

*Transparency International - Czech Republic*

**WHY STUDY PPP (PUBLIC PRIVATE  
PARTNERSHIP) WITH CAUTION?**

**PPP PROJECTS IN THE CZECH REPUBLIC:  
IMPLEMENTATION AND RISKS**

*2007 Prague*

ISBN 978-80-903032-5-6

*Transparency International - Czech Republic*  
**WHY STUDY PPP (PUBLIC PRIVATE  
PARTNERSHIP) WITH CAUTION?**  
*David Ondráčka, M.A. | 2007 Prague*

## INTRODUCTION

According to widely accepted definition PPP “is a partnership between the public and private sector for the purpose of delivering a project or service traditionally provided by the public sector. PPP recognises that both the public sector and the private sector have certain advantages relative to the other in the performance of specific tasks. By allowing each sector to do what it does best, public services and infrastructure can be provided in the most economically efficient manner.”<sup>1</sup> We should not get confused by sophisticated definitions and keep in mind that PPP is in fact just a specific type of public procurement, primarily used for large infrastructure projects. This concept originally came from the UK (where it was used on wider scale in 1990’s) and currently is step by step conquering Europe. The concept is relatively new, popular and strongly supported by many procurement stakeholders (national governments, EU, private companies). Needless to say, the informed research is particularly useful and timely for many European countries that face the challenge of PPP projects.

1) Definition used by the PPP Centrum of the Czech Ministry of Finance (<http://www.pppcentrum.cz/>)

## WHY AN NGO STICKS ITS NOSE INTO PPP

Why TI-Czech Republic (TIC) conducts research on PPP? TI is a civil society movement (NGO) that generally gets involved into anti-corruption research and monitoring. TIC in the Czech Republic has a role of an active player in public policy, public contracting and public finance reform debate and it also acts as a think-tank in related areas. It is always stressing an urgent need for creation of transparent and accountable environment for any type of complex projects. Its primary role in PPP area is to monitor execution of individual projects and to underline all potential threats, risks and wrongdoings. TIC also aims to initiate rich and informed policy debate on proper use of this concept. This economic study of risks and benefits of PPP is our first contribution toward that goal.

Why TIC talks mainly about risks and threats of PPP? The answer is twofold. First, public contracting system in many transition countries (including the Czech Republic) is in a deep crisis and the system is hardly able to meet necessary conditions (efficiency, transparency, non-discrimination) and to bring desired outcomes for public sector (high-quality goods, works and services at reasonable price). In fact very few public sector areas create more temptations for corrupt practices than public contracting. Public and private interests in this game simply differ. The interest of public sector is to get best services possible; the interest of private sector is to make money. The point is to balance those legitimate goals (if possible), cautiously analyze the framework and to learn important lessons from all individual projects conducted abroad (success stories as well as failures) in order to get unbiased view with policy implications.

Second, concept of PPP has many powerful supporters. As stated above, PPP is nothing else but specific public procurement and that is why the drive and enthusiasm of private sector toward wider implementation of PPP is obvious and understandable. Private companies logically lobby for a great business opportunity. Moreover, at the same time in many countries there is immense hunger for public infrastructure investments (roads, hospitals, and schools). People in such situation tend to believe in simple solutions or miracles. This often leads to one-sided, non-critical acceptance of new “magic” tool. PPP projects are large contracts, which also means large risks – and consequently high caution is appropriate.

## PPP: ARE WE SEDUCING OR BEING SEDUCED?

It is useful to mention some of the fundamental criticisms of PPP concept, which are sometimes omitted in public debate. First of all, PPP is enormously seducing concept. It is particularly seducing for public sector decision-makers called politicians, who usually face two conflicting constraints – they have grand visions and plans and they always lack resources to carry them out. In this perspective PPP offers seemingly ideal solution since at the beginning of the infrastructure project (almost) no public money is required (it is secured by private partner). For many politicians it might be perceived as a “free lunch”. This understanding of PPP is short-sighted and potentially very dangerous. There are existing temptations of hiding real fiscal debts under surface that will come up only later and will create fiscal problem in future. Moreover, to understand PPP

projects as fiscal savings is completely false, as these are usually more expensive than traditional public procurement contracts (due to expensive advisors, complexity, etc). Their potential advantages are in private sector know-how and efficiency transfer, not in savings of public funds. In addition to that, international experiences also show that some public sector areas are not suitable for PPPs (health care, defence, prisons).

Another powerful criticism targets political “hazard” connected to the length of contracts. PPP projects are usually designed for a long-term (20-30 years) and in this time frame it is practically impossible to derive political accountability for potentially badly designed or failed projects. We will be able to evaluate their efficiency only ex-post, at the end of the project. As Keynes once said, “in the long run, we are all dead”. Accordingly, in 20 or 30 years all today politicians will be dead (at least politically) and if projects fail, there will be no one to blame or make accountable.

The success of PPP always largely depends on government ability to define precisely outcomes and indicators of the project, to enforce conditions (and sanctions) of the contract and to divide project risks proportionally between partners. The key prerequisite is professionalism and capacity of government officials. It is no secret that private sector is usually more successful in attracting best (legal and economic) experts. It would also be an illusion to think that government is ever able to transfer key project risks on a private partner. In fact these project risks will always remain on government side.

And last but not least, the issue of democratic control need to be raised. The public has the right to know exactly what PPP projects will (primarily fiscally) mean. Yet PPPs are usually designed through complex (and complicated) contracts, which practically do not allow public control. Hardly anyone (except professional advisors) is really able to understand, evaluate and decide about them.

To sum up, PPP is an enticing idea, but the outcome need not always be advantageous for both parties. Clearly the refinement and wit of the PPP concept may only be used to meet certain prerequisites (quality of the institutional environment, transparency of tenders, good quality contracts), which are not always met. PPP is by no means to be understood as panacea for public sector infrastructure projects. It is just an alternative tool to fix certain public services. It is not extra funding resource; it is just a tool for potentially more effective resource allocation. Therefore we should sceptically limit our growing expectations and call for a deep, informed and unbiased political and economic debate that is absolutely crucial.

