

CONCESSIONS AS NEW POSSIBILITIES FOR PUBLIC SERVICE MANAGEMENT - CASE OF ALBANIA

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Abstract

The last decades of the development, market economies have known a new source of funding and efficiency of public projects and those of strategic importance. This new source is found on the partnership between the public and private sectors. The study of relationships and issues associated with this public-private partnership (PPP) was a necessity identified several years ago in Albania, and at the moment this topic was the most discussed in Albanian politics. At that time, the government undertook a series of legislative initiatives to design a contemporary legislation in line with international standards. A large number of concession contracts for the construction of hydropower plants nationwide turned the term "concession" in one of the most used words, not only by the Albanian policy makers and decision makers, but also by business people or those of civil society, who started debating about concessions giving it the importance of a theme of the day.

Key words: energy, hydro energy technology, management

Jel codes: C10, G32

1 . Introduction

The main issue for a government, when it comes to a PPP contract consists of ***how they will organize the interaction between the public and private sectors***. The main goal of this joint venture is of course to improve the efficiency and quality of service and products and their legitimacy. The question how a PPP will be organized cannot receive a general answer, because for every sector and in most cases for each project there is a different answer, relating only to the specific project.

The confusion about the concept of PPP is a matter of political and social debate in today's government. Often the term PPP is used as a synonym for privatization. In fact, it is not the same thing; on the contrary, there are specific differences. In PPP, the private and public parties (stakeholders) share the costs, revenues and responsibilities, while privatization represents the transfer of duties and responsibilities from the public to the private sector, giving the latter the right to manage the financial activity, with its costs, income and responsibilities. Meanwhile, policymakers' confusion lies precisely in the use of PPPs as a way to avoid the disadvantages of privatization for the public sector.

2. Characteristics of PPPs.

To understand PPPs is necessary to determine and define their general characteristics. This section describes the characteristics of PPPs as an ideal model: the basics that this specific organizational structure requires to generate added value as intended. In terms of definitions, the key elements of PPPs are divided into four categories:

- Stakeholders (parties)
- Network
- Project
- Relationship

Nowadays, the planning and creation of construction projects is a challenge for the public sector, the private sector and the civil society. Each of these three sectors has its identity and characteristics (economic): the public sector is oriented towards public interest, social responsibility and environmental awareness; the private sector is supposed to be creative and dynamic; the civil society ('third sector') is strong in areas that require the appreciation and commitment of individuals. However, on a broader scale, their activities and goals overlap, with the varying roles of the government and the private sector, narrowing the boundary that separates them. The "new economic" mentality, for example, typifies this overlap as a "mixed economy": greater interdependence requires more coordination between public and private organizational boundaries.

If when we focus on PPPs, we take into consideration the public and private sectors as groups of organizations and the organizations as a community of actors, it results that the public and private actors are to some extent interdependent

when deciding their organizational goals; therefore the overlap can be typified as a network where the patterns of interaction exist between the actors. The definition of a construction *project* to solve a particular problem does not require the activation of all models, only a part of the network is activated for each specific problem.

3. Operation of PPPs

Creating an inter-organizational relationship is followed by the actual functioning of this relationship when a distinction is made between economic and sociological aspects that describe and explain the operation. The economic aspects deal with the purpose (argument), the type and structure of the partnership, while the sociological aspects are related to the behavior of the actors in the relationship.

The network perspective enables us to identify project stakeholders, their interests and resources. The organizational economic theories help us understand the coordination mechanisms that emphasize the collaboration and its actual formalization in contracts. The networks influence the functioning of the PPPs in a related context, but they are interactions characteristic of the partnership itself.

Problems in the functioning of the PPPs

Partnerships between the public and private sectors are considered as an important instrument for the implementation of construction projects. The nature of the problems, the need for an integrated approach and the fact that the activities of public and private actors overlap requires unconventional operating procedures. However, the benefits from a PPP are still controversial despite many advantages.

PPP supporters stress the added value of private involvement in public infrastructure projects. By working more closely with business, governments can use market forces. Efficiency, knowledge and customer orientation are the strengths of the market that can improve the performance of the public sector and its products. Moreover, PPPs stimulate the private sector to undertake a dynamic approach and a supply chain management that is supposed to improve the ratio price / quality. Early involvement of the private sector in public infrastructure projects makes this sector more aware of the benefits of the project to society.

