## Cities for our grandchildren: PPP projects undertaken with responsibility towards future generations

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### Abstract

PPP‐style cooperation between public and private partners is becoming more popular in Poland. Nevertheless, the issue of intergenerational responsibility for its effects is not taken into consideration while assessing outcomes and drawbacks of PPP contracts. The author examines several Polish PPP undertakings in order to delineate the most important components of intergenerational responsibility.

The scope of intergenerational responsibility may be separated into financial and non-financial factors. It appears that some projects are more intergenerationally-neutral as the others. Those that favour future generations are either addressed to the young or paid back from actual public budgets.

## *Keywords: public-private partnerships, public investments, intergenerational responsibility, infrastructure gap, Poland*

## 1. Introduction

Over fifty years after the initial publication of Jane Jacob's masterpiece, *The Death and Life of Great American Cities*, Polish cities face similar development dilemmas: how to make city streets friendly and safe, what are the relations between a city and its neighbourhoods, what are the best ways of reversing decay, etc.

Jane Jacobs pointed out that humanistic management of cities might be a solution for those dilemmas as it supports social and economic vitality in cities.

Polish local authorities have to manage cities while dealing with numerous obstacles, including budgetary constraints, land owners’ opposition to planning restrictions, the unwanted legacy of socialism, and inefficient laws concerning spatial planning. However, a minority of local Polish leaders is aware of those multidimensional development dilemmas.

Recently, public-private partnerships have been perceived by some Polish mayors and other political and administrative leaders as a useful tool for overcoming financial and organisational problems. Unfortunately, PPP projects undertaken in Poland so far seem to be only aimed at addressing short-term financial ills: the main motivation is to keep the project neutral for the public budget, according to the Eurostat rules.

Additional aspects, such as the intergenerational responsibility for PPP projects – a key part of humanistic management – are ignored. Nonetheless, as follows from the literature review in section 2, this issue is especially important with reference to PPP projects that require long-term obligations of the public sector to its private partner. Higher capital costs in the case of private finance, especially during financial crises, present crucial challenges for future generations, including budgetary challenges (i.e., higher taxes and less total budget available), pollution, and inappropriate use of land.

The goal of the detailed analysis in this paper it is to examine the idea of intergenerational justice in PPP projects, and to assess some of Polish PPP undertakings with respect to this issue.

The rest of the paper is organised as follows: Section 2 deals with a literature review, Section 3 presents some peculiarities regarding Polish infrastructure needs, and Section 4 presents Polish PPP case studies. Final remarks close the paper in Section 5.

## 2. Literature review: attitudes towards PPP liabilities

Before reviewing the literature in the field let us present a short example based on Polish experience. Then we can examine the case while discussing justice theories.

The authorities of Solec-Zdrój (see the case study below for more detailed description of this project) decided to cooperate with a private partner in the form of PPP in order to provide a complex of mineral swimming pools for the local society and tourists. The project is co-financed by the EU funds, central government funds and private money. In this case the local government borrowed money from the private partner with the aim to use the unique mineral water springs. The feasibility study revealed that PPP was the only available option as the local budget faced some constraints. The private money is paid back within PPP over the long-term and the private partner has a unique right to set the prices without any public control. Future generations of Solec-Zdrój would probably have to pay higher taxes as a result of this decision, despite not having been consulted about their preferences concerning this project. Moreover, the mineral water springs are likely to be depleted before future generation might be able to use them. This example shows that perhaps we have some obligations to take account of the rights of people who will be alive in the future when we make our decisions today. That question leads us to three influential theories of justice developed to-date. Each theory provides us with a different approach as regards the right of a current government to undertake any long-term commitments affecting future generations.

John Stuart Mill proposed the concept of utilitarianism with "utility" as a main factor appraising the justice. He argued that people have both negative and positive rights and injustice may be defined as violating somebody's rights. In the case of contradictory individual interests, they should be mediated by developing the solution which will deliver the greatest possible utility (happiness) for the greatest number of citizens. We could therefore expect that utilitarians would vote for building mineral swimming pools from the example, as the project would contribute to the greater good of everyone in the long run.

On the contrary, John Locke and his followers (e.g. Robert Nozick) would take a different point of view: as people have only three natural rights (life, liberty and the right to own property) and all taxation is a form of theft (Nozick's idea) violating the fundamental property right, therefore building swimming pools at a cost to future generations could not be justified. According to this libertarian approach, the concept of a greater good is useless because it is superseded by individual liberty.

The third standpoint, proposed by John Rawls, focuses on justice understood as fairness: inequalities are only permitted if they are directly beneficial to the worse-off group, with the ultimate target of eradicating inequality. [New Statesman, Duties and Obligations between Generations, p. 2] Relating to the Solec-Zdrój example: Rawls probably would be in favour of the general idea of building the swimming pools because they might improve conditions for the poor, but he would propose a different way of remunerating the private partner (e.g., paid by local government instead of using tickets with prices set up freely by a private partner: as this latter method would likely eliminate the poorer from using the pools).

Let us leave the “ivory tower” of great philosophers of the past and consult some contemporary researchers dealing with the issue of intergenerational appraisal of projects.

Economists have underlined the intertemporal nature of investment decisions for years. Hepburn notes that even if discounting (widely employed in social cost-benefit analysis) was a useful tool allowing the formulation of an accurate policy over the short to medium term, it may appear counter-productive for longer term decisions. (Hepburn, 2007, p. 109) Having analysed the issue of alternatives to discounting, Hepburn states that declining discount rates may provide "an appealing solution to the dual problems of intergenerational efficiency and equity" (Hepburn, 2007, p. 118). Schelling proposed a different approach (named "the utility function approach") arguing that long-term investments should not be evaluated with the aid of the conventional discounted cash flow method. Alternatively, such investments should be treated much like foreign aid "with some of the foreigners being our own descendants who live not on another continent but in another century". Using this approach, we should treat investments as transfers of consumption from ourselves to future generations - exactly as we treat foreign aid. Policy makers should then assess every investment with respect to the utility increase achieved thanks to that investment in every world region and time period (Schelling, 1995, pp. 397-400).

However, local authorities seem to remain deaf to those ideas. As S. Fainstein describes, for years public projects were evaluated in terms of their effect on enhancing competitiveness, raising property values and attracting businesses and tourists (Fainstein, 2010, p. 1). Frischmann puts it even in more clear words, stating that "shortsighted decision-making is prevalent in many quarters of our society". The author defines shortsightedness as basing "decisions upon expected impacts within a relatively short timeframe". (Frischmann, 2005, p. 459). In concluding remarks Frischmann warns that "myopic focus on the present - on immediate gratification (...) threatens our own future and puts our legacy, and the nation we inherited, in jeopardy".(Frischmann, 2005, p. 466) According to Harvey, community underestimates "the freedom to make and remake our cities", a freedom that is in fact is one of the most valuable human rights (Harvey, 2008, p. 315). Harvey concluded that a small economic elite adjusts cities to its egoistic needs. However, this was only a “present tense” analysis, without referring to the influence on future generations' situation.

Apparently, the scale of disenchantment with the PPP method in the UK has been recently growing (many critical reports on using PPP in road sector, health care and education). In the report of Parker, a special emphasis is put on PPP-style contracts signed in the UK over the past 20 years. According to the author, over 860 PPP UK contracts have resulted in liabilities of 239 billion pounds, a burden put on future generations. Parker's attitude towards PPP/PFI method is very critical - - for example, the author concludes that the use of PFIs is "highly questionable" because, according to his study, this tool does not provide any significant advantages (as compared to direct public funding) such as superior delivery, lower life-time costs, effective risk transfer or quality of provision. However, Parker suggests some remedies that could help to place more of the liability on current taxpayers, namely the refinancing and creation of a special fund dedicated to PFI debt repayments, to which current taxpayers would make annual contributions. (Parker, 2012, pp. 39-41) Those remedies are not easily applicable to the Polish case, as the vast majority of Polish PPP projects are undertaken by local municipalities that are not entitled to impose taxes[[1]](#endnote-1) on their local citizens.

In a similar vein, Shaoul at al., draw conclusions from the analyses of PPP-style contracts in road infrastructure in the UK, stating that risk transfer (supposed to be achieved by using PPP schemes) does not come cheaply: the state had to pay 25% of construction costs to get the roads built on time and within budget using DBFO (design, build, finance, operate) schemes. The authors suggest that the government could have equally well incentivized the construction companies to construct roads without a PPP scheme, in a timely manner and sticking to the budget. Furthermore, the cooperation with private partners may result in new risks (Shaoul et al, 2006, p. 271).

Building on Hart comments, it is important to emphasize that the central issue while discussing PPP is not its financial aspect but its contracting costs. Hart's analysis supports the idea that PPP contracts are typically incomplete and that "the model suggests that the choice between PPPs and conventional provision turns on whether it is easier to write contracts on service provision than on building provision."(Hart, 2003, pp. C74-75).

The Parker report is foreworded by M. Hodge, who underlines that public authorities cannot tie future generations' hands "by saddling them with debts and service agreements thirty or forty years into the future". (Parker, 2012, p. 3) How does this statement relate to the Polish case, a country affected by a significant infrastructure gap that needs to be reduced in the years to come? Are the remarks presented above valid in every economic situation and every nation? Or perhaps the Polish case is so different that the future generations' needs may be ignored for the sake of the present? Those questions are to be examined in next sections of the paper.

## 3. Discussion: the case of Poland

### Poland at the starting point of 1989

In the centrally planned economy, up until 1989, the infrastructure was adjusted, often with delays and often behind schedule, to needs resulting from the development of the other components of the social system. (Wojewódzka-Król, 2000, p. 10). Infrastructure investments were perceived as inevitable, but not particularly desirable, since they limited directly productive expenditures. Central authorities were concentrating on default management and on solving fragmentary problems, activities not favourable to development of infrastructure, which requires of long-term planning. On the other hand, economic units (companies), operating within the narrow calculations of expenditures and effects, were indifferent to the negative outside effects of their activity, e.g. the degradation of the environment. The estimation of effect through the prism of borne expenditure led to the maximisation of consumption of infrastructure’s services. It follows that in a centrally planned economy a striking discrepancy exists between the tendency to limit development of infrastructure and the increase in demand on its services.

Even some Polish definitions of infrastructure, coming from the sixties and seventies, gave voice to such neglecting treatment of infrastructure. For example, the term was described as “devices necessary for proper functioning of productive segments of the economy.” (Kopalinski 1975, p. 430) In this approach, providing for social needs via infrastructure is not even mentioned.

Thus, Poland began the transformation in 1989 having poorly-developed infrastructure, with its development subordinated essentially for needs of relocating goods *en mass*, its operation based on monopolistic institutions, and in the sphere of international links reflecting the centralized character of the whole system - with domination by the former USRR (Ratajczak, 1999, p. 168).

The membership of Poland in the EU significantly enlarged the possibilities of profiting from loans and guarantees provided by the European Investment Bank and from European structural funds. Nowadays, after over ten years of being a EU funds beneficiary, Poland is still at the phase of "trying to catch up" with a Western-European level of infrastructure provision. For that reason, local authorities focus mainly on growth-promoting policies and often omit the other important factors such as social justice or intergenerational responsibility for public investments.

### Polish experience with PPPs

According to the official database of the Ministry of Economy, there were 82 realised PPP projects in Poland (as of December 2014) but only around 50 PPP contracts reached the construction phase, and about 15 are in operation (see Figure 1). There were also 125 PPP concepts registered in the database. However, the number of 77 projects is not identical with either the number of signed PPP contracts or the number of projects with financial closure. Around 63% of PPP contract proposals end up being cancelled (Raport 2013, p.19; Raport 2015, p. 4).

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| Figure 1. PPP contracts signed in Poland 1.01.2009-31.12.2014, with regard to sector.  Source: prepared by author, based on: *Raport PPP. Rynek partnerstwa publiczno-prywatnego i koncesji w Polsce w 2014r. na tle stanu obowiązującego w latach 2009-2013*, 2015, Ministerstwo Gospodarki, Warszawa, p. 12. |

The Polish PPP market is not well developed and also very specific: projects are rather small in terms of capital expenditure, they are not very complicated, and they are mainly undertaken by local authorities (see Figure 2). While discussing the main obstacles to further PPP development in Poland, there are numerous reasons frequently pointed out, such as inefficient legal framework, lack of trust and social capital, insufficient support from central government. The main reason of so many PPP failures in the eyes of the present author is an approach of public bodies urging to keep the project neutral with regard to public debt. If a contract is structured in an appropriate way, consistent with the Eurostat[[2]](#endnote-2) decision, the borrowing does not appear in the government's accounts. This approach results in inappropriate construction of PPP agreements (inadequate financial models and risk allocation): they are not tuned to the nature of the project but only with the aim of staying neutral for public debt.

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| Figure 2. The decomposition of signed PPP projects in Poland, with regard to the projects' size, 1.01.2009-31.12.2014.  Source: as figure 1, p. 24. |

Moreover, the PPP method is perceived only as a remedy for budgetary constraints. The majority of Polish local authorities surveyed in 2011 valued "possibility of acquiring additional capital" and "off-balance financing" as the most important PPP virtues (Bitner et al, 2011, p. 25). A discussion concerning long-term effects of PPP and the effects on future generations simply does not exist in Poland. The myopia is becoming increasingly common among public entities responsible for PPP projects, as shown in the next section of the paper.