## THE CZECH CASE

The Czech Republic is one of many transitional countries that currently seek to develop PPP market and 10 pilot PPP projects are prepared. In January 2007, TIC conducted a research among institutions involved in PPP. It clearly showed that contracting authorities (ministries, large cities) are not sufficiently prepared for successful implementation of these complex projects. Government offices mostly consider PPP projects as a source of “easy” money that will solve their lack of funding. Such approach is a grave error and can lead to series of unsuccessful and overpriced projects with burden on public budgets (two of previous large PPP contracts failed in the recent past – the D47 highway or the E-toll system). The total investment cost of the planned pilot projects represents a fiscal burden for public budgets of over CZK 35 billion (i.e. 1.1% of GDP).

The research also showed that institutionally the government (central and local) is not ready for PPP and professionalism of its staff is very limited. Also the institutional framework of PPP raises serious concerns. The Czech Ministry of Finance established a special agency – PPP Centrum – to run PPP project methodically. Its current state (disintegration?) evokes serious doubts whether it is fully in control of PPP projects and whether it is able to drive the process. Are there sufficient enforcement and control mechanisms to avoid repetition of former failure PPP stories (like D47 highway to Ostrava project)?

To make things worse, the projects selected for the pilot phase were clearly ill chosen. Individual ministries simply offered „unwanted“ projects that do not ideally fit the PPP scheme and so their success is unlikely. At the moment (April 2007) pilot projects are in the phase of tenders for the principal PPP advisers and project managers. Even these tenders suffer of many drawbacks, there are corruption allegations and their fairness is widely questioned. And more important tenders (for concessionaires) will only follow – what other result may we expect if already the start is manipulated?

## RECOMMENDATIONS

All above said, Transparency International - Czech Republic (TIC) recommends to re-evaluate the PPP policy, slow down the process of launching new PPP projects and thoroughly evaluate whether the pilot projects really work. TIC thus presents the following recommendations:

- Slow down; do not commence new projects without giving them proper thought; and concentrate on implementation of several pilot projects.
- Conduct independent (external) evaluations for at least five years and only then commence the potential next wave. Proper operation of the PPP concept in the Czech Republic must be evaluated prior to its mass launch.
- Instigate a business and political debate about the PPP concept based on the world's best practice adjusted to the Czech legal and institutional environment. The government should, as soon as possible, find a new operational model for the PPP policy and give a clear signal to the market about how it intends to continue and which projects it sees as key ones. In so doing it should not succumb to a one-sided lobby (consulting firms have a common interest, which does not allow them to make an independent evaluation of the usefulness of individual projects).
- Carefully weigh up which projects are suitable for PPP and which are not. It is necessary to take into consideration that there are areas where it is not appropriate to apply PPP (healthcare sector, defence, police force, prison service).
- Place emphasis on maximum transparency of tenders in progress to select an advisor as well as the tenders prepared to select a licensee.

- Focus on a detailed monitoring of the individual entities conducted by an independent institution (specialised office, Antimonopoly Office, Supreme Audit Office).
- Pay extra attention to projects under the competence of the Ministry of Transport, which in past years has proven itself to be remarkably incompetent in this area.
- Forget the idea of using PPP for building an infrastructure for the possible holding of the Olympics – the use of PPP for these investments is totally inappropriate.

*Transparency International - Czech Republic*  
**PPP PROJECTS IN THE CZECH REPUBLIC:  
IMPLEMENTATION AND RISKS**  
*Ing. Jan Pavel, Ph.D. | 2007 Prague*

## INTRODUCTION

The present study analyzes the current situation in the Czech Republic as regards implementation of the Public-Private Partnership Projects (hereafter PPP projects) with the objective to identify problems which may represent significant fiscal risks. The paper includes case studies from the recent past when public administration bodies have implemented PPP projects with very unsatisfactory results. Finally, several recommendations are presented at the end of the present paper to help minimize potential risks.

PPP projects are often seen as a tool through which many of today's problems (namely insufficient and poor-quality infrastructure and a lack of available public funding) can be solved without any risks. Such interpretation is in principle false, and as such may have dire consequences for public finances.

“PPP Projects in the Czech Republic – Chances or Risks?“, a key analysis of strengths and weaknesses as well as of risks associated with the PPP projects' implementation in the Czech Republic, has been commissioned by the Transparency International - Czech Republic in the fall of 2005<sup>1</sup> when the key piece of legislation on concessions entered the legislative process. Since then, implementation of PPP projects moved forward significantly. The legislative framework was passed and several pilot projects are in the phase of selecting the external consultant. Foreign experiences teach us that the initial phase of the project predetermines, to a great extent, success or failure of the project, and that is why the initial stage needs to receive sufficient attention.

1) Available from [http://www.transparency.cz/pdf/analiza\\_ppp.pdf](http://www.transparency.cz/pdf/analiza_ppp.pdf)

## ARE PPP PROJECTS AN EFFECTIVE TOOL FOR ALLOCATION OF RESOURCES OR A SOURCE OF PUBLIC INVESTMENT FINANCING?

It has been since the 1980's that the private sector became involved in activities previously reserved for the public sector. This involvement has taken on various forms, from privatization of entire companies to outsourcing of some services, to PPP projects based on risk-sharing between public and private sectors. The ultimate aim is to improve the effectiveness of public expenditures and enhance the quality of public services, O'Looney (1998).

According to their advocates, PPP projects enable faster development of the infrastructure, speedier implementation of large projects, lower implementation costs, better risk-management and better quality of public services. The underlying philosophy is to take advantage of skills and know-how of the private sector for the benefit of the public sector.

