

Final Report Appendix 3

ASSESSMENT REPORT

Fiscal and Budgetary treatment of PPP pilot projects

Prepared as part of the Twinning Project CZ04/IBI/FI/02-TL



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1 Introduction

This inception report has been prepared for the Ministry of Finance (MoF) in the Czech Republic. It has been drafted with the assistance of the Budget Affairs Department of the Ministry of Finance in the Netherlands in cooperation with Parpublica S.A., Portugal, under the auspices of the EU Twinning Light project:

On 16 November 2006 a Twinning Light (TL) Project with the title “Assistance with the assessment of PPP pilot projects” was commenced at the Ministry of Finance (MoF) of the Czech Republic. In this project the Czech Ministry of Finance will be assisted by the following member state partners:

- The Netherlands (Ministry of Finance, Court of Auditors)
- Portugal (Parpublica S.A.)

The project coordination is carried out by the Dutch Ministry of Transport.

1.1. Purpose of the Twinning Light Project

The purpose of the TL Project is to assist the Czech public administration (Ministry of Finance) with the assessment of PPP pilot projects and to suggest the corresponding assessment and evaluation criteria.

1.2. Project Approach:

The TL-Project is divided in two components:

- *Component 1:* Analysis of the assessment criteria for selected PPP pilot projects
- *Component 2:* Fiscal and Budgetary Impact Analysis

Ad Component 1: Analysis of the assessment criteria for selected PPP pilot projects

Component 1 will focus on the involvement of the Czech MoF (Regulation of PPP projects team) in the assessment of PPP projects during the PPP project decision process.

On the basis of the existing regulatory framework (i.e. Concession law, other regulations and manuals), an analysis will be made to which extent the current regulatory framework enables the CZ MoF – based on its responsibility as guardian of the State Budget - to properly fill in its role in the decision making process for PPP projects. The focus will be on **financial risk management tools** as it is the responsibility for the CR MoF to manage the state expenditure and liabilities.

Ad Component 2: Fiscal and Budgetary Impact Analysis:

Component 2 focuses on the question of “what is needed to successfully incorporate PPP projects into the Budget in a way that ensures fiscal sustainability”. Attention will be paid to the **Eurostat** ruling and other relevant regulations, as regards to the consequences for the



Budget. Additionally other budgetary aspects will be looked at: treatment of guarantees and other risks, consequences for longer term perspectives etc. A potential link with the financial risk assessment element of Component 1 in this regard, will be taken into account.

The Twinning Light project approach is “bottom up”:

An analysis of certain selected PPP pilots is incorporated in the project, to gain insight in the way the MoF is currently involved in the assessment of fiscal and budgetary sustainability of PPP pilot projects. For Component 1 a quick scan will be made of the projects mentioned below.

The PPP projects concerned:

- *Ministry of Transport:* D 3 motorway
- *Ministry of Justice:* Court of Justice Ústí nad Labem
- *Ministry of Justice:* guarded prison Rapotice

For Component 2 one specific project has been selected which will serve as an example: the Ministry of Justice: Court of Justice in Ústí nad Labem.

Both Components are divided into three activities:

- fact finding activity (fact finding mission and writing of inception report)
- provision of recommendations
- provision of training

1.3 Component 2, activity 2.1: fact finding mission

Part of the first activity (for both Components) is a fact finding mission carried out by the experts to assess the current legislative and operational system in the Czech Republic.

The fact finding mission for component 2 has taken place on January 26th and February 7th¹. During this fact finding an assessment was made of the current methods that are available for, and used by, the Ministry of Finance to assess PPP projects from the point of view of fiscal and budgetary sustainability. Experts from the Ministry of Finance were interviewed for the purpose of the fact finding. In addition experts from relevant Contracting Ministries and Supervisory bodies were interviewed².

According to the Twinning Light Contract each fact finding mission should result in an *inception* report. The purpose of this report is to give an overview of the current system regarding the investigated subject in the Czech Republic and make recommendations for improvement.

This inception report covers Component 2 and contains an overview of the current fiscal and budgetary treatment of PPP pilot projects in the Czech Republic, and provides recommendations for improvement, based on international best practices.

¹ The fact finding mission for component 2 was originally scheduled to take place on January 25th and 26th and was to be carried out jointly by the two experts: mr. Rui Monteiro ((Parpublica SA) and mr. Danny Zwerk (Budget Affairs Department Dutch Ministry of Finance). Unfortunately due to severe weather conditions it was not possible for mr. Monteiro to travel to Prague while mr. Zwerk encountered serious delays. As a result the first day (25th) of the fact finding mission had to be cancelled and an extended program was carried out by mr. Zwerk on January 26th. (See schedule enclosed). The remaining meetings were rescheduled for February 7th and were carried out by mr. Monteiro.

² See list of interviewees annex I



2 Fiscal and budgetary treatment of PPP projects

2.1 Introduction:

PPP contracts can take different forms (for example: Design, Build, Finance, Operate contracts / DBFO, or Build, Operate, Transfer contracts / BOT). A PPP contract can concern a “traditional” infrastructure project, i.e. road, rail, or other sectors like healthcare, justice. However PPP projects normally share certain characteristics:

- *The relatively long duration of the relationship, involving cooperation between the public partner and the private partner on different aspects of a planned project.*
- *The method of funding the project, in part from the private sector, sometimes by means of complex arrangements between the various players. Nonetheless, public funds - in some cases rather substantial - may be added to the private funds.*
- *The important role of the private economic operator, who participates at different stages in the project (design, completion, implementation, funding). The public partner concentrates primarily on defining the objectives to be attained in terms of public interest, quality of services provided and pricing policy, and it takes responsibility for monitoring compliance with these objectives.*
- *The distribution of risks between the public partner and the private partner, to whom the risks generally borne by the public sector are transferred. However, a PPP does not necessarily mean that the private partner assumes all the risks, or even the major share of the risks linked to the project. The precise distribution of risk is determined case by case, according to the respective ability of the parties concerned to assess, control and cope with this risk.*

(Source: Green paper on public private partnerships and community law on public contracts and concessions COM (2004) 327 final).

