

PUBLIC-PRIVATE PARTNERSHIPS: A Public Benefit?

New Zealand has recently headed down the path of public-private partnership, the process whereby the government and private sector join hands in public asset development and management. Globally, PPPs have proven contentious and at times political. KATHY OMBLER looks at what we're doing, and asks three experts what they think.

In global terms, New Zealand is a new player in the world of public-private partnerships (PPPs). The current government considers them an option for developing major public infrastructure with a long-term life. Since 2011, eight PPP projects, ranging across prisons, schools and roads, have been initiated. More are under negotiation and, in May, Finance Minister Steven Joyce signalled his wish for yet more PPPs to help with government's infrastructure development programme.

This is not just a National government initiative. Recently, Labour leader Andrew Little told National Radio that if elected to government his party would also consider PPPs to help address a "massive shortfall in infrastructure requirements".

Advocates talk up their merits and point out how we have been able to learn from overseas experience. Critics speak of inherent risks, and privatisation. How are we really faring?

According to the Treasury, a public-private partnership is a long-term contract for the delivery of a service, where the delivery of a service requires the construction of a new asset (or enhancement of an existing asset) that is financed from private sources on a non-recourse basis and where full legal ownership of the asset is retained by the Crown.

Essentially, then, these are major public infrastructure projects, developed and managed in partnership between the

relevant government agency and a private sector consortium encompassing investors and design, construction and asset management companies. Return for the private sector is earned over the life of the project by government payments for the delivery of 'service outcomes', as defined by the project agreement.



Dan Marshall
Head of PPP Programme, Treasury

During the mid-2000s the Treasury started work towards reshaping public sector asset procurement. Dan Marshall says that in doing so it focused on two things.

"One focus was around the service outcomes that are delivered from government infrastructure assets. In an education context, for example, that will be about the educational services and ultimately the educational success of children. In a prison context it would be about recidivism rates and re-integration outcomes achieved by programmes run in prisons.

"The second focus was around value for

money, in particular on a whole-of-life basis. There was concern that traditional processes were perhaps encouraging (government) agencies to squeeze their capital bids and not give as much thought to the ongoing operations and maintenance costs. Therefore we got cheaply built assets that ended up costing the Crown more in maintenance and operations over the life of the asset. One well documented example where we saw suboptimal outcomes arise was the 'leaky schools' issue.

"In summary, my view is that PPP is not about tricky deals, not about privatisation and not taking jobs off public sector employees. It is about using taxpayer money wisely and ensuring we get assets and services that are fit for purpose."

"So that was the rationale for the PPP model."

Having established the PPP programme, the Treasury is now the 'owner' of both that and of the procurement process. According to Cabinet mandate, any agency considering capital investment with a whole-of-life value of more than \$15 million is required to consider a PPP and in doing so they must engage with the Treasury PPP team.

"Many agencies don't procure large scale assets on a regular basis so they don't generally have that specialist expertise in-house. We've been able to build a centre of expertise that works to the benefit of agencies and there is now greater consistency across projects," says Marshall.

Which projects are suited to PPPs?

Typically, says Marshall, they are large infrastructure projects where government ownership is preferred and that have a degree of complexity that allows for innovation in the way asset performance is delivered. "The nature of the asset would be quite specific, a hospital or prison, for example, rather than office accommodation which could be repurposed for anybody.

"We would also argue a PPP is most efficient where the outcomes or outputs you're looking for can be clearly specified."

Durability is also important, he adds. "The asset will be built to a certain design life and we would want to know the services we're looking for will remain relatively consistent. For example, an IT-related project would likely be too short lived to suit the PPP model."

Why not use traditional procurement?

With traditional procurement an agency will decide what infrastructure it needs, then go out and procure that. The agency would then typically be at risk of time and cost over-runs, and be liable for the ongoing maintenance and operating costs, says Marshall.

"Under a PPP the government pays nothing until the operating phase. Because these projects are privately financed, with interest costs accruing, the private partner is very incentivised to deliver on time.

"The process will also take the agency back a step, to identify the high-level outcomes they need the asset to deliver. They will consider the best design that will be able to deliver those outcomes, and how it will perform over the life of the project.

"We (the Treasury) argue that the scope for innovation is far greater with PPPs. They also focus the private partner much more on how the building (say) will perform, because they are responsible for ongoing maintenance and service outcomes. At the end of the day, PPPs change the way we plan infrastructure, and they prioritise certainty around future costs."

