OECD Principles for Private Sector Participation in Infrastructure

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Foreword

On 20 March 2007, the OECD Council approved the *OECD Principles for Private Sector Participation in Infrastructure* to help governments work with private sector partners to finance and bring to fruition projects in areas of vital economic importance, such as transport, water and power supply and telecommunications.

"Helping countries find new ways of financing investment in areas like water supply and sanitation is one of the OECD's priorities," OECD Secretary-General Angel Gurría commented. "These *Principles* will help both developed and developing countries move forward with infrastructure projects to boost economic growth and improve the lives of their citizens."

Under the aegis of the Investment Committee, the *Principles* were developed in co-operation with other OECD bodies and through a process of consultation with a broad group of public and private sector experts from OECD and non-OECD countries, as well as from non-governmental organisations.

They are intended to be used for government assessment, action plans and reporting, international co-operation and public-private dialogue, in conjunction with other OECD instruments, such as the Policy Framework for Investment and the OECD Guidelines for Multinational Enterprises.

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Recommendation of the Council on Principles for Private Sector Participation in Infrastructure, 20 March 2007

THE COUNCIL,

Having regard to articles 1(c), 2(d), 2(e) and 5(b) of the Convention on the Organisation for Economic Co-operation and Development of 14 December 1996;

Having regard to the Declaration on International Investment and Multinational Enterprises adopted by the Governments of OECD Member countries in 1976 and last reviewed in 2000, and to the Policy Framework for Investment adopted by Council in 2006;

Concerned by the important needs for new investment to develop and upgrade infrastructure services in both OECD and non-Member economies in support of economic growth and sustainable development;

Recognising the role that the private sector, including multinational enterprises, can play in providing finance and expertise to develop the infrastructure services of host countries;

a) ***INVITES*** *governments, in assessing their policies toward infrastructure services and in their dialogue with investors, to take due account of the Principles for Private Sector Participation in Infrastructure (hereafter the Principles) which are set out in the Annex to this Recommendation and form an integral part thereof;*

b) ***RECOMMENDS*** *the widest possible dissemination of the Principles with the support of OECD in co-operation with other international organisations, as well as active engagement of business, labour and other civil society organisations;*

c) ***AGREES*** *that the Principles should be reviewed by the Investment Committee in light of experience gained in using them, in co-operation with non-Member partners, other OECD bodies and international institutions and in consultation with stakeholders, and to report to the Council as appropriate.*

OECD Principles for Private Sector Participation in Infrastructure

Preamble

The shortage of infrastructure in developing countries is an important obstacle to meeting populations' needs, to enterprise development and to achieving the goals of the Millennium Declaration. Within the OECD area, many countries face the double challenge of growing demand and ageing physical assets in large parts of their infrastructure sectors, which could become an obstacle to sustained growth. The needs for infrastructure investment worldwide in the coming decades – defined to include public utilities such as telecommunication, power, transportation and water and sanitation – are estimated at levels exceeding US$1,800 billion per year. If such amounts of money are to be raised, policy makers need to mobilise all the potential sources of capital and consider innovative schemes for infrastructure financing.

In many countries such levels of investment cannot be financed by the public purse alone. To meet the needs, encouraging private investment in infrastructure is an option that governments cannot afford to ignore. Moreover, private sector participation can bring other benefits than additional capital. The examples include the end-user benefits of a more competitive environment, as well as the mobilisation of the private sector's technological expertise and managerial competences in the public interest. In a large number of OECD and other countries private participation in infrastructure has in recent decades helped boost both the coverage and efficiency of infrastructure services.

Yet at the same time a number of failed public-private partnerships in the infrastructure sectors attests to the difficult challenges facing policy makers. Infrastructure investment involves contracts which are more complex and of longer duration than in most other parts of the economy, operated under the double imperative of ensuring financial sustainability and meeting user needs and social objectives. The challenges are even more acute when governments bring in international investors, as is often the case where the infrastructure project concerned exceeds a certain size. International infrastructure operators are especially sensitive to commercial risks involved in working in unfamiliar local environments and they are also very exposed to public opinion and political scrutiny.

The objective of the OECD Principles for Private Sector Participation in Infrastructure is to assist governments that seek private sector involvement in infrastructure development, in attracting investment and mobilising private sector resources for the benefit of society and achieving sustainable development.

The Principles are intended as guidance to public authorities contemplating the involvement of private enterprises as one, among several, options to improve the provision of infrastructure services. They shall not be construed as advocating the privatisation or private management of publicly owned infrastructure. The choice between public and private provision of infrastructure services should be guided by an objective assessment of what best serves the public interest – that is, supports the common well-being. Factors to be taken into account include the current levels of service delivery and the condition of assets, affordability to households and companies, coverage of networks, operational efficiency, long-term maintenance of assets as well as social and environmental sustainability. The decision also needs to be guided by the timeframe in which improvements are required and the sources of finance that are available.

The Principles are intended to serve as a first step in the authorities' consideration of private sector participation, offering a coherent catalogue of policy directions to be assessed as part of their development strategies in light of their own national circumstances and needs. The Principles do not aim at detailed prescription or technical advice on implementation of specific aspects of infrastructure investment, contract formulation or regulation. To this end a host of general technical assistance is available, including from international financial institutions, UN bodies and the European Commission. The Principles can also be used by governments as a template for country self-assessment at national and local government levels, an aid for progress reporting by public authorities, guidance for private enterprises, a tool for structuring regional and other inter-governmental co-operation and public-private dialogues.

