

## ENACT – DESIGN APPROPRIATE CONTRACTUAL RELATIONSHIPS

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**CLIENT:** *European Commission, Directorate-General Transport and Energy*

**YEARS:** 2007 -2008

### DESCRIPTION OF ACTIVITIES:

#### *Objectives of the project:*

The increasing involvement of the private sector – mostly in Public-Private Partnerships (PPP) – in the provision of assets and/or services previously provided directly by the states raises significant questions about the application of socially optimal pricing schemes such as Social Marginal Cost (SMC) pricing. Private engagement entails allowing adequate rates of return in a purely financial perspective, which is too often incompatible with SMC pricing principles. The ENACT project has several objectives:

- to understand and describe the incentive framework and associated risks within which the involved parties, as rational economic agents, play their roles in PPP schemes;
- to understand and describe the role of financing, financial markets and associated risks in the development of PPPs in the transport sector;
- to devise ways to incorporate the principles of Social Marginal Cost Pricing into public-private partnership schemes, taking into consideration the players' incentives and the risks involved.

The results of the project will serve as the basis of a set of Guidelines to establish a Common European Policy/Regulatory Framework for socially optimal SMC pricing obligations in Public-Private Partnerships in the provision of transport infrastructure and/or services.

#### *Methodology*

In a first step, the ENACT project will leverage on existing research on the issues of SMC pricing and Second-Best alternatives (optimal mark-ups for cost recovery).

The second step will consist of analysing the PPP phenomenon under the light of Incentive and Contract Theory, and the impacts that SMC pricing might have in terms of the informational and incentive structures of PPP contracts.

The third step will be to focus on financial markets, and on the impacts that SMC calculation and pricing have on the perception of risk and the demanded rates of return.

From this theoretical framework, case studies and simulations will be performed.

#### *Project structure*

In order to attain the declared objectives of the ENACT project, the work will be organised in six scientific Workpackages (WP). This organisation is aimed at ensuring that clear partial objectives are met and that a coherent research output is produced.

A brief description of the Workpackages follows:

WP 1 – Detailed ENACT Methodology will lay the groundwork for the rest of the project and, as such, it assumes a particularly relevant role within the workflow structure of the project.

WP 2 - Social Marginal Cost Pricing and Second-Best Alternatives will develop, taking into consideration prior research, all pertinent issues relating to Social Marginal Cost (SMC) pricing and to second-best pricing alternatives, namely related to optimal determination of mark-ups for cost recovery.

WP 3 – Incentive and Contract Theory will develop all issues related to Incentive and Contract Theory. It aims to understand how the structure of the contracts establishing Public-Private Partnerships (PPP) can induce the private sector to perform according to public-policy oriented goals.

WP 4 – Financing Structures and Costs will analyse the role that financing has on the establishment of PPPs and the impact that SMC pricing has (or not) on the terms of private financing in the transport sector.

WP 5 – Integrated Theoretical Framework has two objectives. The first one is to integrate, in a theoretically consistent document, all research performed in the previous Workpackages. The second one is to devise strict guidelines for the elaboration of the Case Studies and Simulations of WP 5.1.

#### WP 5.1 – Case Studies and Simulations

In this Workpackage, Case Studies and Simulations will be performed in order to assess, in a real-world situation, the impacts of SMC pricing on the viability prospects of PPP projects.

WP 6 – Impacts and feasibility of SMC pricing in PPPs will constitute the final WP of the project. The expected output is an integrated, real-life tested conclusion of the research work performed and, at the same time, a set of policy/regulatory guidelines from a Common European Approach to SMC pricing in PPP projects in the transport sector.

*The role of TRT*

In addition to the contribution to other WPs, TRT is responsible for the WP2.

This WP will explore different workable pricing schemes, with pure Social Marginal Cost as a starting point. For each transport mode, departures from

pure marginal cost pricing will be analysed taking into account as wide as possible a range of circumstances, such as budget constraints, equity, institutional issues, simplicity, etc.

Particular emphasis will be given to the evolution, over time, of the determinant cost components of SMC. Another objective of this WP will be to produce a set of preliminary guidelines for the elaboration of Case Studies and Simulations.

Below is depicted the workflow foreseen for the ENACT project:

