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Cities for our grandchildren: responsibility towards future generations in PPP projects

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. Jacobs pointed out that humanistic management of cities might be a solution for those dilemmas as it supports social and economic vitality in cities (Jacobs, 2011).

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 multi-dimensional 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 and Polish regulations. Additional aspects, such as the

intergenerational responsibility for PPP projects – a key part of humanistic management – are ignored by them.

Previous Polish researchers on PPPs elaborated mainly some detailed aspects of PPP undertakings, such as for example optimal risks sharing and financial montage, but paid little attention (if any) to intergenerational externalities caused by some PPPs. This deficiency in the literature represents a significant gap in the current understanding of PPPs. The very first voice in the discussion of intergenerational projects is a book published in 2018 by Monika Foltyn-Zarychta entitled *Ocena inwestycji międzypokoleniowych (Appraisal of intergenerational investments)*. However, it focuses on every kind of long-term, intergenerational undertaking, without any special emphasis on PPPs.

Nonetheless, as follows from the literature review, intergenerational responsibility 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. All of these factors may be treated as intergenerational externalities of PPPs. 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 the Polish PPP undertakings with respect to this issue.

The rest of the paper is organised as follows: Section 2 deals with a literature review and proposes a catalogue of intergenerational externalities of PPPs, while Section 3 presents Polish PPP case studies, and final remarks close the paper in Section 4.

Section 2: Attitudes towards PPP liabilities

Based on some widely discussed definitions of PPPs (Sobiech-Grabka, 2015), it is possible to point out some important features of any PPP undertaking:

- its subject is a service provision, traditionally delivered by a public sector,
- the public sector retains the responsibility for the quality and quantity of the service (or provided goods) and is obliged to control the private partner as regards meeting the standards of quality and quantity described in a PPP contract,
- it is a long-term commitment, based on the so-called *golden rule of risk sharing* – where each type of risk is taken by that partner who is more skilled for dealing with it.

The post-2009 Polish legal framework for PPPs encompasses two main bills: the Public-Private Partnership Act of 19 December 2008 (that came into effect on 27 February 2009), and the Act of Concessions for Construction Works and Services of 9 January 2009 (binding since 20 February 2009), accompanied by later ministerial orders (for more details: Wrzeszcz-Kamińska and Ścibor-Kowalczyk 2014 (eds.), pp. 112-125). The Concession Act of 2009 was then substituted by the Act of

Contracts for Construction and Services Concession of 21 October 2016.

This paper is not designed to present the whole scope of the PPP legal framework in Poland. Nevertheless, we will point out some elements of PPP contracts (determined by the law) that are crucial from the intergenerational point of view. In other words, PPP-style cooperation may generate some intergenerational externalities, as every other long-term public investment does (Foltyn-Zarychta, 2018). On the other hand, if the PPP contract is well-structured, it can substantially reduce the intergenerational burden, i.e., it may lead to internalization of externalities. The author has already delineated various types of intergenerational externalities connected to PPP investments in the soon-to-be-published book entitled *Partnerstwo publiczno-prywatne jako metoda internalizacji odpowiedzialności międzypokoleniowej (Public-private partnership as a method of internalization of intergenerational responsibility)*, and grouped them into financial and non-financial categories.

Different intergenerational burdens can be generated during different PPP stages. During the stage of PPP contract realisation it is possible to distinguish following types of intergenerational burdens:

- public sector obligation for payments to private partner,
- taking out a mortgage on public property by private partner,
- lack of financial penalty clauses in a PPP contract for the case of inappropriate realization of the agreement,
- tax relief or exemption for the private partner,
- lack of private partner's obligation to insure the PPP project, lack of clear declaration, which partner is responsible for random incidents, or inexact description of this issue in a PPP contract,

- public real estate as contribution to PPP,
- limitation of competition for a PPP project done by public sector using its regulative power,
- public sector obligation for material (financial and non-financial) contributions for private partner,
- lack of proper protection of public interest as regards maintenance standards of infrastructure built within PPP,
- permanent and irreversible land use,
- depletion of natural resource,
- ecological damages.

Potential intergenerational burdens generated by PPP when a PPP contract is finished are mainly connected to the issue of infrastructure transfer to public sector: what elements will be returned, how this process will be organised, how well it is described and regulated in the PPP contract (in terms of the infrastructure standard, financial penalties in case of delays) and so forth (Sobiech-Grabka, forthcoming).

The idea of taking into account intergenerational responsibility while deciding about public long-term investments is not a commonly-shared view in Poland. Therefore, it may help to refer to the thinking of great philosophers focusing on the idea of justice in order to find some arguments for incorporating intergenerational responsibility in the decision-making process.

J.S. Mill and J. Bentham proposed the concept of utilitarianism with *utility* as a main factor appraising the achievement of justice. They 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 (happi-

ness) for the greatest number of citizens (Mill, 2006).

