PPPs – Dispelling the Myths

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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)

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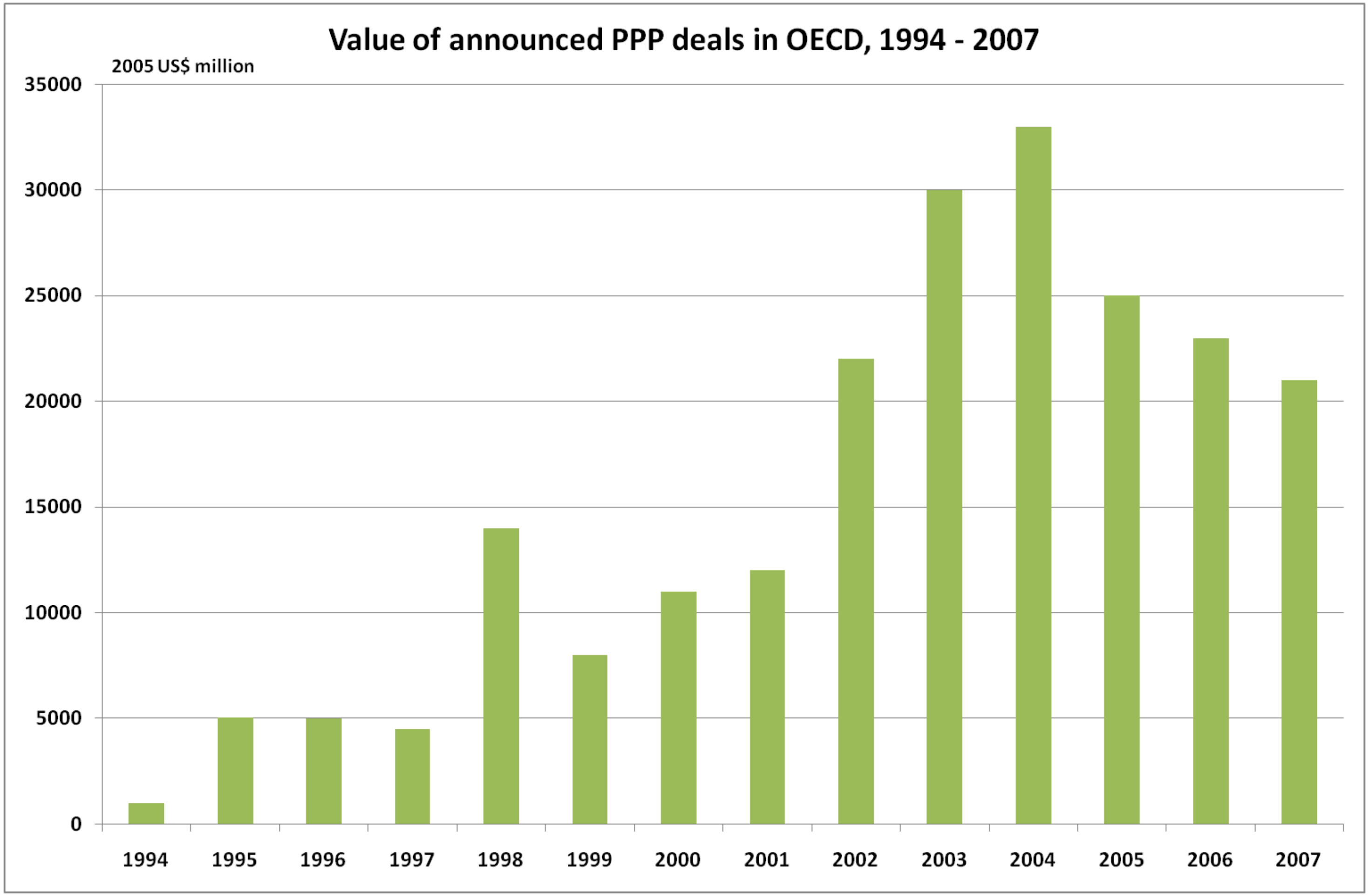
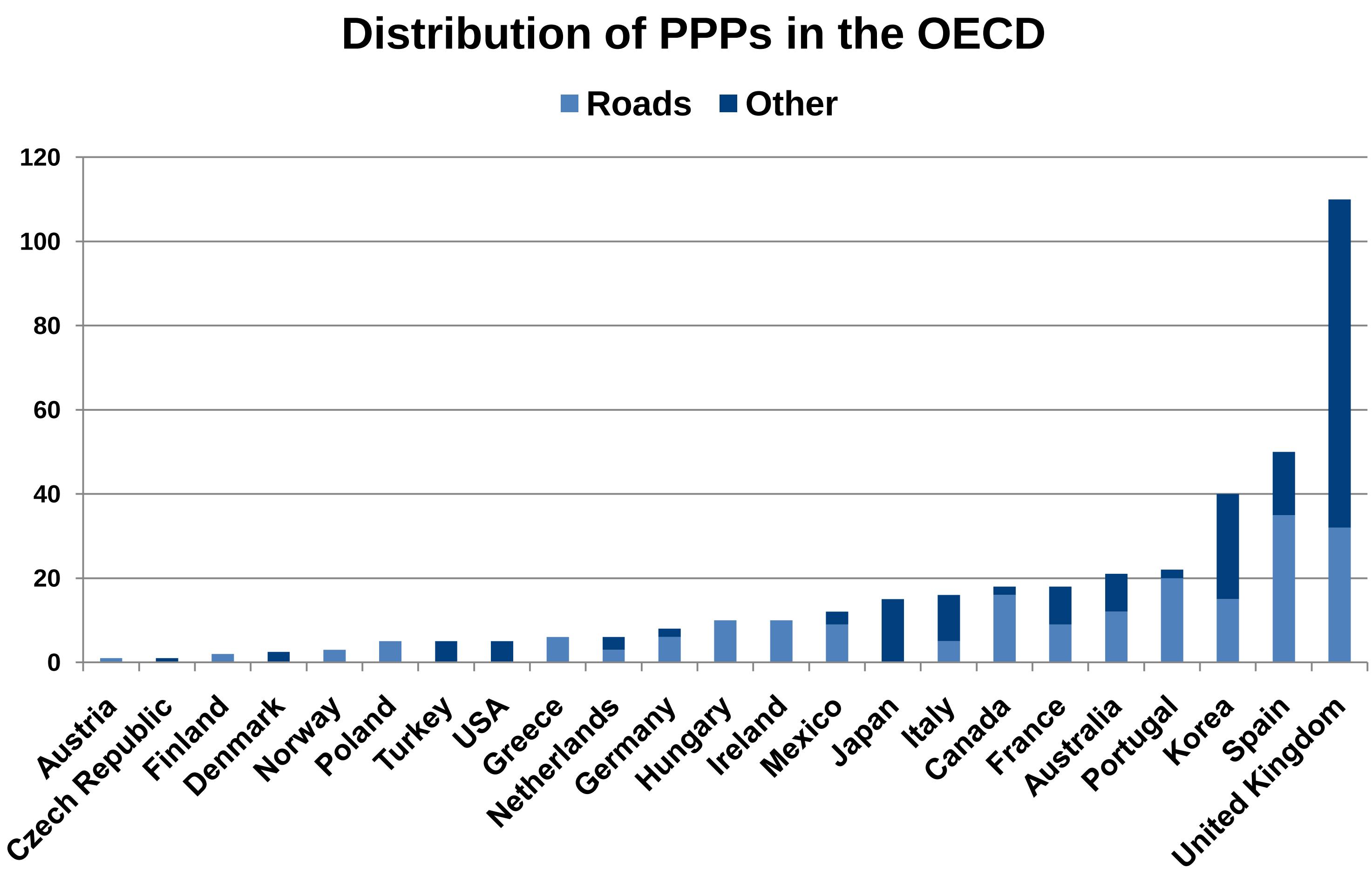
Myth 1: PPPs are new



