, 108/05 – correction and 123/07);
- Law on Utility Services ('Official Gazette RS' No. 16/97 and 42/98);
- Law on Public Services ('Official Gazette RS' No. 42/91, 71/94, 79/05 –other law, 81/05 – correction of other law and 83/05 – correction of other law);
- Law on Assets Owned by the Republic of Serbia ('Official Gazette RS' No. 53/95, 3/96 –correction, 54/96, 32/97 and 101/05 –other law);
- Public Procurement Law ('Official Gazette RS' No. 116/08);
- Waste Management Law ('Official Gazette RS' No. 36/09);
- Law on Companies ('Official Gazette RS' No. 125/04);
- Decree on the Procedure of Temporary Suspension of the Transfer of Funds from the Budget of the Republic of Serbia to Local Government Unit, and/or Transfer of the Appertaining Portion of Proceeds from Income Tax and Profit Tax to Autonomous Province ('Official Gazette RS' No. 6/06 and 108/08)

However, the very act of passing laws that regulate the area of public-private partnerships is not the only condition for better development of infrastructure. In order to successfully implement infrastructure projects in Serbia, other pre-conditions also need to be met; some of them are: developed and modern corporative management in the country, a developed securities and insurance markets, regulated property and legal relationships in the public sector and clearly defined allocation of institutional responsibility.

CONCLUSION

Public-private partnership is a term that covers different contractual forms of transactions, where the private sector is given the right to conduct business over a longer period of time, at the same time assuming the responsibility traditionally reserved for the public sector. Starting from short-term contracts, concession contracts, to joint investments, where there is shared ownership between the public and private sector, PPPs have an important place between traditional project implementation and complete privatization.

In recent years there has been substantial cooperation between the private and public sectors with the goal of faster and better development of the infrastructure, which is a function of many economic activities. The public-private partnership phenomenon represents one of the most important legislative instruments within the European Union, since it enables provision of public services, infrastructure improvement, as well as a number of other project activities related to realization and improvement of transport, health, education, security and water and waste management.

It also represents a big opportunity for Serbia, since there is a great need for infrastructure investments. But before that, legal framework that will also organize this financing concept is expected, as well as founding of institutions that will make the investment process more transparent and reliable for interested investors from the private sector. In addition, the existing laws need to be revised, which would give an overview of options available to potential investors, regardless of whether they are interested in entering Serbian market or spreading investment activities. At the same time, improved communication between regional (local) and central government from the aspect of possibilities and potential of implementation of PPP concept as an infrastructure project financing model is expected.

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UTICAJ ZAKONA O FINANSIRANJU INFRASTRUKTURE OD STRANE JAVNO-PRIVATNOG PARTNERSTVA

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Uvođenje i razvoj javno-privatnog partnerstva kao koncepta finansiranja postaje od suštinskog značaja za razvoj i implementaciju infrastrukturnih projekata. Iako je finansiranje infrastrukture sektor koji se tradicionalno oslanjao na budžetska sredstva, ekonomska kriza i ograničen privredni rast i razvoj, uslovljavaju iznalaženje novih načina finansiranja. Zato se interes javnog sektora za uvođenjem novih finansijskih instrumenata namenjenih finansiranju infrastrukturnih projekata povećava, što zahteva spremnost za stvaranje političkog, ekonomskog i pravnog okvira koji će to omogućiti. U isto vreme, privatni investitori postaju sve više zainteresovani za stvaranje uslova koji omogućavaju efikasniju i uređeniju implementaciju koncepta javno-privatnog partnerstva, sa adekvatnim regulatornim okvirom. Radom se želi ukazati na potencijalne mogućnosti, ali u isto vreme i smernice koje treba inkorporirati u zakon o javno-privatnim partnerstvima od koga se mnogo očekuje u procesu obezbeđenja finansijskih sredstava namenjenih izgradnji i razvoju infrastrukture u Srbiji.

Ključne reči: finansiranje infrastrukture, javno-privatno partnerstvo, zakonodavstvo