To make effective use of the PPP projects and to cash on the above benefits is conditional upon a number of prerequisites. The most important prerequisites include transparent political decision-making, the ability to formulate desired outputs, high level of enforceability of law, and the capability of the public sector to secure appropriate risk-sharing between the contracting authorities and the contractor. Such conditions can only be met if public sector employees are sufficiently professional and skilled, decision-making processes transparent and the institutional framework of desirable quality. Unfortunately, these are areas in which transitional post-communist countries, including the Czech Republic, have noticeable problems.

In addition to the above missing preconditions, the concept of

PPP's is largely misconstrued and misunderstood in transitional economies. Most politicians see them as a source of finances for large infrastructural projects for which there are no available public funds.

This aspect of PPP projects has been already noted for instance by Bezděk (2005). Those countries whose public budgets are in a bad shape and which suffer a chronic deficit in public finances regardless of the phase of the economic cycle tend to address the problem not through structural reforms but by way of cutting capital expenditures. The reason for such solution is that structural reforms for the most part affect mandatory social expenditures (social benefits), a measure not welcome by the voters, and therefore not acceptable to politicians who make decisions within the framework of one electoral term and want to seek reelection. As a result, it appears simpler, in case the government is forced to stabilize public finances (for instance to meet the Maastricht convergence criteria), to cut investment expenses which the voters will not feel for a significantly longer period. Consequently, the infrastructural gap between the advanced countries and the transitional economies grows wider which in turn leads to lower long-term economic growth.

PPP projects appear to be an ideal solution to the problem. In the short run, PPP projects do not pose any apparent and additional demands on the public finances and do not increase the public finance deficit. As has been already noted in Pavel (2005), such perception is a fundamental misconception of the PPP concept. PPP projects are commonly misunderstood in other countries, not only in the Czech Republic, notes Boeuf (2003). According to Boeuf, PPP projects enable to overcome lack of public money only in the short run. The price for it is growing hidden debt.

The problem with PPP projects is that they are largely presented by politicians as an instant solution to problems and needs. The benefits can be seen relatively quickly and the political representa-

tion which initiated the project profits from the generated goodwill. Only later problems (such as poor quality of rendered services, overdependence of the public sector and/or consumers on a monopoly provider etc.) arise which need to be dealt with by another administration than the one which made the key decisions. Sanctions against politicians who were in charge become, to a large extent, impossible, and the principle of political accountability is disrupted.

The survey conducted by TI at the end of 2006<sup>2</sup> shows that this misconception of PPP projects as sources of public financing, continues. Several public sector organizations which contemplate a PPP project were approached with some questions. One of the questions asked about the reasons for selecting a project for PPP. In many cases, the answers contained the arguments that the budget limitations may be overcome by substituting public money with private investment. Higher efficiency of the private sector has not been referred to. The answers in the survey also indicated that most contracting authorities (for the most part ministries) lack any strategic plan in that regard.

The situation in the Czech Republic confirms the findings in Bezděk (2005) who recommends that the lack of finances for public investment projects be dealt with through a systemic change, i.e. profound structural reform of public expenditures. As a result, not only the efficiency of the public sector and availability of public finances for investment projects (i.e., classical investment projects without the risk involved in PPP) will grow, and the government will have improved opportunity to carry out anti-cyclic fiscal policy. PPP projects will then cease to function as a replacement of lacking finances but will be used wherever a need for skills and capabilities of the private sector arises. Very controversial as well as sensitive is the issue of balanced risk sharing between the public sector and

the private entity. Surveys and research projects so far conducted (ACCA 2005; OFDMFM 2005) indicate that a proper risk assessment and its distribution influence the success of the PPP project in 60%, i.e. influence the amount of saving. Naturally, both parties to the contract try to shift the majority of potential risks upon the other contracting party. In doing that, the public sector is in a weaker position for two reasons. The first reason is the motivation or the lack thereof on the part of the government officials to negotiate the best possible conditions. Government representatives (negotiators) are not directly accountable for incurred liabilities and are not directly vested in the success or failure of the contract (i.e. success or failure will not de facto affect their salaries which are based on tariffs), and that in itself has an impact on the way they proceed, including potential corruption. The other problem connected with risk-sharing is the issue of government response in case problems appear and the contracted services stop to be delivered in a desired scope and quality. The government is directly liable for a number of services and must not allow for their failure. In such a situation, it is likely that the government will have to intervene and help the service provider, at least by purchasing the infrastructure and equipment. Types of services which are prone to running into such difficulties are penitentiary institutions, air-traffic control or firefighters. The asymmetric sharing of risks is further enhanced by the fact that the state is an institution which cannot go bankrupt.

It should not be derived from the above that the PPP concept should be entirely abandoned and should not be carried out in the Czech Republic. To the contrary, when applied correctly, PPP projects can serve as a very effective tool to increase quality of services provided or guaranteed by the public sector. However, they have to be based on a careful selection of the sector and a thorough

2) <http://www.transparency.cz/index.php?lan=cz&id=2895>

analysis of the desired output<sup>3</sup>. Additionally, the main benefit of the PPP concept which is represented by cost saving has to be kept in mind. Foreign experiences teach us that there are not as many types of services suitable for PPP solutions as some proponents assert. For instance, McKee et al. (2006) notes very problematic results of PPP's in the healthcare sector, whereas Ouyahia (2006) points out a number of negative consequences of the PPP applications in water and sewerage industry.

## CURRENT SITUATION OF PPP PROJECTS IN THE CZECH REPUBLIC

It has been already noted that the Czech Republic has not been spared the vogue of PPP projects and several are in their pilot stage. The Act No. 139/2006. Coll., on concession agreements and concession proceedings (hereafter the Concession Act), has been adopted to cover legal aspects of the procedure. The Act is applicable in conjunction with Act No. 137/2006 Coll., the Public Procurement Act.

