

2. The broad environment for concessions

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The success of a concession depends not only on the details of the contract or license but also on the adequacy of the broader legal and institutional environment governing the concession's design, award, and operation. This chapter looks first at how governments can best organize themselves to manage the process of designing and awarding concessions, and then at laws and regulations that affect the operation of concessions.

2.1 Government Organization

The interface between the government and the private sector is key to the success of private infrastructure arrangements. Governments need to perform numerous tasks when planning, designing, implementing, and regulating concessions. And inefficient organization can result in substantial cost to the government, developers, and consumers.

2.1.1 Government Responsibilities for Concessions

The functions that governments must perform regarding concessions span a wide range, from the establishment of an enabling environment to the award of specific concessions and their regulation (box 2.1).

2.1.2 Costs of Government Disorganization and Guiding Principles for Improved Operations

A lack of definition and transparency in government processes can increase uncertainty for investors and developers and thus multiply costs or stop projects from going ahead. For example, unclear assignment of authority to grant concessions and adopt related support measures or overly complicated and undefined

approval processes can prevent concessions from developing smoothly (box 2.2).

Governments should try to implement the following principles in order to improve the way they manage concessions:

- Effective coordination of relevant government policies and approvals.
- Clarification of roles and responsibilities with respect to private investors.
- Acquiring access to the expertise required to design and implement complex transactions.

The design and implementation of concessions requires the coordination of several governmental actors. Sectoral ministries will usually be responsible for developing overall sectoral policy, finance ministries will usually have a close interest in the public revenue or liability implications of particular projects, and environmental ministries or authorities may have an interest in projects, as may ministries of justice, competition authorities, and others. Some coordination will often also be necessary between actors at central, provincial, and municipal governments regarding, for example, necessary approvals or the granting of guarantees.

When the government does not effectively coordinate all relevant actors, it risks sending mixed signals to private investors and causing delays, either of which can deter investors or increase development costs substantially. When several large transactions are envisaged, governments should

Box 2.1 A Sample of Government Responsibilities for Concessions

Framework

- Adopting legal provisions to enable the granting of concessions.
- Establishing or identifying regulatory authorities.
- Managing government support to infrastructure projects.
- Managing public relations and information.

Project identification and analysis

- Identifying projects amenable to concessions (including in-house and unsolicited proposals).
- Prioritizing projects amenable to concessions.
- Hiring advisers.
- Performing a preliminary review of the costs and benefits of the project (without duplicating the analysis to be performed by the private sector), especially in cases where the government will be assuming part of the market risk.
- Reviewing legal and regulatory issues.
- Determining preliminary selection criteria.
- Granting permission for the project to go ahead (for example, for the opening of the bidding process).
- Setting a timetable for the project.

Enabling and supporting measures for specific projects

- Granting permits and other necessary authorizations (such as environmental permits, rights of way).
- Determining the form of government support for the project.

Design of the concession arrangements

- Choosing legal instruments.
- Allocating responsibilities.
- Choosing and designing pricing rules and performance targets.
- Determining bonuses and penalties.
- Determining duration and termination.
- Designing adaptation mechanisms to new or unforeseen circumstances.
- Choosing and designing a dispute settlement mechanism.

Concession award

- Choosing the method of award.
- Making decisions regarding prequalification and shortlisting.
- Determining bid structure and evaluation method.
- Determining bidding rules and procedures.
- Proceeding with the bidding.
- Negotiating.

Exercise of regulatory function

- Implementing regulatory rules.
- Supervising and monitoring.
- Enforcing rules (for example, imposing penalties).

Source. Klein, So, and Shin (1996); Fishbein and Babbar (1996); and World Bank staff.