The Principles cover five important sets of challenges for national authorities. First, the decision to involve the private sector has to be guided by an assessment of the relative long-term costs and benefits and availability of finance, taking into account the pricing of risks transferred to the private operators and prudent fiscal treatment of risks remaining in the public domain. Second, authorities need to ensure an enabling policy framework for investment. Third, the success of private involvement in infrastructure depends on public acceptance and on the capacities at all levels of government to implement agreed projects. A fourth challenge for public authorities and the private sector is to establish a working relationship toward the joint fulfilment of the general public's infrastructure needs. Fifth, as indicated by the last section of the Principles, insofar as they are not rooted in formal legal requirements, governments' expectations regarding responsible business conduct need to be clearly communicated by governments to their private partners.

The Principles cannot be seen in isolation. They are intended to be used in conjunction with other OECD policy guidance and tools. The *Policy Framework for Investment* provides a non-prescriptive checklist of issues for consideration by governments engaged in creating an environment that is attractive to domestic and foreign investors and that enhances the benefits of investment to society. The *OECD Guiding Principles for Regulatory Quality and Performance* and the *OECD Recommendation Concerning Structural Separation in Regulated Industries* provide general guidance on good practices for regulation, as well as specific recommendations for the balance between competition and regulation in regulated sectors. The *OECD Guidelines on Corporate Governance of State-Owned Enterprises* provide recommendations to the state on how to exercise its ownership function *vis-à-vis* state-owned enterprises. Where incumbent utilities providers persist alongside with private participants this is of particular importance.

The *OECD Guidelines for Multinational Enterprises* offer recommendations to multinational enterprises operating in or from adhering countries. They provide voluntary principles and standards for responsible business conduct in a variety of areas, most of which are directly relevant to international investors in the infrastructure sector. The *Risk Awareness Tool for Multinational Enterprises in Weak Governance Zones* is designed to help multinational enterprises investing in countries characterised by weak or non-existent government. With regards to the development dimension of infrastructure, including official financial support for services accessibility and capacity building, the Principles could be seen as a complement to the Development Assistance Committee's guidance to donors on Pro-poor Growth: Infrastructure, which addresses the role of donors and their interactions with developing countries and the private sector.

No exhaustive definition of private sector "participation in infrastructure" is attempted. The Principles are relevant to a range of models of private participation, ranging from relatively limited service and management contracts, to public-private partnerships (PPP), to full or partial public divestiture. Any infrastructure project in which the public and private partners retain an interest, or partake in the risk in the case of failure, may benefit from the recommendations laid down in the Principles.

The OECD, working proactively with non-member partners, other international organisations and donors, business and other civil society, will assist in methodologies and policy capacity building for the effective use of the Principles taking into account different circumstances and needs. Implementation guidance will be developed as part of this process. Such activities are for example foreseen in the context of regional investment programmes supported by OECD. The Principles will be reviewed and improved in light of experience with their use.

I. Deciding on public or private provision of infrastructure services

Principle 1: The choice by public authorities between public and private provision should be based on cost-benefit analysis taking into account all alternative modes of delivery, the full system of infrastructure provision, and the projected financial and non-financial costs and benefits over the project lifecycle.

The involvement of private operators has its main advantage over publicly run projects when there is a potential to take advantage of the private operators' operational and administrative efficiencies (such as the technical expertise and the managerial competences of commercial operators), increased competition and enhanced services to end-consumers. Even where the public sector, dependent on credit ratings, has access to cheaper funding than private companies, efficiency gains from private sector participation may outweigh the extra financing costs.

Some public authorities face fiscal burdens saddling them with liquidity constraints or raising their funding costs to a point where private financing of infrastructure may appear as the cheapest – or the only feasible – option. This narrows the options of public planners, who may find they have to choose between privately-financed infrastructure and no infrastructure. However, this does not alter the basic tenets of a sound cost-benefit analysis taking into account all costs and risks over the long run. Embarking on privately financed infrastructure projects as a way of acquiring additional assets without properly considering the longer-term economic, financial and social consequences almost invariably leads to problems.

Cost-benefit analysis needs to take into account not only individual contracts but also the full system of infrastructure provision. In network industries such as infrastructure, linkages between different segments and actors are crucial. The relevant costs and benefits of a given project include its knock-on effects throughout the system. A comparison with the cost-benefit balance of alternative or competing projects should also be undertaken. Another important consideration is the ability of authorities to understand and implement the often complex contractual obligations incurred in the context of private infrastructure participation. Risks need to be accounted for, and contingent liabilities in this respect should be included in cost-benefit analysis.

When assessing overall costs and benefits, all relevant aspects of sustainable development should be taken into account. In particular, infrastructure projects often have important environmental and social repercussions that need to be properly accounted for, including through impact assessments. Independent sustainability impact assessments could be commissioned to assist this process.

Sectoral differences need to be carefully considered. Models for private involvement that serve the public interest in some parts of the infrastructure sector may not be optimal in others. For example, in some infrastructure services the efficiency gains from private participation hinge on the ownership of assets; in others private expertise can be procured in the context of less comprehensive partnerships.

Principle 2: No infrastructure project – regardless of the degree of private involvement – should be embarked upon without assessing the degree to which its costs can be recovered from end-users and, in case of shortfalls, what other sources of finance can be mobilised.

A realistic assessment must be made of the cost of meeting authorities' targets for service coverage and affordability and the share of these costs that can be recuperated from the infrastructure users. Any expected shortfall of funds should be fully accounted for by the implementing authorities.

