

the **N**etwork Industries ^{quarterly}



Concessions

—And

their Regulation in the Different Network Industries

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The use of concession agreements to provide public services in the different network industries has been growing over the past decades around the world, mainly as a way to facilitate private investment. Motorways, seaports, water and sewage, among other sectors, have gained experience in the use of these instruments and some important lessons have been learned. The articles in this issue highlight some of the most relevant considerations in the use of concession contracts, their advantages and disadvantages compared to the traditional public provision, the implications for institutional design, the way of dealing with new investments during the contract period, and how to introduce performance clauses

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Institutional Design for Concessions

Rodrigo Harrison*, Roberto Muñoz**, José Miguel Sánchez***

This paper stresses the importance of the institutional framework for the success of a concession process, and discusses a methodology to design and evaluate its interaction with the concessionaire. The institutional design has proven in practice to be critical in explaining the failure or success of the concession model

Keywords: institutional design, concession, role assignment.

I. Introduction

Introducing private sector participation in the provision of public services through the concession model has been a widely used policy to increase the investment in publicly used infrastructure in several developed and developing countries as well. In recent years, the use of this model has shifted towards a greater concern regarding the quality of the service being provided. Chile has already two decades of experience in applying the concession model and therefore a number of lessons can be obtained from the analysis of the performance of the different contracts. In general, there is a positive evaluation of the application of the system (see for example, Domper 2009). However, performance variance among contracts has been high, with some contracts delivering poor services to the users. In this paper, we argue that an important and often excluded element for the evaluation of the pertinence of a concession process is the institutional framework, mainly because it defines the interaction between its relevant actors. For this reason, we develop an analytical framework, that is useful for evaluating the convenience of a process of this nature in the first place – when the alternative of direct public provision exists –, and to provide recommendations as to which institutional framework is more appropriate in different situations/cases. A more detailed explanation of this methodology can be found in Harrison et al (2012).

Our premise is that functional institutions are a necessary condition for the success of a concession, and so our proposed analysis, along with other consideration such as those that could arise from a political economy approach, should be part of the decision of whether grant them or not, and if possible, of how institutions should be designed to support a concession model for the provision of public services.

II. A Simple Model of Institutional Design.

A concession contract is an instrument by which a public entity (central government, municipality, public agency, etc.) grants a private provider the right, for a certain period of time (exogenous or endogenous) and with significant market power, to provide a service of public interest. In return, the private provider is obliged to deliver the service following the requirements detailed in the concession contract and has the right to a flow of income that comes from the fees paid by the users or from

the government subsidies.

Given the nature of a concession contract, one can expect them to be especially sensitive to the context in which they develop. Nevertheless, the fact that developing countries have institutional limitations that affect the results of regulation and contracts designs such as concessions has only been recently studied in the literature. Important examples include Laffont (2005), who used the term “institutional failures” to refer to institutional limitations affecting regulation in developing economies, and Estache and Wren-Lewis (2009), which identify four broad limitations: limited regulatory capacity, limited commitment, limited accountability and limited fiscal efficiency. The methodology explained in this paper aims at dealing correctly with these kind of problems, in the process of institutional design when a concession has already been granted.

The evaluation of the convenience of a concession can be understood as a two stage process, where the first one corresponds to the traditional analysis of social objective definition, and its maximization through the election of decision variables such as pricing schemes, quality of the service, etc. The second one, in turn, requires looking at the broader picture, and to assess if the existing or created institutions are sufficiently strong and independent from one another so that the authority can have a reasonable certainty that the social objectives defined in the first stage will be attained. If the answer is negative, the options are to implement alternative solutions (such as public provision), or to design a set of institutions, which may be specific to the service provided, and define the way in which they will interact, so the efficient result defined of the first stage can be implemented. For this second option, we have identified six main roles that are crucial in a concession process and must be assigned by a planner in the institutional design process. These roles are:

1. Grantor: role of granting the concession contract.
2. Contract Manager: role of managing the contract during the concession period.
3. Supervisor: role of supervising sector norms about quality of service.
4. Regulator: role of pricing regulation.
5. Planner and Coordinator: role of planning and coordination with other units and/or sectors of the economy or the society.

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6. Fiscal Responsible: role of ensuring fiscal responsibility.

Three important issues should be stressed at this point. First, the role assignment has to assure that all roles are assigned. When a role is not explicitly assigned, any of the actors/agents that have an interest in the activity or service provided will assume it resulting in a de facto assignment that may not be necessarily optimal. Second, it is highly important that the assignment of roles is done taking into consideration potential conflict of interests among two or more of them, if held in the same entity. If this is the case, the result of the concession process would probably be far from optimal. Thirdly, it is also important to note that the different roles identified above become more or less relevant depending on the stage the concession process is in. For example, the long run roles of fiscal responsibility and of planner and coordinator are always present from the moment the decision to grant a concession contract is taken, until the concession is in full operation. The fiscal responsible role is present in the whole period due to the potential existence of contingent liabilities taken on by the state. The role of concession grantor is one of the first to appear since it is who is in charge of designing and awarding the concession. Once awarded, the roles of contract manager and service quality supervisor appear, since they have to assure that the concession contract is being honored. On the other hand, the role of regulator appears only occasionally when the initial or a new set of tariffs has to be calculated and put into effect. Figure 1 shows schematically the roles and its relevance at different moments in the horizon of a concession contract.

