PPPs – Dispelling the Myths

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Public Private Partnerships Conference
Wellington, 24 February 2011
Background

1. PPPs involve change

2. Much emotion/many myths

3. My focus on the evidence
   • try and take ideology out of it
   • look at the empirical evidence – positive and negative
What is a PPP?

1. Private provision of publicly funded services: eg,
   • contracting out design, construction and operation of prison
   • contracting out hospital cleaning services

2. Private funding of traditional public services (eg, privately financed roads)

3. Joint ownership (eg, Air NZ)
Myth 1: PPPs are new

![Graph showing the value of announced PPP deals in OECD, 1994 - 2007](Source: OECD)

Source: OECD
Myth 1 ctd: PPPs are new

Distribution of PPPs in the OECD

Source: OECD
Myth 1 ctd: PPPs are new

- NZ has long had PPPs
  - central government level
  - local government level

- What is potentially new for NZ is the scope of PPPs
Myth 2: PPPs have failed overseas

- Some have worked well
- Some have not worked well
- The real question is when do PPPs work best
Myth 2 ctd: PPPs have failed overseas

Evidence on construction projects from the UK’s National Audit Office

<table>
<thead>
<tr>
<th></th>
<th>Conventional procurement</th>
<th>PPP procurement</th>
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<tbody>
<tr>
<td>Cost overruns in the public sector</td>
<td>73%</td>
<td>22%</td>
</tr>
<tr>
<td>Delay in project delivery</td>
<td>70%</td>
<td>24%</td>
</tr>
</tbody>
</table>

NAO, “PFI Construction Performance, 2003
Myth 2 ctd: PPPs have failed overseas

<table>
<thead>
<tr>
<th>Quantitative Evaluations ctd.</th>
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<tbody>
<tr>
<td><strong>Arthur Anderson &amp; LSE (2000)</strong></td>
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<tr>
<td>Evaluation of 29 projects in UK (1/3rd of all in PPPs in UK at time)</td>
</tr>
<tr>
<td><strong>Australia</strong></td>
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<tr>
<td>- some high profile failures</td>
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<td>- many less high profile successes</td>
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Myth 2 ctd: PPPs have failed overseas

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<tr>
<td>Saussier et al (Review of Industrial Organisation 2006)</td>
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<tr>
<td>Road M4 Finland.</td>
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<td>UK Prisons National Audit Office</td>
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</table>

Myth 3: PPPs are always the answer

- Transaction costs matter

- PPPs don’t tend to work well when:
  - writing contracts is very costly
  - performance evaluation is difficult
  - trust and credibility does not exist among parties. Either the private or public groups (or both) are not perceived as reliable partners
  - working together, for mutual benefit, clouds accountability
  - politics means the government is unlikely to allow the private venture to fail
Myth 4: The government can borrow more cheaply

- Yes, the government can borrow more cheaply
- But question of risk
- If logic was correct, then Govt ought to borrow and buy all high risk/high return assets
- Why do PPPs: greater value for money and improve efficiency
Myth 5: Mixed ownership works best

“The sort of mixed-ownership model under which Air New Zealand operates – where the government owns most of the company but there is a minority of outside equity – gives the best of both worlds.”

John Key, State of the Nation Address, 26 Jan 2010.
Myth 5 ctd: Mixed ownership works best

• The evidence:
  – full privatisation leads to improved performance on average and over time
  – allowing foreign ownership likely to increase the gains to NZ
  – partial privatisation can have initial advantages over full state ownership
  – but not clear the gains from partial privatisation are lasting

Myth 5 ctd: Mixed ownership works best

• New Zealand’s experience
  – Air NZ
  – Auckland Airport
  – BNZ
  – Ports of Auckland
Myth 6: Failure of a company = PPP failed

- Several PPP providers have gone bankrupt

- 69 PPP projects in Australia (6 jurisdictions)
  - 7 encountered change of ownership (2 in pipeline)
  - 4 surrendered concessions (2 cross-claims)
  - 5 bids withdrawn/cancelled
  - 2 renegotiated successfully

M Regan, “Worldwide review of PPP Performance, Bond University.”
Myth 6 ctd: Failure of a company = PPP failed

- Loss of equity – nominal and real
- No loss of service continuity
- No evidence of significant loss to debt providers
- Commercial risk means some will fail
- Failure is if government bails out the private company
Myth 7: Making profits from PPPs is “bad”

- Profit – value added - is what drives economic growth
- Firms make profits in competitive markets by providing goods and services that customers want
- Key is that government gets regulatory environment right
Myth 8: Social services are not suited to PPPs

<table>
<thead>
<tr>
<th>PPPs by sector</th>
<th>Share in total</th>
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</thead>
<tbody>
<tr>
<td>Roads and motorways</td>
<td>39%</td>
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<tr>
<td>Tunnels and bridges</td>
<td>22%</td>
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<tr>
<td>Urban development</td>
<td>17%</td>
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<tr>
<td>Airports</td>
<td>7%</td>
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<tr>
<td>Trains</td>
<td>6%</td>
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<tr>
<td>Social infrastructure</td>
<td>5%</td>
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<tr>
<td>Water</td>
<td>2%</td>
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<tr>
<td>Electricity</td>
<td>2%</td>
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<tr>
<td><strong>Total</strong></td>
<td><strong>100%</strong></td>
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</tbody>
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Source: European Investment Bank
Myth 8 ctd: Social services are not suited

- Most countries start with transport & move to other sectors
- Has been gradual move to use PPPs in social infrastructure
- Provision
  - health, education, prisons, defence
- Financing
  - UK: Social Impact Bonds
  - USA: Pay for Success Bonds
Myth 8 ctd: Social services are not suited

Separation of funding and provision in health and education

<table>
<thead>
<tr>
<th></th>
<th>Services provided by public sector</th>
<th>Services provided by private sector</th>
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<tr>
<td><strong>Public financing</strong></td>
<td>Public education</td>
<td>Contracts</td>
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<td></td>
<td>Public health facilities</td>
<td>Vouchers</td>
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<td></td>
<td></td>
<td>Scholarships</td>
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<td></td>
<td></td>
<td>Insurance</td>
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<td></td>
<td></td>
<td>Social security</td>
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<tr>
<td><strong>Private financing</strong></td>
<td>User fees</td>
<td>Fee for service</td>
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<td></td>
<td>Loans for public education/health</td>
<td>Pharmacies</td>
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<tr>
<td></td>
<td></td>
<td>Insurance</td>
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<td>Private schools</td>
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<td>Private universities</td>
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Myth 8 ctd: Social services are not suited

• Common feature: seek to harness innovation and creativity of private sector

• Caveat: difficult to specify and measure performance in service delivery
What helps a PPP succeed?

1. An appropriate legal and institutional environment
2. Well-informed decision making
3. Clear, unambiguous contracts
4. Open, competitive, and transparent procedures
5. A predictable and non-discriminatory regulatory environment
6. Appropriate sharing of risks
Risk sharing

Risk should be shifted to the party best able to bear it.
Conclusions

• PPPs can work well

• Case by case approach required – no presumption that PPP always better VFM than conventional procurement

• Challenge is to align public and private interests

• Worst case is private sector enjoys profit and public sector ends up bearing losses