Infrastructure services are among the sectors which have traditionally received large public subsidies as a means of balancing commercial viability and social objectives. The need to determine an optimal level of public subsidisation in principle applies equally to publicly and privately-provided infrastructure services. Non-transparent practices have in the past included the provisioning of infrastructure services to existing clients at unrealistically low prices, financed through insufficient depreciation allowances against deteriorating infrastructure assets. In consequence, decisions regarding subsidisation in the case of a transfer of assets from the public to the private sector need to take into account the performance and efficiency of the incumbent as well as pre-existing commitments.

A second best approach to on-budget financing of subsidies may be cross-subsidisation. For instance, standard infrastructure tariffs can be set so that households in easily accessible areas effectively subsidise remote communities, or extensions of coverage may be rendered possible through differentiated pricing schemes. However, such mechanisms should generally be kept to a minimum on account of their market distorting effects and lack of transparency. The scope for on-budget and cross-subsidisation are both limited in the poorer countries. Developing countries may consider bilateral and multilateral assistance as well as concessionary financial arrangements by international lenders as ways of financing infrastructure subsidies.

Principle 3: The allocation of risk between private parties and the public sector will be largely determined by the chosen model of private sector involvement, including the allocation of responsibilities. The selection of a particular model and an associated allocation of risk should be based upon an assessment of the public interest.

Commonly accepted principles for risk apportioning imply that any given risk should be allocated to the contractual party that is best able to assess and control it. If contractual parties are unequally capitalised the ability to carry the financial burden may also need to be taken into account. This implies that risk which can be mitigated by the private partner (e.g. regarding operational efficiency) should be borne by the private sector, whereas risk of a public-interest nature (e.g. regarding public attitudes and/or the pursuit of non-commercial objectives) should reside with the public partner.

Risk allocation is mostly determined by the chosen model of private sector involvement. The degree of control over infrastructure assets, ranging from full private ownership (divestiture); to temporary control and/or investment commitments (concessions); to full public ownership (management or service contracts) in itself implies a continuum of risk-sharing arrangements between the public and private partners. On top of this, the ultimate risk allocation on any project is highly case-specific. Contractual stipulations regarding service commitments, maintenance, coverage, financial obligations and a number of other considerations bear on the allocation of risk.

Public authorities may perceive an incentive to shift as much risk as possible onto the private sector, but they need to balance this against the price that the private partners will need to levy to render the assumption of such risks financially justifiable. And they also need to realize that public guarantees of private commercial behaviour can affect not only the degree of risk allocation and the reporting of the investment as on or off budget, but more importantly it can greatly affect the incentives the private sector has to accomplish operational and administrative efficiencies.

Principle 4: Fiscal discipline and transparency must be safeguarded, and the potential public finance implications of sharing responsibilities for infrastructure with the private sector fully understood.

Private sector participation in infrastructure should not be used as a vehicle for escaping budgetary discipline by hiving financial commitments off public sector balance sheets. Infrastructure projects should generally be reflected by public sector budgets unless all relevant risks truly reside with the private sector. Moreover, if risks are mitigated by public guarantees, then placing such investment off budget becomes even more questionable.

When the allocation of risk between the public and private sector involves guarantees, whether implicit or explicit, from the public sector to the commercial operators, such guarantees need to be accounted for. And, they should be subject to a similar degree of scrutiny during public budget processes as other spending. Public authorities need to be alert to the potentially significant fiscal consequences of guarantees, including in the event of financial or macroeconomic crises. They need to provision in their annual budgets against the expected cost of payments to meet called guarantees. Third party oversight, e.g. by parliamentary bodies, may help safeguard the integrity of the process.

II. Enhancing the enabling institutional environment

Principle 5: A sound enabling environment for infrastructure investment, which implies high standards of public and corporate governance, transparency and the rule of law, including protection of property and contractual rights, is essential to attract the participation of the private sector.

Successful private participation in the infrastructure sector of a country depends, like any other business activity, on the quality of the national investment climate. All of the issues raised by the *Policy Framework for Investment* developed by OECD and its non-member partners apply to the infrastructure sector and should be considered by authorities responsible for infrastructure projects. Authorities should not limit themselves to addressing a small number of legislative challenges bearing directly on infrastructure projects (e.g. privatisation and concession laws). Success depends on a wide range of legislation and administrative practices bearing on private companies, their employees and other stakeholders, and the ability of local suppliers and subcontractors to partner with infrastructure providers.

In an environment where laws and agreements cannot be adequately enforced most other success criteria are of secondary importance. This is particularly the case in the infrastructure sector where projects tend to be large and, insofar as they involve asset ownership by the private sector, difficult for investors to disengage from. Investors will be unwilling to put capital at risk unless their rights and responsibilities – *vis-à-vis* the public sector, other enterprises and the general public – are firmly established and enforced by independent entities. This does not preclude governments from exercising their right to regulate in the public interest, including by changing legislation bearing on the viability of infrastructure projects. However, they should do so in a transparent and, as far as possible, predictable manner, including prior consultations with the private sector participants and other affected parties.

Principle 6: Infrastructure projects should be free from corruption at all levels and in all project phases. Public authorities should take effective measures to ensure public and private sector integrity and accountability and establish appropriate procedures to deter, detect and sanction corruption.

While corrupt practices may arise for a variety of reasons, privately funded infrastructure has a number of characteristics that makes it a likely target. The monopoly structure of many types of supply can provide significant opportunity for rent-seeking, including in the awards phases. The political protection and intervention given to infrastructure often blurs financial accountability, and provides cover for a range of corrupt activities and other misbehaviour, including in allocating scarce services, overstaffing and excessively high remunerations. With difficulties in establishing the relationship between level of capital investment and service outputs, corruption can lead to a misallocation of resources. The large scale and duration of infrastructure creates opportunities for kickbacks and bribes associated with procurement.

