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PUBLIC-PRIVATE PARTNERSHIPS - MYTHS AND FACTS

i. *MYTH: ñPPP is akin to privatisationò*

FACT:

Public-private partnerships are not the same as privatisation, which involves the sale of publicly owned assets to the private sector.

PPPs are about the state moving from a role of direct operator to one of organiser, regulator and controller, as stated in the Green Paper on public-private partnerships, April 2004[1]. PPPs mean the provider will either construct and deliver assets or provide services that would traditionally have been undertaken by the state. At the end of the contract, the assets will revert to public control pending the establishment of a new PPP through a competitive process.

In the case of privatisations the stateôs only remaining control over the private owner-operator is regulation, whereas in a PPP control is exercised through a contractual relationship that defines each partnerôs rights and obligations.

ii. *MYTH: ñPrivate financing of public assets is a pre-condition for PPPsò*

FACT:

The primary purpose of a PPP is to improve the delivery of a public service or the construction and operation of public infrastructure.

When the partnership involves an investment, it is usually the private sector contractor that will arrange the financing. However, this is just one option open to a commissioning authority. There are cases of PPPs involving the construction and operation of infrastructure by the private sector where funding comes from public sources.

There are many types of partnerships which do not involve the construction of a building or facility, but instead are designed to ensure more effective operation of a particular service. Examples of this include:

- Operation of water and wastewater services;
- Operation of local waste collection and processing;
- Operation of transit systems;

[1] COM (2004) 327.

THE CONFEDERATION OF EUROPEAN BUSINESS a.i.s.b.l.

AV. DE CORTENBERGH 168
BE-1000 BRUSSELS
BELGIUM
VAT BE 863 418 279

TEL +32(0)2 237 65 11
FAX +32(0)2 231 14 45
E-MAIL: MAIN@BUSINESSEUROPE.EU
WWW.BUSINESSEUROPE.EU

- Delivery of welfare to work services for the long-term unemployed and benefit recipients;
- Delivery of prison services including building management, psychological and medical care for offenders, education and recreation management;
- Delivery of school improvement services in joint ventures with local authorities: in the UK, for example, these partnerships have delivered better outcomes for children and young people.

iii. *MYTH: ñPPP involves a loss of control by the public sectorò*

FACT:

The public partner in a PPP exercises control through the contract. In the majority of PPPs, ownership remains in public hands. Outcome-based payments to the private partner ensure both control and efficiency as they provide incentives for the provider to innovate and sanctions if the provider does not deliver to agreed standards and/or timelines.

Setting the right performance criteria and sharing risk appropriately mean that the public partner is able to hold providers to account, helping to ensure a better quality of service for citizens.

iv. *MYTH: ñIn a PPP, the private sector picks the most profitable parts of a public service and abandons the restò*

FACT:

Under a PPP arrangement, the specifications of the service to be delivered are set by the public partner prior to engaging in the procurement process ï good quality procurement means that contracts are priced at levels which offer a good deal for the taxpayer and a commercially viable proposition for potential providers. Once agreed, the contract is binding.

If the contract specifies that non-profitable parts of a public service must be provided, abandoning them would constitute a breach of contract.

Increasingly, governments are using óoutcome-based contractsô which reward providers on the basis of their performance ï for example getting unemployed people into sustainable employment. This means profit is linked directly to performance and still results in overall savings for the taxpayer.

v. *MYTH: ñService standards decline when they are delivered outside the public sectorò*

FACT:

Public authorities are not subject to performance requirements in the same way as private partners are. In the UK, independent studies on user satisfaction with PFI projects (the most common form of UK PPP) demonstrate a consistently high proportion of positive user views of both service facilities and the way services are delivered.

Cooperation between the different sectors brings together skills and ideas in designing and developing better services for the end user.

Bids for public service delivery must provide taxpayers with value for money, but this does not necessarily mean opting for the cheapest tender. It is all about the best option for the long term and the focus must remain on quality.

vi. ***MYTH: ñPublic sector borrowing is cheaper than private sector borrowing. Therefore, PPPs are more expensive than traditional public servicesò***

FACT:

Some authorities choose to let the private sector design, build and operate new infrastructure assets funded by public money. The decision to use public or private finance rests on the relative availability of public funding and on the capability of users to pay.