What about the PPP procurement process?

Marshall notes that the PPP procurement process is sometimes criticised as being too long and convoluted; however he stands by the process and the need for care, to get it right. Here, in summary, is how it works.

"After an expression of interest phase we will arrive at a shortlist of no more than three respondents to take through the

Request For Proposal (RFP). For up to six months they have regular engagement with the agency in what we call an interactive tender process, so they can understand exactly what it is the agency is asking them to deliver.

"We are heavily cognizant of probity throughout this process. We have to make sure everyone is getting the same information, so there are some constraints for an agency in responding in these sessions.

"Bidders will then submit their bids, which we require to be fully financed and fully committed. Once we've identified the preferred bid there is further negotiation. That's where things we think need to be tweaked in their design can be ironed out, before we sign the contract. This ensures we pragmatically engage with the respondents to get the best outcome."

Marshall says the Treasury is currently working with the private sector to streamline the procurement process to reduce the cost of participating – including through a current review of the interactive process.

Risks

Marshall believes there is a misconception with PPPs that all risk is shifted to the private sector. "It's simply not true. We believe that risk should sit with the party best able to manage it. If a contractor agrees to deliver a building on time and doesn't resource it sufficiently to do that, arguably that should be their risk and cost. However, if there was an earthquake, a force majeure event that is uninsurable, the Crown would retain those risks.

"One of the risks when you contract for a long-term period is that the model of service delivery will change in that time. So with each project we need to ensure the right level of flexibility is retained. In that sense PPP school projects have led the way, in the design of flexible spaces that can be used in different ways.

"If there are regulatory changes, for example in respect of how prisons have

to operate, government would retain the risk. But if we're talking about a change in corporate tax rates, we see that as a general business risk that the Crown would not retain."

Risk of litigation would depend on the particular situation, he adds. "If, say, someone challenged the right to build a hospital in a certain location, the Crown would take that risk. If it was litigation in relation to elements a private contractor was responsible for - if, in an extreme example, a building collapsed - the contractor would be liable."



"For risk of inflation and cost escalations, we agree we need to keep to an index so we use both the CPI and LCI indices."

"All these things tend to be very well discussed in the PPP procurement process, and the standard form contract now has some well accepted (by the market) positions on risk."

What lessons have been learned?

One of the biggest lessons was about the value of having, and sticking to, a standardised contract, says Marshall. "That was something that came through the research we did in Australia. Now both New South Wales and Victoria are also standardising their contracts to reform the way they engage with bidders."

"Also, you can't underestimate the value of the upfront process. People can be critical that the procurement takes too long. What we see is that investing in that front end has removed so many of the challenges that otherwise get thrown up through the construction process."

"In summary, my view is that PPP is not about tricky deals, not

about privatisation and not taking jobs off public sector employees. It is about using taxpayer money wisely and ensuring we get assets and services that are fit for purpose."

Whether, in fact, that is being achieved is too early to conclusively say, adds Marshall. "We are confident that we have put in place some good contracts but ultimately our programme is only as successful as the outcomes it delivers. Much of that success relies on how agencies and the private sector manage those contracts and engage in a different way of thinking about procurement."



Phil O'Reilly
Director, Iron Duke Partners

A PPP can be effective; however measurement, clear roles, and defining the service outcomes are essential for their

PPPs the International View

With public private partnerships now matured in many countries, Copenhagen Business School professor, Carsten Greve, says Canada, France and the Netherlands lead the way in 'getting them right'.

There is now a lot of international experience with PPPs, he says. "Most PPP projects worldwide can be found in the areas of transport, health, education, sports facilities and other types of infrastructure. The United Kingdom and Australia are considered among the early 'leaders', having both started in the 1990s."

"However, the really advanced countries which seem to have got it right, in the sense of setting up a proper institutional framework and a sensible government

structure, are the Netherlands, France and Canada. The Canadian experiences with PPPs are probably the most advanced in the world."

As a benchmarking Canadian example, Greve points to Partnerships BC, established and owned by the Province of British Columbia to support the private sector in the procurement of complex capital projects. Since 2012, Partnerships BC has participated in 52 projects with a combined capital value of almost CA\$18 billion in healthcare, accommodation, transport and utilities.