Corruption may occur in any of the phases of a complex project: design, awards, procurement, operation and, according to project type, transfer of assets. Measures to ensure transparency, evaluation and the presence of checks and balances should be in place to safeguard against corrupt practices at each of these steps. In the operation phases the private involvement may provide options for countering some forms of corruption: the power to collect tariffs has in some countries served as leverage for public officials to demand illicit payments from the end-users.

Corruption in the infrastructure sector is particularly problematic where the involvement of the private participants is in itself subject to public scepticism. Doubts about the integrity of the awards and procurement processes will inevitably exacerbate such scepticism. Moreover, the selection of the "wrong" private partners and inefficient operations due to corrupt practices will create an additional financial burden ultimately shifted on to the end-consumer. Particular vigilance is needed to prevent the shifting, through illicit practices, of financial burdens onto future consumers and public authorities who may wield no direct influence at the time of the awards.

Principle 7: The benefits of private sector participation in infrastructure are enhanced by efforts to create a competitive environment, including by subjecting activities to appropriate commercial pressures, dismantling unnecessary barriers to entry and implementing and enforcing adequate competition laws.

Elements of natural monopoly throughout the infrastructure sector make it more difficult to establish conditions for effective competition. Authorities achieve the best results by exposing as many activities as possible to competitive pressures while subjecting areas of monopoly or scant competition to regulation in the public interest. An internationally open investment environment may facilitate competition, and enhance its benefits, by widening the number of potential participants and broadening the "relevant market" to an area extending beyond national borders. To achieve these benefits authorities are encouraged to maintain an open and non-discriminatory investment environment, and to take into account the *OECD Recommendation Concerning Structural Separation in Regulated Industries*. Ensuring that domestic and foreign-owned firms can compete on an equal footing also implies the observance of labour and other recognised international standards by all operators.

For the purpose of service efficiency, efforts to bolster competition in infrastructure often go hand-in-hand with broader structural reform. To achieve a number of infrastructure providers sufficient to ensure a healthy degree of competition, "horizontal separation" of operations may be necessary. "Vertical separation", by which competitive parts of the supply chain are separated from essential-facility elements, may provide a way of maximising the number of infrastructure activities that can be made subject to competition.

Where privately owned infrastructure providers coexist with publicly owned incumbents, particular measures to maintain a level playing field may be needed. According to the *OECD Guidelines on Corporate Governance of State-Owned Enterprises*, they include a clear separation between the public sector's ownership function and other factors that may influence companies' position, transparency regarding service obligations, access to finance and transparency concerning financial assistance and guarantees covered by the public purse.

Principle 8: Access to capital markets to fund operations is essential to private sector participants. Restrictions in access to local markets and *obstacles to international capital movements should, taking into account macroeconomic policy considerations, be phased out.*

Countries with well functioning domestic capital markets find it both easier and cheaper to involve private enterprises – particularly international operators – in their infrastructure sectors. Where exchange rates are fully convertible and capital can easily move in and out of the host country, infrastructure operators fund their operations at competitive international rates and consequently need to shift no "financing premium" onto the domestic infrastructure users. When infrastructure projects are set in countries without fully convertible exchange rates or an easy access to repatriation of profits and investments, investors find it difficult to mitigate their exchange rate risk and often face a strong incentive to fund themselves locally. In these cases, the success of infrastructure projects can be bolstered by giving investors full access to local capital markets. The experiences made so far by host authorities attempting to compensate investors for exchange rate risks by accepting infrastructure tariffs linked to foreign currency have been far from encouraging.

Private participation in infrastructure can also help develop financial markets. Loans to infrastructure projects can be securitised with the double benefits of lowering the funding cost and adding depth and liquidity to domestic capital markets. The financial resources for purchasing such instruments are available in the insurance and pension sectors of most countries. Concerns have been raised regarding the impact of corporate bond issuance to finance infrastructure on the cost of host governments' own borrowing. However, it is generally inadvisable to let such short-term considerations stand in the way of the long-term gains from developing domestic financial markets.

III. Goals, strategies and capacities at all levels

Principle 9: Public authorities should ensure adequate consultation with end-users and other stakeholders including prior to the initiation of an infrastructure project.

Private participation in infrastructure is unlikely to be successful unless authorities have assured themselves beforehand that the envisaged undertakings are in the public interest and are acceptable to consumers and other stakeholders. It includes consultations with all affected parties and establishing a realistic expectation of what the private sector can achieve. This is particularly the case in situations where newcomers are expected to address long-standing problems of inefficiency or mismanagement. Moreover, if the transfer of infrastructure services to the private domain is linked with a cessation of subsidies – for instance where the shift is motivated by a need to break a long period of underinvestment – a particular effort to explain public strategies is called for. The resultant shift to "cost recovery pricing" to finance the new capital spending may otherwise be seen by existing consumers as a denial of well-earned rights.

Where infrastructure involves the construction of large physical assets a process of prior consultations with the potentially affected communities is called for in order to ensure that the interest of communities concerned, including respect of human rights, will be taken into account and duly protected. It is advisable to involve the private partners as soon as they have been identified, as impact mitigation is likely to rely in large measure on them. Where a part of the motivation behind private sector participation is to lower costs in the provision of infrastructure, projects are almost invariably faced with resistance from domestic constituencies such as employee representatives and incumbent operators. Where employer-employee relationships and competition frameworks are codified and transparent, and based on the ILO Declaration on Fundamental Principles and Rights at Work of 1998, controversy can mostly be avoided. Otherwise, authorities may need to make a concerted effort to gain support around their objectives.

