PPPs and public infrastructure

by David Hall
d.j.hall@gre.ac.uk

Public Services International Research Unit (PSIRU)
University of Greenwich, UK
www.psiru.org

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Summary

- Value for money
- Risks
- Skewed choices and ‘off-balance-sheet’
- Public sector aid for PPPs
- Conclusions: learning from cases

- Annex: Ryrie rules
- Annex: efficiency references

VFM: history

- Welcome attention to VFM
  - reflects long-standing TU view that PPPs fail VFM tests
  - note UK Ryrie rules in 1980s were about VFM, scrapped because no PFI proposal ever passed them
- Framework for VFM comparison:
  - capital costs of PPPs higher (even higher since crisis)
  - no efficiency gains
    - incentive to cut pay, jobs, service levels: hence TU concerns
  - completion times: result of expensive turnkey contracts, of value to private financiers
  - transaction costs and incomplete contracts
  - so never better value

VFM: comparing PPPs with public sector procurement

- Cost of capital always higher for private sector
- Construction 'on time' is costly 'turnkey' contract, for bankers' benefit
- No systematic efficiency savings (IMF: "the theory is ambiguous and the empirical evidence is mixed.")
- Real transaction costs and uncertainty

	Factor	Comparing	Evidence indicates
1	Cost of capital	Debt interest + dividends	PPP more expensive
2	Cost of construction	Comparative costs and completion	PPP more expensive/neutral
3	Cost of operation	Comparative efficiency	Neutral
4	Transaction costs	Procurement + monitoring, management	PPP more expensive
5	Uncertainty	Incomplete contracts, contingent liabilities, impact on service	PPP riskier

VFM: Efficiency

- Empirical evidence does not support assumption that private sector will be more efficient
  - “While there is an extensive literature on this subject, the theory is ambiguous and the empirical evidence is mixed.”(IMF, March 2004)
- Studies across countries and sectors find no consistent difference
  - Water and electricity: “Most cross-country papers on utilities find no statistically significant difference in efficiency scores between public and private providers.” (Estache et al, World Bank, 2005)
  - Telecoms: global study comparing private and public companies found that there was indeed “efficiency growth following privatizations” – but - “it is significantly smaller than growth in public sectors.” (Knyazeva, Knyazeva and Stiglitz 2006)
  - Buses: no significant difference in efficiency between public and private bus operators, or mixed systems (Pina and Torres 2006)
  - Auditing: Australia: ‘outsourced audits are more costly than in-house audits’ (Chong et al 2009)
  - Liberalisation: “No evidence of consumer benefits from electricity/gas/telecoms liberalisation” (Florio et al, 2008)

Risks

- Risk transfer is not an objective in itself
  - Only if improves VFM
  - used to massage comparisons
- Cannot transfer risk of public service delivery
  - Private sector indifferent to public service
  - Eg Brussels sewerage treatment PPP pollutes river for 10 days
- PPPs create risks to other services, especially with proposed cutbacks
  - Eg UK spending cuts affect PFI hospitals more, due to contractually fixed expenditure on PFI

Skewed choices and government deficits

- Avoidance of deficit rules has always been overwhelmingly key reason for PPPs
  - Deficit rules mean projects only allowable if ‘off-balance sheet’, hence importance of Eurostat rules
  - EIB evaluation finds 'there is no alternative' for sample projects, only allowed if off-balance sheet
  - Note implication that infrastructure projects per se are more important than deficit rules
- Irony now of infrastructure boost for stimulus via higher deficits - but PPPs are not VFM
  - but public policy objective is infrastructure, not PPPs
  - eg Build America Bonds as v successful public finance for infrastructure, increases investors
- Access to capital matters, not ownership (Knayezeva 2009)

Public sector aid for PPPs

- Post-crisis inability to finance for PPPs
  - cost of capital even higher, PPPs even more unpopular
  - VFM response should be: use public sector option
- But massive efforts by public sector bodies to support, rescue and promote PPPs despite this
  - By governments – eg UK, France, India create special public financing mechanisms for private projects
  - By international institutions eg IFC creates special fund, UNECE et al create special unit to promote PPPs
  - By EU, with range of special propaganda and legal initiatives to support PPPs alone (Nov 2009 paper)
  - Misleading language of

EU: public assistance to PPPs

Category	Instrument	Mechanism
Research funds	JTI	Public finance, private activity
Financial engineering	JASPERS	Administrative support for designing PPPs
	JESSICA	Channelling EU money via funds to PPPs
	JEREMIE	Money to SMEs
EIB	Public sector development bank	Low interest rates
TEN-T	Loan Guarantee Instrument for TEN-T Projects (LGTT), Construction cost grants, state equity investment,	'also an expression of a political commitment by the EU'
R&D funding	Risk Sharing Finance Facility (RSFF), CIP)	Loans out of public finance to PPPs (€4billion via RSFF since July 2007)

Source: EC Communication on PPPs, November 2009

Conclusions 1: Learning from cases

Country	Case	Comments
Germany	Frankfurt schools	In 2007 Hochtief took over four schoolsas PPPs in Frankfurt am Main, although conventional public procurement would have been €4million euros cheaper.
Portugal	Roads	Annual payments to two major road PPPs cost €800million, larger than the entire national transport budget of €700million
UK	Greenwich hospital	PFI scheme costs 11.3% of budget, nearly double the government allocation for capital costs. Hospital makes 10% cut in clinical services in 2007.
Denmark	Farum municipality	Farum was committed to radical use of private contractors and PPPs, including contracting-out of day care which led to a storm of complaints from parents and the termination of the contracts in 2001, and 3 PPPs found to be illegal. Citizens have to pay an extra 3,2% local income tax to rectify the municipal finances.
Europe	Roads	An EIB report compared the cost of PPP road projects across with conventionally procured road projects, and found that the PPPs were on average 24% more expensive than the public sector roads.
Bulgaria	Trakia Highway	An attempted PPP delayed the implementation of the project, and led to costs that are causing problems for the state budget.

Sources: see Hall 2009, 2010

Conclusions 2: the summary failure of Metronet (London underground PFI)

- "The return anticipated by Metronet's shareholders appears to have been out of all proportion to the level of risk associated with the contract…"
- "In terms of borrowing, the Metronet contract did nothing more than secure loans, 95% of which were in any case underwritten by the public purse, at an inflated cost…"
- "Metronet's inability to operate efficiently or economically proves that the private sector can fail to deliver on a spectacular scale.."
- "The Government should remember the failure of Metronet before it considers entering into any similar arrangement again. It should remember that the private sector will never wittingly expose itself to substantial risk without ensuring that it is proportionally, if not generously rewarded. Ultimately, the taxpayer pays the price…"
- "we are inclined to the view that the model itself was flawed and probably inferior to traditional public-sector management. We can be more confident in this conclusion now that the potential for inefficiency and failure in the private sector has been so clearly demonstrated. In comparison, whatever the potential inefficiencies of the public sector, proper public scrutiny and the opportunity of meaningful control is likely to provide superior value for money. Crucially, it also offers protection from catastrophic failure. It is worth remembering that when private companies fail to deliver on large public projects they can walk away—the taxpayer is inevitably forced to pick up the pieces."

(UK House of Commons Transport Committee January 2008)

Conclusions 3

- Infrastructure investment matters for economic and social development
- Government deficit rules and application need review to allow for decisions based on VFM
- State aid for PPPs is perverse – no public interest in specific form
- A world without PPPs is possible and acceptable
- More public finance is needed due to private failures – eg fibre-optic telecoms, renewable energy

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Annex: Ryrie rules

"(i) decisions to provide funds for investment should be taken under conditions of fair competition with private sector borrowers; any links with the rest of the public sector, government guarantees or commitments, or monopoly power should not result in the schemes offering investors a degree of security significantly greater than that available on private sector projects; and

(ii) such projects should yield benefits in terms of improved efficiency and profit from the additional investment commensurate with the cost of raising risk capital from financial markets"

(Treasury, 1988, Annex; quoted in Heald 2003).

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