One of the – widely recognized - benefits of PPP for governments, next to efficiency or value for money, is that the private financing that is, as mentioned above, characteristic for PPPs, can support increased infrastructure investment for a government without immediately adding to government borrowing and debt.

Containing the government deficit and debt is a major concern for all EU governments in light of the EMU convergence criteria commonly known as the “Maastricht criteria”. These Maastricht criteria stipulate the requirements that have to be fulfilled by every EU member state that wants to participate in the third stage of EMU and introduce the Euro. Similar requirements are applicable to Member States that have already introduced the euro.

The structure of PPPs, in which the construction of the infrastructure is - for a large part - pre financed through private finance and the government (public user) will only pay a periodic user fee when the infrastructure is in use, provides new opportunities for all government levels for infrastructure investments that would, if financed “in the traditional way (i.e. financed by government)” be a significant burden for the deficit and debt levels in the near future.

2.2 Eurostat requirements

All PPP projects of EU Member states are subject to criteria that Eurostat has formulated regarding the “off balance sheet financing” of PPP projects. Only when PPP projects fulfill the criteria as stipulated by Eurostat (which concern mainly significant risk transfer) is it possible for governments to qualify the assets as non-government assets, which means that the initial investment will not influence government deficit and debt.



It is important to take these Eurostat criteria into account in all stages of preparation of the project: in case the assets are qualified as government assets, there will be serious consequences for government finances, both for the deficit and the debt. The initial capital expenditure relating to the assets will be recorded as government fixed capital formation, with a negative impact on government deficit/surplus. As a counterpart of this government expenditure, government debt will increase in the form of an “imputed loan” from the partner, which is part of the “Maastricht debt” concept. The regular payments made by government to the partner will have an impact on government deficit/surplus only for the part relating to purchases of services and “imputed interest”.³

Box 1. Extract from Eurostat decision 18/2004:

Eurostat recommends that the assets involved in a public-private partnership should be classified as non-government assets, and therefore recorded off balance sheet for government, if both of the following conditions are met:

1. *the private partner bears the construction risk, and*
2. *the private partner bears at least one of either availability or demand risk.*

Of course the importance of the Eurostat criteria imply that governments at all levels (central and regional) need to be aware of the Eurostat requirements and need to be able to apply these requirements in all stages of preparation of the project, in order to avoid a situation in which Eurostat will classify the assets as government assets. Eurostat explicitly states that the analysis of the risks in such partnerships should be carried out in all Members under the responsibility of the National Statistical Offices⁴.

However, one should avoid tailoring PPP projects according to Eurostat criteria. As a rule, we should say that an efficient PPP project will be classified by Eurostat as off-balance sheet. However, one should also be aware that classifying the assets of a PPP as either public or private does not adequately capture fiscal risks. The simple “on/off” balance sheet treatment developed by Eurostat provides strong incentives to design a project to “pass” the Eurostat test (i.e. allowing it to be recorded off-balance sheet), rather than to gear project design toward the best allocation of risk to achieve efficiency.

2.3 Fiscal reporting and accounting requirements

Because of the payment mechanism of PPPs, there is a risk that PPP projects are entered into with the main aim of bypassing expenditure ceilings and without properly taking future costs into account.

It should be clear that, although PPPs provide a method for increased investment in infrastructure and government, a government may still face potentially large fiscal costs, especially over the medium to long term. These future liabilities may not always be fully taken into account while deciding on a PPP projects, as initial (short term) costs of a PPP project are low (or zero), as a contracting government normally starts paying user fees only after construction is finished and increased costs only occur after a period of time that often exceeds the medium term outlook of a budget. Political reality is that short-term goals often play a role in the investment decision. If the longer-term fiscal liabilities deriving from a specific PPP project are not made clear, a PPP project may be judged to be a cheaper option than it is in reality and entered into without taking the future fiscal burden into account. Fiscal control of PPP therefore is necessary to avoid bypassing expenditure controls. Transparency in reporting and accounting mechanisms of PPP projects which give clear

³ See Eurostat ruling 18/2004: http://epp.eurostat.ec.europa.eu/cache/ITY_PUBLIC/2-11022004-AP/EN/2-11022004-AP-EN.HTML

⁴ See Eurostat ruling 18/2004: http://epp.eurostat.ec.europa.eu/cache/ITY_PUBLIC/2-11022004-AP/EN/2-11022004-AP-EN.HTML



insight into the future liabilities for the whole duration of the project, is therefore considered necessary to avoid unforeseen excessive financial burdens for future budgets. These mechanisms should also give an insight in the total liabilities of all PPP projects (central and regional) combined.

The IMF recommends the following minimum disclosure requirements for PPPs:

Box 2. Disclosure Requirements for PPPs

Budget documents and end-year financial reports should include an outline of the objectives of a current or planned PPP program, and a summary description of projects that have been contracted or at an advanced stage in the contracting process (their nature, the private partner or partners, and capital value). In addition, the following more detailed information should be provided for each PPP project or group of similar projects:

- Future service payments and receipts (such as concession and operating lease fees) by government specified in PPP contracts over for the following 20-30 years.*
- Details of contract provisions that give rise to contingent payments or receipts (e.g., guarantees, shadow tolls, profit sharing arrangements, events triggering contract renegotiation), with the latter valued to the extent feasible.*
- Amount and terms of financing and other support for PPPs provided through government on lending, or via public financial institutions and other entities (such as special purpose vehicles) owned or controlled by government.*
- How the project affects the reported fiscal balance and public debt, and whether PPP assets are recognized as assets on the government balance sheet. It should also be noted whether PPP assets are recognized as assets either on the balance sheet of any special purpose vehicle.*

In countries with significant PPP programs, disclosure could be in the form of a Statement on PPPs which is part of the budget documentation and accompanies financial statements. Within-year fiscal reports should indicate any new contracts that have a significant short-term fiscal impact. PPP contracts, or summaries of their key features (preferably in standardized format), should also be made publicly available.