A particular challenge arises where controversy occurs after an infrastructure project has been embarked upon. Public authorities may perceive an incentive to shift blame rather than engage in consultations with stakeholders on the basis of the actual project responsibilities. However, doing so imperils the process of stakeholder involvement alongside the long-term relationship with the private partners.

Principle 10: Authorities responsible for privately-operated infrastructure projects should have the capacity to manage the commercial processes involved and to partner on an equal basis with their private sector counterparts.

It should be kept in mind that involving the private sector in infrastructure may represent a sea change in public procurement in many countries. The most basic challenge for public authorities and their staff involved in infrastructure projects is managing the inherently commercial nature of private sector involvement in infrastructure. Public officials and administrative staff should not go to the extreme of perceiving businesses' profit maximising behaviour as somehow "illegitimate" or convey this impression to the public. Their duty to act in the public interest is best expressed in the form of a competent, equitable and diligent attention to contracts, regulation and legal frameworks.

The "ability to deliver", i.e. the presence of relevant administrative capacities and competences, is another important consideration. Private sector participation in infrastructure often involves sophisticated technological, corporate and financial solutions that government entities may not be fully equipped to handle. This challenge is not limited to developing countries. Even in the world's most advanced economies – including some that count as among the most experienced in terms of privately financed infrastructure – a consistent complaint from private sector participants is a lack of implementation capacity among their public-sector partners. Hands-on corporate experience is in short supply among government employees in most countries, as is in some cases competency in public procurement and monitoring of contracts. Authorities need to build the necessary competencies to act as an equal partner to the private sector participants and the costs of doing so need to be considered as part of the overall project design. This is an area where governments may wish to seek outside assistance – in the case of developing nations including from development agencies.

Finally, some forms of private participation in infrastructure – including the development of new infrastructure activities from scratch by private investors – are driven by the private sector rather than initiated by public authorities acting in the public interest. In those cases no specific sectoral regulations and oversight may be in place. The regulatory responsibility then lies with authorities overseeing corporate laws and, in some cases, securities regulators.

Principle 11: Strategies for private sector participation in infrastructure need to be understood, and objectives shared, throughout all levels of government and in all relevant parts of the public administration.

An important concern for public authorities is the coordination of infrastructure policy, *inter alia*, because divergent strategies may be pursued at the national and sub-national levels. A need for coordination arises from the fact that infrastructure projects often have important repercussions outside the implementing jurisdiction. Such "externalities" may turn negative, for instance when infrastructure projects conducted at the local level have an adverse effect on the reputation of the entire host country. Projects at the sub-national levels may also have fiscal repercussions for the host economy as a whole. Many governments have found it necessary to pass separate legislation on infrastructure subsidies to avoid sub-optimal outcomes at the local and regional levels.

Within individual jurisdictions or administrative branches authorities need to secure a high degree of cohesion. Successful infrastructure programmes involve a host of different functions – e.g. responsibility for areas such as planning and financing, technical implementation and overall fiscal sustainability. If any of these is unable, or unwilling, to play their part, the overall outcome is at risk. In consequence, national authorities will normally want to anchor their strategies for private sector participation in infrastructure in an overall policy programme, which is agreed, communicated and implemented throughout all levels of public administration.

Principle 12: Mechanisms for cross-jurisdictional co-operation, including at the regional level, may have to be established.

Where infrastructure projects involve separate jurisdictions, including sovereign nations pertaining to a same region, special caution is warranted to ensure that project objectives are widely shared and underpinned by formal agreements and dispute resolution mechanisms. This applies to infrastructure projects generally, but it is particularly important where non-government participants are involved as uncertainty about chains of command and jurisdictions greatly increase the political risk perceived by private investors. The compatibility between legal systems can be an issue of concern. The transportability of financial instruments between jurisdictions can be another.

IV. Making the public-private co-operation work

Principle 13: To optimise the involvement of the private sector, public authorities should communicate clearly the objectives of their infrastructure policies and they should put in place mechanisms for consultations between the public and private partners regarding these objectives as well as individual projects.

Building trust between the public and private sector is a matter of high priority. This is not least the case where private enterprises decide to participate in infrastructure project in countries whose enabling environments for investment are considered as weak. If the two sides are to work together amid a difficult investment climate, a high degree of openness about what is to be achieved and by what means is essential to reassure the partners and to avoid costly misunderstandings.

Public sector expectations of the performance of infrastructure providers should be, to the greatest extent possible, specified in terms of the services to be provided to the public and the pricing methods that may be applied to them. Output-based specifications of objectives are easier to verify, more relevant to stakeholders and encourage greater efficiency and flexibility than other arrangements. Granting private sector participants the freedom to meet the end-users needs in the way they deem most efficient also, from their perspective, removes a number of risk factors.

In the interest of a good long-term working relationship between the public and private partners, forums or channels should be created through which both sides can make their concerns heard. Regular and timely consultations are generally preferable to ad-hoc meetings organised when one of the contractual partners, or stakeholders, perceive a problem. To avoid perceptions of impropriety, affected third parties could be invited to participate in consultations.

Principle 14: There should be full disclosure of all project-relevant information between public authorities and their private partners, including the state of pre-existing infrastructure, performance standards and penalties in the case of non-compliance. The principle of due diligence must be upheld.

Due diligence implies that authorities should undertake such actions as an ordinarily prudent or reasonable party would normally apply to avoid harm to another party or itself. In practice this implies that foreseeable risks should be accounted for and disclosed and no essential information withheld. Failure to make this effort is considered negligence.