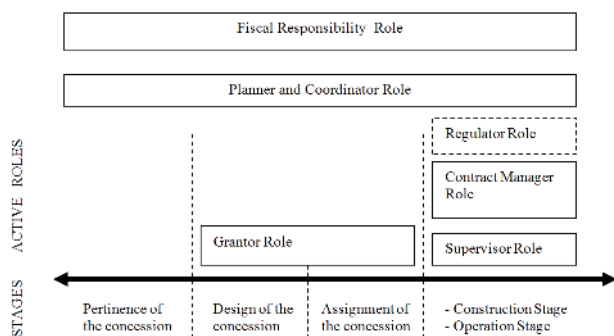


Figure 1: Roles at different stages of a concession

Once the roles have been defined, the institutional design problem can be seen as a partition of the set of roles, where the institutions that bear the responsibilities of the different roles are defined. This process is illustrated in Figure 2.

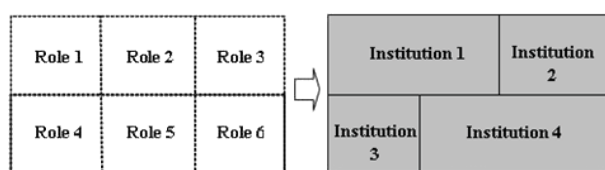


Figure 2: Institutional Design Problem: Assigning Roles

The process of role assignment is not without restrictions. Particularly, two additional aspects must be taken into account: the incentives associated with the context variables (market conditions), and the potential tradeoff between legal security and flexibility. In the case of the former, examples are the level of competition, the type of activity and the complexity of the sector where the concession is to be granted. These variables are critical to determine whether the roles are or not in conflict. Regarding the tradeoff between legal security and flexibility, in the latter, the point is the necessity to achieve a balance between the requirements of a strict legal framework and the flexibility a business model needs to work properly. The importance of both elements relies in that they can have a significant impact in the way the institutional framework interacts with the development of a concession, as a consequence of the case-by-case nature of the institutional design analysis.

III. Applying the Institutional Model: A Diagnostic of Infrastructure, Water and Ports Concessions in Chile.

As Harrison et al. (2012) show, the approach previously described is useful for the analysis of the institutional aspects of a concession process. They apply the methodology to analyze concessions in three different sectors of the Chilean economy: water distribution, ports and public works. In the first one, they conclude that there is a well developed regulatory framework and institutional design to deal with the concessionaire, given that the service can be described as a local natural monopoly. However, they recommend that the granting and contracting roles should be given to a specialized agency. In the second one, their diagnosis show that most of the institutional roles have been assumed by the same actor, the port authority. With several of those roles in conflict, it is not surprising that the authority have had to confront many problems where its decisions seem not consistent. As the authors pointed out, a wrong implicit diagnosis of the level of competition in the industry (market conditions) could have led to assign multiple and conflicting tasks to port authorities. The recommendations of Harrison et al. (2012) include the creation of a Superintendence to play the regulatory role; a separation of the supervisor role, because port corporations are to some extent partners of the concessionaire (their profits are related); and, as in the water sector, to give the grantor and contract manager roles to a specialized actor. Finally, in the public works sector they conclude that a Superintendence should at least assume the supervisor and regulator roles, because most of the roles have been assumed by the Ministry of Public Works, with the corresponding risk of being captured by counterparts. Additionally, they recommend that a Concession Agency should be created to gather the accumulated knowledge gained in numerous concessions process that MOP handles.

In sum, a proper institutional design is one where all the roles are assigned avoiding conflict between them and taking into consideration the context variables and the tradeoff between a strict legal framework and the necessary flexibility a business model requires. Most likely, specific characteristics of the situation under analysis will largely determine the sufficiency of the institutional framework being designed.

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Highway networks and PPPs: An alternative to traditional public provision?

E. Engel*, R. Fischer**, A. Galetovic***

PPP's can be valuable contributors to the transport infrastructure. In this paper, we describe the main risks and benefits of PPPs, specially in the highway sector, the sector most naturally suited to PPPs.

I. Introduction

Highway networks are essential to transportation of goods and people in modern economies. In developed countries, the networks are mature but often require upgrading or increased capacity; whereas in developing countries this infrastructure is usually still in its growth stage, requiring additional trunk roads apart from the need for increased capacity and improved standards. In both sets of countries, though for different reasons –perceived budgetary constraints in the first case, the fear of the size of the needed investment to increase the size of the network in the second– governments have looked at alternatives to develop their transportation networks.

These perceived budgetary constraints have created an interest on alternative sources of financing improvements or expansions of highway networks. One possibility would be to sell outright new highways, but governments have preferred –for political, image and long-range planning purposes– the option of time-limited contracts with private firms in which the infrastructure project eventually returns to government ownership.

Public Private Partnerships (PPP's) represent an alternative in which transfer of the highway is for a limited time, and at the end of the contract, the infrastructure project returns to government control. The difference between PPP's and the traditional approach to highway (or other infrastructure finance) is that a PPP integrates (or bundles) construction and service provision into a single contract. During this long term contract, the private firm operates and controls the highway, in exchange for user fee revenue, government transfers or a combination of both sources of revenue. The tight bundling of construc-

tion and service provision implies that the private partner has an interest in reducing costs –including maintenance and operations– over the lifetime of the contract.

In this short note we show that the financial motivation (saving public funds) for PPP's is erroneous (see Engel, Fischer, and Galetovic [2013a] for the formal arguments), and that the advantages of PPP's are to be found in increased efficiency and maintenance¹.

However, we point out that these advantages are coupled to serious risks that may lead to adverse results in a PPP program. The main problems are renegotiations and its counterpart, the inflexibility of contracts, as well as the use of inappropriate contractual forms. These problems are compounded by political economy issues, because PPP's add long lived contractual relations with the public sector to the already existing problems in public provision of infrastructure. [Williamson, 1976]

In the following sections we describe the importance of PPP's around the world, the irrelevance of the finance argument for PPP's, the problems of renegotiation and flexibility, and the political economy problems associated to PPP's.