Source: <https://www.imf.org/external/np/seminars/eng/2006/rppia/pdf/hemmin.pdf> (page 9)

An accounting and reporting system for PPP projects should be based on the above mentioned requirements. The system should take into account the specific aspects of PPP. Most budgetary systems are based on a short- or medium-term budgetary outlook. Some of the specific aspects of PPP projects (extended payment mechanism, duration of the contract) may result in that PPP projects do not “fit in” with an existing accounting and reporting systems that cover only a short- or medium-term. In that case adjustments will be necessary to the existing system so that PPPs can be fully accommodated in the budget.

2.4. PPP projects contracted by regional or municipal governments

In many countries regional and/or municipal authorities have a large governmental autonomy. Often these governments can enter into (traditional or PPP) contracts without needing consent from the central government, as long as the costs of the contract can be covered by the regional or municipal budget. While taking into account the constitutional autonomy of these governments, it should be noted that the PPP projects that are contracted



by these regional or municipal governments can possibly influence state debt and deficit, through for example insufficient risk transfer according to the Eurostat criteria, or large unforeseen future liabilities. In the cases where the regional or municipal budgets are insufficient to cover these events, the state budget in most cases will have to “pick up the bill”. A central government (and its Ministry of Finance) should therefore have insight in the PPP projects that are contracted at regional or municipal levels and their consequences, and depending on the constitutional context, should have the ability to advise on and monitor these projects.

3. Key Observations by Twinning Experts

Based on the documents that were provided to the experts and the interviews that were conducted as part of the fact finding mission, the experts have made the following observations. However, it should be noted that, whilst reading the findings it is important to keep in mind that the fiscal and budgetary system in general, and therefore also the fiscal and budgetary treatment of PPP projects will vary from country to country and depends on several factors. The position of the MoF for example is one of these factors. Any budgetary system therefore needs to be assessed in that context and it is impossible to copy a budgetary system from one country to another country. However there are some general recommendations to be made and experiences that can be shared.

3.1: Findings:

3.1.1. *Organisational embedment:*

Documents used for the assessment:

Organisational Chart MoF

Document no: 2006-11-06/1: Organisational Rules of the Ministry of Finance

Within the MoF:

The State Budget Department (Department 11) of the MoF is responsible for drafting the budget and drafting the relevant legislation.

Department 114 (Department for Regulation and Methodology of PPP Projects) is part of the State Budget Department. Department 114 is responsible for all the legislation concerning PPP within the competence of MoF, including – and most relevant for this report - the drafting of legislation that requires line ministries and regional or municipal governments to provide relevant information on PPP projects for the Budget and the medium-term outlook. Department 114 represents the MoF in the Project Board of the PPP pilot projects.

The Financial Policy Department (Department 31) is – among other things - responsible for collecting and processing data regarding the state deficit and debt, for the purpose of the Czech Statistical Office.



The organisational rules of the MoF contain the general division of tasks and responsibilities within the MoF. There is no internal procedure (manual) within the Ministry of Finance that describes the practical division of tasks and responsibilities regarding fiscal and budgetary treatment of PPP projects.

Other organisations involved:

Financial departments of line ministries: they manage the Chapter Budget of the Ministry. In that capacity the Financial Department of the Line Ministry plays an important role in the assessment of fiscal sustainability of a project.

Czech Statistical office: it is responsible for providing the data regarding deficit and debt to Eurostat.

3.1.2. Legislative framework in Czech Republic

Budgetary regime (State Budget Rules):

Documents used for assessment:

- **Act 218/2000 on Budgetary Rules**
- **Regulation 131/2001 (based on Act 218/2000 regarding “the determination of the extent and structure of information necessary for drafting the state budget Bill and the deadline for submission of this information”) including 4 PPP tables.**
- **Doc. No. 2006-12-14/2: Proposed measures for enhancing the role of Ministry of Finance and for mitigation of risks of the existing PPP in the Czech Republic.**

The Ministry of Finance (MoF) Department 11 is responsible for drafting the State Budget. The state budget covers one year. The Budget that is to be submitted to Parliament for approval has to be accompanied by a Medium term outlook, which covers the budgetary year and 2 consecutive years.

The act on budgetary rules stipulates that for commitments of the state resulting from approved concession contracts the period of a medium-term outlook shall coincide with the stated duration of obligations resulting from Concession contracts (among which PPP Concession Contracts).

Each Line Ministry manages its own Chapter of the Budget. The Chapter administrator (Contracting Ministry/authority) is primarily responsible for this part of the Budget.

Expenditure for PPP projects will normally have to be found within a Chapter of the Contracting Authority (i.e. Line Ministry). Note, however, that PPPs typically start generating government disbursements only after a period of four years after contract closure, implying that in fact no appropriation is needed for PPP contracts when the contract is signed.

The Chapter administrator is obliged to provide the MoF with the relevant data for drafting the budget and reporting to EU institutions. For this purpose the MoF has drafted an implementing regulation 131/2001 (based on Act 218/2000) regarding “*the determination of the extent and structure of information necessary for drafting the state budget Bill and the*



deadline for submission of this information". Attached to this regulation are four tables for submitting information on PPP projects.

The line ministry should, by means of these tables, provide information on closed Concession contracts. The period that is covered by the tables is 3 years (in line with medium term outlook). The tables have not yet been formally approved. Another regulation (16/2001) which should enable the MoF to obtain information on the whole duration of the project, has been rejected.

Concession act No 139/2006 :

Documents used for assessment:

- **Act 139/2006: Concession Act**
- **Draft governance guidance d.d. 3 March 2005**

According to the Concession Act, Government has to give its approval in two stages of the preparation process:

- After the feasibility study has been prepared and before entering into the procurement stage (par 22).
- Before closure of the contract (par 23).

The Concession Act concerns only projects that are covered by the Concession Act (i.e. Concession contracts). Projects that are not governed by the Concession Act fall outside the scope of Government approval.

In addition to this: government approval is only required for important projects on central government level (not regional/municipal level) (art. 21 Concession act).

