

THE IMPACT OF COVID-19 ON THE REALIZATION OF PUBLIC-PRIVATE PARTNERSHIPS PROJECTS

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Summary: *The aim of this research is to present the practical problems in the realization of public-private partnerships projects that are arising as a consequence of COVID-19 and which occurs on construction projects contracted under this model. Furthermore, key channels of transmissions of the pandemic crisis that are affecting PPP projects across the globe will be outlined. Bearing in mind that there is little hard data available on how PPP projects and plans have been affected, this research paper will focus on predicting the medium-long term impacts of the pandemic. In addition, author will suggest how parties involved in PPP projects might address the ongoing issues, taking into account that the impact of the pandemic and economic downturn on PPP projects varies depending on the stage of the PPP process.*

Keywords: *Public-Private Partnerships, covid-19, force majeure, risk, crisis*

1. INTRODUCTION

COVID-19² is spreading across the world at alarming speed. This is an unprecedented crisis and calls for unprecedented measures. It is affecting the global economy, hitting manufacturing and service sectors alike, with huge impacts on the labor force. The current COVID-19 crisis has strained infrastructure projects globally, and in particular PPPs³, at all stages and in all sectors - with implications for governments, providers of infrastructure assets and services, their financiers, and end-users. PPPs are vulnerable to both the financial and the real impact of the COVID-19 crisis. Although the final consequences and duration of the crisis are not yet known, the likely effects on PPPs can already be identified. Both existing and planned PPP programs could be affected through various channels, such as the availability and cost of credit, lower growth, and unforeseen exchange rate movements. Depending on the contractual arrangement between the parties, the changed distribution of risks can shift the cost burden between the parties, weakening the attractiveness of PPPs. Parties are being forced to reevaluate risk. [1] Analysts and institutions alike predict that GDP will decline for almost all countries in 2020 and potentially into 2021 [2]. Public spending has soared as governments try to mitigate these

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² Corona Virus Disease 2019

³ Public-Private Partnerships

initial impacts, particularly through income support to businesses and individuals, and by strengthening health services [3]. The current health crisis will most likely affect PPPs in three ways [4]:

1. creating additional costs for all PPP projects,
2. affecting significantly the revenue of user-funded PPP projects,
3. posing specific challenges to projects that are in the construction phase.

The impact of the COVID-19 will depend on the length of disruption and will be felt differently by each PPP project depending on its specific conditions (country, sector, phase of the project cycle, design of the contract, etc.). For instance, PPP projects in transportation and energy will face significant losses of revenues. The aim of this research is to predict the likely implications of the COVID-19 pandemic on PPPs. Additionally, it will present possible ways by which public authorities could address consequences of the pandemic. At the time of writing this research paper the world has been in pandemic mode for a year and a half. The virus continues to spread at a slow burn, while intermittent lockdowns are the new normal. It is obvious that the full impacts of the COVID-19 will take time to be felt, especially in the PPPs, so big amount of real data that could be analyzed at this time is not available. Consequently, this paper does not seek to provide a comprehensive menu of responses but aims to highlight the most sensitive aspects and risks that would benefit from an immediate, proactive steps by government, sponsors, and lenders - given contracts' limited flexibility to adjust to drastic changes.

2. PUBLIC-PRIVATE PARTNERSHIPS

PPPs are a contractual means to deliver public assets and public services. PPP contracts include those intended to develop and manage new infrastructure, contracts to undertake significant upgrades to existing infrastructure (these are called infrastructure PPPs), and those under which a private partner manages existing infrastructure or only provides or operates public services (known as service PPPs). There is no universally accepted definition for the PPP concept. In fact, the term PPP is sometimes used to mean any form of association or co-operation between the public and private sectors for the purpose of reaching a common goal. The Organization for Economic Co-operation and Development (OECD) defines a PPP as an agreement between the government and one or more private partners (which may include the operators and the financiers). Within the agreement, the private partners deliver the service so that the service delivery objectives of the government are aligned with the profit objectives of the private partners. Furthermore, the effectiveness of the alignment depends on a sufficient transfer of risk to the private partners [5]. According to the International Monetary Fund, PPPs refer to arrangements in which the private sector supplies infrastructure assets and services that traditionally have been provided by the government. In addition to private execution and financing of public investment, PPPs have two other important characteristics: an emphasis on service provision and investment by the private sector. In this way, significant risk is transferred from the government to the private sector. PPPs are involved in a wide range of social and economic infrastructure projects. However, they are mainly used to build and operate hospitals, schools, prisons, roads, bridges and tunnels, light rail networks, air traffic control systems, and water and sanitation plants. For the European Commission, the term Public-Private Partnership is not defined at the community level. In general, the term refers

to forms of cooperation between public authorities and the world of business which aim to ensure the funding, construction, renovation, management and maintenance of infrastructure for the provision of a service.