In particular, there must be full disclosure of all project-relevant information between the partners. Unless sufficient technical, economic and environmental data are made available to would-be investors, a project is at risk from the outset. In a worst-case scenario where potential private sector participants are certain that information is withheld, some may withdraw; others may perceive an incentive to make unrealistic offers on the expectation that a renegotiation of contracts is nevertheless unavoidable. When accurate project information is not available and the parties enter into a contractual relationship based on operational estimates, contractual adjustments should be anticipated in the contract.

Information about the checks that the public sector will apply to a project to decide whether the private participants have complied with their obligations must be available throughout the process. The penalties that will be put in place in the case of underperformance must be specified beforehand, or deferred to a judicial instance, rather than based on administrative discretion.

Principle 15: The awarding of infrastructure contracts or concessions should be designed to guarantee procedural fairness, non-discrimination and transparency.

Where competition has been successfully introduced into a given type of infrastructure services, the public authorities may generally rely on market forces to safeguard the interest of end consumers. Where this is not the case, and the chosen infrastructure provider will enjoy a degree of monopoly (e.g.

as laid down in a concession agreement) a common adage has it that "if there can be no competition *in* the market, companies should be made to compete *for* the market". This may, however, in practice be easier to achieve where entry/exit costs and "sunk costs" are limited than in cases where the incumbent enjoys an advantage in subsequent bidding rounds. Competitive tendering is in most cases the best way of allocating infrastructure contracts. In a limited number of cases, though, alternative mechanisms may be considered – for instance where large amounts of proprietary information are exchanged in the pre-contract phases.

Based on the experiences with infrastructure concessions over the last two decades, an emerging consensus is that the likelihood of a successful tendering process is enhanced when relatively simple award criteria are applied. Complex criteria make it virtually impossible to discern what bid is "best" and lay the tendering process open to manipulation and illicit practices. As a general rule, the competitive advantages of private sector participants are best mobilised in the public interest when award criteria focus directly on the quantity and quality of services, and their price, to be provided to end-users. This encourages individual companies to propose innovative and efficient solutions.

Awards procedures have sometimes been compromised by a lack of resources and capacity on the part of the public authorities designing and implementing them. As in the case of regulatory entities (below), establishing the capabilities of such implementing agencies should be a high priority for policy makers.

Principle 16: The formal agreement between authorities and private sector participants should be specified in terms of verifiable infrastructure services to be provided to the public on the basis of output or performance based specifications. It should contain provisions regarding responsibilities and risk allocation in the case of unforeseen events.

The adherence to contractual terms is easier to verify when these are specified in terms of a concrete quantity and quality of services to be provided to the end users of infrastructure. Where tariffs are subject to regulation, provisions about future tariffs (as also follows from Principle 14) need to be clearly specified. This is in practice often one of the most controversial parts as it affects the "well-earned rights" of incumbent consumers. Particular attention also needs to be given to such issues as technical maintenance and, where applicable, technology transfer.

Authorities should insist on the "sanctity of contracts" – that is, that all contractual parties fulfil their obligations even where this turns out to be financially disadvantageous to them. At the same time, circumstances change over the duration of an infrastructure project and contracts must be flexible enough to accommodate these changes. One way of reconciling these concerns is to incorporate explicitly in contracts the conditions under which they may be reconsidered or renegotiated.

Principle 17: Regulation of infrastructure services needs to be entrusted to specialised public authorities that are competent, well-resourced and shielded from undue influence by the parties to infrastructure contracts.

The quality of regulatory frameworks in general is an integral part of the enabling environment for investment covered by Principle 5. The specifics of infrastructure regulation, however, often gives rise to some additional challenges. Activities with a monopolistic element – whether because of natural monopolies or a scarcity of private sector providers – must be subjected to regulation in the public interest. The detailed nature of the regulation goes beyond the scope of the Principles. National authorities will wish to take advice from commonly accepted good practices, including as regards the duty of efficiency on behalf of the public, transfers of efficiency, transparency, constructive notice, control of transfer pricing, regulatory accounting and users' participation.

Most generally, there appears to be a high degree of trade-off between contractual clarity and the need for infrastructure regulation. After the transfer of infrastructure services from the public to the private domain, a case can be made for relying on formal agreements leaving little scope for regulatory discretion. However, insofar as more flexible contracts are preferred to accommodate a changing environment a greater degree of regulatory discretion is also called for.

The challenge for authorities is to safeguard the independence and objectivity of regulatory bodies, generating the necessary confidence by all stakeholders (together with the emergence of a body of case-law) to allow regulators to fill this enhanced role. In the pre-contractual and negotiation phases the authorities may draw upon the expertise of specialised regulatory bodies to ensure that the contractual undertakings embarked upon are meaningful. In the operational phases, it is very important that the regulators be seen to operate at arms-length from those parts of the public sector that are party to the infrastructure contracts concerned.

Principle 18: Occasional renegotiations are inevitable in long-term partnerships, but they should be conducted in good faith, in a transparent and non-discriminatory manner.

No contract is flexible enough to cover every eventuality. Moreover, overly detailed contracts attempting to cover any conceivable aspect of a long-term partnership may in practice be incompatible with operational flexibility. Also, excessively detailed arrangements give the contractual parties incentives to "look for loopholes" rather than make their partnership work. Consequently, renegotiation of contracts will occasionally be necessary in long-term partnerships such as infrastructure projects. The best way of balancing the sanctity of the contract with the necessary flexibility may be to include contractual stipulations specifying under what circumstances revisions to the original agreement shall be considered. Permanent and active review panels, dispute committees and arbitrational instances should be established as part of the contractual structure and operated to strengthen the parties' relationships.