The MoF can execute budgetary supervision on PPP projects carried out by self-governing bodies (municipalities, regions etc) by ways of giving an opinion (art. 30 Concession act). The self governing body is obliged to apply for such an opinion before closing or altering a concession contract and the validity of a concession contract is conditional on the delivery of the opinion. This opinion however is not binding.

The MoF has no special position in these decisions⁵.

PPP governance in the Czech Republic.

Documents used for assessment:

- **Draft governance guidance d.d. 3 March 2005**
- **Doc. No 2006-12-14/2: Proposed measures for enhancing the role of Ministry of Finance and for mitigation of risks of the existing PPP in the Czech Republic.**

Based on resolution 7/2004, which approves the PPP policy in the Czech Republic, the *Department for Regulation and Methodology of PPP Projects* was established at the MoF in 2004. In addition a PPP Centrum was established. In 2005 (3 march 2005) the PPP Centrum issued a draft document "PPP Governance Guidance". This document describes the

⁵ In the draft governance guidance d.d. 3 March 2005 the MoF is granted a veto right in these decisions. However, the document is not formally adopted and, according to the interviewees, in practice the MoF does not "have the power" to exercise a veto right.



procedural aspects of PPP projects in the Czech Republic. It should be noted that the current status of this document is not clear to the experts, as it is stated on the document that was provided that it is only a draft. It seems that parts of the document are being applied to the selected PPP pilot projects. Other parts of the document are seemingly not being applied or fulfilled.

In the draft document the tasks and competences of the Department for Regulation and Methodology of PPP Projects is described as follows:

“PPP Regulator” is, based on the Government resolution no. 7 issued on 7 January 2004, a stand-alone Office for Regulation and Methodology of PPP Projects of the Ministry of Finance (hereinafter referred to as “Regulator”). The role of the Regulator is to supervise the compliance with general binding standards of PPP and to check the whole process of preparation and delivery of the PPP Projects, and later on to monitor them.

As long-term liabilities of the public sector will be arising from the contracts with the private partners, **“the Regulator shall keep a record of these liabilities and ensure fiscal security in line with the MoF CZ rules (e.g. by setting up a maximum proportion of liabilities arising from the PPP Project in the overall public finance budgets)”**.

(Source: draft Governance guidance 3 march 2005, page 5)

From doc. No 2006-12-14/2: “Proposed measures for enhancing the role of Ministry of Finance and for mitigation of risks of the existing PPP in the Czech Republic” the experts understand that Department 114 is – partly - proceeding to carrying out its tasks as mentioned above. It is however not clear what the results of these efforts are, other than the documents that were provided to the experts and used for the assessment.

3.1.3: The PPP pilot projects:

Most likely the current pilot projects will fall within the scope of the Concession Act. Therefore the Government will have two formal decision moments as stated above. In addition to this act the Government has defined selection criteria that need to be fulfilled for a project to be appointed a pilot project. One of these criteria is Budgetary Impact. As the coverage for a PPP project should normally be found in the Budget Chapter of the Contracting Ministry, it is the Financial Department of the Contracting Ministry (and normally not the MoF), that assesses the project on the basis of this criterion.

The MoF takes part in the Project Board of all the PPP pilot projects⁶. The MoF is represented in this Project Board by the department for Regulation and Methodology for PPP Projects.

The selected PPP pilot project: Courthouse Usti nad Labem

Documents used for assessment:

- **Outline for the Proposed PPP (Public Private Partnership) Pilot Project**
- **Appraisal of the proposed PPP Pilot Project**
- **OBC first final version**

This project is carried out by the Ministry of Justice (MoJ). The project will be charged to the Ministry of Justice Budget. The financial department of the MoJ has assessed the project in light of fiscal sustainability. The MoF was not involved in this assessment.

⁶ Source: draft governance guidance d.d. 3 March 2005, also ppp fact sheets PPPcentrum website



The project is in OBC state (first final version of OBC has been provided in English) to the experts. Some of the questions that arise in this stage concern risk transfer in light of the Eurostat criteria and application of the Eurostat criteria in general.

3.1.4. Self governing bodies (municipal/regional governments).

Documents used for assessment:

- **EBRD report: Contract for Consultancy Services to Update on Best International Practices in Public Private Partnership with Regards to Regional Policy Issues**
- **Doc. No 2006-12-14/2: Proposed measures for enhancing the role of Ministry of Finance and for mitigation of risks of the existing PPP in the Czech Republic.**
- **Act 139/2006: Concession Act**

Although this issue was not discussed in detail during the meeting between the experts and Department for Regulation and Methodology for PPP projects, from the EBRD report the experts understand that the Czech government system is fairly decentralised. Municipal and regional governments have a significant fiscal autonomy. The MoF does not in all cases have the ability to influence/monitor contracts that are closed by self governing bodies. For example, contracts that fall outside the scope of the Concession Act are not subject to a MoF opinion. Contracts that do fall under the scope of the Concession Act are subject to this opinion, as stated in 3.1.2, but at present this opinion is not binding.

The MoF has limited possibilities to require for the budget and Maastricht statistics all necessary information about regional/municipal PPP contracts. The MoF has launched some activities to remedy this situation⁷. However, the exact status of these measures is not known to the experts.