However, in practice PPPs often do not involve the intensive collaboration required in ideal models. In some cases moreover, partnerships are similar to privatizations, causing failure in the performance of PPPs and therefore often taking on a negative connotation in language.

The public-private partnership is not always the right solution: it is applicable in some situations to overcome a series of problems and circumstances. Theory is necessary to adapt the PPP as an instrument to situations. To use PPPs in a sufficient level in specific situations and thus exploiting their advantages instead of their disadvantages, we must deal with the risks they pose.

In general, these risks represent American and European contexts and based on literature and empirical research, they are subdivided into two categories of performance failure: performance of the *product* and the *process*. Although the systematic analysis of the performance of interaction is problematic in urban development and generalization is difficult because of the complexity and multiplicity of relevant factors, we can draw some conclusions about performance, within the context of PPPs. The differences between the characteristics of the ideal model of PPP and PPP practice are examined in the next section, particularly in the case study of concessions in Albania.

4. Advantages and disadvantages of PPPs

Why has there been an increasing interest about PPPs around the world in the recent years? The movement of the public sector reform known as "New Public Movement" provides the theoretical background information for PPPs, but in fact the main stimulus for this growth is that PPPs avoid restrictions on public sector budgets. However, a thorough discussion on the merits and disadvantages of PPPs is quite complex. A number of arguments are used by governments to promote PPP projects but many of them are of a nature somewhat *ex-post*, so they are used to justify a decision already taken for budgetary reasons. These arguments will reappear throughout the book but it is worth summarizing the issues in advance. Key elements of the debate revolve around these facts:

- Whether PPPs provide an investment of 'additional resources' in public infrastructure;
- Higher costs of financing PPP indirectly;
- Whether the transfer of risk and the financial effectiveness of PPPs can offset the higher financing costs;
- Economies of scale benefits from financial calculation and maintenance throughout the life of the project;
- Value added through the use of private sector skills as main manager of PPP;
- Modulator for public sector reform;
- Complexity, and
- The impact of PPPs on the flexibility in the public sector;

- Finally, the political context of this debate should be taken into account

5. Concessions in Albania

The new legal framework for concessions in Albania found its application mainly in the hydropower sector. The government showed the highest engagement in support of the private initiatives to invest in this sector.

At the time of the adoption of the law on concessions, at the Ministry of Economy, Trade and Energy were deposited over 80 requests for the construction and operation of small hydropower through concession contracts.

By the end of 2009, the government counted about 95 concession contracts awarded in accordance with all the legal procedures of public bidding and selection.

The Albanian Government, to support and promote private initiative to intervene in the hydropower sector, undertook some other ongoing initiatives:

- Amended the law on concessions, including the right to financing institutions to "step in" in case of a possible failure of the concessionaire in the project;
- Ensured the buying and selling of electricity for hpp-s up to 15 MW for the first 15 years of the life of a 35 - year concession contract;
- Has initiated the creation of a " One Stop Shop " for granting all the necessary licenses after receiving the concession contract, which would help immensely private investors in advancing the first preparatory phase to start the construction, avoiding the unnecessary bureaucracy of the public entities;
- Amended the law no. 30.10.2006 "On the local tax system " by reducing the tax for projects in infrastructure construction , from 1-2 % and 2-4 % in 0.1 % of the investment: *"Exclusively for infrastructure projects , the construction of national roads , ports , airports , tunnels , dams , construction of energy infrastructure , including machinery and equipment for these projects , the tax for the impact on infrastructure of new constructions is 0.1 percent of the investment value, but not less than the cost for rehabilitation of the damaged infrastructure."*

Currently about 35 concession projects have started construction works and their performance speaks for a good progress, but certainly not everything is perfect....

6. Problems in implementing the law on concessions

To identify the problems associated with the concession practices in Albania, in the implementation of the new legislation (Law adopted in December 2006), this study is an analysis of the performance of concessions in Albania, compared with the theoretical model of the overall characteristics of PPPs and concessions.

As discussed in Chapter 3 of this study the main risks facing the public and private sector, while deciding to enter into a partnership between them, are: (i) the performance of the product and (ii) the performance of the process.

