

Between Public - Private Partnerships and public finance in the public infrastructure sector: The water and sanitation sector in Albania

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Abstract

It's known in the literature that public-private partnerships (PPPs) are one of the main instruments that permit private collaboration in projects that are public otherwise. It's also clear that their implementation is different depending on the rules of the countries, their market level of acceptance etc.

The first objective of this paper is to revise PPPs projects in the water sector in Albania, seen in the context of alternative financing ways for joint-stock companies of Albanian water sector, due to the nature of the market (a developing emerging market), in the context of bad financial times after 2008 (the start of the international financial crisis). The second objective is to describe the development of the Albanian legislation for management contracts introduced for the first time in the waters and sanitation sector in 2004 and privatization practices in public sector.

The main conclusion is that in the developing markets creating possibilities for private sector participation in the infrastructure public services (especially in the drinking water and sanitation sector) will be seen with skepticism because of failed previous privatization practices or the sensitivity degree of the water sector related to the penetration level of private factor in the sector. Public finance will be explored as a convenient alternative.

Keywords: public-private partnerships (PPPs), water and sanitation sector, privatization, water utilities, public finance.

Introduction

The first law that created the legal framework for the participation of private sector in Albanian infrastructure is the Law Nr. 7973 in 1995, "On Concessions and Participation of the Private Sector in Public Services and Infrastructure, after the tendencies of the private sector participation in the main infrastructure public services, such as water and sanitation, electricity, urban solid waste in 1990. The above law provided issues as concessions, management contracts in the water production, treatment, or distribution activities. The role of private factor in public infrastructure was stated in the National Strategy for Social and Economic Development (NSSD) in 2001, in the National Strategy on Water and Sanitation in 2003, and confirmed in the revised National Strategy on Water and Sanitation (2011-2017). In Albania, the first traces of privatization process in the water and sanitation sector are in the year 2000 including six water and sewerage public companies. In all of those six companies the privatization process was in the management contract form except in Elbasan that was a full concession contract. After the above management contracts expired the companies are of public operator.

As a developing country, in Albania is more important to identify the framework and the conditions under drinking water services are more efficient (when are complete public, complete private or a combination of the two forms) rather than to categorize the services in public or private.

The paper will revise the past of public-private partnerships experiences in water and sanitation sector in Albania in order to identify the pros and cons of reimplementing it in the future.

Public-private partnerships (PPPs)

“If you’re a good public sector, you shouldn’t need PPPs. If you’re bad, you shouldn’t go near them.” (Bain, 2009)¹

This concepts is known as a legal contract between a private company and a government under which: (i) the private company enter in the public sector financing some elements of it, (ii) the contract duration is several years during the private company get paid by users (known as concession) or by the public authority, or a combination of both. The concept of PPPs is know even that concession have been a practice very known for centuries. Public private partnerships (PPPs) are long lasting contracts, generally involving large sunk investments, and developed in contexts of great uncertainty (Cruz, 2012).

The economic philosophy behind this is that the private operator invests his funds and in return the government ensures monopolist position on supplying the service to get the expected return by charging the users. Public Private Partnership (PPP) is considered to be a suitable option for complex capital projects with significant ongoing maintenance requirements. To these partnerships, private companies can offer innovative design, project management skills and risk management expertise (Tahir, 2013).

During the 19th century were very common concession for water, gas and electricity sector, sectors which often ask for a high capital investment and not able to offer the needed service with reasonable charges so they were replace by public ownership using public finance.

The so-called modern version of PPPs, was invented in 1980s, in UK. The government borrowing was limited but they were able to invest in public infrastructure sector and PPPs were the solution.

The number of PPPs continued to grow until 2000s and later the financial crisis affected it negatively. In Europe, the number and value of PPPs in 2012 was the lowest for at least 10 years, with 66 new deals worth €11.7 billion. Half of this was in the UK; the rest of Europe made very little use of PPPs.²

Nowadays PPPs are worldwide promoted especially for countries that are into International Monetary Fund (IMF) regimes, and in other developing countries, is common the political pressures and large promotion. Revising the last 15 years in this context, we can deduct that PPPs are an expensive and inefficient way of financing infrastructure projects and create possibilities for governments to bias government

¹ “Review of Lessons from Completed PPP Projects Financed by the EIB”, May 2009)

² David Hall:”Why public-private partnerships don’t work -the many advantages of the public alternative”.

spending away from other public services. They ensure long-term profit for private companies concealing public borrowing.