3.2: Analysis of the findings

3.2.1: Positive elements

- The Czech government has in 2004 approved the PPP policy in the Czech Republic. In its approval the Government has very specifically stressed the importance of PPP for the Czech Republic. In the approval the special position of the MoF as “guardian of the budget” was explicitly recognized. This has resulted in the establishment of the Department for Regulation and Methodology of PPP Projects, within the MoF, and a PPP Centrum that is an independent advisory entity but owned by the MoF. One of the tasks of the Department, according to the draft governance guidance, is to prepare a legal framework for the fiscal treatment of PPP Projects.
- The importance of position of the MoF is reflected specifically in the draft governance guidance. Apart from involvement in the formal government decisions on the basis of the Concession Act, additionally the MoF has the opportunity to be involved in the preparation of PPP projects as it takes part in the Project board of every PPP pilot project. This enables the MoF to monitor a PPP project in all stages of the preparatory process from a fiscal sustainability point of view.
- Within the Department for Regulation and Methodology there is awareness that the proper assessment of fiscal sustainability and fiscal impact of PPP projects is very

⁷ Doc. No 2006-12-14/2: Proposed measures for enhancing the role of Ministry of Finance and for mitigation of risks of the existing PPP in the Czech Republic.



important. The Department has been involved in the adoption of several measures to improve the quality of fiscal impact assessment of PPP projects:

- The Act on Budgetary rules stipulates that in the Medium Term outlook, data regarding PPP contracts should be entered for **the whole duration** of the project.
 - The Concession Act stipulated that it is **obligatory** for self governing bodies to **request a MoF opinion on a PPP project**, before contract close.
- In the interview that was held with the Deputy Minister of the MoJ, the Deputy Minister expressed that in his view fiscal sustainability and proper application of the Eurostat ruling are very important also for Line Ministries. He looks for the MoF to provide guidance in that regard.

3.2.2. Challenges:

- The current legislation reflects to a certain extent the importance of a sound fiscal treatment of PPP projects. In practice, there is room for improvement:
 - The Concession Act and draft governance guidance formalise MoF involvement in the decision process. However, the MoF has no special formal position (no veto rights). In addition this formal involvement is limited to “important concession contracts” at government level. Other contracts fall outside the scope of MoF involvement. The Concession contract stipulates that self governing bodies are required to ask for MoF opinion before contract close, but this opinion again is not binding.
 - The Act on Budgetary Rules stipulates that liabilities for PPP projects should be reflected in the Medium term outlook for the whole duration of the contract. However, in practice it is only possible for the MoF to request information on a three year period. In addition, the provision is applicable only to contracts that are already closed and not to contracts that are under preparation.
- The Department for Regulation and Methodology has been attributed significant responsibility regarding the assessment of PPP pilot projects from a fiscal point of view. It is to be involved in the Project Board of all the projects and should draft the necessary legislation for the fiscal treatment of PPP projects. However, the capacity and practical experience of the Department is very limited.
- It seems that the Department does not have the support of all levels of the MoF organization. It seems that opinions differ as to the necessity of an active involvement and monitoring role for the MoF with regards to the fiscal treatment of PPP projects. As a result line ministries are able to decide almost autonomously on the fiscal sustainability of PPP projects.
- Although the importance of the Eurostat ruling is widely accepted within the MoF the practical knowledge and experience with the application is very limited. This is the same for the Czech Statistical office. The departments involved seem to have different views on which department is responsible for the Eurostat assessment. There is no organisational structure or agreement that ensures involvement of all relevant departments in the assessment.

4. Recommendations:

- Although PPP projects can provide a possibility to increase investment opportunities, it is important to ensure that PPP projects are not used (solely) with the purpose to bypass short-term budgetary pressure (EMU-deficit and/or expenditure ceilings).



Therefore the total life-cycle costs of a project (traditional and PPP) should be clear and real value-for-money should be ensured.

- Create a budgetary system that, while taking into account the different responsibilities of different stakeholders, reflects the real fiscal costs of PPP projects for the whole duration of the project. If the PPP method is chosen for a given project, make sure that these costs are reflected transparently in the budget for example by creating a special annex to the Budget. This document should provide an overview of the total amount of liabilities regarding PPP projects that have been entered into at any given time. Therefore PPP projects that are in preparatory stages should be included in this overview as well. The extension of this disclosure scheme to sub-national governments should be addressed by the Budget Department according to EMU goals and fiscal sustainability rules.
- Use an objective method for calculating the (estimated) costs for projects that are in the preparatory stage (for example the results of the Public Sector Comparator)
- Enable the MoF to request all necessary information on PPP projects.
- Strengthen the position of the MoF in the decision process.
- Increase the level of knowledge and expertise of the Eurostat rules within the MoF and the Czech Statistical Office. In addition there should be an organisational agreement in place that involves all relevant departments and organisations, and clearly reflects the division of responsibilities in this assessment (reaching an agreement on who does what).

5. Agreed upon actions

The Dutch and Portuguese experts have agreed during the fact finding meetings to execute the following activities and provide the following information to the Czech Ministry of Finance to help the MoF with the carrying out of (some of) the recommendations. Further assistance will be provided to the Czech authorities during the course of them carrying out the recommendations, depending on the need of the Czech authorities and availability of the MS experts.

- The Dutch experts have on request of both MoJ and MoF agreed to perform a quick scan of the second draft of the OBC Courthouse, from the point of view of the Eurostat rules, as soon as this second draft version is available for the experts in English.
- Information will be provided on the Dutch and Portuguese fiscal system, the extent of Dutch/Portuguese MoF involvement in PPP projects and any other information that will be deemed relevant/ be requested by the Czech authorities.
- A short overview of the budgetary system and Eurostat application in NL and PT is added to this report in annexes III and IV.



Annex I: List of interviewees

Ministry of Finance

1) Department 114 - PPP Regulation and Methodology

Ms. Kateřina Helikarová Head of Department
Ms. Dagmar Hrnčířová
Ms. Vladimíra Trojanová

2) Department 31 – Financial policy

Mr. Vilém Valenta
Ms. Dagmar Sojková

3) Department 11 – State Budget

Mr. Karel Tyll Director
Mr. Martin Kolitsch
Mr. Jiří Šiman
Mr. Irena Válková

Ministry of Justice

Mr. František Steiner Deputy Minister
Ms. Jana Němečková

Czech Statistical Office

Ms. Ludmila Věbrová
Mr. Jan Heller

Annex II: List of research documentation



1. Act 218/2000 on Budgetary Rules
2. Regulation 131/2001 (based on Act 218/2000 regarding “*the determination of the extent and structure of information necessary for drafting the state budget Bill and the deadline for submission of this information*” including 4 PPP tables.
3. Doc. No. 2006-12-14/2: Proposed measures for enhancing the role of Ministry of Finance and for mitigation of risks of the existing PPP in the Czech Republic.
4. Act 139/2006: Concession Act
5. Draft governance guidance d.d. 3 March 2005
6. Outline for the Proposed PPP (Public Private Partnership) Pilot Project
7. Appraisal of the proposed PPP Pilot Project Courthouse Usti nad Labem
8. OBC first final version Courthouse Usti nad Labem
9. EBRD report: Contract for Consultancy Services to Update on Best International Practices in Public Private Partnership with Regards to Regional Policy Issues