### Case studies

#### Solec-Zdrój: The mineral water swimming pools complex

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| *Solec-Zdrój: key facts and figures*  - Total net expenditure 16 mln PLN (around 4 mln euro)  - Financial structure:  \* EU Funds 42,5%  \* Central budget 7,5%  \* Private partner 50%  - DBOT model  - Contract duration: 27 years (+/- three years, depending on the repayment period)  - Private partner shapes prices freely  - Project is currently in operation (since 2013) |

According to official documentation of the project, its main aims were as follows: the enhancement of tourism in the region, promotion of tourist attractiveness, and the creation of positive image of Solec-Zdrój by offering a brand-new tourist product. The project was intended to supplement the therapeutic bathing facilities and it was based on unique mineral springs. Surprisingly, the local authorities did not consult the local community at any phase of the project preparation.

Only one potential private partner participated in the procurement procedure. This implies that negotiation power of the public entity, desperately seeking for lacking sources of capital for the project, was very limited. The private partner had been already present since 2005 in Solec-Zdrój as the owner of a four-star medical spa hotel "Malinowy Dwór". The swimming pools complex, built in its neighbourhood, was a natural complement to the hotel. The private partner was unquestionably the beneficiary of the project. Is the assessment from the public point of view also unambiguously positive?

It seems that the nature of the project is more recreation-like than medical-one - the website (http://www.basenymineralne.pl/) of the complex puts special emphasis on the recreational virtues. The complex is divided into two parts: a curative pool and a water park. Given that the latter prevails, it is useful to assess the local competitors of a water park. In the Świętokrzyskie region there are several water parks, as Figure 3 shows.

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| Figure 3. Water parks in the neighbourhood of Solec-Zdrój  Source: author's own study, prepared using Google Maps, data on water parks found at: http://www.wodneparki.pl/swietokrzyskie-baseny-aquaparki-sauny (accessed 1.04.2015) |

In order to assess if the project fulfils public needs, let us check the typical one-hour cost of using the pools (cf table 1).

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| Water park | Adult single 1 hour ticket, in PLN |
| Morawica | 9,5 |
| Ostrowiec Świętokrzyski | 8 |
| Nowiny | 10,5 |
| Strawczynek | 8,5-9,5 |
| Starachowice | 9 |
| Solec-Zdrój | 18 |

Table 1. Prices of tickets in water parks in the region of Świętokrzyskie, as of April 2015

Source: author's own study, based on: www.olimpicstrawczyn.pl/index.php?id=232; www.basenymineralne.pl/pl,baseny,page,Cenniki,23,.html; www.mosir.ostrowiec.pl/cennik-mainmenu-61.html; www.perla.nowiny.com.pl/cennik; www.starachowice.eu/starachowice/web//uploads/pub/pages/page\_199/text\_images/CENNIK%20BAsen%202013-dobry.pdf; www.koralmorawica.pl/plywalnia\_koral/cennik\_uslug.html (accessed 1.04.2015)

It should be underlined here that the region of Świętokrzyskie is one of the poorer Polish regions, with an unemployment rate of 14,6% in April 2015 (the Polish average is 11,7%) and the average regional salary is much below the average for the whole country. These figures, combined with the table 1, provoke an important question about the affordability of mineral swimming pools for the local community. According to the information presented on the official website of the project, around 270 people use the pools daily (however, it is not possible to verify how many of them are tourists or hotel guests).

The investment is also a substantial intervention in terms of reshaping the landscape of the town of Solec-Zdrój. The additional question about depleting the springs may also be posed here. Assuming that the “just city” is "a city in which public investment and regulation would produce equitable outcomes rather than support those already well off" (Fainstein 2010, p. 3), it is a highly questionable project from the just city point of view.