Review of PPPs' legal framework in public infrastructure services in Albania

In Albania, the experience with developing PPPs is still relatively new. A strong point regarding the legal framework of PPPs is that Albania has an act that deals with PPPs/concessions, a legislation that allows also build-operate-transfer contracts (BTOs) or other derived contracts. Albanian laws of public procurement are clear and without any confusion.

After eleven years of the first law on concessions in public sector (1995) was approved the law "On concessions", Nr. 9663 (2006) and after seven years more, in 2013 a new law was formulated, the law Nr. 125 "On Concessions and Public Private Partnership". Specifically, the law that served to the situation on the water sector was the law Nr. 7926 (1995) "On the transformation of the state owned enterprises into joint-stock companies". In the context of the private sector participation framework, it allowed the transformation of the state owned drinking water providers into joint-stock companies with all shares owned by the State. This legal step was motivated for improvement of quality of drinking water or treatment of wastewater as well as for increasing of efficiency of the activity of the providers in the sector.

Practically, the two common forms of participation of private sector in public services are present in Albania: concession form and management contract form. In 2002 to the water and sanitation provider of Elbasan city was awarded the concession contract from Berlin Wasser international company, supported by KfW Bankengruppe. The contract expired after two years. In 2003 a management contract was awarded to AquaMundo in the Kavaja city. Also from the World Bank, were awarded some management contracts in the city of Durrës, Lezhë, Sarandë dhe Fier in the sector of utility. Since 2008 there is no presence of private sector in the water and sanitation sector in Albania. The management contracts were not repeated and there were not new negotiations after the poor results of the presence of private sector in the water and sanitation sector. To understand why this practice had poor results there are several reasons:

- The incentives for the participation of private sector in the public infrastructure sector were from international organizations: World Bank and KfW. Albanian governments embraced them achieving in this way the highest rate of rapid privatization in the region;
- For the last past two decades of the economic transition, in the mentioned above context, the main concern of Albanian governments was the high fiscal burden of the water and sanitation sector for the central budget. The water providers were facing massive debts, each year they ended up with financial losses (due to high electricity costs or high labor costs) covered by the state budget through the so-called the operating subsidy;
- The water sector had been facing problems such as the poor quality of the drinking water and sanitation services, low access of the population to this public services provision comparing with the European standards and higher urbanization rate

and rapid population growth rate;

- The presence of private sector in the public infrastructure sector was seen as the needed solution by the government leading to a decrease of the political efforts to manage to find solutions for the operation and management of the utilities by the private agents;
- From the different perspective, the international private agents failed to manage the main stakeholders in the government during the transition period and also to face correctly cultural differences. The whole process of implementing the PSP strategy or the concept of corporate governance in the water sector was slowed down by the poor governance and institutional capacities in Albania;
- The policy of increasing the staff of drinking water companies (imposed politically) or the increasing of water tariffs policy in order to collect the missing revenues to cover operating costs was in contraction with the common belief that accessing on drinking water and sanitation services is a human right, so this was seen as an obligation of the government to provide water and sanitation services to the population regardless of the financial effects on the utility;
- At last, the engagement of the private sector in public infrastructure sector was not transferred to the local government, due to the incorrect and not rapid implementation of reform of decentralization in the sector.

We can say that the lack of experience of private participation in public infrastructure sector was very crucial for the poor results (or failure) of the taken incentives even that Albania has the well formulated legislation and the governments had the willing to change the situation in the water and sanitation sector.

Albanian water sector performance during 2015

Data is referring to the Performance Report of 2015 from the Albanian Regulation Authority of Water (ERRU). The Figure 1 illustrates the distribution of water providers depending on the served size population.

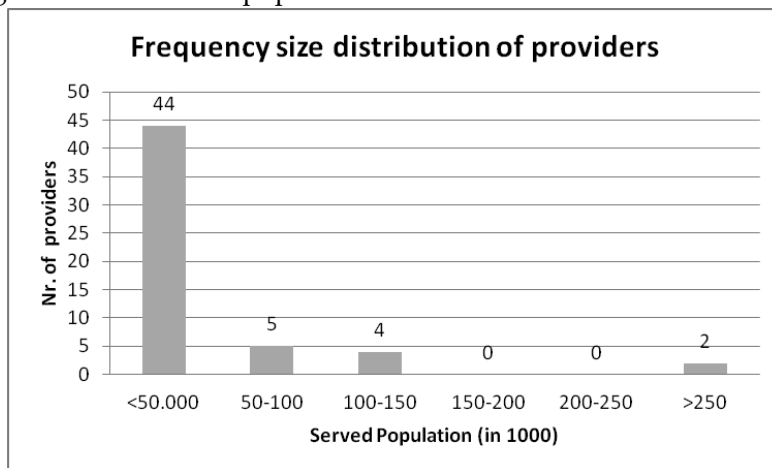


Figure 1: Frequency size distribution of water 55 providers
Source: Own graph, data from ERRU "Performance Report of 2015"

As is shown in the first graph 44 out of 55 companies serve to a population less than 50.000 habitants. As stated in the literature, for companies to profit from economies of scale it's needed them to serve a population greater than 50.000 habitants (Padeco, 2009). For year 2015 only 11 companies are fulfilling this indicator. Also a categorization of companies according to the number of water connections it's shown in the Figure 2:

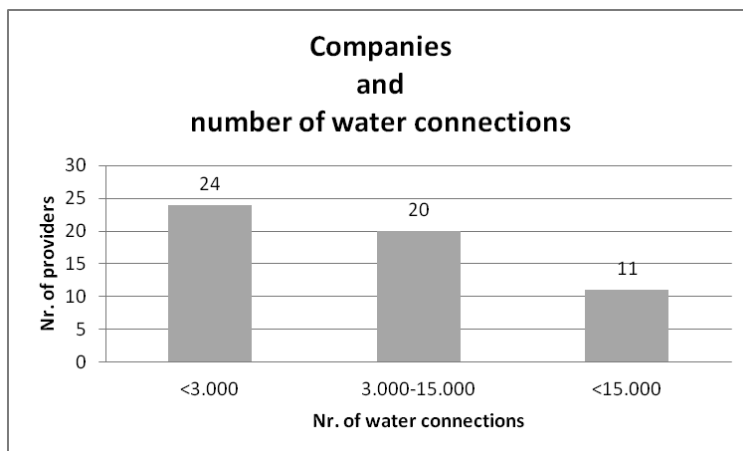


Figure 2: Companies according to the number of water connections
Source: Own graph, data from ERRU "Performance Report of 2015"

The Albanian Regulation Authority of Water uses 9 indicators for the annual performance ranking of 55 out of 57 Joint-stock companies that operate in the water and sanitation sector (for the year 2015 two companies didn't declare data).

The first indicator is *Operational and Maintenance Costs Coverage indicator*. For the year 2015 the average level of this indicator was 102% from 122% of the previous year. This decrease is due to the decreasing revenue - expenses ratio. 18 out of 55 companies achieved to cover 100% of the Operational and Maintenance Costs, 8 out of 55 companies achieved to cover 80%-100% and the rest above 80% (from these 16 out of 29 didn't cover even the half of the Operational and Maintenance Costs).

The second indicator is *Total Costs Coverage indicator*. The average for the year 2015 of the sector was 79%, a decrease with 8% compared to the previous year. Companies have the same costs structure when the higher percentage is for labor and electricity cost and amortization and loan expenses.

The third is the *collection rate indicator*. For 2015, the average collection rate was 92%, increased with 1% compared to the previous year. This level didn't meet the objective level of National Strategy of Water and Sanitation Services (2011-2017) that was set around 96%. 29 out of 56 companies achieved to have this indicator 82-100%.

The forth one is *staff efficiency indicator*. For the year 2015 wasn't measure a change in this indicator because the number of water connection was increased with 66.000 connections and the number of staff was also increased with 400 individuals. One third of the companies are above the objective for this indicator.

Water without revenues indicator is another crucial indicator and one of the most important included also in the National Strategy of Water and Sanitation Services (2011-2017). The indicator has the value 67% very far away from the objective of year 2015 (around 48%).