Annex: III: Budgetary system and Eurostat application in Portugal

1. The current budgetary treatment of PPPs was designed when PPP programmes took off in Portugal, reaching the tens of billions of euros, but although presented in the year 2000 Budgetary Framework Law, was implemented only for the 2004 State Budget, after all the appropriate institutions and technical capacity were in place, namely the MoF PPP Unit responsible for assessing Public Sector Comparators and advising on risk-sharing and efficiency.

The State Budget. The Portuguese Budget presents a medium-term framework for the investment expenditure, but is in fact a one-year budget, and the medium-term (three-year) framework is irrelevant. Therefore, appropriation for PPP expenditures is not viable, so PPP expenditure needed a special procedure, and it is addressed through a specific memo attached to the Budget.

The PPP memo. The system is based on a memo attached to the Budget Proposal (Budget Report), presenting the main PPP programmes and projects and a table including, for each PPP programme, the expected value of payments from Government to the PPP operators, for each year of contract duration. (This table is presented below, with an English translation.)

The table includes three types of PPP projects:

- Projects with contracts already closed – expected payments are computed from contract provisions and expected production/demand scenario
- Projects being tendered – expected payments are computed from the Public Sector Comparator values, re-distributed according to the expected time profile of PPP payments
- Projects being prepared to tender – expected payments are computed from draft Public Sector Comparator values

According to a MoF rule, the computation of those payments from (Central) Government to PPP operators is based on a 2% long-term inflation forecast.

In the 2007 Budget Proposal, a special presentation is provided for PPP Health projects, detailing all projects, their procurement/implementation stages, and individual (contracted/expected) costs for government.

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[...]

III.7. Public-Private Partnerships (PPP, Parcerias Público-Privadas)

III.7.1. PPP Framework and Pluri-annual costs of contracted PPPs

Decree-Law 86/2003, dated 26 de April, was the first step toward standardising and disciplining the basis for long-term commitments between the State and the private



sector, namely building public sector comparators, standardising tender documents and contractual documents, or the definition of risk-sharing rules. However, after three years of implementation of the referred Decree-Law, some weaknesses in PPPs were persisting: slow delivery of public infrastructures and requests for financial compensation from PPP operators. Therefore the Government established as a priority reviewing the Decree-Law 86/2003, introducing stricter rules for the approval of PPP projects: prior emission of Environmental Impact Decisions, higher cohesion and co-ordination between the Ministry of Finance and line ministries, as well as stronger control by the Ministry of Finance on facts potentially able to generate financial re-equilibrium claims such as unilateral project changes or additional requirements presented by Government to the PPP operators. In addition, new rules were defined for the equitable sharing of unexpected benefits.

New PPPs are being procured, in the road and health sectors. In the road sector, bids are being evaluated for the future Grande Lisboa and Douro Litoral toll-road contracts, and the tender for Marão Tunnel toll-road contract is being prepared. In the health sector, the procurement for Cascais, Braga and Vila Franca de Xira hospital PPP contracts is being advanced. The SIRESP IT system, for the police and emergency services, was contracted, allowing for the renovation and upgrading of their communications network.

The following table presents details of the commitments for future payments by government, for the main activity sectors.

Table III.7.1. Fiscal burden arising from the main PPP programmes (1)
(Million euros)

| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 |
|------------------------------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|
| Toll-roads | 147,2 | 20,7 | 20,7 | 20,7 | 18,5 | 11,6 | 11,6 | 11,6 |
| Shadow-toll roads (SCUT programme) | 705,4 | 733,9 | 737,2 | 747,4 | 765,6 | 717,1 | 721,0 | 731,3 |
| Sub-total highways | 852,6 | 754,5 | 757,8 | 768,1 | 784,1 | 728,7 | 732,6 | 742,9 |
| Railways | 41,7 | 25,2 | 11,0 | 9,7 | | | | |
| Health sector PPPs | 105,6 | 209,0 | 237,4 | 290,6 | 322,7 | 335,7 | 344,9 | 355,7 |
| Other PPPs | 19,3 | 25,3 | 41,1 | 42,9 | 46,6 | 45,5 | 45,0 | 50,0 |
| Total | 1.019,2 | 1.014,0 | 1.047,3 | 1.111,3 | 1.153,4 | 1.109,9 | 1.122,4 | 1.148,6 |

| | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 |
|------------------------------------|----------------|----------------|----------------|--------------|--------------|--------------|--------------|--------------|
| Toll-roads | 11,6 | 11,6 | 11,6 | 11,6 | 11,6 | | | |
| Shadow-toll roads (SCUT programme) | 732,5 | 722,9 | 735,1 | 707,7 | 714,8 | 710,6 | 706,1 | 702,5 |
| Sub-total highways | 744,1 | 734,5 | 746,6 | 719,2 | 726,4 | 710,6 | 706,1 | 702,5 |
| Railways | | | | | | | | |
| Health sector PPPs | 370,3 | 386,1 | 230,4 | 43,2 | 43,2 | 43,2 | 43,2 | 43,2 |
| Other PPPs | 50,3 | 47,7 | 45,4 | 44,5 | 33,3 | 32,0 | 18,2 | |
| Total | 1.164,7 | 1.168,2 | 1.022,4 | 807,0 | 802,9 | 785,9 | 767,6 | 745,8 |