Product performance is related to the financial performance (cost effectiveness, transaction costs, risks) and content performance (financial effectiveness, innovation).

Often the private sector has been involved in projects for the construction and operation of hydropower plants without calculating well the cost effectiveness and without taking into account the risks that in the case of concessions the public partner transfers completely onto the concessionaire, so financial analysis completed by the proponents in the bid often takes no account of the initial cost of the application which starts with the design of a project proposal, is accompanied by a bid security of 2 % and further the bank guarantee for the contract with a value of 10 % of the investment . This cost is significant in the initial moment, and adding the cost of preparatory work for the procurement of necessary permits and the start of work, it results that at the time of the beginning of construction works, the concessionaire has spent an amount of 5-7 % of the project.

We should remember here that many concession contracts are being awarded to national companies, who were the first to "dare" and identified new hydro projects as unsolicited proposals; for lack of experience in concession projects, the private partner was not prepared for the project risks, the increase of the loan rate etc...

Statistical data from different studies show that the possibility of an increasing construction cost in a long-term project is 71%, the possibility of delay in the completion of the work is 59%; mistakes in project cash flows are at 35%, not to mention market problems, political and inefficiencies related risks of the project itself (Scott L.Hoffman).

Project feasibility is the basis of every project, which should identify the potential risks in the project. Without forgetting, the inexperience of Albanian experts in project development feasibility for construction of concession projects by applying the principles of the financial project (Project Finance¹), we recall also that the project feasibility (about the self-determination provided by technical experts in the case of hydro-technical projects) are not detailed projects. Thus, the investor or the prospective concessionaire, as well as the public entity which awards the concession contract are not prepared for the possible contingencies of the project, increasing the risks for the completion of the project. In more detail, the lack of a full project feasibility before concluding a concession contract for the construction of a hydropower could jeopardize the project because:

- The hydrological study is based on measurements made 20 years ago, as there are no hydrological data for the recent years; for the last few years the method of calculation has been interpolation; meanwhile even for the next 35 years of the project, hydrologists follow the same technique, but not starting from today, but starting from 20 years ago; this increases significantly the error in water flows calculation, which is the basic element in energy production and revenue assurance for the project according to its cash flow;
- The geological study is not detailed, there haven't been any geological drillings carried out and the stability of the terrain is not known in the realization of hydro-technical works; detailed study of the implementation phase of the project may change the technical solution with 30-50% by placing the financing scheme of the project in a new scenario, for which the parties are not prepared.
- The cost of construction can vary for previously not calculated reasons of the market, or due to late commencement of works that can be linked to belated receipt of licenses / authorizations necessary for the onset of labor, or the delay in crediting the project.

On the other hand, besides the risk related to the project and its feasibility, there is the risk of lending:

- First, for a project to be credited, the latter must "prove" its feasibility, otherwise it might not be able to be credited;
- Secondly, the completion of a full feasibility after entering the concession contract shifts the application for the loan in a new period of at least 2-3 years after entering the concession contract; it is likely that in this period the credit rate will be different from the one calculated at the moment of entering the concession contract, and this is something that has practically happened; in hydropower projects the loan interest rate is calculated 5 % -6 % , while banks now offer loans with an interest with a rate of 10 % -12 % , which changes entirely the cash-flow of the project and puts the parties (concessionaire and the state) in unwanted situations.
- Thirdly, the economic crisis that has seized the world market has "frozen" the decision - making of financial institutions to engage in infrastructure projects.

Meanwhile, the product performance is related to the applicable legislation and regulatory effects of the market. Thus, starting from the period of the evaluation of the project by the contracting authority, it has been observed that the criteria for judging the proposals of the bidders are often subjective and difficult to measure. Thus, the proposal which generally has higher technical parameters (installed capacity, electricity production) is the winner, although the Contracting Authority must believe the values presented by the proposer, as there is no other possibility to know whether the values of flows are real or not, etc... In this way, to avoid possible abuses with the offer, the CA has decided the inclusion of the elements of the offer in the contract as non-negotiable issues and binding on the parties, namely the power and energy presented in the offer should be applied during the entire life of the concession. Thus, the possibility of subjectivity in the evaluation, can lead to an inability of project implementation if the technical parameters are not calculated accurately during the project design. The CA may terminate the contract of the concession, but it has in fact lost an opportunity to select the second bidder, that "perhaps " could have been more reliable in the drafting of the offer. Meanwhile, the cancellation of a contract, in any case has negative economic effects for both sides.