The Czech Republic resolved to start with PPP projects in the form of several pilot runs which should test the feasibility of the concept in domestic terms. The government cabinet selected suitable projects in two rounds.<sup>4</sup> Until now, seven projects have progressed to the phase of selecting the consultant. Search for the consultant was cancelled in one project; two projects are in their initial phase. The projects, including their basic parameters, are described in the following table.

3) The analysis should be based on the transaction costs theory. See O'Looney (1998).

4) For details see [http://www.mfer.cz/cps/rde/xchg/mfer/hs.xsl/pub\\_priv\\_part.html](http://www.mfer.cz/cps/rde/xchg/mfer/hs.xsl/pub_priv_part.html)

TABLE 1 PILOT PPP PROJECTS FOR WHICH CONSULTANTS HAVE BEEN SELECTED

Project	Contracting Authority	Type of PPP Project	Time Period (Years)	Investment Costs (mil. CZK)	Annual Costs (mil. CZK)	Type of Payment
New court building in Ústí nad Labem	Ministry of Justice	DBFO or BOT	25	1,340	80	availability fee
Building of the branch of Pilsen Regional Court in Karlovy Vary	Ministry of Justice	DBFO or BOT	25	483	38	availability fee
Penitentiary institution with supervision	Ministry of Justice	DBFO	25-30	1,142	125	availability fee
Construction, maintenance and operation of D3 highway Tabor-Bošilec, 30 km	Ministry of Transportation	BOT	36	1,0815	91,5	shadow toll or availability fee
Revitalization and development of sport fields, including infrastructure, in the Ponava brownfield	Chartered City of Brno	DBFO	25	2,000	?	?
Complete refurbishment and modernization of the Regional Hospital in Pardubice	Pardubice Region	DBFO	30	2,197	?	?
Construction, maintenance and operation of the hotel and parking lot in the Military hospital compound Prague, Střešovice	Ministry of Defense	DBFO	20-30	440	?	?

Legend: ? – information not available from public sources

Source: [www.mfer.cz](http://www.mfer.cz), [www.ppcentrum.cz](http://www.ppcentrum.cz)

TABLE 2 PILOT PPP PROJECTS FOR WHICH NO CONSULTANT HAS BEEN SELECTED AS YET

Project	Contracting Authority	Type of PPP Project	Time Period (number of years)	Investment Cost (mil. CZK)
Na Homolce Hospital: Design, construction, financing and maintenance of a new seven-storey health-care building and a 300-parking spaces garage	Na Homolce Hospital, Prague	DBFO	15-20	625
Aircon: Modernization of the railroad between Prague and Kladno with link to the Ruzyně Airport, including operation and maintenance	Ministry of Transportation	BOT and O+M contract for maintenance	30-40	13,500
Jan Evangelista Purkyně University Campus in Ústí nad Labem: Design, construction, financing, operation and maintenance of the new compound of classrooms, conference facilities, chancellor's offices, library, ICT center, housing and catering facilities and facilities for leisure time. The compound shall include parking lots.	Jan Evangelista Purkyně University in Ústí nad Labem with support of the Ministry of Education, Youth and Sports	DBFO, transfer of buildings upon the state	25 - 30	2500

Source: [www.mfer.cz](http://www.mfer.cz), [www.pppcentrum.cz](http://www.pppcentrum.cz)

As the above tables indicate, projects to build and develop infrastructure have been selected for the pilot phase. For most of them the DBFO (design, build, finance, operate) method has been chosen; fewer shall use the BOT (build, operate, transfer) method.<sup>5</sup> The average contract period is around 30 years. The other indicators mentioned in connection with the project are just for general information. Risk sharing mechanisms between the two parties continue to be unclear. How the risks are split influences how the implementation of the PPP project reflects upon the public finance deficit, in other words, the indebtedness which is relevant for the Maastricht convergence criteria.<sup>6</sup> If most of the risks are borne by the public

5) For details about the PPP types, see Boeuf (2003) or Beblavý - Sičáková-Beblavá (2006).

6) The convergence criteria are assessed with the ESA95 methodology guaranteed by Eurostat. The methodology is based on the accrual basis and captures to the maximum extent possible also hidden liabilities incurred by the public sector.

sector, then the investment costs shall be included in the public debt. Potential fiscal risk in connection with the projects for which consultants have already been selected amounts to 18.4 bill. CZK, which is equivalent to 0.6% GDP. Should we add also investment cost of the three projects for which the consultant has not been selected, the fiscal risk is around 35 bill. CZK, i.e. 1.1% HDP.<sup>7</sup>

As has been already noted, to quantify fiscal risks of the PPP projects in the Czech Republic is problematic as the precise structure and balance of the contracts is not known. The TI survey indicates that the contracting authorities are not able to state clearly how the risks shall be shared. According to most of them, this will be dealt with by the consultants who are responsible for negotiating the exact terms of the concession contracts.

In addition to fiscal implications, the success of PPP projects is determined by the ability to define the outputs of the contracts, mostly in the form of key indicators. The survey once again showed that the contracting authorities are not very clear about that. They refer to consultants who are to propose the system of monitored indicators, and possible sanctions.<sup>8</sup>

Generally speaking, the contracting bodies are not at this time able to quantify the impact proposed PPP projects shall have on public finances and how that will affect the indicators relevant for Maastricht convergence criteria. In addition to that, contracting authorities do not have a clear idea about the risk sharing and monitoring of contracts. All these activities should be „supplied“ by external consultants who have been already selected for the first seven projects.

7) This amount equals the annual amount paid from the government budget to health-insurance companies to cover insurance of those individuals for whom insurance is paid by the state, i.e. pensioners, children, or about a half to the budget of the State Transportation Infrastructure Fund.

8) For instance, the chartered city of Brno answered the question about risk-sharing as follows: „In case the Ponava project is implemented by the PPP method, then the issue of risk-sharing between the public and the private sector shall be dealt with in the invitation for bids in the quasi concession public tender.“

It is possible to conclude that the public organizations responsible for PPP projects lack a consistent strategy and deal with the projects on individual basis.