| | 2023 | 2024 | 2025 | 2026 | 2027 | 2028 | 2029 | 2030 |
|------------------------------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
| Toll-roads | | | | | | | | |
| Shadow-toll roads (SCUT programme) | 698,2 | 630,8 | 615,3 | 492,8 | 418,0 | 410,5 | 361,9 | 200,9 |
| Sub-total highways | 698,2 | 630,8 | 615,3 | 492,8 | 418,0 | 410,5 | 361,9 | 200,9 |
| Railways | | | | | | | | |
| Health sector PPPs | 43,2 | 43,2 | 43,2 | 43,2 | 43,2 | 43,2 | 43,2 | 43,2 |
| Other PPPs | | | | | | | | |
| Total | 741,4 | 674,0 | 658,6 | 536,1 | 461,2 | 453,7 | 405,1 | 244,2 |



| | 2031 | 2032 | 2033 | 2034 | 2035 | 2036 | 2037 | 2038 |
|------------------------------------|--------------|-------------|-------------|-------------|-------------|-------------|-------------|------------|
| Toll-roads | | | | | | | | |
| Shadow-toll roads (SCUT programme) | 103,1 | | | | | | | |
| Sub-total highways | 103,1 | 0,0 | 0,0 | 0,0 | 0,0 | 0,0 | 0,0 | 0,0 |
| Railways | | | | | | | | |
| Health sector PPPs | 43,2 | 43,2 | 43,2 | 43,2 | 43,2 | 43,2 | 23,1 | 0,0 |
| Other PPPs | | | | | | | | |
| Total | 146,3 | 43,2 | 43,2 | 43,2 | 43,2 | 43,2 | 23,1 | 0,0 |

(1) Figures do not include additional costs (from unilateral project changes, delays in land acquisition, delays in environmental licensing etc.) Includes Tax on Value Added.

III.7.2. PPPs in the Health Sector

[details for each PPP Health project are presented]

2. The Budget memo is prepared by the Budget Department using information delivered by line ministries. Parpública, the MoF PPP Unit, is usually asked to review the table. As well as the State Budget, the annual Budget Proposal (Report, or «Relatório», including the PPP memo) is Internet-downloadable (in Portuguese) – see <http://www.min-financas.pt>.

3. The Decree-Law 86/2003 created the institutional support for the Budget memo and for checking the efficient delivery of PPP projects. This Decree-Law created a gateway for PPP projects, including assessment by the Minister of Finance at several project phases, and requiring his approval at each phase. Subsequently, the Minister of Finance delegated his technical responsibilities on Parpública (a firm 100% held by the Treasury and involved into privatisation and management of the Treasury shares in private and public firms). So, a small PPP Unit (around 5 senior staff and 3 junior staff) was created inside Parpública. Its role is to assess projects, review and optimise contractual and incentive schemes, review Outline Business Cases and Public Sector Comparators, review and optimise tender documents, evaluate contracts before closure, and keep information on PPP costs, risks and performance. The PPP Unit is not responsible for project management or delivery, only for its review and optimisation. The PPP Unit is not responsible for PPP contract management, supervision or auditing. Staff from the PPP Unit is routinely sitting in tender boards as representatives of the government appointed by the Minister of Finance.

4. Being focused on efficiency, the MoF PPP Unit is not concerned with Eurostat criteria, according to the ideas that efficient projects will certainly obey Eurostat rules, and that projects should not be tailored for Eurostat rules but only for efficiency. So the scrutiny for Eurostat criteria is provided by the National Accounts experts in the Budget Department, who are deeply acquainted with Eurostat reasoning and Eurostat rules.



Annex IV: Budgetary system and Eurostat application in The Netherlands

To understand the treatment of PPP (by MoF) in the Netherlands a short description of budgetary policy and the budget process is necessary. Budgeting is about making choices, setting priorities and control expenditures. At the start of each term of office the government announces its plans for the coming four years in a 'coalition agreement'. This includes the detailed arrangements for budgetary policy (including a target for the deficit/surplus).

Budgetary Policy

The Global Agreement on Government Policy includes agreements on budgetary rules to achieve the government's objective. One of the goals is to achieve a structural budget surplus of 1% of GDP at the end of the government's term of office. This is in order to facilitate future repayment of the national debt which is required to cope with the increasing costs of ageing in the Netherlands.

The main budgetary rules are the following:

- Realistic (and independent) economic forecasts. This to limit the impact of financial setbacks during budget execution as much as possible.
- Strict separation between revenues and expenditures. The main purpose of this rule is to stop every change in the government's revenue projections triggering a discussion on additional outlays (in the case of higher revenues) or spending cuts (in the case of lower revenues).
- Expenditure frameworks and expenditure ceilings. On the expenditure side of the budget, a fixed 'expenditure framework' is set. That is to say, total outlays are set for each year of the government's term of office. Three sectors are distinguished in this context: central government, social security and health care. A maximum level of real spending is set for each sector, the 'expenditure ceiling'.
- Budget Discipline Rules. One means of ensuring that spending remains within the expenditure framework is to apply a set of budget discipline rules, the rules governing the budget process (see box budget discipline rules).
- Taxation framework. A fixed framework is also set on the revenue side. That is to say, the total burden of taxes and social security contributions for citizens and businesses is set for each year.
- Automatic stabilizers and signal values. Full automatic stabilization is assumed for the revenue side. Any windfalls on the revenue side are added to the EMU balance, and



any setbacks on the revenue side are deducted from the EMU balance. The advantage of this approach is that on the revenue side the budget can be responsive to some extent to economic developments. In the case of setbacks, additional measures are only taken when the signal values for the EMU balance are exceeded.

- Signal values. Under the European agreements, the actual deficit must not exceed 3% of GDP. To be on the safe side, the government uses a signal value of 2% of GDP.

Box Budget discipline rules

To prevent overruns on spending limits efforts must be made to prevent looming setbacks on the expenditure side by taking appropriate measures in time

To signal overspends and underspends windfalls and setbacks must be reported to the Minister of Finance and the Council of Ministers in time.

To compensate for overspends and underspends:

- In principle each setback must be compensated within the line ministry or sector in which the setback occurs. This is called specific compensation.

- In exceptional cases the Council of Ministers may decide a 'general compensation'. In that case the compensation is spread across other ministries or sectors.

- Windfalls on the expenditure side must be used to compensate setbacks. In principle they should not be used for new policies.

The budget process

Each year on the third Tuesday in September, the government announces its plans to the parliament within the framework of the budgetary policy. The Minister of Finance has a special position in the budget process under the Government Accounts Act (GAA). The GAA is supported by the rules on budgetary policy (as mentioned above). According to this Act ministers must submit all their plans and the financial implication to the Minister of Finance. He is the guardian of the terms of the coalition agreement (which entails the main budgetary rules) and the government's other arrangements on budgetary policy.

The budget process splits decision-making on major reallocations and expenditure ceilings from the detailed discussion of line ministry budgets. This two-step budget preparation enables MoF and the line ministries to have in-depth discussions on reallocations within the ceilings.

The main steps of the budget process are as follows:



- The Minister of Finance sends a 'budget notice' to the other ministers. This circular contains technical and procedural instructions (e.g. inflation, interest-rate, etc) which the ministers must follow when drawing up their departmental budgets. The purpose of the budget notice is to ensure that all ministries base their budgets on the same principles.
- Line ministries send policy letters to MoF including their budget proposals. The outcomes of the implementation of the current and previous year's budgets are also taken into account. At this stage, the Financial and Economic Affairs Directorate of the ministry in question has already screened the proposals. Each policy letters includes multiyear expenditure forecasts linked to the fiscal policy objectives in the Coalition Agreement.
- Based on the information in the policy letters and the latest economic insights the Minister of Finance sets out the possibilities and the problems for the forthcoming budget; all within the expenditure framework.
- The decision making process in the spring is key period in the budget preparation process. The decisions taken yield a budget total for each ministry. A letter from the MoF thus sets the maximum limits for the departmental budgets.
- Next, the ministers submit 'initial draft budgets' to the MoF. The Inspectorate of the Budget staff examine whether the initial draft budgets comply with relevant agreements. This directorate within the ministry of finance also decides whether the ministry in question has set out its objectives clearly, what it plans to do to achieve them, and how much money will be spent on each objective.
- In August the final decisions are taken on the central government budget (mainly on the revenue side). The presentation of the Budget Memorandum concludes the preparatory stage and marks the start of the budget proceedings stage (in which amendments can be made by members of parliament).

PPP in the Netherlands

In 1999 the government established the PPP Knowledge Centre as a part of MoF, to promote and stimulate PPP activity. Since then a small number of important investment projects have been designed, built and operated through PPP contracts (most of them being DBFM), including the high-speed rail link to Brussels and Paris. The efficiency gains vary between 2.5 and almost 20%. The PPP-way of financing is only used when the benefits are 100% clear; otherwise traditional public investment prevails. The decision to PPP is made by the Financial and Economic Affairs Directorate of the line ministry in question in close cooperation with MoF.



There is no legal framework for PPPs so far. Current policy is to encourage development of expertise and knowledge in the line ministries, as well as to encourage decentralised development of PPP arrangements by the municipalities. However, MoF does not monitor PPP activity for local government.

Last year, after seven years, the Knowledge Centre Public Private Partnership changed its role. Initially a pioneering stimulant to the realisation of capital-intensive projects between two parties, the Knowledge Centre is now incorporated into the Ministry of Finance as a department where it will focus on PPP knowledge management and those sectors where PPP still needs to be improved.

In the meantime, the entire Government is actively applying PPP policy and several specialist departments are also involved with PPP. The positive impact of this is clearly visible: first generation PPP projects have been wound up and second generation projects are now in full implementation with a considerable number of projects in the pipe line. The activities and employees of the Knowledge Centre will continue in a new department within the Ministry of Finance: Public Private Partnership and Asset Management.

The arrangement of the PPP process is as follows: the initiative for PPP lies in the hand of the line ministries. The role of MoF is supportive in a number of ways:

- The PPP Knowledge Centre helps drafting the PPP-contracts (complex from a judicial perspective)
- The Inspectorate of the Budget examines whether the use of PPP is to be preferred above traditional investment and whether the costs fit in within the multi-year budget chapter.
- The Budget Affairs Directorate examines whether the PPP expenditures fit in within the overall expenditure framework and provides knowledge on Eurostat rules: to make sure that the Eurostat classification (regarding the balance sheet) of the PPP will not be a surprise
- The Eurostat ruling says (roughly): when the government bears the majority of the risks, the PPP is recorded on the balance sheet of the government (government assets).

A line ministry is allowed to change the way of financing a project as long as they stay within their multi-annual budget (policy autonomy). For example, if the minister of transport has room in his multi-annual budget to build a highway then it's up to this line minister whether he performs PPP or not. The outlays during a period of 20/30 years are guaranteed by the line



ministry with the approval of MoF. Of course, other political priorities in the longer run may lead to cancellation of a project but that also goes for traditional investment.

To formalize this practice (and to formalize a level playing field for PPP) the new government implemented an additional budgetary rule on PPP:

Application of the PPP construction takes place as follows: the cash budget of a line ministry is converted into multi annual availability fees (budgetary neutral in time). Technically, this implies a lowering of the expenditure ceiling (of this ministry) in the years where the cash budget was available and a raising of the expenditure ceiling in the same amount in the years where the availability fees will be paid, provided that the efficiency gain comes in the favour of the line ministry in question.

Statistics Netherlands (www.cbs.nl) is formally only involved when the PPP contract is signed (ex-post). The classification in terms of EMU deficit and debt is performed according to the Eurostat Manual on deficit and debt (ESA 1995). In order to make the right decision Statistics Netherlands has developed a questionnaire (which will be provided to the Czech MoF). The line ministry is responsible for answering this questionnaire, but in practice it's a joint operation with all directorates of MoF involved (primarily the PPP Knowledge Centre). Of course, when drafting the Budget and the Stability Programs, MoF needs to make an assumption on the EMU classification of the PPP contract. The knowledge on the Eurostat manual is available within the Budget Affairs Directorate. Several staff members are in contact with Statistics Netherlands for preliminary advice.

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