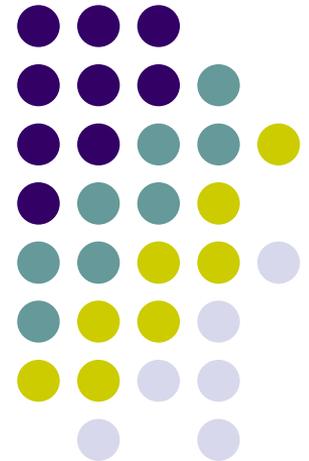
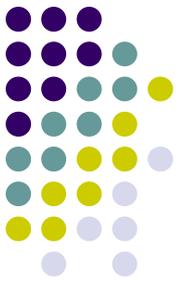


Public-private partnerships and Health

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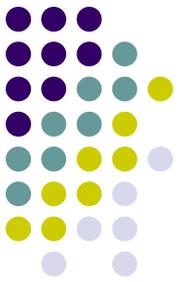




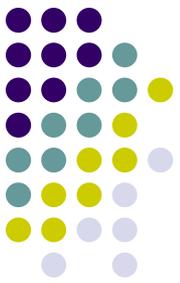
- Healthcare one area where government historically played a large role – particularly with the advent of the modern welfare state
- Traditional procurement, i.e. state-run hospitals and clinics, but also state-run medical aid schemes
- Given that it is health, emphasis often more on effectiveness (i.e. delivery of desired quantity and quality), than on efficiency
- Has the potential to be a very sensitive political issue



- Political sensitivity linked to the confusion about the difference between a health PPP and privatised healthcare
- Confusion heightened particularly when user charges are involved
- In this setting ensuring good communication to the public as to how the role of government differs between PPPs, concessions and privatisation becomes important

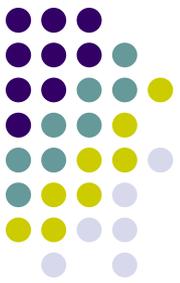


- For government issue is Value-for-money (VFM): Balance between the interest of the client versus the interests of the taxpayers
- VFM: maximum quality and features that closely fit client's specifications and at the best price possible
- How to ensure VFM
- Focus on three aspects:
 - Importance of competition to ensure VFM
 - Contractual flexibility, renegotiation and risk

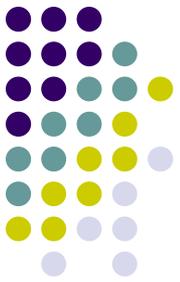


The level of competition

- Monopolistic behaviour and lack of competition: no VFM
- Competition important in pre- and post-contract phases.
- Pre-contract phase competition occurs in the bidding process.
- Zitron: 86 recent UK PPPs at tender stage: on average 3 bidders for each contract. However, 20% of 86 PPPs less than 3 bidders
- Few bidders increase danger of opportunistic (monopolistic) behaviour by the bidders.



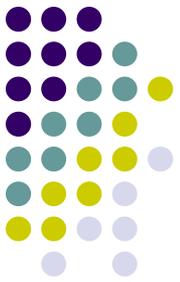
- Too few bidders: VFM is not attained
- How does government end up with too few bidders?
 1. Paradox of many potential and few actual bidders
 - With many bidders: probability of being preferred bidder is small
 - Given bidding cost, this may cause strong potential private partners not to bid, even if the project itself and the risks that it entails are acceptable to them
 2. Few specialist companies
- Danger is that just a small group of companies may bid for every project that comes along



- Distinction should be made between bidding risk and the risk of the project itself.
- Can address this by having government cover the bidding cost
- However:
 - Government will have to enter this subsidy as as part of the total project cost
 - Before agreeing to pay a private company's bidding cost, that company must first demonstrate that they have the capacity to bid and to deliver the service in the event that they should get the contract



- Competition in the post-contract phase also a complex issue.
- Once preferred bidder is announced and the contract is signed, the unsuccessful bidders move on, some leaving the industry.
- Thus, once the contract is signed, the preferred private partner becomes a monopolist supplier.
- Exception if the market is contestable

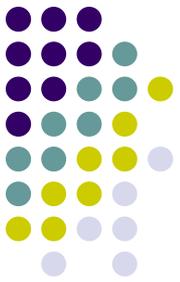


- *While risk transfer is the driver of efficiency and VFM, competition and contestability ensures effective risk transfer.*
- In the absence of competition or potential entry it will be difficult to attain higher efficiency and VFM.