## RISKS RELATED TO SELECTION OF CONSULTANTS FOR THE PILOT PPP PROJECTS

With those projects which have progressed the most, external consultants have been already chosen. The selection process has not been, however, coordinated and as a result the assessment criteria as well as the selection methods differed. This is somewhat surprising in light of the fact that a new entity to centrally coordinate processes around PPP projects, PPP Centrum a.s.,<sup>9</sup> has been set up. Should this prove to be a consistent trend, then questions should be asked about the purpose and usefulness of this organization.

By now (March 2007), consultants have been selected for seven projects, in one case the competition was cancelled (see below). Only five selection processes, however, were completed as the Ministry of Justice combined the consultancy services for its three projects (court buildings in Karlovy Vary and Ústí nad Labem and the penitentiary with supervision) into one. Particulars about the selection

9) With respect to transparency and efficacy of the public sector, the fact that the PPP Center is a commercial company (joint-stock company in this case) owned by a public sector organization appears problematic as it is one of the least transparent solutions. Information about the company and its business cannot be found in the ARIS system and its representatives are often reluctant when it comes to applying the free access to information law and the provisions of the public procurement law. In case of the PPP Center, oversight is essential as all its activities are funded from the public money (Ministry of Finance and contracting authorities).

methods, evaluation criteria and the outcomes of the competition are summarized in the following table.

TABLE 3 COMPETITION FOR EXTERNAL CONSULTANTS IN PILOT PPP PROJECTS: CHARACTERISTICS

PPP project Launch of competition	Type of competition Number of bidders	Estimated price (mil. CZK)	Obtained price (mil. CZK)	Obtained price as % of estimated price	Obtained price as % of investment costs	Evaluation criteria (weight of criteria in %)
D3 highway April 2006	OC; 2	240.0	99.7	41.5	0.9	Price (50), Manner of delivery and proposed project management (40), Proposed retention fee (10)
Regional Hospital in Pardubice August 2006	OC; 4	7.5	6.92	92.3	0.3	Price offered (55), Methodology – comprehension of the issue (25), Methodology – implementation and organization of the project (20)
Ponava April 2006	OC; 9	9.5	7.99	84.1	0.4	Price offered (50), Methodology & time schedule – comprehension of the issue and identification of risks (28), Methodology and time schedule – implementation of the project (12), Contract draft (10)
Military hospital Prague November 2005	OC; 2	30	19.8	66.0	4.5	Lowest price offered (60), Terms and conditions (40)
Court and prison buildings October 2005	NC; 5	50	88	176.0	3.0	Price offered (40), Organization (35), Methodology (15), Contract obligations beyond those demanded by the contracting authority (10)
Na Homolce hospital* February 2006	OC; -	30	-	-	-	Price offered (50), Methodology, schedule and organization (40), Retention fee (10)

Legend: OC – open competition, NC – narrow competition, \* open competition was cancelled in November 2006  
Source: www.pppcentrum.cz; <http://www.isvz.cz/isvz/>

Open competition was the preferred form in choosing the consultant, only the Ministry of Justice chose the narrow competition. In terms of assessment criteria, the economic and fiscal factors were always taken into account. In addition to price, partial criteria such as the manner of execution and methodology were applied. The weight of the price ranged between 40 and 60%. The balance, i.e. the remaining 60-40%, were largely subjective criteria.

The competition documentation (invitation or call for tender), in particular a detailed description of the responsibilities of the consultant, give rise to one, important question. With most projects, the bidding consultants were asked, during the preparatory phase, to compare the advantages and disadvantages of the project when implemented through PPP or by way of traditional public order. All other responsibilities pertain to the concession proceedings and the actual implementation of the PPP project. In other words, the invitation for bids presupposes that the PPP method will be the preferred one. Two legitimate questions should be asked in that connection:

- If the analysis should conclude that a standard public works contract is preferable (and not the PPP), would the consultant continue to be involved in the concession proceedings or would the remainder of his job be cancelled?
- If the contracting authority is certain that the PPP form is more suitable than a standard public contract, what sense does it make to carry out such analysis – is it not a waste of taxpayer's money?

Unfortunately, the contracting authorities merged two phases of consultancy needed for the implementation of the PPP projects. The first step should be to call for an independent comparative analysis between the PPP form and standard public contract. In case the PPP form is selected, then a competition for the consultant should be launched. The present form of the invitation for bids (competition documentation) predetermines the outcome of the comparative analysis which then becomes pointless.

Additionally, private consultancy firms are not completely independent in carrying out the analysis. Based on the outcome of their comparative study between the PPP form and the standard public contract, their services will be in greater or lesser demand. If the preferred choice is PPP, a lucrative and extensive market of long-term contracts opens up for the consultancy companies. What

is the guarantee that these firms will be rational and impartial and will not side with the PPP concept?

The question arises who should conduct the comparative analysis. Ideally someone who is not in any manner even potentially vested in the results. In view of the past experiences, such impartiality cannot be expected from the present public administration bodies. Perhaps, universities with studies in economics or research institutes could be a solution in this regard, together with some involvement of nongovernmental organizations.

In addition to problems connected with the invitation to tender, it is interesting to look at the outcomes of the competitions. One evaluation criterion is the comparison between the estimated price and the obtained price and also between the obtained price and the proposed volume of the contract. The data in the table indicate that the contracting authorities have for the most part inflated the estimated price, in some instances very substantially. Only in case of the Ministry of Justice, the obtained price appears higher (in fact, significantly higher) than the estimated price. Equally interesting appears the comparison between the cost of consultancy services and the volume of the investment. Whereas in cases of competitions launched in 2005, the obtained price represents between 3% and 4.5% of the investment, in competitions launched in 2006, the same indicator dropped under 1%. The reason for this development may be increasing competition among consultancy companies for which these contracts are very lucrative. At the same time it became apparent that larger projects, such as the D3 motorway, can be only served by a limited number of consultancy firms (only two bidders entered the competition).<sup>10</sup>

10) This, however, could have been influenced by entry criteria which inter alia included the turnover in the past years. The entry criteria are analyzed further.