II. Use of PPP's

PPP's were common in several European countries, specially the UK and Portugal, from the 1990's to 2008, until activity fell as a consequence of the financial crisis (figure 1, left). Similarly, investment in the developing

¹ Even though we do not examine them, PPP's have been used for other infrastructure such as schools, jails, hospitals, airports and seaports. Other types of infrastructure, such as telecoms, electric sector, water and sanitation, etc., can be provided through regulated utilities or by competing private firms, as in the case of mobile communication services.

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Ronald Fischer and Alexander Galetovic wish to thank the support of the Instituto Sistemas Complejos de Ingeniería. Most points made in this review appear in Engel, Fischer, and Galetovic [2013b]. Due to space constraints, this note does not cover the important topics of: project selection, the infrastructure maintenance benefits of PPP's, and the institutional design of the PPP authority.

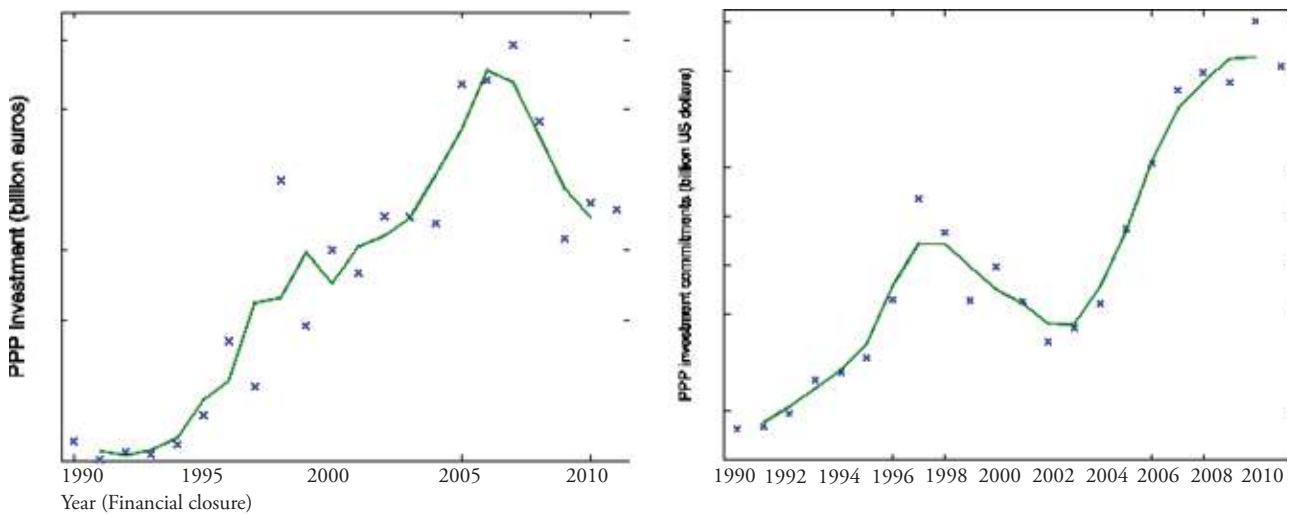


Figure 1: Investment in PPPs: Europe and in Low-and Middle Income Countries 1990-2011

countries grew quickly until the Asian crisis of 1998, but after a short hiatus, has been growing at very fast rates (Engel et al. [2013b]), reaching more than US\$ 150 billion in 2008, see figure 1, right.

The data reflect a massive use of PPPs in many countries, but with much variation among countries. For example, the US, with an economy that is many times larger than Canada, has similar levels of transportation PPPs. In Europe, the leading users have been the UK and Portugal. Investment in PPPs during the period 2001-2006 represented 32.5% and 23% of total public investment in the UK and Portugal, respectively [Blanc-Brude, Goldsmith, and Vålilä, 2007]. In Latin America, the main users have been Argentina, Brazil, Chile, Colombia, Mexico and Peru, mainly on highways.

The results have not been homogeneous: in Mexico, Colombia and Portugal, the projects have been more expensive than governments expected. In Europe, Portugal and Spain are hobbled by the large obligations associated to PPPs. The UK regrets the inability to modify the terms of PFI contracts at a time when fiscal resources are tight². On the other hand, Chile has been successful in using PPPs to renew its outdated highway infrastructure. However, now it is facing congestion in PPP projects awarded more than ten years ago, and the prospect of expensive contract renegotiations to increase capacity. Finally, Argentina expropriated its PPPs.

2 See John Kay, "Public projects obscured by private finance", Financial Times, February 15, 2011.

III. Finance³

Originally, PPPs appealed to governments as a source of increased investment in public works without an impact on the public balance sheet of the government. Some governments managed to improve their highway systems in a short period, without facing the increase in officially recognized public debt. However, believing PPPs should not be considered as debt can be a costly conceptual mistake.

The UK has discovered that the 717 projects in the PFI Initiative, including many schools and hospitals, will require a fiscal outlay of £9-10 billion annually until 2030 to pay capital costs⁴. Portugal, which invested heavily in a highway system without a cost-benefit analysis of the projects, must divert almost 1% of its GDP to pay for its PPP commitments until 2015, and more than €1.6 Billion annually until 2025, just when its public finances are stretched⁵.

A more favourable case is Chile, which upgraded its main highways in the decade 1995-2005. A prudent management of its obligations means that its maximum possible exposure is around 4% of GDP, and a contingent analysis shows that its expected value is only 0.2% of GDP⁶.