3. COVID-19 CRISIS IMPLICATIONS AND TRANSMISSION MECHANISMS

The impact of the COVID-19 crisis and ensuing economic downturn on PPPs varies depending on the phase of development [1]:

1. Operational phase: The PPP is negotiated, the construction phase is completed (if applicable), and services are being provided by the private partner(s).
2. Construction phase: The PPP is negotiated, but the construction of physical assets is still underway and service provision has not commenced.
3. Pipeline phase: The PPP is planned and may even be tendered. However, the public and private partners have not reached financial closure and physical works have not started.

There are several channels through which the financial crisis, the associated increase in risk aversion and the ensuing recession may affect PPP programs. The channels include upward pressure on interest rates (see Figure 1), decrease in the availability of credit, the real effects of the economic slowdown on revenue cash flows and unforeseen exchange rate movements.



Figure 1. Interest rates from 2018 to 2021 [6]

Different parties carry different types and amounts of risk, and not all will be affected in the same way. This may alter the attractiveness of PPPs for the parties most affected and reduce their interest in participating in PPPs unless they are compensated. Potential short-term and a long-term COVID-19 implication can be as following [7]:

1. Short term - delays in project preparation and tenders; reduced bidder interest in PPP tenders; lenders' natural caution extending time needed to achieve financial close; construction delays, both as a result of local restrictions and due to supply chain disruptions for imported equipment and materials; requests from contractors to invoke force majeure clauses in PPP Contracts.
2. Long term – work and travel restrictions; a flight to quality project financing by investors and lenders; investors and lenders are likely to require governments to take on more risk than previously; investor claims and requests to revisit PPP

Contracts, particularly force majeure provisions; disputes, legal cases and contract terminations.

These impacts can be mitigated with modest success through force majeure and compensation clauses, using bridge financing, capital injections, renegotiation of key project parameters, and introduction of regulatory flexibility on performance indicators, among other measures. If the pandemic's impacts are limited to the short or medium term, project credit risk and access to financing may not change substantially [8].

4. COVID-19 CRISIS IMPACT EVIDENCES

The impact of the COVID-19 crisis on PPP programs can be seen by looking at the impact of past crises. Investment commitments in the first half of 2020 stood at US\$21.9 billion across 128 projects, a decline of 56 percent from the same period in 2019. COVID-19 has significantly decreased financial closures of investment projects across the globe, particularly in the East Asia and Pacific region [9]. Investment in the first half of 2020 accounted for US\$21.9 billion across 128 projects, a 56 percent decrease from investment levels in the first half of 2019 (Figure 2).

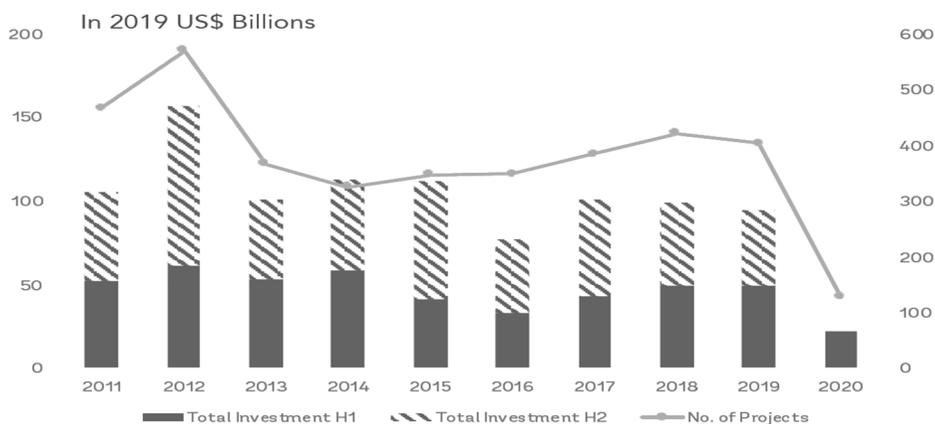


Figure 2. Investment commitments in Infrastructure Projects with Private Participation [9]