Box 2.2 One Measure of the Cost of Government Disorganization

One measure of the effectiveness of government organization in the design and award of concessions is the amount of transaction costs incurred by participants in the process. Developing an infrastructure project with private sector participation is a complex task requiring firms and governments to prepare proposals, conduct bidding, negotiate deals, and arrange funding. These activities may generate high transaction costs, including travel costs, staff costs, time delays, and advisory fees for investment bankers, lawyers, and consultants. In general, the weaker is the policy framework and institutional capacity of the government, the higher these transaction costs are likely to be.

On average, transaction costs may amount to as much as 5 to 10 percent of total project costs. But there can be wide variations depending on the stability of the policy environment. Where there is a well-developed policy framework, costs average 3 to 5 percent, whereas they may be as much as 10 to 12 percent in untested environments. Interestingly, empirical evidence suggests that transaction costs have little to do with project size.

Rather, they stem from a lack of definition and transparency in government processes, which increase uncertainty for investors and developers and thus multiply costs. Unclear lines of authority between national and local entities and an onerous approval process can delay projects, sometimes for years, or even cause them to be abandoned. China, for example, is notorious for its tortuous bureaucratic processes: any project valued over \$30 million requires review and approval by the central government, in addition to authorization by the concerned province, and must pass twice through the State Planning Council.

While the transaction costs incurred in private projects are often more apparent than in public projects, private projects do not necessarily generate higher overall costs. Greater attention to project parameters and better monitoring may avoid the time and cost overruns that are common in executing public sector projects. Also, as governments gain more experience with such projects and clarify the policy framework—resulting in speedier processes—these costs tend to fall.

Source: Klein, So, and Shin (1996).

consider establishing an explicit sequencing plan to help in marketing the projects and to avoid over-burdening local financial markets.

Investors will want to know what entities are responsible for providing what approvals and against what criteria. This knowledge is essential to effective coordination within government, but it is also important to guide and give confidence to potential investors. In addition, it is a prerequisite for transparent approval and bidding procedures.

Governments need expertise in a range of new areas to design and implement concessions. In addition to the technical engineering requirements of particular projects, new skills will be required in financing, regulating, and marketing to potential investors and consumers. Inadequate expertise in these areas can prevent the establishment of mutually beneficial and sustainable private infrastructure arrangements.

All countries undertaking major private infrastructure arrangements—industrial and developing countries alike—must hire outside expertise from investment bankers, lawyers, and others. While detailed technical expertise can be contracted out in this way, governments still require staff with relevant expertise to hire and oversee the consultants, and to incorporate the lessons of experience for future transactions (box 2.3).

2.1.3 Degree of Decentralization in Government Organization

In order to manage their concession programs, governments may organize themselves in a more or less decentralized manner. Government activities regarding the design and award

of concessions in Chile, for example, are much more centralized than those in Brazil. How does this difference affect the design and implementation of concessions?

First, decentralization is used here in two situations. The first is vertical decentralization, in which the authority to grant and administer concessions has been transferred to local governments. The second is horizontal decentralization, in which the functions regarding concessions have been dispersed within one level of government. For example, responsibilities for concessions in transport, water, or electricity could be assigned to sector departments or ministries within a single tier or level of government—this would be horizontal decentralization. On the other hand, a single unit or entity (within a single tier or level of government) could be assigned the administration of all concessions in transport, water, and electricity—this would be horizontal centralization.

Second, one has to keep in mind that organizations for concessions combine centralization and decentralization in different ways. For example, a country's administration of concessions can be vertically decentralized at the same time as being horizontally centralized. Take the case of Brazil. There, some responsibilities for concessions belong to the state of Rio de Janeiro—meaning that functions are vertically decentralized (although not all the way to the municipal level). On the other hand, Rio de Janeiro uses a central unit to manage its concessions; which means that its functions are horizontally centralized. Similarly, the organization can be vertically centralized but horizontally decentralized. This is the case in New Zealand, where the central government has the

Box 2.3 Hiring Advisers

In hiring advisers, governments must address a number of issues:

- *What type of consultants are needed?* Concession advisory services can require economic and regulatory consultants, legal advisers, technical consultants and engineers, environmental consultants, investment bankers, and others.
- *How should the advisory work be packaged?* If a range of advisory services is needed, governments have the option of hiring a consortium (with a lead firm, which can be easier to manage and can result in more uniform advice) or hiring separate advisers (which provides access to a range of advice on complex issues and can promote a more informed discussion).
- *How should the advisers be hired?* As a general principle governments should use competitive bidding to select advisory firms, as competition will generally enhance the quality of proposals, enable governments to choose from a number of proposals, and increase transparency in the process. Direct hiring may be justifiable, but governments should use it judiciously and follow a transparent process that stands up to public scrutiny.
- *On what basis should advisers be remunerated?* Establishing appropriate fee structures for advisers is a complex but important task, as the fee structure may affect the type of advice given. For example, investment banks frequently are paid on the basis of a success fee for completing a transaction. Thus the advisory firm will benefit if a public enterprise is sold as a legal monopoly (that is, it will fetch a higher market price), but the sector as a whole and the economy may suffer as a consequence.
- *How should advisers be managed?* Governments can enhance the effectiveness of advisers during the assignment by having a strong counterpart on their side, ensuring that advisers have access to all pertinent information on a timely basis, and making timely decisions throughout the process to provide continued clear direction to the advisers. Otherwise, advisers will work in a vacuum, with high cost and little return to the client government.

Source: World Bank staff.

main responsibility for concessions (vertically centralized), but sectoral departments have the lead (horizontally decentralized). Further, in some countries certain sectors are the responsibility of vertically decentralized authorities while other sectors remain vertically centralized. For example, in France water is vertically decentralized but telecommunications and electricity are vertically centralized.

Third, it is important to remember that much depends on the political system and traditions of the country in question. One should not, however, give up trying to tailor or improve the system in place. Even in cases where the jurisdiction and organization of different tiers of governments, or entities within them, have clearly been defined in the constitution, most systems will have room for some improvement in the conduct of government business.

2.1.3.1 Vertical decentralization.

There is no universally good or bad way of making changes. There are common trade-offs, however, between vertical centralization and decentralization (table 2.1), as well as between horizontal centralization and decentralization (table 2.2). An analysis of such trade-offs shows the strengths and weaknesses of each approach and indicates how an organization can be improved in these regards.

Most systems are not perfectly centralized or decentralized. In practice, intermediate solutions can be devised in order to strike a more optimum balance between the two extremes. For example, policy determination and implementation can be separated and assigned to different tiers

Table 2.1 Trade-Offs in Vertical Decentralization

Criterion	Centralized approach	Decentralized approach
Provides flexibility to adapt to local conditions, priorities, and preferences	–	+
Promotes consistent policies	+	–
Promotes experimentation with different approaches	–	+
Favors learning between jurisdictions	+	–
Helps the development of expertise that is specific to local conditions	–	+
Uses economies of scale to deal with the problem of constrained capacities	+	–
Provides decisionmakers with better information	–	+
Enables decisionmakers to take into account the effect of local policies on other jurisdictions	+	–
Promotes the accountability of decisionmakers	–	+
Facilitates the consideration of how decisions regarding concessions can affect trade between jurisdictions (such as standards, subsidies)	+	–

Source: World Bank Staff.

of government. Different tiers of government can also deal with different policy questions. And different levels of government might cooperate on certain matters.

In a system that emphasizes vertical centralization one of the main challenges is to take into account specific local conditions. Consultation mechanisms could be useful to achieve this. In a system that emphasizes vertical decentralization one of the main challenges is to deal with constrained technical capabilities. Expertise can be enhanced through the use of a central unit staffed with skilled individuals that are at the disposal of local authorities for guidance, advice, and training.

2.1.3.2 Horizontal decentralization.

There are similar trade-offs between horizontally centralized and decentralized approaches (table 2.2).

Most governments do not take an approach to concessions that is totally centralized or decentralized horizontally. Intermediate solutions can, in fact, be better. Responsibilities regarding budgetary commitments may, for example, remain entirely centralized within the finance ministry to ensure control, while sectoral policymaking can be decentralized toward individual sector ministries.

In a system that emphasizes horizontal centralization one of the main challenges is to take into account sectoral specifics. The formation of sectoral departments within a centralized entity can serve this purpose. In a system that emphasizes decentralization one of the main challenges is to maintain coherence among sectors. Establishing coordination mechanisms between sectors will be important in this regard.

Table 2.2 Trade-Offs in Horizontal Decentralization

Criterion	Centralized approach	Decentralized approach
Enables a focus on sectoral specifics	–	+
Promotes consistent policies across sectors (that is, reduces the risk of distortions arising from inconsistent approaches to common issues)	+	–
Promotes experimentation with different approaches	–	+
Favors learning among sectors	+	–
Helps the development of sector-specific expertise	–	+
Uses economies of scale to deal with the problem of constrained capacities	+	–
Minimizes the impact of sectoral politics	–	+
Improves resistance to improper influences from particular industries or political authorities	+	–
Decreases the opportunity to inappropriately apply precedents from one sector to other sectors	–	+
Improves the ability to deal with blurring industry boundaries	+	–

Source: World Bank Staff.

The adoption of cross- sectoral regulatory frameworks can also play a significant role (see section 2.1.4 below).

Most of the new institutional models being adopted around the world reflect some balance between extreme cases of centralization and decentralization and exhibit different ways of tackling the challenges mentioned above. Section 2.1.5 presents some country illustrations.

2.1.4 The Use of Cross-Sectoral Regulatory Frameworks

All concessions contain many project-specific details. In addition, some issues are unique to a particular industry and hence require attention on a sector-specific basis. Examples include technical and safety standards and market structure arrangements. But many of the issues associated with the awarding of contracts and some other key principles are nearly identical across sectors. For these issues there are a number of potential advantages to adopting common rules across sectors, including economies of scale, common interpretations, avoidance of the rule-making process being captured by industry-specific interest groups, and the sending of a clear signal by government authorities that they are committed to promoting private sector participation in infrastructure (box 2.4).

2.1.5 Government Organization: Illustrations

Governments around the world are working to improve and reform their organization in order to facilitate the development and execution of private infrastructure projects. A few cases are presented here. These examples demonstrate how some governments have applied the guiding principles presented in

Box 2.4 The Role of Cross-Sectoral Regulatory Frameworks

A growing number of countries are adopting cross-sectoral frameworks for private infrastructure, including Brazil, Bulgaria, Chile, China, Colombia, Hungary, the Philippines, and Vietnam.

While details vary among countries, the key elements of cross-sectoral frameworks include clear rules on:

- Which infrastructure sectors are open to private participation.
- Which agencies are responsible for approving private projects or contracts.
- Tariff adjustment.
- Contract amendment and termination.
- Competitive bidding, including the scope of exceptions.
- Availability of international arbitration.
- Other issues important to private infrastructure arrangements that are not dealt with adequately in other laws. Examples vary from country to country but include the treatment of security interests in private projects and rules on liquidated damages (that is rules regarding setting in advance of the amount of compensation to be paid in case of certain breaches of obligations).

Source: Kerf and Smith (1996).

section 2.1.2 and have met some of the challenges presented by centralization and decentralization (section 2.1.3).

2.1.5.1 Bolivia.

In 1994, to implement its bold Capitalization Program, Bolivia created the position of minister for capitalization. The Minister was made responsible for all aspects of government programs covering telecommunications, electricity, railways, airlines, airports, hydrocarbons, and water. Sector-specific working groups were formed within the Capitalization Ministry, drawing on relevant expertise from state-owned entities, sector ministries, and the private sector. A central procurement unit was formed and made responsible for handling the large number of contracts for consultants and advisers. Having accomplished its objectives, the ministry closed its doors in the summer of 1997.

2.1.5.2 Peru.

Privatization of state-owned enterprises was the first stage of the Peruvian government's endeavor to develop private participation in infrastructure. Initially, the Private Investment Promotion Commission (COPRI) was responsible for the entire privatization program, including divestiture of state enterprises. COPRI is an interministerial commission composed of six members of the government and assisted by a small technical secretariat. Various special committees were set up to privatize individual state-owned enterprises chosen by COPRI (Guislain 1997: 156).

With many infrastructure assets now divested to the private sector, Peru is entering the second stage of its strategy,

focusing its attention on concessions, including many greenfield projects. The Private Concessions Promotion Commission (PROMCEPRI) was created in December 1996 for this purpose. Modeled after COPRI, PROMCEPRI is meant to be the only agency in charge of promoting private investment within the area of public infrastructure and utilities. PROMCEPRI will also use special committees to implement its concession program.

2.1.5.3 Mexico.

Mexico uses a relatively decentralized approach to support its infrastructure privatization program. Sectoral ministries primarily design and implement the projects, while the cabinet, supported by an interministerial commission, does the high-level policy coordination. The secretariat to the interministerial commission, located in the Ministry of Finance, is not directly involved with specific concessions but is used as a channel for managing concessional loans and donor support to the program.

2.1.5.4 The Philippines.

The government of the Philippines created a novel institutional structure to support the country's large private infrastructure program (under the 1989 BOT Law and Regulations). Each sectoral agency has a specialist "BOT Unit" responsible for coordinating the design and implementation of its projects. National, provincial, and municipal authorities select and award projects under the framework. The authorities prepare a list of priority projects, which must be approved by either the Investment Coordination Committee (ICC) of the National

Economic Development Authority (NEDA), the NEDA Board, or by local or regional councils, depending on the conceding jurisdiction and the cost of proposed projects, as specified in the Implementing Regulations to the Law. Projects undertaken on a build-own-operate (BOO) basis, or through contractual arrangements other than those defined under the Law, require presidential approval.

As part of its program, the government created a BOT Center. The Center has about 14 professional staff members and performs the following tasks:

- Keeping an updated national inventory of all nominated projects that are eligible for development under the BOT framework.
- Providing general advice to foreign investors doing business in the Philippines.
- Developing infrastructure projects.
- Providing technical assistance and training to central and local government officials on the design and implementation of projects.
- Spearheading promotional activities for the Philippine BOT program and specific projects through brochures and roadshows.

Initially, the Center was mainly involved in marketing the BOT concept to private investors. As the concept has become better known, most marketing and similar tasks have been devolved to the BOT units in each sectoral agency. The BOT Center now spends more time training national and local government officials.

2.1.5.5 Australia-State of Victoria.

State governments in Australia have the main responsibility for most infrastructure sectors. In the State of Victoria individual government departments are ultimately responsible for concession design and award. Project responsibility is assigned to a single minister in each case. This minister is then responsible for facilitating consultation with the other government departments involved in the project. The minister will also work with the Department of Treasury and Finance. In order to provide guidance and promote consistency in analysis and procedures, the Victorian government has formulated an "Infrastructure Investment Policy for Victoria," a description of which was published in June 1994 by the Department of Treasury and Finance. That department also acts as a reference center when guidance is required by other government entities (see Department of Treasury and Finance 1994, 1996).

2.2 The Broader Legal and Regulatory Environment

One of the first things investors will want to check before becoming involved in a concession is whether the country's legal and regulatory environment is favorable to concession operations. A concession agreement cannot unilaterally modify or override the provisions of a law or the country's constitution. Thus one cannot assume that all issues or problems can be handled within the boundaries of a concession agreement.