The outcomes of the competitions for external consultants show the relative decline in prices and also a relatively high number of bidders in individual tenders. Also, the use of open competitions as the most transparent form should be appreciated. However, reservations can be expressed regarding the evaluation criteria. The weight of the offered price is quite low for some contracting authorities (40% in case of the Ministry of Justice), and some other partial criteria do not appear suitable at all (proposed retention fee or contract obligations beyond those demanded by the contracting authority). Proper attention needs to be given to assessing offers according to the criterion of methodology of execution which is as such quite subjective.

In addition to evaluation criteria, the outcome of the selection process is influenced by the criteria for entry. The entry criteria are set differently in the individual calls for bids and in some cases seem to lack rationality. Such irrational conditions include environmental certification which is totally unrelated to consultancy work and relatively high turnover in the past fiscal year. Consequently, such entry conditions reduce the number of eligible companies which may bid in the tender. Such limitations on the supply side may in turn soften the pressure on the price and generally increase tendency towards cartels in the industry.<sup>11</sup> Entry criteria lacking rationality and the subjective nature of some of the partial criteria bring along greater chances of corruption and nepotism. Failed or erroneous searches for the external consultants may adversely affect the entire PPP project.

Involvement of external consultants in the process of putting together the concession tender documentation also poses risks of corruption. Private businesses which will want to bid in the

tenders are mostly large corporations which use consultancy firms to do business, i.e. same firms which will draft the tender documentation for individual PPP projects. A question arises whether such links may influence the way in which invitations will be structured, in particular the entry criteria which may be „tailored“ to fit a pre-selected bidder.

Some of the above problems already arose in connection with the launch of selection competition for the external consultant for the Na Homolce hospital project. The tender was cancelled in November 2006<sup>12</sup> for objections regarding lack of impartiality on the part of the jurors and lack of rational grounds for partial evaluation criteria. In particular, the ratio between the offered price and the quality of the offer was seen as problematic. It should be noted that the PPP Centrum, a.s., has not been notified of the cancellation of the tender even though the Center provided the documentation. This is yet another proof that the efforts to centralize and coordinate the process of projects' implementation have not succeeded and individual contracting authorities proceed without coordination. That consequently reduces the transparency of the process and increases the risks to public sector.

11) A similar conclusion regarding problematic entry criteria in the invitation to bid in the competition for external consultants for the PPP projects has been made by the PPP Association in June 2006.

12) <http://www.isvzus.cz/usisvz/usisvz01029Prepare.do?znackaForm=5001787851001>

## HISTORY OF PPP PROJECTS IN THE CZECH REPUBLIC

Although the legislation that covers PPP projects has not been adopted until 2006, the Czech Republic had previous experience with this type of financing. For the most part, however, these experiences have not been positive and the existing institutional framework appears problematic for PPP's implementation.

It was as early as in the first half of the 1990's that PPP projects began to be contemplated as a concept, largely for financial reasons (lack of public finances for investments). The Ministry of Transportation considered private capital for the construction of the D5 highway, in particular the by-pass highway around Pilsen. The project was not implemented because of low level of technical preparedness, including missing ownership rights to land, that prevented for the benefits and efficacy of the solution to be duly assessed. Additionally, there were numerous problems on the cost side. Preliminary calculations indicated that the toll would have to be extremely high and therefore the idea of a toll road was abandoned and a standard project of highway construction carried out.

The reason why the first attempt at a PPP project in the country failed (fortunately without adverse fiscal effects on public finances) was a lack of understanding of the PPP concept. The reasons for selecting (or rather contemplating) the PPP solution were financial which, as was stated above, is not the right way to start. The failure of the D5 project, however, did not lead to a changed perspective on PPP projects as such. The public sector, namely the Ministry of Transportation, did not learn any lessons from the failure and embarked on another, far more extensive project of highway D47.

Unlike the D5 project, the D47 highway had been in the center of media attention as it was the first comprehensive attempt at a PPP project in the Czech Republic. The proposal to use the BOT (build, operate, transfer) method was justified mainly by lack of public finances and by a pressing economic need for the highway in the industrial North Moravian region. What happened with this project is a classic example of what should not have been done when implementing a PPP project.<sup>13</sup>

The first and very serious problem was the fact that no specific design existed when the project was launched. The contracting authority, the Ministry of Transportation of the Czech Republic, did not have a clear and definite idea as to where the highway should run and it did not have rights to land plots on which the highway should lie. Consequently, the Ministry was unable to draft a solid invitation to tender and the negotiations with potential contractors were based on very vague definitions. That in turn rendered it difficult for the potential contractor to make serious cost calculation.

The next mistake made by the contracting authority was the failure to conduct a cost and benefit analysis and compare it with standard public works order (with debt-financing). The Ministry of Transportation skipped this phase and directly opted for the PPP solution.

The most problematic aspect of the D47 case was the choice of the private partner. The partner was selected without a tender and the negotiating position of the government turned out to be very weak. In addition to unprecedented openness towards one investor which involved disclosure of business sensitive information, low administrative capacities of the government also contributed to the failure. In negotiating and drafting the required documentation (in

13) Details and references to relevant documents are to be found in the Award of the Supreme Control Office 04/25 „Development of transportation infrastructure in the cohesion of Central Moravia and Ostrava“. Available from <http://www.nku.cz/kon-zavery/K04025.pdf>

particular the Memorandum and the Implementation Agreement), the government negotiators were weak and the documents put the private investor in a very strong position. As a result the price attained in the form of so called shadow toll amounted to 125 bill. CZK for the period of 2008-2030.