National authorities may need to take legislative or regulatory action that fundamentally alters the conditions under which an infrastructure project is conducted. This is commonly accepted as part of a sovereign government's right to regulate in the public interest, but it should be done in a transparent and non-discriminatory manner, including prior consultations with all affected parties. If it rises to a level considered as constituting an expropriation of the investors' assets a timely, adequate and effective compensation should be paid.

Principle 19: Dispute resolution mechanisms should be in place through which disputes arising at any point in the lifetime of an infrastructure project can be handled in a timely and impartial manner.

It is in the public interest, and the interest of all participants, to found private participation in infrastructure on what has been termed "sustainable arrangements". The relationships themselves, and the mechanisms for adjusting them, should be considered as "fair" by all stakeholders. In the interest of maintaining the long-term contractual relationship between the public and private partners, amicable settlement or mediation is generally preferable to adjudication or arbitration. The public authorities can contribute to such an outcome by making it their option of choice, and by including in infrastructure contracts clauses establishing mechanisms through which disagreements will be handled.

Even so, long-term commitments are seen as notoriously risky by private sector participants unless they are backed by impartial and independent forums for dispute resolution, as, *inter alia,* stipulated in the contract between the parties. In jurisdictions where the rule of law is firmly entrenched and underpinned by an impartial and efficient judiciary, private sector participants may be inclined to attempt to resolve disputes in domestic civil or commercial courts or in arbitrational tribunals. However, the recourse to investor-state dispute settlement mechanisms under international investment agreements ratified by the host country may be of vital importance to international investors as well.

V. Encouraging responsible business conduct

Principle 20: Private sector participants in infrastructure should observe commonly agreed principles and standards for responsible business conduct.

The core mission of business is to identify and manage investment projects that yield competitive returns to suppliers of capital. In fulfilling this core function, responsible business conduct consists above all of complying with applicable law, but may go beyond this. Responsible business conduct also includes responding to societal expectations which may be communicated through channels other than the law – especially in weak governance zones and other areas where legislation and regulatory action do not reflect the wishes of the public. This problem may be particularly pertinent in the infrastructure sector where host country public officials have a direct interest in the commercial process.

One of the main instruments companies can draw upon in their quest to embrace principles of responsible conduct is the *OECD Guidelines for Multinational Enterprises*. The Guidelines constitute a set of recommendations to multinational enterprises in all the major areas of business ethics, including employment and industrial relations, human rights, environment, information disclosure, combating bribery, consumer interests, science and technology, competition, and taxation. While the observance of the Guidelines is non-binding for businesses, adhering governments have committed to promote them among multinational enterprises operating in or from their territories and to assist parties involved in "specific instances" by offering good offices to resolve the issues. The Guidelines reflect good practice for all enterprises.

Principle 21: Private enterprises should participate in infrastructure projects in good faith and with a commitment to fulfil their commitments.

The difficulty in disengaging from infrastructure projects provides both the public sector and private contractual parties with leverage to improve their financial position following the awards. From the perspective of the private side this may be done by means of insisting on renegotiations of contracts, or by raising profitability by reneging on service agreements and other commitments. However, it is in the interest of private sector participants to uphold the "sanctity of contracts", even where this may lead to short-term losses.

If there is evidence that investors have acted in bad faith – for instance signing contracts that they knew, or should have known, they could not realistically honour – they are at risk of legal suits, and of souring the working relationship with their public partners, antagonising affected communities and sparking international criticism. The principle of due diligence implies that private sector participants should engage in a process of investigation and evaluation into the details of a potential investment, such as an examination of operations and management and the verification of material facts, drawing on all available sources before embarking on a project.

Private sector participation in infrastructure often involves a variety of complex corporate transactions and structures. The board members of private enterprises should be particularly mindful of the responsibilities, including contractual obligations and due diligence, when engaging in infrastructure projects. Such instruments as the OECD Principles of Corporate Governance provide guidance regarding board responsibility.

Principle 22: Private sector participants, their subcontractors and representatives should not resort to bribery and other irregular practices to obtain contracts, gain control over assets or win favours, nor should they accept to be party to such practices in the course of their infrastructure operations.

One of the main challenges for private sector participants in infrastructure wishing to conduct their business in a responsible manner, especially in the early phases of a project, is fighting corrupt or collusive practices. In weak governance zones and other national contexts where corruption is commonplace, the procedures for awarding infrastructure contracts as well as subsequent regulatory practices have been criticised, sometimes with the effect of lowering the private sector participants in the public regard and weakening their "social license to operate".

In countries that are party to the OECD *Convention on Combating Bribery of Foreign Public Officials in International Business Transactions* it is a crime to bribe foreign public officials, regardless of the laws and regulations of the host country jurisdiction. The *UN Convention against Corruption* similarly requires all parties to criminalise the act of bribing foreign public officials. Companies will also find it in their interest to avoid other controversial practices even if these do not fall foul of applicable law. Corporate governance, including financial control mechanisms and staff incentives, is at risk when illicit methods are accepted, and significant reputation costs can be incurred.

Companies should compete for infrastructure contracts on the basis of the merits of their proposals. They should not bring improper political pressure to bear on host countries to open market segments, award contracts or change regulation.