Measure level indicator is the ratio of the water metered connections over the total number of connections. This indicator measures the formality level of the sector; for 2015 was 63.5% also far away from the objective of year 2015 (around 72%). Only 8 out of 55 companies have operated with positive performance of this indicator.

Continuity with water service indicator measures the number of hours per day that companies are providing with water service. The average level for the sector for 2015 was 12 hours per day when the target level for 2015 was 16 hours per day.

Continuity with sanitation and wastewater treatment service indicator measures the number of hours per day that companies are providing the mentioned service. Only 32 out of 55 companies are licensed for providing this service. The average level for the sector for 2015 was 50% when the target level for 2015 was 70%. For rural areas only for 3.1% of population this service is provided.

Regulation perception index is the companies' ratio of fulfilling the targets set by ERRU related to: the license, approved water tariffs by ERRU, regulation payments, communication with ERRU etc. The best performance in this indicator for 2015 was achieved by Sh.a. UK Lezhë with 95 points followed by Sh.a. UK Korçë and Sh.a. UK Elbasan city with 90 points.

Summarizing Albanian PPPs experience in public infrastructure sector

Albania as a developing country has experienced the PPPs in infrastructure and public services. There is a record of failed projects in this framework; the trend seems to be the same if there are no real and significant changes for the PPPs practice. Currently there are some concession contracts signed by the government but it's needed to be said that the information about requirement and procedures for Albanian PPP framework is not complete; also the knowledge is relatively low. There is no full trained staff in the public sector about the required procedure so there is a real confusion and uncertainty. Often the PPPs projects are proposed by private investors who provide the initial costs of PPP project preparation, feasibility analysis, and contract drafting. The monitoring process of PPPs performance has been continuously inefficient; there is a need for PPP contract monitoring units (CMU). Also in governmental level the Ministry of Finance (MoF) doesn't rely on a trained staff that has knowledge for the evaluation of the public sector risks (future liabilities) for the PPP contracts that Government signs. The public sector is at risks entering into PPPs; the probability they could produce higher costs to limited public sector financial resources is significant.

If not PPPs in public infrastructure sector, what's next?

There are some strong arguments deducted from international experiences and many studies on PPPs that are against this practice in the public infrastructure sector as follows:

- For developed and developing countries the cost of capital is lower without a PPP;
- It's evaluated that under a PPP the build costs are higher (25 % more expensive);
- The public sector is more flexible, the private one is less operational efficient;
- The cost of monitoring a PPP increases by 10-20% the total costs;
- There are real risk from incomplete contracts, possibility of new negotiations or probability of bankruptcy or default by the private company;
- For the public sector there are negative effects of PPPs in environment, labor market etc.

An alternative suggested to PPPs is public finance. This allows government to improve infrastructure using public finance for investment and the private companies to deliver the service with more flexibility, higher control and efficiency. Any private company by user charger can be repaid back in the long term. The public sector has to choose between taxes or user charges to finance a project or service, so in this way it ensure more flexibility, certainty and also gains from economies of scale.

Also in order to provide services through public finance, central and local governments can use direct employees; any change in technology will bring lower transaction costs. This practice could also help with the unemployment issue.

Conclusions

- PPPs are worldwide promoted especially for countries that are into IMF regimes, and in other developing countries, is common the political pressures and large promotion.
- PPPs are an expensive and inefficient way of financing infrastructure projects and create possibilities for governments to bias government spending away from other public services. They ensure long-term profit for private companies concealing public borrowing;
- In Albania, the experience with developing PPPs is still relatively new;
- Albania as a developing country has experienced the PPPs in infrastructure and public services with a record of failed projects in this framework;
- The two common forms of participation of private sector in public services are present in Albania: concession form and management contract form;
- PPPs especially in the water sector had been a failure and the situation in the sector is quite far away from the target.
- The lack of experience of private participation in public infrastructure sector was crucial for the failure of the taken incentives in PPPs framework even that Albania has the well formulated legislation about it;
- An alternative suggested to PPPs is public finance; it allows government to improve infrastructure using public finance for investment and the private companies to deliver the service with more flexibility, higher control and efficiency;

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