When PPP projects relate to the construction of infrastructure, there is a choice to use public or private financing ï government should opt for what will provide best value for the taxpayer in the long term and over the whole life of the contract. This will not always be private financing, but that should always be an option ï and the cost of finance is only one aspect in the economic comparison. Others are the efficiency generated by PPPs, the ability to meet deadlines, and the adoption of the delivery risk by the private sector.

vii. MYTH: ñPPPs tend to oust SMEs from the marketò

FACT:
PPPs are suited for projects of all sizes but contracts should be adapted to the size of the project before it is launched.

The criteria for some PPPs, such as financial acumen and relevant experience on large deals, may be too great to be viable for SMEs. However, it is the very purpose of a PPP to share risk and to seek a guarantee of performance over the long term. If a smaller company cannot give these guarantees, it may still seek an alliance ï in a subcontracting role ï with a bigger company that will back its performance.

If SMEs are not in the position to meet the required guarantees, they may operate via consortia of SMEs.

viii. MYTH: ñPPPs often failò

FACT:
If managed properly, PPPs will deliver benefits ï but projects sometimes fail to meet their objectives whether they are run by the private sector, public sector or a combination of the two. If they do fail, public authorities have recourse to a number of options. They can fine the private sector operator for not delivering on agreed outcomes, they can retender the contract to bring in a better private operator, or they can take the service back in-house. These options to deal with underperformance or failure provide transparency and accountability for the public. The alternative ï publicly-delivered service with no prospect of competition if services are poor ï means there is no real alternative for the public who will have to put up with low quality services.

Nevertheless, there are lessons to be learnt from unsuccessful PPPs. Failure to deliver is often related to one or several of the causes below:

1. <u>Lack of sufficient competition</u>
   Some competitors may be deterred by the financial guarantees required from participants; such guarantees should be proportionate to the degree of implication of specific participants in the global project. It is important that the tenders do not artificially restrain participation by smaller companies which could find a role within either larger consortia of SMEs or in smaller projects.

2. <u>Inadequate risk-sharing</u>
   It is important that risk be apportioned in an appropriate manner. The private sector should only be expected to endorse risk that it understands and masters. For instance, expecting the private partner to endorse the impact of unannounced changes in legislation would be unrealistic. Any situation where risk-taking verges on gambling may bear the seeds of future problems.

3. <u>Unbalanced capacity to manage the procurement process</u>
   It is imperative that both parties have matching abilities to understand the complexities and challenges inherent to the mission being discussed. It is also key that they both be able to project themselves in the future to understand how changes in circumstances may alter the delivery of the service and, consequently, how guidance could be formulated in the contract to allow solutions to be devised in due course.

ix. MYTH: ñProfit is incompatible with public servicesò

FACT:
Profit is not incompatible with a public service ethos ï it acts as an incentive to change and helps fulfil customer needs. It is the most efficient mechanism available to distribute market signals through the economy. Profit can be seen as a reward for taking on risks that were traditionally borne by the state. As an incentive, profit delivers

improved services. Profit can deliver efficiencies as providers seek innovative ways of delivering public services that reduce cost without damaging quality.

The public can benefit from profit-sharing in two main ways: first, profits can still result in overall savings for the taxpayer as they are offset by the overall cost of providing the services. Second, profit from the public services industry adds to national wealth and helps to fund pensions through dividends and other public services through tax.

x. MYTH: ñRisk transfer is exaggerated. Most risks stay with the public sectorò

FACT:

Optimal risk allocation means that risk is borne by those best able to manage it. In a PPP, the private sector usually assumes at least construction risk, delivery risk and operating risk. The public sector retains only those risks which it is best able to manage, such as political risks (e.g. the risk that a future government will shut down a costly service) and in some cases financial risk, as well as ultimate responsibility for services being delivered. There are examples where a PPP has failed because too much risk was shifted to the private sector, which is unable to manage risks beyond its control.

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