The next phase of the D47 case started with the signing of the Implementation Agreement during which the Ministry's strategy changed due to government reshuffling and hiring of an external consultant. Paradoxically, even the external consultant was selected without a public tender. However, once the existing contracts were analyzed, it was concluded that they represent substantial fiscal risks for the Czech Republic. On those grounds, a decision was made to terminate cooperation with the private contractor. The contractor had to be reimbursed for expenses already made which came to the amount of CZK 635 mil.

The D47 project experience once again showed that the concept and purpose of the PPP projects continues to be misunderstood. From the very beginning it was seen as a method to avoid increasing the public finance deficit while providing certain services. The approach of the contracting authority appeared very suspicious or amateurish at the least in combining lack of transparency (no public tender) with too many concessions to the private partner. It all resulted in a problematic contract.

The third example of a failed implementation of a PPP project in the Czech Republic is the case of electronic road toll. Officially, this contract has not been placed in the category of PPP projects as the underlying legislation was not in force yet. Should it be in place at the time of the electronic toll contract, the contracting authority would have had the obligation to proceed in keeping with it as the law defines a concession contract as an over the limit contract for a period longer than 5 years, in connection with which the contractor assumes some of the risks which are normally carried

by the contracting authority. The electronic toll contract meets the above criteria. Also in economic terms, this is a PPP project as it is an extensive and costly contract for provision of services for consideration for a relatively long period of time (10 years in this case).

Because the project received a lot of media attention, we should look at it more closely. The first step the contracting authority should take, is to clearly define the characteristics of the desired product. This is needed in order to structure the contract in a proper way. A simple tool to do so is the Brown-Potoski model as described below.<sup>14</sup>

**SCHEME 1 BREAK-DOWN OF SERVICES ACCORDING TO SPECIFICITY OF INVESTMENTS AND MEASURABILITY OF OUTPUTS**

Measurability of Output	Specificity of Investment	
	Low	High
<b>Easy</b>	(A) Measurable market services TrC: +	(B) Measurable monopoly services TrC: ++
<b>Difficult</b>	(C) Not measurable market services TrC: ++	(D) Not measurable monopoly services TrC: +++

Legend: TrC = Total transaction cost

Source: Brown - Potoski (2002), own modifications

Brown-Potoski model is based on judging two key characteristics of the delivered goods or services. The first characteristic is the measurability of the outputs and the second is the question whether a monopoly position may arise as a result of specific nature of the investment. As regards the first characteristic, in case of the electronic toll, the measurability of outputs is relatively simple and expressed in terms of how effective the collection is, i.e. the ratio between the „ideal“ state (number of trucks on the road) and the actual transactions accounted for. Here, there are no substantial

14) Detail description of the model is in Pavel (2004).

risks which could complicate the relations between the contracting authority and the contractor.

In terms of the other characteristic, the situation is just opposite. The selection of a particular technology (microwave system) and its implementation through toll gates puts the government, as the single recipient of the service, into a dependent position. That is further aggravated by time limits for the launch and by the fact that the legislative process was adjusted to meet the needs of the contract. Such was the situation in case of the Czech Republic. If the electronic toll collection mechanism was not launched in a timely fashion, the government would lose part of the revenue as the highway vignettes for trucks over 12 tons were abolished at a certain date.

By its nature, electronic toll falls in the category of measurable monopoly services. Therefore, the contract should strive to minimize risks associated with the danger of abuse of monopoly position. This has not been sufficiently taken into account as the present problems prove.

Unfortunately, information about the contract for electronic toll is not publicly available. However, because of the persistent problems in connection with its implementation and operation, the quality of the contract is undoubtedly dubious.<sup>15</sup> It is quite apparent that the contracting authority failed to eliminate the risk of abuse of the monopoly position on the part of the contractor. Further, it is quite likely that there is not a sufficient terminating provision

15) Transparency International - Czech Republic asked the Ministry of Transportation in February 2007 for information from the electronic toll contracts about indicators to measure the quality of the service and about threshold figures to determine due delivery or failure to perform under the contract. The information was not provided by the Ministry with reference to business secret. Such reference makes little sense as the indicators themselves are not a know-how of the contractor and are defined for the most part in the „Contract for provision of services in connection with operation of the system of electronic toll collection on selected roads in the Czech Republic“ which is to be found on the website [http://www.mdcz.cz/cs/Silnici\\_doprava/Silnice+dalnice+mosty/mytne/vyberove\\_rizeni/](http://www.mdcz.cz/cs/Silnici_doprava/Silnice+dalnice+mosty/mytne/vyberove_rizeni/) as part of the invitation to tender documentation.

in the contract for the contracting authority to apply and that there is no obligation imposed on the contractor to transfer the technology upon another provider. That all increases the transaction costs in the event the contracting authority wishes to transfer to another provider. These circumstances along with a strict deadline for a launch of the system (due to a follow-up legislation to be adopted) caused an uneven negotiating position between the two parties which in turn resulted in the signing of Annex One to the contract which clearly disadvantages the government and which is against the law according to the Award of the Anti-Monopoly Office.<sup>16</sup>

In addition to the possible abuse of the monopoly position, the contracting authority did not probably do a very good job in defining the output indicators. An independent auditor should have been selected to monitor the collection of the electronic toll, however, the tender to select such an auditor was cancelled due to terms which proved to be technically impossible to meet (the terms required that the quality of collection is measured with 0.1% accuracy). The fact that the tender was cancelled has been challenged by several bidders and currently (March 2007) the Anti-Monopoly Office is looking into it. Consequently, no independent measurement was carried out during January 2007. Since February 2007 the collection has been monitored by an independent auditor who, however, received a contract without a tender, supposedly an interim solution. The problems linked to the monitoring of the collection quality necessitate additional negotiations between the contracting authority and the contractor since the indicator determines the remuneration and/or sanctions.