Even in this case, the financial benefits of PPPs are small or non-existent. To see this, consider that, as men-

3 For a formal treatment, see Engel, Fischer, and Galetovic [2013a].

4 HM Treasury: UK Private Finance Initiative Projects: Summary data as at March 2012.

5 Ministério Das Finanças, Direcção-Geral do Tesouro e Finanças, Parcerias Público-Privadas e Concessões Relatório 2011, Agosto 2011.

6 Ministerio de Hacienda, Dirección de Presupuesto, Informe de Pasivos Contingentes 2011, December 2011.

tioned above, there are three ways to reward the PPP investor: either through capital payments over time, or with user fees, or by a combination of these two. In the first case, the capital payments are public debt under another name. In the second case, these user fees could have been collected by the government, if it had developed the project, so the lack of outlays is balanced by foregone revenue.

Being slightly subtler, it is possible to find a public finance advantage for PPPs under some conditions. Assume the government is inefficient in making transfers from tax revenues to pay for services (due to corruption or excessive bureaucracy). Then it may be more convenient that a private firm collect tolls as compensation without the intervention of the government. Alternatively, it may be that the government is sensitive to populist complaints about tolls, while a private firm will be less willing to accept reductions in revenue to appease voters. In the US, when the City of Chicago owned the Chicago Skyway, it had to be ordered by the Courts to raise tolls in order to pay bondholders. Even when a toll road is leased, however, the government may intervene to keep low tolls. In the leased Indiana Toll Road, the state government intervened to freeze tolls, but it had to pay compensation to the private firm, and this tends to discourage populist interventions.

IV. Contract renegotiation

In any long term contract there will be changes in conditions that eventually require the adjustment of the contract. For example, a highway may need to be expanded when there is an unforeseen expansion in demand and congestion becomes excessive. While many future conditions can be included in the original contract, it is impossible to foresee all possible future outcomes, so there are always cases in which the contract needs to be modified.

Now, in general, the initial award of the PPP is made under competitive conditions, so rents for the private party are dissipated by competition. As Williamson [1976] observed, when a long term contract is signed, the initial competitive situation becomes a bilateral monopoly, in which rents reappear when it is necessary to adapt the contract to new conditions. The number of contract renegotiations is very high, as Guasch [2004] has documented in a study of Latin American PPP projects previous to the year 2000. The fiscal cost of renegotiations as a percentage of initial investment value reached 20.3% for Chile and 26.5% for Peru⁷.

These renegotiations can corrupt the political system, since the outcome is decided by the relative bargaining

capability of the parties and there is no obvious standard to guide the results. While all infrastructure contracts are subject to renegotiations, PPPs provide more opportunities to do so, since they are long lived.

Renegotiations can also be used to modify a project during construction so as to satisfy interest groups or for political considerations. A particularly galling case occurred in Chile where the contract for a large urban PPP (Américo Vespucio Sur) was increased after adjudication to include a large mains collector for rainwater after winter flooding.

In addition, the fact that rents can be obtained in the renegotiation process means that firms that are specially good at negotiation have an advantage in a competitive bidding process. They can bid low for the project, being confident in their ability to compensate their low bid by future renegotiations. Since there is no reason to believe that firms that have this ability are the best firms in the technical/engineering sense, and may discourage participation of technically able firms that do not take advantage of renegotiations. One remedy is to have good institutions. In the UK, renegotiations during construction have been limited: only 35% of the projects had increases in their contracted price, and the increases were relatively small⁸.

Thus the problem lies in devising a mechanism for fair renegotiations of PPP contracts. A good approach is when the government is allowed to repurchase the contract at a fair price. Then, whenever important and unforeseen modifications of the contract are needed (a major change in the highway standards, for example), the government can buy back the PPP contract, and initiate a new PPP process under the changed rules. The question is how to determine this fair price. In a PPP contract with no user fees, where the private party is remunerated by government payments (as in the case of the UK's PFI), the fair price corresponds to the discounted value of the remaining periodic payments stipulated in the contract, minus maintenance costs. The private discount rate to use should be set in the original contract and resemble the rate used by the private sector.

IV. a - Present Value of Revenue approach⁹

When the remuneration is obtained from user fees, i.e., highway tolls, the fair value corresponds to the discounted value of future user fee revenues, net of costs. The difficulty is that this value depends on the future growth in demand, whose value is uncertain, making it hard to reach an agreement on a fair value. This is a reason to use

⁷ Eduardo Bitrán, personal communication. In Colombia, the fiscal cost to initial investment ratio is 223%.

⁸ National Audit Office, Performance of PFI Construction, October 2009, UK.

⁹ Engel, Fischer, and Galetovic [2001].

the Present Value of Revenue (PVR) to assign PPPs. The firm requests the discounted value of user fee revenues that it requires to build, operate and provide maintenance for the project, using a predetermined discount rate as above. Thus, the public sector can always buy back the project at a value given by the difference between the contracted PVR and the discounted user fees that have been collected. The resources required to buy out the original franchise holder can be obtained when offering the project as a PPP, including the modifications.

In addition, the PVR approach has the advantage of reducing the risk to the private party, since the uncertainty associated to demand is much lower. In the case of highways there is little that the private party can do to affect demand for the highway, so demand risk does not provide incentives for efficiency. Risk should be assigned to the party that can act to reduce it or, failing this, to the party that can bear it best Irwin [2007]. Since revenue risk affects a large fraction of the revenues of the concessionaire, but a small fraction of users income, it should be assigned to them. The decreased risk in user fee revenue associated to PVR leads to reductions in the risk premium required by bidders. In Engel et al. [2001] we estimate a reduction of 30% in the cost of a PPP highway.