Indeed, the pattern of concessions in Albania transfers entirely related risks on to the concessionaire and he seems to have identified himself in the project, to have estimated the investment and realized the "cash flow" in the context of a liberalized market of buying and selling energy. The government initiatives to guarantee the purchase of electricity from AEC, for small HPPs, for the first 15 years of production, are a tool that will help small producers to realize revenues from projects. But very few of the concessionaires have information about how energy price will change in the

¹ It represents a long-term financing of a infrastructure / industrial facility, etc. based on the planned cash flow of the project more than on the financial balance of the investors (concessionaires); the financial structure of a project includes the investor / s (project sponsor) and financial institutions that offer the loan. The loans are secured by the project assets and paid entirely from money derived from the project; the project lenders are given a lien on all these assets, and is able to take control of a project if the project company has difficulties in compliance with the terms of the loan.

international market for the upcoming years, although it is theoretically accepted an average increase of 2 % per year. However, this forecast is for a long term average of 35 years, in fact, what will happen if precisely in the first years of a concession's life the sale price results in lower values and the period of self-expiation is extended from a period of 5-7 in 10 -15 years? What happens if climate change will reduce the water flow? How prepared is the concessionaire for global risks (political, legal, commercial and environmental)?

In the above, it is estimated that neither the concessionaire, nor the Contracting Authority have an accurate estimate of the "cash value" of the project, since many elements of product performance are not elaborated from the beginning.

There were two possibilities that the government decision -making had to face: (i) to implement a project with public funds for the use of water resources throughout the country, a project with considerable financial cost and that would require at least 3 years' work, or (ii) to evaluate unsolicited proposals to private investors trusting the financial analysis of their projects and accepting the start of the process in benefit of the public interest, for the provision of electricity as an increasing necessity for the country and region. The Albanian government decided to start the process, thus making possible time reduction; minimizing of costs; risk transfer; benefiting from the efficiency of the private sector experience and "know how" of the latter, and in this sense I consider this to be the right decision-making. But, at this juncture, no one can judge the "cash value" of this decision -making, as long as there can be provided an estimate of how much it would cost if the project would be designed, built, operated, funded and maintained etc., with public funds.

7. The Future of Public-Private Partnership

We have seen worldwide public -private partnerships (PPPs) that have emerged in urban development, for the provision of transport infrastructure, schools, hospitals and other public services. For several years, PPPs between governments and private organizations have formed a well-established basis to ensure facilities that governments have neither the resources nor the expertise to do themselves. As mentioned in the previous chapters, there are many types of concepts for partnerships: Concession contracts are best known worldwide. Despite the implementation and ongoing development of PPP schemes, the measures have been criticized by both the public and private sectors, and PPPs are a constant topic of political debate. A major criticism has to do with the cost of operation and the time spent for the procurement of PPP that is too great: many procurement methods would require up to 18 months or even more before financial closure. Another aspect of PPPs often criticized and that is particularly applicable to concessions is the contracting of services instead of 'true' partnerships on the basis of shared responsibility and risk sharing.

And in recent years, many efforts have been made to improve the performance of the PPP, at the operational as well as at the strategic levels. At the operational level, policy measures are implemented to standardize procurement processes and to make the operation of PPPs more efficient. At the strategic level new forms of partnerships have been developed. This development can be characterized as the birth of partnership portfolio instead of a single object or mono-functional partnerships. Trends and developments will be discussed in this chapter.

Lessons. The presentation of PPPs is associated with various expectations. In this paper we discussed some forms of PPPs and concluded that the causes, motives and added values in support of starting a partnership vary depending on the type of PPP. The joint risks and income, for example, is one of the main motivations for the introduction of joint ventures, transfer of risks and income is one of the motives for the concession measures. However, both types of PPP are known as an inevitable reaction for the weakening of boundaries between public and private sectors, and the adverse financial positions and wild spatial problems which governments in some countries encounter. Moreover, PPPs aimed at granting some benefits in terms of efficiency and risk reduction beyond traditional procurement method.

Expectations. Hopes that came with the launch of PPPs were mainly concerned with efficiency resources and were accompanied by the introduction of the private sector's role in delivering public services.

General lessons

The success of PPP-s depends not only on one aspect. Thus, the following list of lessons should be considered in an integrated manner. In any case, PPPs should be a strategic choice: a PPP is not an end in itself, but a method by which certain objectives are achieved.

Required changes in contextual level

The legislation must be adapted for the regular use of PPPs for providing public goods and services. It requires:

- Establishing and clarifying the legitimacy and competence of public authorities to enforce PPP contracts,
- Integration of different spatial procedures that apply to construction projects,
- The removal of tax anomalies that may be disadvantageous to the concession stands,
- Improved control regimes of capital public spending for the implementation of PPPs.

In addition, well-defined strategies are needed, as well as transparent procurement and standardization of procedures. Issues or problems encountered during the development of PPP projects are related to poorly defined methodologies of procurement and lack of standardization, this results in poorly structured contracts, long and costly procurement processes, high bidding cost and low value for money. In Europe, governments are obliged to award contracts through a competitive bidding process.

Necessary changes to the organizational level. The professionalism of the public partner is necessary; skill development by the public is an important condition for success. Ahadzi&Boëles (2003) drew the conclusion from a survey among public and private managers involved in PPPs that important requisites for the public party are the following:

- Technical skills, such as that of being capable of setting clear parameters and specification of the outcome;
- Organizational skills, as the commitment at the level of the cooperation with the public sector.

Changes needed at project level. The appropriate levels of risk transfer are required; an important aspect of PPPs is the conception of the possible risks to the project, and the implications that these risks may have in terms of project cost, time and quality. Risk assessment and allocation is an important part of PPP contracts. Consequently, risk assessment has become a subject of debate recently; one of the main topics of discussion was the fact that some risks are transferred to the public sector as soon as problems start to arise. It seems that the commitment of the private sector in the acceptance of an appropriate level of risk (without a guarantee from the public sector) is essential for PPP projects.

New trends in PPP

Three types of improvement can be seen in PPPs:

- Management of the project to the portfolio;
- From a function to a integrated project of PPPs;
- From project-based partnerships to those based on policy.

The first of these has to do with engaging economies of scale to deliver value for money. The main motives for a stand on the basis of the portfolio has to do with flexibility, opportunities for innovation and reducing transaction costs.

A portfolio-based approach can also lead to less competition or even in a monopoly position for private sector companies in the construction sector, although current practices in Germany and the UK do not have this indicator. As noted above, there is no optimal measure PPP, there is always the need to find a good balance between the public interest, quality and cost efficiency.

The second change has to do with a shift towards more integrated approaches: since space is scarce, spatial functions must be integrated. Due to the demand for optimal integration of coherent functions (multi-functional approach), interdependent actors should be included (approach with many actors). For every single actor there must be a balance between added value and investment. Cooperation is expected to realize added value for all stakeholders.

The third progress has to do with the trend towards joint ventures based more strongly on policy. To be able to influence the design of objects to be secured, private partners insist on being included in the process. It is interesting that the private sector considers the early involvement more important than their public sector counterparts do, indicating that the government remains convinced that it is the only actor responsible for determining what is best for society.

The division of responsibilities, income and risks for many projects over a long period of time is characteristic of joint ventures based on policies that are different from most traditional risk transfers and income-based measures in

concessionaire projects. In PPPs with concessions, one could argue that the term concession refers to its other meaning, which is the solution, as many concession contracts result in claims and compromises. In policy-based partnerships, the focus is more on cooperation and the coordination of project goals at multiple levels.

8. Conclusions

Our results correspond with these differences and we draw the conclusion that the success of concessions will depend on the factors listed below.

A –The situation of context

Institutional conditions (legal aspects, for example, procurement rules, procedures). Many governments have adapted their legislation to develop optimal conditions for concession agreements. In many legislative frameworks, the transfer of responsibilities for the provision of public services is complex and restrictive.

Moreover, the financial control mechanisms within the public sector do not allude that public services are financed and provided by the private sector. As a result, many countries have introduced new legislation to facilitate the provision of public services by the private sector. It seems that the following aspects need attention:

- Creating or clarifying the jurisdiction and competence of public authorities to award concession contracts
- Eliminate tax anomalies that can counterbalance concessionary approaches
- Processing of control regimes for capital expenditures granting concessions.