The electronic toll project has been marked with dubious and unclear selection of the contractor when all bidders but one were

16) For details, see <http://www.compet.cz/verejne-zakazky/aktuality-z-verejnych-zakazek/article/2007/03/v-dodatku-na-mytne-jsou-pochybeni/>

disqualified for formal insufficiencies. At present, when decisions are being made about phase II of the project (for roads of first-class), it becomes once again apparent that the contracting authority has not been clear from the onset about the overall concept of the project. Possible change in technology, which is being contemplated, will result in complete redrafting of the invitation to tender (as well as the price of the contract) which is in violation of the Public Procurement Act, and a corresponding response from the Anti-Monopoly Office can be expected.

The electronic toll project is an example of incredibly badly prepared and implemented contract showing a lack of professionalism and competency in the public sector to implement extensive and costly projects in cooperation with the private sector.

## CONCLUSION

Having analyzed the present situation of the PPP projects in the Czech Republic, we cannot make a clear-cut conclusion about the success or failure of such projects. However, underlying risks can be identified even in this early stage. They include lack of clarity on the part of the contracting authorities regarding fiscal consequences of the projects and regarding monitoring of outputs. All responsibility is passed on the external consultants. Initial comparisons between the PPP solution and a standard solution are not made systematically. The invitation to tender for external consultants presupposes the outcomes of such an analysis which then becomes a mere formality and not a tool for decision making.

Having looked at the past cases, we have shown that the administration is not able to contract out and manage large infrastructural projects in which some of the risks are passed on the private sector. The contracting authorities fail not only when negotiating the terms but also in securing transparent selection processes of contractors. This is in line with generally accepted truth about low quality of the institutional environment and professional skills in the public sector.

Based on the above analyses, the following recommendations are made:

- The public authorities should strive to reform public finances in order to secure enough funds for extensive investment projects. PPP projects should be used only marginally in case when significant savings in the operational costs may be expected thanks to better management of private contractors.
- Drawing from foreign experiences, those sectors and industries should be singled out which are not suitable for PPP projects or which contain too many risks (for instance, health care sector). PPP pilot projects should not be carried out in these sectors.
- Benefits of a proposed PPP project should be compared to a standard public tender in a separate phase, and such analysis should not be part of the agenda handled by the external consultant who is responsible for the PPP project itself. Comparative analysis (PPP projects versus public contracts) should not be carried out by those consultancy companies which benefit from the decision in favor of a PPP project by increased demand for their services. Perhaps, universities with studies in economics or research institutes could be a solution in this regard, together with some involvement of nongovernmental organizations.
- Before the Czech Republic embarks on massive adoption of the PPP projects, it should evaluate the existing ones. No new PPP projects should be launched and attention should be given to

the ones in progress (pilot projects). After a minimum of five years, the projects should be evaluated by an independent (external) assessor before the next phase is embarked upon.

- All parties of the process should be closely monitored (for instance by the Anti-Monopoly Office, Supreme Audit Office or nongovernmental, nonprofit organizations), and particularly the projects under the jurisdiction of the Ministry of Transportation which in the past proved to be completely incompetent in connection with these projects. The Ministry as the contracting authority should implement only one of its projects (the D3 project is already in an advanced stage) since the fiscal risks are substantial.

**LITERATURE**

ACCA (2005): Evaluating the Operation of PFI in Roads and Hospitals, Research Report no. 84, London

Beblavý, M. – Sičáková-Beblavá, E. (2006): Inštitucionálne dilemy pri zabezpečení verejných služieb, Transparency International - Slovensko

Bezděk, V. (2005): Managing Fiscal Risks in Public-Private Partnership, vystoupení na konferenci Světové banky v ČNB 16. 11. 2005

Boeuf, P. (2003): Public-Private Partnerships for Transport Infrastructure Projects, Seminar Transport Infrastructure Development for a Wider Europe, Paris

Brown, T. L. – Potoski, M. (2002): The Influence of Transaction Costs on Municipal Government Choices about Alternative Modes of Service Provision, Indiana University

EK (2003): Guidelines for Successful Public – Private – Partnerships, Brussels

McKee, M. – Edwards, N. – Atunc, R. (2006): Public-private partnerships for hospitals, In: Bulletin of the World Health Organization, November 2006, 84 (11), p. 890-896

Medved, J. – Nemeč, J. – Orviská, M. – Zimková, E. (2005): Verejné financie, Bratislava: SPRINT vfra

Pavel, J. (2004): Vliv transakčních nákladů na zabezpečování veřejných služeb, sborník ze semináře „Konkurence ve veřejném

sektoru. Objektivizace dělby práce mezi státní správou a samosprávou v řízení veřejného sektoru“, Šlapanice

Pavel, J. (2005): PPP projekty v ČR – šance nebo riziko?, Transparency International - Česká republika

OFDMM (2005): Review of Opportunities for Public Private Partnerships in Northern Ireland, Belfast

O'Looney, J. A. (1998): Outsourcing State and Local Government Services, Quorum Books

Ouyahia, M. A. (2006): Public-Private Partnerships for Funding Municipal Drinking Water Infrastructure: What are the Challenges?, Government of Canada

Williamson, O. (1981): The Economics of Organization, American Journal of Sociology

[www.compet.cz](http://www.compet.cz)

[www.mdcr.cz](http://www.mdcr.cz)

[www.mfcr.cz](http://www.mfcr.cz)

[www.nku.cz](http://www.nku.cz)

[www.pppcentrum.cz](http://www.pppcentrum.cz)

## NOTES

This document has been produced with the financial assistance of the European Union. The contents of the document are the sole responsibility of Transparency International - Czech Republic and can under no circumstances be regarded as reflecting the position of the European Union.

The project is supported by the British Embassy in Prague.



Transparency International-Czech Republic is one of more than 80 branches in the international network of Transparency International. TIC's goal is to monitor corruption in the Czech Republic and contribute to its active system reduction.

**[WWW.TRANSPARENCY.CZ](http://WWW.TRANSPARENCY.CZ)**

ISBN 978-80-903032-5-6