V. Conclusions

PPPs can be valuable contributors to the transport infrastructure. We describe the main risks and benefits of PPPs, specially in the highway sector, the sector most naturally suited to PPPs. The main benefits of PPPs lie in the improved maintenance and the reduction in life cycle costs of highways. These benefits must be balanced against

the risks attached to PPPs. These include unrecognized fiscal debt, inappropriate contracts, costly renegotiations, and lack of flexibility in response to exogenous changes. Embarking in a PPP program should not be taken lightly, and requires careful attention to institutional design and legislation.

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Incentives for new investments in concessions: proposals from the Italian Seaports outlook

Francescalberto De Bari*, Riccardo Gabriele Di Meglio**

This article deals with concessions in seaports as key elements to enhance port investments. The Italian experience is regarded as case study to highlight the main hindrances in involving private funding.

I. Introduction

During last decades, seaports in many countries of the world have experienced a massive swing to private involvement both in managing and building of infrastructures. However, this involvement, which was achieved through concessions or through Public Private Partnerships (PPPs), has not yet led to a clear subdivision of liabilities and responsibilities between the two parties involved: the private operator on one side and the regulatory body on the other. In the European Union the Port Authority (PA) usually acts as a public body exercising both regulatory and landlord functions (Verhoeven 2010), but it does not take part in the operations within port boundaries. Operating infrastructures, such as berths and terminals, and providing port services is devolved to private undertakings that are granted licenses or concessions, the latter occurring when the private operator is granted with the exclusive right to manage port land.

This brief introduction outlines the quite complex framework in which the fully privatized assets (as port equipment and superstructure) coexist along with totally public infrastructures (generally the basic and operational infrastructure, World Bank 2007). Meanwhile, the demand of greater private commitment to finance port infrastructure, even the basic one, has risen. This development has happened partially because of strict public balances but also because private participation is assumed to improve effectiveness and efficiency in port operation and management (Cullinane and Song, 2002). Therefore, we need to characterize port assets, so that we can firstly answer the question on what kind of features and related property rights are associated with them. Secondly, we will give a brief explanation of the most relevant regulatory issues arising from these assets characterization, outlining the similar issues existing in other network industries.

In fact, within seaports there are several assets which have typical features of pure public goods, such as the breakwaters or- obviously- the lighthouse, as their use is marked by neither rivalry nor exclusion. Since they are common - user facilities, their funding by the State does not involve State aid rules, as the public intervention does not produce benefit only to a specific category of port

users (or only one port user). Thus it can be seen as general measure (Farantouris, 2009).

Private assets are in this sense all assets whose benefits are not shared by the port community, regardless they are effectively privately owned assets (such as, in Landlord ports, the equipment and superstructure). However, some of them are necessary to port operations and play a crucial role in port economics: these assets are the essential facilities, in the sense that they are not duplicable and are indispensable in providing services in down-stream markets.

The essential facility doctrine (Efd) has played a relevant role in the debate on network industries, marked by the existence of bottle-neck facilities operated and owned by an enterprise, which competes with other firms in down-stream markets. Significantly, the European Commission referred to Efd for the first time in the port field (Holyhead Decision, 94/19/EC).

For the purposes of this article, the presence of essential facilities in seaports is relevant as these facilities, generally owned by the State (like in Italy) or by the PA itself, are leased or granted in concession to port operators. In particular, within ports, terminals are essential facilities, and as a consequence, they are not shared during the concession period by other undertakers, raising a great attention on regulation of the competition for the market (Winkelmanns et al., 2002). Granting concessions represents, however, for many PAs, only a matter of exerting real property rights, without fully considering the implication on the port market competition and port development in general. This consideration should advise PAs to develop, on the contrary, a concession policy: by this term we mean a broader approach to concessions, which involves port planning, port competition issues and port development. Terminal awarding procedures are, in this view, only a part of this policy. Concessions represent the key pillar to port development, as the improvement of facilities can only be achieved through the interaction between private investor and the PAs. This interaction involves private operation and management of port assets and PAs planning of land allocation and uses, in addition to basic infrastructure construction and maintenance (at least in Landlord ports like Italian ports).

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In the following we shall discuss how this interaction should be and how it takes place in Italian seaports.

II. Key features of concession policy to promote private investments

Seaports are places where both public and private interests meet. A concession agreement should define to what extent the private operator is responsible for the completion, by the scheduled time, of the investments planned; at the same time, such agreement sets the main obligations of the PA.

During the 1980s and the 1990s, many governments tried to improve port productivity by contracting out port operations, but overall port development has proven to be a more difficult task. Private management has surely made port operations more adherent to market requirements (World Bank 2007) but, at the same time, concessions were not seen as a tool to implement port facilities and enlarge the port services market. Thus, concessionaires, who gained the access to port market, had little interest in expanding capacity and committing to further investments. Often, the principal investments registered in this sector were linked to projects of carriers (especially in the container shipping industry) interested in enlarging their global network. Consequently, the infrastructures within many ports (as it happens in Italy) date back to post-war years or even before, and the shape of several ports has little changed since then.

We believe that concessions, in order to enhance port development, should not be out of context agreements, but they should be fitted firmly into port planning and into a coherent division of public and private competencies, including funding of port assets. Since the concessionaire faces the demand and operational risks, the foreseeable competition in the port service market should allow the investor to recover its investments. Port master plans should consider the conditions of future port service market competition, through land allocation, with the broader goal of expanding or improving capacity. The uncertainty for the potential investor is significantly reduced if the above mentioned conditions are known in advance. The investors should also be aware in advance of the public commitment related to the development of facilities and of the stakeholders involvement (not only port operators).