Market relations (relationship between government and market and between construction firms and financial institutions). An important issue raised by many authors is the level of competition; concessions can only be successful if there is a truly open competitive market.

B –Cultural – historical situation

Some countries have a long history of concession contracts, others do not. Experience provides expertise through learning, so, to gain experience, a series of concession projects must be implemented.

Organizational variables

- The size of construction firms and financial investors. One of the great advantages of the Spanish market is that of having construction firms of considerable size: the size should be such proportions as to take on considerable risks
- The skills and capacities of the government and the market. An important issue in historical description was the existence of a central PPP unit. Formation of PFI or PPP units, a centralized support unit, a public sector advisory group, or a special task force, for example, is the best way to manifest the government's commitment. Within these units a consistent and coordinated approach to concessions can be developed, political guidance and standardized tender documentation. Furthermore, these units can assist ministries to select, prioritize, include and procure projects and refine knowledge and experience within and between ministries. The creation of special PPP units and task forces throughout Europe has mobilized public administration following concessions for political support of high level. Also, an important fact was that a minister had to support and promote the concession process within the government.

A stable and reliable government policy also is required. Fairly large influx of concession projects in Spain and the UK is largely the result of direct government policy. Government as a supporter has also a responsibility to create an enabling regulatory environment for the development of concessions. One of the major risks of concessions is the issue of the resistance toward risk management. The political agenda is a major risk. Nowadays, concessions get more attention from both the public sector and the private sector. However, negative stories publicized by the media can lead to a decrease in the number of concessions or public resistance. An example of the impact of policy on the development of PFIs is seen in Portugal. A change in the Portuguese administration led to renegotiation of the existing concession contracts because the political will to change the terms of the contract from a long term (say 30 years) in short term (say 5-6 years) and political impetus to introduce toll roads instead of shadow toll roads due to great claim of the latter for public gain.

Project specific variable

- The approach to the process
- Organizational Structure
- Legal and financial framework.

These aspects will be further discussed in Chapter 5 where we will discuss in detail on several projects.

9. Recomandations

Given what this study has to say on the overall characteristics of concessions, the experience of developed countries on PPPs and concessions, the observed problems and learned lessons, as well as the Albanian experience in the treatment of concession projects, it is estimated that the performance of concessions depends on a number of factors. Nowadays, many governments are working on guidelines, standardization and professionalism to improve the performance of concessions. Some of these improvements focus on the creation and functioning of other concessions; so we can list some conclusions as follows.

- 1) Customers are very focused on details rather than on strategic issues: due to the relatively long duration of the contract, there are many uncertainties on circumstances that may occur during the partnership. In general, the government tends to allocate all risks in connection with these uncertainties through the contract. However, this makes the contract very detailed and therefore not flexible; moreover, this type of risk allocation is not a strong foundation on which to develop trust between the different actors in the contract.
- 2) Transaction costs should be lowered: an important issue today is how to reduce the costs of managing and bidding. Standardization and reduction of the bidding process are two main improvements for which governments are working steadily.
- 3) Consumers find it hard to clearly define the performance or the requirements of final products: many private partners complain about the uncertainty of the performance criteria and the method for judging the various offers.
- 4) The criterion of quality is inferior to the financial criteria in the current way of judgment; the selection based on the price criteria is a clear and transparent one.
- 5) Insufficient innovation of the project plan: although probably not the primary motive for starting concessions, innovation in project planning becomes increasingly important, because the space is scarce and society requires innovative solutions. Stimulating innovation and evaluation of bids on the level of innovation must become an inseparable part of the bidding process.
- 6) The selected bidder is selected often too late in the process: the private sector finds early involvement of a greater importance than their public counterparts. It is argued that early involvement brings more opportunity to influence the project plan and therefore to make an optimal proposal.
- 7) Public-private configuration is often a burden for success: in many cases we see difficulties in configuration between national, regional and local levels. In the execution of concession projects problems arise due to inadequate distribution of duties between the central and local governments. It is recommended addressing a coordination unit to accommodate the different departments and levels (of government).
- 8) There is lack of a clear and well-structured methodology for selecting the appropriate procurement strategy: such a methodology should facilitate the selection of the procurement method.

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