Source: OECD

Myth 1 ctd: PPPs are new



Source: OECD

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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

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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

	Conventional procurement	PPP procurement
Cost overruns in the public sector	73%	22%
Delay in project delivery	70%	24%

NAO, " PFI Construction Performance, 2003

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Myth 2 ctd: PPPs have failed overseas

Quantitative Evaluations ctd.	
Arthur Anderson & LSE (2000) Evaluation of 29 projects in UK (1/3rd of all in PPPs in UK at time)	Average percentage estimated savings (against public sector comparator) was 17%. Risk transfer accounted for 60% of forecast cost savings.
Australia - some high profile failures - many less high profile successes	VfM from PPPs in Victoria Weighted average savings of 9% against risk-adjusted public sector comparator (Fitzgerald, 2004)

Andersen, Arthur and Enterprise LSE (2000), “Value for Money Drivers in the Private Finance Initiative”
Fitzgerald, P (2004) “Review of Partnerships Victoria Provided Infrastructure” GSG Strategy and Marketing

Myth 2 ctd: PPPs have failed overseas

Quantitative Evaluations ctd	
Saussier et al (Review of Industrial Organisation 2006)	Some evidence of higher water prices in France (reflecting true costs or increasing costs from PPPs)
Road M4 Finland.	Motorway between Helsinki and Lahti. Through PPP built 5 years earlier and at lower cost.
UK Prisons National Audit Office	Allowing private prisons improved performance of public prisons

'The Operational Performance of PFI Prisons', NAO 2003.
'The interrelationships between public and private prisons" J F Blumstein and M A Cohen, 2003.

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

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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.

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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

1. Boardman and Vining (1989) Journal of Law and Economics, 32:1, pp 1-33;
2. Ehrlich et al (1994), Journal of Political Economy, 102, pp 1006-38;
3. Estrin et al (2009), Journal of Economic Literature, 47, pp 699–728;
4. Megginson and Netter (2001), Journal of Economic Literature, 34, pp 321-389.

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

PPPs by sector	Share in total
Roads and motorways	39%
Tunnels and bridges	22%
Urban development	17%
Airports	7%
Trains	6%
Social infrastructure	5%
Water	2%
Electricity	2%
Total	100%

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

	Services provided by public sector	Services provided by private sector
Public financing	Public education Public health facilities	Contracts Vouchers Scholarships Insurance Social security
Private financing	User fees Loans for public education/health	Fee for service Pharmacies Insurance Private schools Private universities

Myth 8 ctd: Social services are not suited

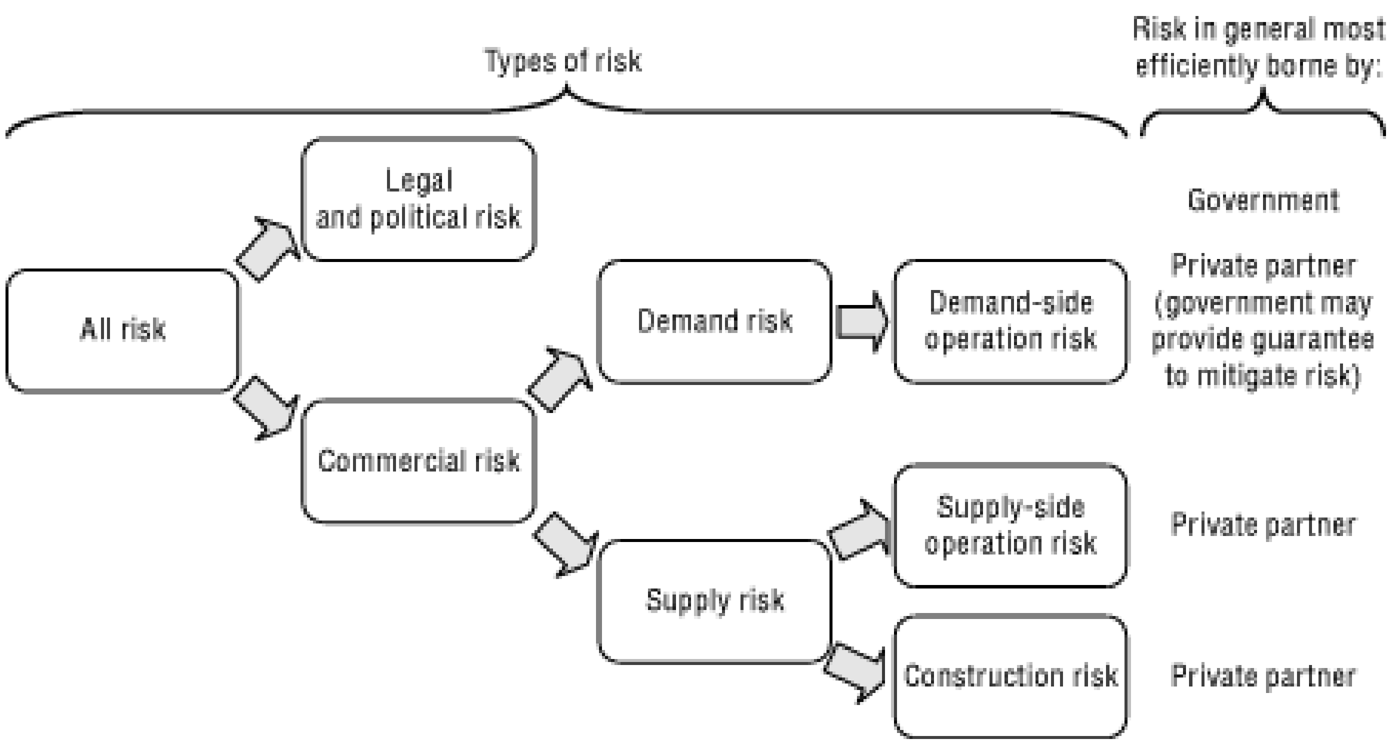
- Common feature: seek to harness innovation and creativity of private sector
- Caveat: difficult to specify and measure performance in service delivery