Thus, in our view, the proper solution relies mainly on the effectiveness of port planning, namely the funding program of port infrastructures in accordance with a port master plan, which takes into account the different needs of cargos handled in a port. By effectiveness we mean a substantial subdivision of port areas dedicated to each cargo category, with more attention and land resources devoted to those traffic categories showing a greater potential growth. In relation to port expansion plans, one point often underestimated by PAs, is the need of early stakeholder involvement: among the stakeholders we should include not only the most obvious ones, such as the pure stevedore companies or carriers, but also other undertakers involved in the transport chain, like railway and logistics operators. Ports, as nodes of broader transport chains, may fail in their interconnections with hinterland, thus undermining the potential growth of extensive port plans.

The concession policy comes from effective port

planning, that would be the first task of the landlord functions embodied by a PA. Terminals should be awarded in concession when there is no pending conditions that could affect the course of the contract's provisions: these conditions could be the transferring of other cargo categories in the terminal area, the appearance of other competitors in the same port, who were granted concessions for handling other types of cargos, and so on. The great variance of many concession agreements, such as the restriction or the enlargement of granted areas, is rather the result of poor port planning, which ultimately forces PAs to make frequent changes in the allocation of port land. These changes should be not confused with a greater flexibility in port planning, which would be related to the adaptation of port projects to changeable economic conditions and technical and legal requirements (Taneja, Ligteringen and Walker, 2012).

In this framework, PAs can successfully promote private investments, provided that long term agreements help both party's commitment and port planning is mutually agreed with major stakeholders. Greater and deeper involvement of major stakeholder is crucial also for the intra-port competition and particularly for the development of hardly-duplicable facilities. Discussing the Italian seaports case we will find some critical issues, which have undermined the development of effective concession planning and port development.

III. Italian experiences and perspectives

Italian ports are state owned infrastructures, whose land belongs consequently to the State domain. Up to 1994, State both managed and operated port land, through public economic bodies, thus being responsible for the management of port land; after that date, the port reform introduced by Law 84/1994 has split the "static" management, that is the management of state domain within seaports, from the "dynamic" management, that is the management of port land as business activity, devolved to private operators through concession agreements (Carbone and Munari 2006). The one-time establishment of Port authorities in main Italian seaports was aimed at enforcing port planning at local level and effectiveness of concession policy. However, after some twenty years, there are many signs that this has not yet been fully achieved because:

1) there is evidence that the concession policy broadly varies among seaports, thus resulting in wide difference of conditions such as contract length, concession fees and overall procedures to award terminals (Parola, Tei and Ferrari 2012). This is the consequence of weak national regulation on awarding concessions, and a lack of strong and consistent European framework;

2) there is great uncertainty about financial resources for port development, i.e. there is not an adequate and trustworthy national budgetary planning;

3) moreover, overall resources for national port system are shared among too many port authorities, without taking into account objective criteria of allocation, such as port relevance and the PAs investments in port assets (Italian Ministry of Infrastructure and Transport, report on Port authorities activity, 2010);

4) PAs tend to emphasize project dimension, in order to receive as much public funds as possible. This leads to misallocation of resources to projects with little chance to

be completed, at least in a reasonable time, whereas more effective, smaller projects are left with scarce funds. This happens in a time when the public finances crisis should lead to major private involvement in project funding. Such a goal could only be achieved with projects which prove to be financially feasible and do not show too many pending risks or high level of uncertainty.

On the contrary ports will unlikely raise more funds if their projects are not developed in accordance with greater stakeholder involvement since the very beginning of the project, i.e. the feasibility study.

Concessions should be awarded with broadest publicity and transparent tender procedures, which include evaluation of various aspects of bids in accordance to port authority's goals. There is little research about criteria for selecting the bidder, partially due to scarce evidence of tenders from Italian seaports. In most cases PA negotiates directly with potential concessionaire, whereas it is not fully exploited the interest of other potential bidders. Although it could be seen as an attempt to favor local community interests, it eventually penalizes local undertakers by impeding the analysis on profitability and value of the concession contract. Major private involvement is based upon early commitment in developing a strategy that can emphasize the return on investment project. Generally speaking, this pattern should be followed by port planning: the project should rely on the core competences developed by the port operators, rather than (only) adding more capacity.

Apart from the tendering procedures for awarding terminal in concessions, one critical aspect is represented by the absence of consistency between port planning and concession policy. After 1994, port land was granted in concession without developing plans which could have included concessions for the implementation of port projects. Once this phase came to end, with all available port land granted in concession, the activities carried on by the concessionaire were not linked to development programs. The implementation of development programs was impeded also by lack of port resources for such plans.

In fact, most tax revenues generated by Italian ports are still turned over to central government, even if recent reform introduced a fund, up to € 70 million, by collecting one per cent of total VAT levied in Italian ports, in order to finance port development projects (Law Decree 22 June 2012). The government finances with scarce resources several ports of relevance, and the funds vary greatly year by year for each port. Consequently, the Italian port managing bodies have more incentive to try to be granted these funds and plan the development of single projects, whose completion is often delayed. These single projects however do not foster effectively port development, since they are not bounded with a wider port program, and so do not create basic conditions for sustainable traffic improvement. In other words, the impossibility for PAs to constitute their own funding is major drawback to long term and more comprehensive development, causing the selection of scattered project which bring little overall result.

IV. Conclusions

This article was aimed at pointing out the opportunities underlining a concession policy not only focused on awarding phase but also related to a wider program of works and activities led by the Port authority.

The present situation in Italy, however, does not help much in giving incentives to early stakeholder involvement in order to make effective and substantial port planning and rationalization of funds.

We rather think that concession policy can represent the beginning of a new phase for port development because, along with PPPs, it can address private funds to implement port projects that are able to be achieved in short time and are functional to effectively improve port operations. In this sense, the task of a PA should include the coordination of these single port projects, and their timing, as overall port development stems from private commitment under public governance.