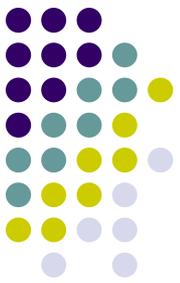
Contractual flexibility, renegotiation and risk



- PPP contracts usually long-term contracts (25-30 years)
- Government specifies the quality and quantity and payment depends on delivery of specified quantity and quality
- Thus, PPP contracts can be very inflexible



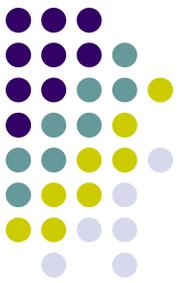
- Design, standards and forecasted demands may prove inadequate or irrelevant to shifting societal needs
 - Given the continuous change in medical science, healthcare might be more exposed to this than, say, a toll road
 - In healthcare there might be an issue of technological redundancy or changing demographic health features that changes the demand for services



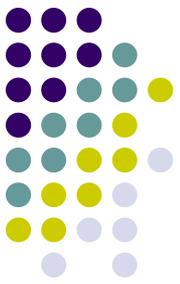
- Government might miss out on cost-saving effect of new technology if it has to pay private partner to deliver service, while new technology causes technology that partner uses to become obsolete
- With traditional procurement government would have been able to switch to the new technology
- Inflexibility together and long-term nature of contracts: major weaknesses of PPPs
- Thus, contractual commitment might result in government buying a relatively expensive service: destroy relative VFM of PPP



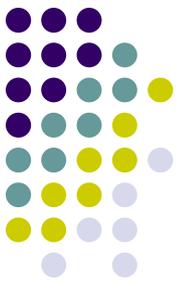
- This raises the question as to who should bear the risk of technological redundancy.
- The allocation of this risk will depend on the degree of rigidity (as opposed to flexibility) of contracts:
- The more rigid the contract, the more risk government carries, while the more flexible the contract, the more risk the private partner carries
- The private partner, though, will probably only be willing to carry the additional risk if government pays it to do so.



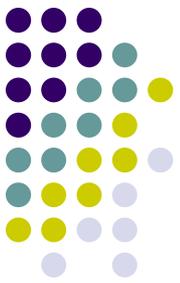
- Of course, government can take steps to improve flexibility of PPPs
- Some countries have taken steps to improve flexibility
- UK: The right to modify specifications (of course at a cost to government) and the right to set out a tender for modifications.
- France: Contracts between local authorities and private operators are administrative contracts. Thus, authorities have the right to change specifications once contracts are signed
 - Of course, the authority must justify the changes and compensate the private operators for the changes



- The question, though, remains, who should bear the risk technological redundancy?
- *Ex ante* a private partner can probably agree to carry this risk, but only if it is paid to do so
- Technological redundancy is an exogenous risk (i.e. private partner cannot prevent the actual outcome from deviating from the expected outcome)
- Thus, having the private partner carry it, will not improve the efficiency with which they deliver the good
- As such, it makes sense for government to carry this risk or to at least share it with the private partner



- What about changing demographics that change the level and composition of demand (e.g. modern lifestyles that increase heart disease relative to other diseases)?
- If risk is endogenous, i.e. if private partner can manage demand risk, it should also carry it. Otherwise, government can carry it or share it with private partner
- Most demand for health services, not endogenous



Conclusion

- Given the specialised nature of healthcare, government should pay special attention to competition, both in pre- and post-contract phase
- PPPs are long-term contracts with specified output levels, delivered at specified prices.
 - However, medical science is dynamic and may render technology quickly redundant.
 - In addition, demographic factors may change the level and composition of demand for medical services.
- These are exogenous risks, and having the private partner carry them will not improve VFM. Thus government should carry it or, at least, share it with private partners