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

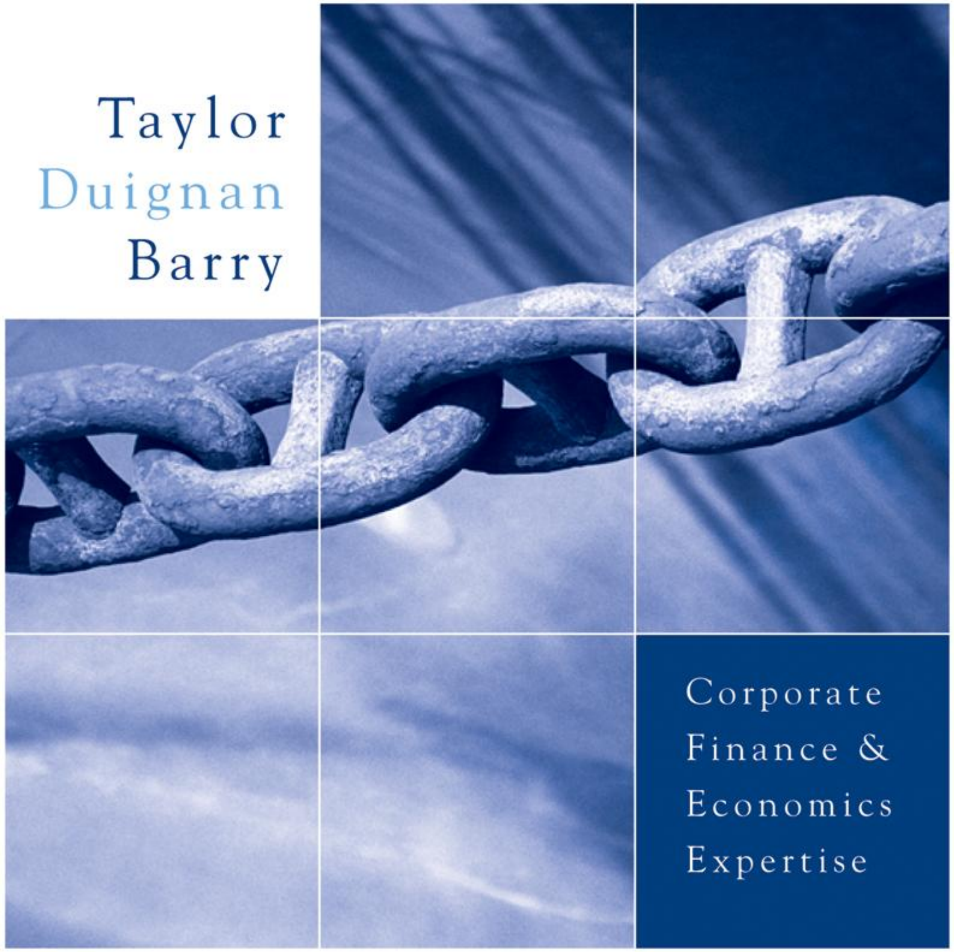
Risk sharing

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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