COVID-19 has brought many sectors, including infrastructure, to a near standstill. Since the beginning of 2020, existing infrastructure projects were delayed or cancelled due to supply chain disruptions, travel and shipping restrictions, and other obstacles. Decreased demand or required renegotiations also either prevented or delayed many projects already in pipelines from achieving financial closure. Investment levels in the first half-year have not been as low since the first half-year of 2005, when investment totaled US\$21.5 billion. By comparison, during the period of the great financial crisis, investment levels dropped 14 percent from the first half of 2009 to the first half of 2010, and then dropped again by 13 percent in the first half of 2011, before rising by 19 percent in the first half of 2012. The current downward trend is expected to continue into the second half of 2020 [9]. The average (mean) project size in the first half of 2020 (US\$173 million) was lower than the average project size for the first half of 2019 (US\$244 million). Investments in each project

size category decreased compared to the first half of 2019. The share of medium-sized projects (US\$100 million to US\$500 million) decreased substantially, from 41 percent in the first half of 2019 to 27 percent in the first half of 2020 (Figure 3).

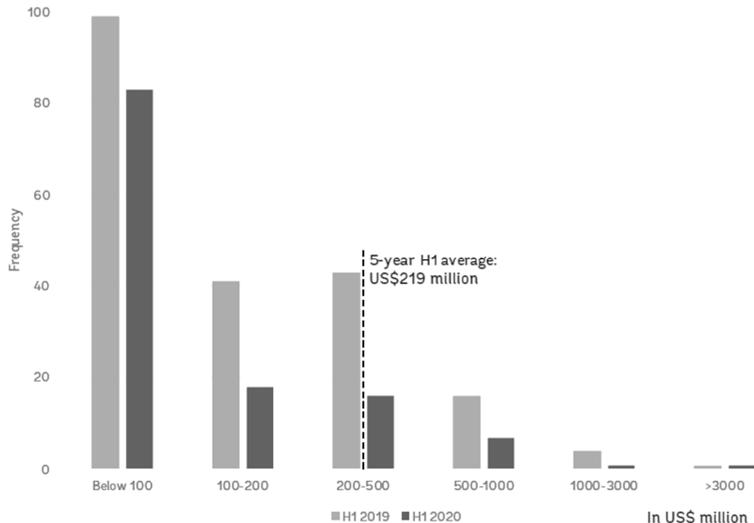


Figure 3. Size Frequency Distribution of Infrastructure Projects with Private Participation [9]

5. CONCLUSION

During the implementation of the new PPPs and realization of existing ones, each party in the process has different interests and seeks to strengthen its contractual position as much as possible. However, in a situation of a COVID-19 pandemic it is necessary that all parties involved in the PPPs show solidarity and do everything in their power to protect the health of all its workers and to ensure compliance with all the measures adopted by the relevant government authorities. The author's recommendation is that, regardless of what is stated in the contract, all parties make an effort to ensure minimization of the consequences of the COVID-19 pandemic on the realization of the PPPs. Moreover, parties should be willing to revisit all the risks that were not sufficiently balanced in the contract and through the annexes to the contract ensure better risk allocation to the legal entity that is in the best position to manage technical and organizational challenges. Also, it is crucial that through the PPP realization each party performs diligent and quality contract administration, including the right procedures to collect, store and use data that may be relevant for potential claims for extension of time or additional payments. The next steps in the research should be focused on contributing to making PPP legal frameworks fit for a post-COVID-19 world, with the broad participation from both public and private sectors, civil society, and the international development community. Additionally, the fact that COVID-19 has effectively put PPP plans on hold, at least temporarily, provides an opportunity for governments to review their PPP frameworks and plans in the light of the likely new normal.

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УТИЦАЈ КОВИД-19 НА РЕАЛИЗАЦИЈУ ПРОЈЕКТА ЈАВНО-ПРИВАТНОГ ПАРТНЕРСТВА

Резиме: Циљ овог рада јесте приказ практичних проблема у току реализације пројекта јавно-приватног партнерства који настају као последица КОВИД-19 и који се јављају на грађевинским пројектима уговореним по овом моделу. Поред тога, биће приказани и кључни токови којима се утицај кризе изазване пандемијом одражава на реализацију пројекта ЈПП широм света. Имајући у виду да је тренутно на располагању мала количина података о утицају кризе на реализацију пројекта ЈПП, циљ овог рада биће да предвиди средњорочне и дугорочне утицаје пандемије. Додатно, аутор ће предложити могуће начине помоћу којих уговорне стране могу превазићи текуће проблеме, узимајући у обзир да утицај пандемије и економског пада на пројектима ЈПП варира у зависности од фазе у којој се пројекат налази.

Кључне речи: Јавно-приватно партнерство, ковид-19, виша сила, ризик, криза