On the contrary, J. Locke and his followers (e.g. R. 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, any state-driven market intervention is unjust (Nozick, 2010).

The third standpoint, proposed by J. 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 (Rawls, 1994).

Let us now leave the "ivory tower" of great philosophers of the past and consult some contemporary economists dealing with the issue of intergenerational appraisal of projects. Economists have underlined the intertemporal nature of investment decisions for years. C. Hepburn notes that even if discounting (widely employed in social cost-benefit analysis) were 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). 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). T.C. 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*. Let us underline here that this proposal is very "Rawls-like". 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).

However, local authorities seem to remain deaf to those ideas. As S. Fainstein (2010) describes, for years public projects were evaluated in terms of their effect on enhancing competitiveness, raising property values and attracting businesses and tourists. B.M. 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, communities underestimate *the freedom to make and remake our cities, a freedom that is in fact one of the most valuable human rights* (Harvey, 2008, p. 315). Harvey concluded that a small economic elite moulds cities according 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 (there are many critical reports on using PPP in road sector, health care and education). In the report of D. 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

(Private Finance Initiative) 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 service 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). However, the vast majority of Polish PPP projects are undertaken by local municipalities that are not entitled to impose taxes on their local citizens. Taking into account that in Poland the majority of taxes is collected by the central administration and then is partially redistributed to local authorities, we must underline that those remedies are not easily applicable to the Polish case.

In a similar vein, J. Shaoul, A. Stafford, P. Stapleton 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).

Building on O. 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? 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 the next sections of the paper.

Section 3: Polish experience with PPPs

According to the official database of the Ministry of Investment and Economic Development, there were 126 realised PPP projects in Poland (as of June 2018). Around 74% of PPP contract proposals end up being cancelled (Korbus, et. al, 2017).

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. 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 for so many PPP failures in the eyes of the present author is the priority of public bodies to keep the project neutral with regard to public debt. If a contract is structured in an appropriate way, consistent with the Eurostat decision, the borrowing does not appear in the government's ac-

counts. The Decision was implemented within the Polish legal framework by the order of Minister of Economy, issued in 2015.

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.

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). A discussion concerning the long-term effects of PPP and the effects on future generations simply does not exist in Poland. This myopia is becoming increasingly common among public entities responsible for PPP projects, as shown in the next section of the paper.

Section 4: Case studies

Solec-Zdrój: The mineral water swimming pools complex

The main aims of the project were as follows: the enhancement of tourism in the region, the 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 the negotiation power of the public entity, desperately seeking 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

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%
- Contract duration: 27 years (+/- three years, depending on the repayment period)
- Private partner shapes prices freely
- Project is currently in operation (since 2013)

„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 – 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. 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 the potential threat of 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.

It is possible to examine every PPP undertaking through the prism of justice theories presented earlier in the text. Let us do this intellectual exercise for the case of Solec-Zdrój investment.

The local government borrowed money from the private partner with the aim

of using 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 will be 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 in Solec-Zdrój will 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. Each influential theory of justice developed to-date provides us with a different approach as regards the right of a current government to undertake any long-term commitments affecting future generations.

We could expect that utilitarians would vote for building mineral swimming pools, as the project would contribute to the greater good of everyone in the long run. According to the libertarian approach of R. Nozick, the concept of a greater good is useless because it is superseded by individual liberty. Nozick probably would be strongly opposed to the Solec-Zdrój investment, arguing that building swimming pools at a cost to future generations could not be justified. In his eyes, as mentioned before, government

interfering in the market is simply wrong. On the contrary, 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). Rawls might also be very concerned about the depletion of the springs. Using his *veil of ignorance* concept, we could consider the following questions: would you want to be poor in this generation with access to mineral pools? Or would you want to be poor in a future generation with either unaffordable access or no access at all (because the springs were depleted)?

Energy performance contracting projects

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 of this kind was undertaken in the 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 private partner is remunerated from the savings (the difference in public spending on energy is paid to the private company during a given contract period). 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. It is good for the current generation and is even more important for future generations.

Railway station project: Sopot

The case of 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 private partner may also construct 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).

On one hand, this scheme seems to be honest and it is a market-oriented one. However, if we assess it from the wider perspective of responsibility towards future generations (and from an intergenerational justice point of view), it appears that the local authorities of Sopot determined the use of the place for a very long

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 (MRR, 2012; Zamel, 2012).

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 the commercial part of the project (hotel, parking ramps, commercial buildings) without any direct payment from the city council (MRR, 2012).

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.

time. In other words, today's municipal budget profits from the right of building on public land (sold at a cost to future generations). The resulting built-inheritance may not be perceived as desired by our successors. 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 investments within the real estate market.

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 3 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 paid back the private partner do not adversely affect future generations financially, 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 issue. 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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