In order to create a legal environment that is conducive to concession arrangements, governments may have to amend or repeal some laws and regulations. They may also have to adopt new legal provisions to permit the granting of certain rights.

While the overall legal framework should be reviewed, it would be pointless in the context of a specific concession to document and remedy all the shortcomings that can be found in a country's legal environment. Efforts must be focused on the core part of the legal framework that must be in place for the concession program to succeed (Guislain 1997: 46, 87). This section identifies the main issues that should be tackled.

2.2.1 Threshold Legal Impediments to Private Participation

Governments must remove impediments that prohibit private participation in infrastructure. Two of the most important obstacles regarding concessions are laws and regulations that prohibit the private ownership and operation of public services and foreign investment in infrastructure sectors. Sometimes, although they do not prohibit the participation of the private sector or foreigners in infrastructure, governments impose conditions on participation. Investors will want to be aware of these conditions, as they may severely limit the scope of private involvement.

The following questions regarding limitations on private participation must be answered:

- Does the law permit the private provision of infrastructure services? In some cases the constitution or a law must be amended in order to abolish the legal monopoly of state-owned enterprises.
- Does the law permit the sale of certain infrastructure assets to the private sector?
- Does a specific law need to be adopted to transfer

infrastructure assets to the private sector? This is not necessary in most common-law countries, unless there is specific legislation to the contrary, but it is often required in civil-law countries.

- Are there limits or conditions for participation? For example, is the concessionaire obliged to form a joint venture with a public entity or to incorporate itself locally?

Likewise, the following questions on participation by foreign investors must be addressed:

- Are foreigners legally entitled to hold concessions?
- Are there limits to the foreign operation of public utilities? For example, do foreigners need to partner with local firms? Are foreigners limited to a maximum number of shares?
- Are foreigners excluded from certain sectors? For example, foreigners are sometimes excluded from "strategic" sectors.
- Are there other forms of discrimination against foreigners? For example, are domestic firms preferred in the bidding terms?

2.2.2 Property and Land-Use Rights

To attract private investment at a reasonable cost, governments must make credible commitments to rules that safeguard property rights. Investors need adequate protection against unwarranted government expropriation and want to know that the land rights they hold can be exercised and protected.

2.2.2.1 Legal provisions and restraints on expropriation.

All countries reserve the right to expropriate property for public purposes. In some countries such powers will be found in the legislation on the "eminent domain" right of the state (which describes the government's expropriation powers). Such powers can also be found in the Constitution. Many Latin American countries (for example, Colombia, Brazil, Bolivia, and Peru) have adopted new constitutions in the 1980s that include rights and obligations on expropriation.

Investors will want to know the conditions for expropriation. For example:

- Are investors compensated, and which standards apply to compensation?
- Are the rights to expropriate limited in scope?
- Are the rights to expropriate subject to judicial review?

2.2.2.2 Land law

Concession operations often require the use and ownership of land. Investors are likely to find answers to their questions regarding property rights in the country's legal system.¹

- Does the constitution recognize private ownership (of land, for example)? Many constitutions had to be amended in Eastern Europe and countries of the former Soviet Union (1989-90) and in some countries like Vietnam (1992) in order to allow privatization.
- How are ownership rights defined, recognized, and protected in the host country?

- What restrictions, if any, are placed on the transferability of those rights?
- How do titling and registration function in the host country (or in what ways are they deficient)? This information is important for determining the availability of title, for example.
- What enforcement mechanisms protect property rights?
- What restrictions may be placed on foreigners with respect to the acquisition and exercise of ownership rights for land or other real estate assets?

Concessionaires often need to acquire rights of way, for example for electricity transmission, fuel supply, or roads. They will also want to know:

- What are the rules applicable to the acquisition of rights of way? Can titles be secured and transferred in a timely manner?
- Who has the legal authority to acquire rights of way?
- If the government has this authority, can the exercise of those rights be delegated?
- How will the cost be apportioned?