This co-ordination task can be also viewed in the port governance perspective. As showed in Verhoeven (2010), beyond the three traditional functions of a PA, this public body can act as community manager, and promote and defend the interests of port stakeholders. The enforcement of Trans-European Transport Network (TEN-T) corridors, including Motorways of the Sea (Proposal of Regulation 650/2011) can result in stretching of PAs role towards logistic chains, both on land side and sea side. Consequently, if a PA manages to use effectively governance tools such as concessions (Notteboom 2007), there can be no geographical limitation or capital restriction to involve private's participation in port development.

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About the insertion of performance clauses in the concession agreements

Ferrari Claudio*, Tei Alessio**

Current paper highlights possible criticalities of the concession policy introducing the possible effects of performance clauses aiming at sharing goals between the concessionaire and the public authority.

I. Introduction

Transport infrastructures for their own nature and economic characteristics represent a network industry and they are usually managed in a monopolistic (or quasi monopolistic) manner, where competition is mainly restricted to enter the market (instead of a competition in the market). When infrastructures are not managed by a public authority, concession contracts regulate relationships between a private operator and a public entity. Examples of this kind of organisation can be found in several economic sectors, such as motorways, railways and seaport terminals (Kerf et al., 1998).

The main aim of this article is to highlight the benefits deriving from the insertion of performance clauses in the concession contracts binding the goals of both a private concessionaire and a public authority regulating the management of network infrastructures.

In fact, in several countries, public authorities often use the concession contract to manage different kind of infrastructures (e.g. highways, ports) giving the duty to operate the public goods to private companies, using an awarding process.

Moreover, infrastructures contribute to the achievement of social objectives as well as to spur the regional competitiveness. In this situation, the public authority (or agency) has to set up an awarding process able to tackle a twofold goal: the search for public goals (e.g. regional accessibility, preserve the environment, enlarge market areas, etc.) without any prejudice towards a fair remuneration of private capital. Thus the main issue of concession contracts is represented by a fine tuning between the public goals and the private interests.

This paper is organised as follows. After this brief introduction, Section 2 discusses the main criticalities related to the concession tool and the main characteristics of this policy instrument. Section 3 highlights the possible trade-offs and how they may be tackled through the concession policy, while Section 4 addresses some conclusions and hints for further researches.

II. A general framework

Concessions are administrative tools used by public authorities to regulate private operators which are managing a public area (or an infrastructure) in order to

achieve both public and private goals. Concessions have been deeply studied in the last few years (e.g. Guasch, 2004; Fayard, 2005; Parola et al., 2012), since they have been widely used when the public authority assigns to a private operator some of its duties and also in order to enhance Private-Public Partnerships (PPPs) in several economic sectors (e.g. Kerf et al., 1998, Guasch, 2004; Arionites et al., 2010). Concerning network economies, starting from the '80s concession agreements have been introduced in order to administrate transport infrastructures (e.g. ports, motorways) and attempting to attract new capitals with the final aim of enhancing the regional accessibility. Recently, concessions found a new role as possible instruments capable of binding public and private interests (e.g. Ferrari et al., 2011) in order to force the private sector to achieve also public goals in a long run perspective.

Recent literature (e.g. Baltazar and Brooks, 2001; Verhoeven, 2011) highlight that concessions differ among the countries in which they are applied, and even among different sectors in the same country. On the one hand, in the European port sector each country has slight differences in the application of the concession and of its definition. Some of the differences are connected to the right and duties of the parties and to the regulation applied (e.g. the renewal system or the analogies of the concession to a normal private contract). On the other hand, some countries register differences among the concessions used in different sectors, within their own legislation. An example of this case can be found comparing the Italian port and motorway industries: in both sectors concessions are used to regulate potential monopolies, but aiming to achieve different goals and so structuring several clauses in different ways. For instance, motorway concessions are binding the motorway fares to a "price cap" rule while terminal tariffs are chosen by the terminal operator without a proper rule or any interaction with the concession agreement. Despite the differences some common aspects can be underlined and some common elements can be found, mainly connected to the potential achievement of specific goals.

Concessions are usually used in two cases: to regulate a market characterized by limited competition or to attract private investments in order to partly substitute public funds (e.g. in Public Private Investments). Moreover

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the concession agreement gives two distinct rights: the right to establish an economic activity and the right to manage a specific infrastructure as a “monopolist”. This issue is normally connected to a public auction in which the authority chooses the private operator and during this process, afterwards there is a bargaining stage in which they tune the rights and duties scheme for the concession duration; even if the main characteristics of the concession contract are defined (at least in their general terms) in advance of the auction.

An important point defined by the concession contract relates to the tariff of the service applied to the users and the concession fee that the concessionaire has to pay to the public body in charge to administrate the infrastructure or the area given in concession. While the concession fee is normally related to the characteristics of the infrastructure at the beginning of the concession period and to the promised investments, tariffs are normally free to vary. In some cases (e.g. the motorways in Italy or in France, when they are subject to a toll) tariffs vary following a price cap regulation. Nevertheless, a lack of the dynamicity can be generally highlighted in the concession fee regulation – which often makes the concession fee similar to a normal rent – while the tariffs can be hardly regulated mainly due to the incompleteness of contracts (due to information asymmetry) and the costs of proper controls.

Several researches (as those concerning the port sector made by Verhoeven, 2011) highlight two connected major points that belong to all concession agreements: the duration of the contract and the renewal process. In several economic sectors the estimation of the duration can be a really important aspect mainly due to the rapid changes occurring in the market. Thus the concession duration should be decided in accordance with rapid market modifications (e.g. several container port terminals have been awarded for periods longer than 30 years while the container market itself has less the 50 years). The difficulties connected to these two aspects are mainly due to strict relation between the exclusivity of the management of an infrastructure (e.g. a motorway), the needed investments – and so their amortizations – and the information asymmetry in the related costs. This issue can also be connected to the fee and the tariffs evaluation processes, making a proper estimation of a right duration extremely difficult, and often also affecting the renewal process and the sustainability of the applied tariffs, as highlighted in some cases (e.g. Zhang, 2009).

The four main points briefly discussed above can be all faced together during the awarding process, mainly through a more competitive bidding phase and the insertion of performance clauses (e.g. Kerf et al., 1998; Theys and Notteboom, 2010). The necessity to improve the management of these aspects is mainly due to the different perspective that a private operator and a public authority could have in order to achieve their own goals. In fact, public authorities have to follow not only economic and financial goals (e.g. to enhance the efficiency of the transport network) but also social ones (e.g. environmental impact of the infrastructures; social accessibility to the market) that at times might be in contrast with the private operator goals, which in some cases tends to behave as a monopolist or tries to reduce its own costs. In this situation the possibility for a regulator to use clauses to bind the goals of the two concession parties represents a solution

for possible conflicts of objectives and to avoid potential damages due to the information asymmetries.

III. Performance clauses

Performance clauses are often used to achieve minimum quantitative goals in different kind of contracts. Normally they represent a minimum amount of output or level of promised savings, in order to reach a certain prize or discount. In the concession agreements, the proposed clauses should normally be connected to the achievement of qualitative and quantitative results, such as the achievement of a certain level of emissions, a certain traffic value or a certain amount of investments, in order to have the possibility of raising the tariffs (e.g. motorways) or to have discounts in the concession fee (as in some port terminals). On the contrary, if the concessionaire doesn't reach the promised result, it could be either penalised or not, depending on the agreement. Generally the insertion of these clauses in the concession contracts is influenced by the regulatory captures and the absence of dynamic consideration when these clauses are calculated.

Examples of the limits in the performance clauses can be found both in the motorway and in the port sector. As far as the first one is concerned, accidents are normally included in the variables considered for tariff rising, even if this variable has not a strong (direct) correlation with the concessionary activity. As for the second, the traffic value is accounted in its absolute value without any correlation to the market trend. Moreover when there is an attempt to include dynamic elements in the regulation, as in the case of the price cap applied to the motorways, the regulation costs appear so high that several limitations in the evaluation method can be registered.

Even if each public authority should be aware of the critical issues highlighted above, a correct use of the clauses seems to be the best instrument in order to tackle possible contrasts between the concessionaire and the public authority. In order to achieve its own final goal the clauses should respect some general principle: first of all, they should be dynamic and fit with the market structure. Moreover clauses should take into account the duration issue and should be structured in order to incentivise the private operators to spread information (thus avoiding possible distortions).

An example could be found in the port industry. In several countries possible discounts of concession fees are connected to traffic volume but in some of the main ports (e.g. Antwerp) the discount is not based on pure traffic performance because of possible fluctuations, as shown by the effects of the economic crisis in the last years. Alternatively, a performance clause solution is represented by the insertion of the market share instead of the simple traffic variable (Ferrari et al., 2012) thus reducing the effect of economic shocks and allowing a dynamism of the incentives. Similar clauses could regard the cargo modal split or the environmental emissions, comparing performances with the main competitor statistics.

The introduction of clauses should contribute to reduce possible negative impacts due to the long duration of concession contracts and the possible negative effects of the rapid market changes. Therefore dynamic elements could easily give to the private operator incentives that automatically change in accordance with the market trend, helping the concessionaire during the downturn

period. Similarly, several dynamic instruments could be introduced in order to have dynamic fees based on either quantitative as well as qualitative aspects, contributing to mitigate the effects of the information asymmetries.

IV. Conclusion

Concessions are a powerful instrument to regulate network infrastructures; in fact, they have been intensively used in the last few years in order to regulate markets (after their liberalisation/privatisation) and to attract private investors in several economic sectors. Together with the great opportunities given by this tool, some shortcomings emerged from the practical application of the concession contracts: they are mainly related to the duration period, the definition of the concession fee and the controlling power of the results achieved by the concessionaire. This article has briefly discussed how the introduction of dynamic clauses could partially mitigate these critical issues binding the objectives of grantors and concessionaires also contributing in mitigating the distortion due to the information incompleteness. In this respect, an agreement in which the rights and duties of both sides may be tuned in accordance with the market cycle, and in a transparent manner, could increase the attractiveness of the transport sector and reduce the entry barriers with positive effects on its efficiency.

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Conference on Corporate Governance in Network Industries 30./31. October 2013, Vienna Austria

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Network industries establish a highly interesting research area, as business operations generally need to account for both competition and regulation. Adequate performance is only reached by balancing economic efficiency and reasonable profits with public interests and investment needs. Especially the relationship between liberalization and regulation of monopolies dealing with public needs creates multi-disciplinary research questions related to corporate governance. In particular, market-orientated corporate governance mechanisms might not perfectly work in a partly monopolistic environment.

The conference intends to bring together academics, professionals, and representatives of governments and operators. The aim is to address key issues in network industries arising from the intersection of regulation and competition on the one hand and corporate governance on the other hand.

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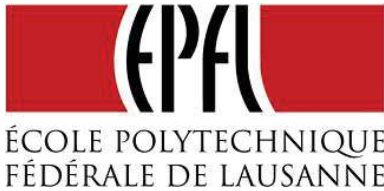
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