#### Energy performance contracting projects

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| *PPP in thermo modernization: Radzionków case study*  The goal of the project was to decrease heating energy consumption by more than 54% and decrease electricity usage by more than 39% in education buildings in the municipality of Radzionków.  The private partner, Siemens, guarantees the level of energy savings. If that level is not achieved, Siemens is obliged to pay substantial compensation to the municipality. Because of that mechanism, the goal of public partner (i.e., the required level of efficiency) also becomes the goal of a private partner.  A report after the first year of operation indicated that the project was meeting the energy saving objectives designed in the PPP agreement (Raport Partnerstwo 2012, p. 192-153; Zamel 2012, pp.30-32). |

There is a growing number of PPP projects in Poland aiming at bringing substantial savings in energy used in public buildings (schools, city halls etc.) One of the first one of this kind was undertaken in a town of Radzionków. In this project, the private partner guarantees the efficiency effect of the project and is obliged to pay substantial fines if the required quality is not met. The partner is remunerated from the savings (the difference in public spending on energy is paid to the private company during a given contract time). Owing to this repayment scheme, the goal of public entity (i.e,, achievement of high energy efficiency in old municipal buildings) becomes also the goal of private partner. Projects of this kind do not bring any burden for future generations because the payments are not postponed. Furthermore, achieving better energy efficiency is one of the EU’s priorities.

#### Railway station project: Sopot

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| *Sopot: key facts*  The objectives of the project are to revitalize the railway station area, redesign the transport infrastructure in order to solve increasing transport problems, and create an upscale city quarter.  The plan for this regeneration is that the Polish Railway company will sell two pieces of land to the city council, and will also give the city council six additional pieces of land in exchange for a new railway station building that will be built by the private partner.  The city of Sopot and the private partner signed a PPP agreement, in which the private company is obliged to:   * build a hotel, parking ramps, and commercial buildings, all of which it will own later * build a new road intersection with a roundabout and green spaces, ownership of which will pass to the city of Sopot * build a new railway station terminal, ownership of which will pass to the Polish Railways company.   The private partner will be paid back from revenues generated by a commercial part of the project (hotel, parking ramps, commercial buildings) without any direct payment from the city council (Raport Partnerstwo, 2012, pp. 178-180).  One of the resources used in the mix of financing for this project is a low-interest JESSICA loan. This is the first hybrid PPP project in Europe (combining PPP with EU funds); it is based on a revolving credit instrument instead of a typical EU grant. |

Sopot is a typical example of projects aimed at substantial improvement of railway station infrastructure in Poland. In this project, the private partner is responsible for redevelopment of the whole area, construction of new building for the railway station, reshaping the roads, and regenerating the place overall. As a reward, the partner may construct also some buildings for commercial purposes (shopping centre, offices and hotels). The profits achieved using the commercial part of the project are the only source of repayment for the private partner. Moreover, the potential private partners competed on the basis of the concession sum offered (Sopot authorities decided that the private partner had to pay for the investment rights on a unique public piece of land[[3]](#endnote-3)).

On one hand, this scheme seem to be honest and it is a market-oriented one. However, if we assess it from the wider perspective of responsibility towards future generations, it appears that local authorities of Sopot decided on the use of the place for a very long time. Given that consumption patterns of the future may differ from current ones, it may appear that we did not leave much public space unbuilt. That reservation is actually valid for majority of actual investments within the real estate market.

## 5. Concluding remarks

Investment decisions (especially those concerning core infrastructure assets) undertaken by public authorities influence land use within their jurisdiction. The quantity of land (both publicly and privately-owned) is obviously finite and real estate investments change the place and the landscape for ages (if not for centuries). They affect the quality of public space that belongs to the category of public goods, and therefore should be especially protected by the public authorities. The use of PPP in investments adds one more aspect to the analysis, namely the financial responsibility towards future generations. In general, we can determine both financial and non-financial factors of intergenerational responsibility, as the short analysis in Section 4 revealed.

It appears that some PPP projects may be more favourable for our successors than the others, for instance, the non-financial benefits of educational projects may be substantial; energy costs savings paying back the private partner do not adversely affect financially future generations etc.

The paper is only a first attempt to address the issue of intergenerational responsibility for PPP projects, presenting some Polish examples in the field, and with the aim of drawing more interest to this aspect. Future, more detailed research is needed in order to fully determine what factors make PPP projects responsible towards future generations, and how this issue may be included into feasibility studies.

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1. In Poland the majority of taxes is collected by the central budget and then partially redistributed to local authorities. [↑](#endnote-ref-1)
2. *New Decision of Eurostat on debt and deficit no 18/2004. Treatment of public-private partnerships* - according to this decision, the assets involved in a PPP project should be classified as non-government ones, 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.

   The Decision was implemented within the Polish legal framework by the order of Minister of Economy, issued in 2015. [↑](#endnote-ref-2)
3. The mechanism is interesting and should be used widely in PPP projects in Poland but if we consider it from intergenerational justice point of view, it appears that today's budget profits from the right of building on a public ground (sold on the cost of the future generations). The resulting built-inheritance may not be perceived as desired by our successors. [↑](#endnote-ref-3)