Building infrastructure often requires that numerous people move to a different location (box 2.5). Many people have had to be resettled because of hydro dam projects and because of railway projects (such as in Mexico). Some of the issues concerning resettlement are similar to those raised by expropriation, while others are specific, they include:²

Box 2.5 Resettlement Issues in Chile

A dam being built on the Bio Bio River in Chile, with financing from the International Finance Corporation (IFC), has caused resettlement and environmental problems and shows how the breach of an indigenous law can hinder a private infrastructure project.

The dam has caused the river to rise in some areas, flooding the ancestral lands of the native Pehuenche Indians living there. Groups opposing the dam have claimed that the program to aid and resettle inhabitants has been inadequate and that the rights of the Pehuenche to remain on the land under a new Indigenous Law in Chile are being violated. The IFC withdrew its support from the project amid claims that the developer had failed to meet the conditions of the loan with regard to the resettlement of inhabitants.

Source: Inter Press Service (1997).

- What is the scope of the power of eminent domain?
- What is the nature of compensation associated with it? For example, what valuation method will be used? What is the timing of payment?
- Which legal and administrative procedures are applicable? For example, which appeal processes are available? What is the normal time frame for such procedures?
- What is the legal framework for land titling and registration procedures?
- Which laws and regulations apply to the agencies responsible for implementing resettlement? Which laws and regulations apply to the agencies responsible for land use, environment, water use, and social welfare?

2.2.3 Environmental and Safety Laws

Concessions are often conferred for projects that can have significant environmental impacts in sectors such as electricity transmission, ports, hydropower, airports, railways, and roads (box 2.6). Safety and health standards can also affect the planning and operation of the concession (in, for example, water and power plants). Investors will want to know:³

- Does the law require environmental impact studies, environmental permits, or licenses?
- What procedures are used? For example, does the concessionaire need to submit a project summary? What assessments must be performed?

- Does the law affect the construction and operation of facilities? For example, what conditions apply to the preservation of the natural environment, to temporary facilities, and to the state-use of pollutants?
- Will the concessionaire be liable for past environmental damages?
- Will the concessionaire be liable for future environmental damages?
- What are the standards of environmental compliance and reporting?
- What laws and regulations apply to wildlife, health, water, and land use? Who is responsible for applying them?
- What safety regulations apply to the concession?

2.2.4 Labor and Immigration Laws

Labor and immigration laws will present the concessionaire with a more or less conducive environment for operation:

- Does the law mandate the use of local employees?
- Are there restrictions on the use of foreign managers?
- What are the visa requirements for foreign personnel?

Issues also arise when the employees of a state-owned enterprise slated to be privatized are to become employees of the concessionaire. These include questions regarding whether the labor regime applicable to the personnel of state-owned enterprises continues to apply under the concession (that is, does the employment relationship continue?). In Morocco, for example, there is a legal presumption of

Box 2.6 Environmental Issues in Malaysia

The breach of an environmental law can delay and seriously disrupt a project. In Malaysia, for example, local people initially won a court case to stop Erkan, the main contractor of the 2,400 megawatt Bakun hydroelectric dam, from starting work on the project. A breach of the Environmental Quality Act was the basis for the decision. On February 17, 1997, however, the ruling was overturned on the grounds that the Act referred to in the original decision was not applicable in Sarawak, where the dam is located.

Source: Oxford Analytica (1997).

continuity of the employment relationship, despite changes in the employer's status, be it as a result of succession, sale, merger, split-up, absorption, transformation, or otherwise: "all labor contracts in effect on the day of such change remain in force between the new employer and the staff of the enterprise" (article 754 of the Obligations and Contracts Code, quoted in Guislain 1997: 74).

2.2.5 Competition Law and Policy

Especially in network industries, concessionaires will be concerned with the conditions and terms of their access to the network. If private operators rely on a state enterprise for access, and if the state enterprise is also a competitor in the market, concerns may arise about the abuse of market power. Rules regarding mergers and acquisitions can also affect a concessionaire's business strategy.

Competition rules can be found in individual agreements, sectoral laws, general competition laws and regulations, and possibly in all such instruments at once. It is important to know:

- Does the country have an economy-wide competition law?
- Do sectoral laws contain competition provisions?
- In case of conflict, which law takes precedence?
- Which bodies have jurisdiction over competition matters?
- In case of conflict, which body takes precedence, the utility regulatory body or the competition authorities?
- What rules apply to mergers and acquisitions? How do these affect the concessionaire?

2.2.6 Business Operation Provisions

Many laws and regulations affecting business operations can have an important impact on concessions (table 2.3). Investors must understand what benefits can be found in the law (for example tax benefits) and what obstacles must be alleviated or how the project can be modified to accommodate obstacles.

Some questions will be more important than others for certain concessions. For example, foreign exchange rules might be especially crucial to investors when project revenues are in local currency. A number of questions then arise:

- Does the concessionaire have the ability to exchange local currency into foreign currency?
- How will the rate be determined? Is the rate different for foreigners?
- Can project revenues be transferred to offshore revenue accounts and retention accounts?
- Can profits be repatriated? Under what conditions?
- What types of approvals are required?

2.2.7 Enforcement Provisions

Finally, investors will want to make sure that all the rights they benefit from under the law can be enforced. Investors should be aware of these facts and assess in each case how the host country's court system functions. In some cases alternative dispute settlements mechanisms can be considered. Important questions include:

Table 2.3 Business Operation Provisions and their Potential Impact on Concessions

Accounting rules	Standards applied for purposes of taxation and regulatory oversight Accounting and auditing procedures (for example, is audit by a public agency mandatory?)	Intellectual property rights law	Protection of patent, know-how, and business secrets Ratification of international conventions
Bankruptcy law	Conditions and procedures for liquidation, bankruptcy, and insolvency Protection afforded to the project company's creditors	International law	Ratification of international conventions, for example on trade and investment, which affect other areas of the law (such as expropriation and currency convertibility)
Contract law	Conditions for the formation of contracts (for example, contractual capacity of key customers and suppliers)	Public procurement law	Conditions of publicity, access, and competition (for example, is there a preferential treatment for state-owned enterprises?)
Company law	Provisions on the establishment of companies Limits to ownership forms (for example, with or without limited liability, and joint stock companies) Ability to "unbundle" control and voting rights from the rights to dividends and income Provisions for minimum capital requirements, on the conditions of sale or transfer of shares and on the protection of minority shareholders	Securities law	Conditions for the issuance and trading of shares and operation of financial intermediaries Existence of a securities exchange market and regulatory body Creation, perfection, and enforcement of collateral interests (see section 6.1.)
Financial law	Ability to get financing from local banks, pension funds, and other financing sources	Tax law	Application of corporate income tax, real estate tax, value-added tax (for example, regarding tax withholding treatment, standards applied to transfer pricing, depreciation norms, tax exemptions, double taxation) Tax administration procedures
Foreign exchange rules	Conditions of money convertibility, repatriation of profits, and so on		
Import/export law	Right to import materials and liabilities for import duties Submission to export controls		

Source: Guislain (1997) and World Bank staff.

- How well do courts perform their functions (in terms of delays, costs, expertise, problems of corruption)?
- What alternative dispute settlement mechanisms are available in the country?
- Are public parties able to submit disputes to international arbitration?
- Will international arbitral awards be recognized in the country?
- Can these awards be enforced in practice?

Dispute settlement mechanisms are discussed in more detail in section 3.10.

Notes

1. This list of questions is derived from Guislain (1997: 47).
2. This list of questions is derived from World Bank (1990).
3. This list of questions is derived from World Bank (1989) and Guislain (1997: 81-83).