Principle 23: Private sector participants should contribute to strategies for communicating and consulting with the general public, including vis-à-vis *consumers, affected communities and corporate stakeholders, with a view to developing mutual acceptance and understanding of the objectives of the parties involved.*

A key element of responsible business conduct is communication and consultation with affected communities and other stakeholders. In the early stages of an infrastructure project, and regarding the overall priorities of the project, consultation is a responsibility of the public authorities (Principle 9). Following the contract award both the public and private partners should partake in communication and consultation with the public and affected parties. Moreover, corporate approaches to communication and consultation generally work better when applied in concert with – rather than in *lieu* of – public communication strategies. This applies in particular to infrastructure projects where private and public entities cooperate to provide the general public with infrastructure services and have a shared interest in facilitating an exchange of information. Companies need to understand the social, economic and environmental values of the societies in which they operate.

Some of the generally-accepted lessons from past experiences include a need to engage in dialogue with affected communities and stakeholders early in the planning process in order to give them a genuine chance to be heard. Private sector participants are advised to adopt a high degree of transparency with due regard taken of costs, business confidentiality and other competitive concerns. Providing as much information as feasible is essential, including about technological and location options the investor faces. The pricing of infrastructure services and other project parameters with a direct impact on end-consumers raise important issues of communication and consultation. End-users should have an appropriate access to information about the financial and technical state of infrastructure operations as well as the future plans of the project partners – and get a chance to make their concerns and priorities heard. Failing this, the chances are that the public will respond with hostility to tariff adjustments and any shortfall in services relative to expectations, potentially leading to a backlash against the contractual parties.

Private sector participants are also encouraged to engage actively with their financiers over the issue of environmental and social consequences of their actions. The Equator Principles and the OECD Recommendation on Common Approaches to the Environment and Officially Supported Export Credits are two examples of good practices recommended to financial institutions involved in infrastructure finance.

Principle 24: Private sector participants in the provision of vital services to communities need to be mindful of the consequences of their actions for those communities and work, together with public authorities, to avoid and mitigate socially unacceptable outcomes.

A central issue, especially in the poorest regions, is the access to and affordability of vital services. Whether to subsidise basic utility services is ultimately a public choice, and companies may often treat issues such as the imposition of penalties and denial of service to households in case of non-payment as contractually legitimate actions. This is particularly the case where private companies are operating infrastructure assets that predate their involvement and have not been contractually asked to assume direct responsibility for their state of maintenance and the coverage of networks.

While promoting and upholding human rights is primarily the responsibility of governments, where corporate conduct and human rights intersect, enterprises do play a role. Enterprises should respect the human rights of individuals affected by their activities, in a manner that is consistent with host governments' international obligations and commitments. Private participants in infrastructure projects need to be aware that the denial and withdrawal of vital infrastructure services, whether for commercial or any other reasons, could be perceived as impairing the human rights of affected individuals. Infrastructure investors need to take into account these concerns and be willing to engage with their public partners and local communities to address them.

Further resources

1) International instruments

OECD Declaration on International Investment and Multinational Enterprises www.oecd.org/daf/investment/instruments [text: www.olis.oecd.org/olis/2000doc.nsf/LinkTo/daffe-ime(2000)20], including the OECD Guidelines for Multinational Enterprises www.oecd.org/daf/investment/guidelines.

OECD Code of Liberalisation of Capital Movements www.oecd.org/dataoecd/10/62/4844455.pdf

OECD Recommendation concerning Structural Separation in Regulated Industries www.oecd.org/competition.

OECD Principles of Corporate Governance www.oecd.org/daf/corporate/principles and Guidelines on Corporate Governance of State-Owned Assets www.oecd.org/dataoecd/46/51/34803211.pdf

OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions www.oecd.org/daf/nocorruption/convention [text: www.olis.oecd.org/olis/1997doc.nsf/LinkTo/daffe-ime-br(97)20]

United Nations Convention against Corruption www.unodc.org/pdf/crime/convention_corruption/signing/Convention-e.pdf

International Labour Organisation Declaration on Fundamental Principles and Rights at Work www.ilo.org/dyn/declaris/declarationweb.indexpage

2) Tools and guidance

The Public-Private Infrastructure Advisory Facility (PPIAF) Toolkits http://wbln0018.worldbank.org/ppiaf/activity.nsf/toolkits

EU Commission Guidelines for Successful Public-Private Partnerships http://ec.europa.eu/regional_policy/sources/docgener/guides/ppp_en.pdf

UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects www.uncitral.org/uncitral/en/uncitral_texts/procurement_infrastructure/2001Guide_PFIP.html

International Finance Corporation's Equator Principles www.equator-principles.com/principles.shtml

Business Leaders Initiative on Human Rights' Guide for integrating human rights into business management www.blihr.org/

Human Rights and Business Project http://hrca.humanrightsbusiness.org of the Danish Institute for Human Rights.

OECD Policy Framework for Investment www.oecd.org/daf/investment/pfi

OECD Risk Awareness Tool for Multinational Enterprises in Weak Governance Zones www.oecd.org/dataoecd/26/21/36885821.pdf

OECD Guiding Principles for Regulatory Quality and Performance www.oecd.org/dataoecd/19/51/37318586.pdf.

OECD Recommendation on Common Approaches to the Environment and Officially Supported Export Credits http://webdomino1.oecd.org/olis/2005doc.nsf/Linkto/td-ecg(2005)3

OECD Best Practices for Budget Transparency www.oecd.org/dataoecd/33/13/1905258.pdf

DAC Guiding Principles for Guidelines Guiding Principles on Using Infrastructure to Reduce Poverty (in Promoting Pro-Poor Growth: Infrastructure) www.oecd.org/dataoecd/16/46/36301078.pdf

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