Greve says that a coherent policy approach, such as that found in Canada, and also in the Netherlands, includes the



success, according to Phil O'Reilly. We also need to avoid traditionally 'lazy thinking' around what the public and private sectors can respectively offer, says the former Business New Zealand CEO.

"Both the private and public sector need to seek out what citizen benefit looks like and agree and be clear about it."

"New Zealand has decided yes, we're interested in PPPs, not just for horizontal infrastructure such as roads and bridges but also for projects that involve 'social infrastructure'. Examples are schools and prisons where the private sector will be paid if certain standards or outcomes are met. So it's all about how government values outcomes. You can't toll a prison, obviously, so those outcomes could be about recidivism, or prisoner behaviour or welfare, and you can get the private sector reacting quite efficiently to those incentives.

"What's critical is that these outcomes can be measured."

In the prison example, O'Reilly says that, despite what some social scientists might claim, government holds increasingly

'big data' that shows not just the cost of putting a person in prison, but the flow-on costs of recidivism – of a 'broken life' – in terms of family violence, drug abuse and so on.

"So the government needs to be clear about putting a price, even if it's a shadow price, on what success might look like. The measurement really matters, in terms of your capacity to incentivise the precise behaviour from the public sector that you seek."

The private sector can help here, he adds. "Often these operators will have knowledge about what success looks like in other projects, so we think it is good for government to enlist the innovation of the private sector."

O'Reilly says there is a lot of 'fluffy thinking' around the world about PPPs; many are not well thought out, and both the private and public sectors get involved for the wrong reasons.

"Public servants should be clearheaded around why they are doing this project. If the only reason is to make the balance sheet look dandy, then don't do it. Yes, of



course there is a fiscal upside but there has to be something on top to make it work. It's about the magic of the additive stuff. Both the private and public sector need to seek out what citizen benefit looks like and agree and be clear about it."

The government also needs to be clear in its negotiations about risk, he says. "Things like roads not being completed on time, or solution risk, as in the solution that was procured wasn't actually the solution required. Every time you build something there is risk around that."

In the absence of that final conversation about where the risks of the project should fall, O'Reilly says the private sector will tend to overprice. "They'll punch the price up to cover the potential risk."

The overly long PPP procurement process

following components: "A clear, formulated PPP policy, a PPP unit close to the central government decision-making, a robust institutional framework (including the appropriate legislation and contractual governance arrangement), a portfolio of projects and a proper audit institution."

Greve also quotes from a recent (2017) OECD report, Principles for Public Governance of Public-Private Partnerships, that states it is not so much about the delivery modes itself but rather "the use of a pragmatic approach to getting the infrastructure right".

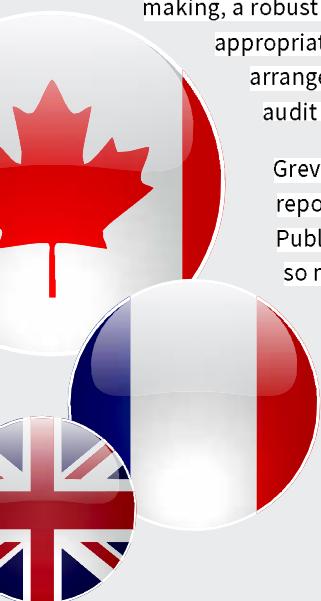
"What makes PPPs successful is a clear economic business case for each project, a clear policy framework, a well-functioning PPP unit with expert staff, risk sharing, a solid institutional

framework (including legislation and a contract form that works), a portfolio of projects and a proper audit institution."

Greve says failures happen when the economic case is overstated, the institutional framework is not in place, the market for PPPs is not developed, risks aren't shared, and the contract is too loose.

A wealth of international research about best practise with regards to PPPs is now available from organisations such as the OECD and the World Bank says Greve.

"New Zealand could use that knowledge, and also take advantage of the fact that a number of companies and other governments would be interested in doing PPP business in New Zealand."



could be tightened with more clear thinking, he adds.

“Making it shorter is not the point, making it better is. I suspect better will lead to shorter anyway. What tends to make it long is when the government players haven’t thought things through: what should the private sector bring, where should risk lie, what do we agree success looks like? There needs to be clear understanding about the respective roles. The private sector offers capital, innovation and global best practice, and the government offers, for example, funding certainty over a period.

“It’s early days yet. Government still tends to have a procurement mind set when it’s really a partnership.”

O’Reilly shrugs off the negativity around PPPs. “There are many people who would argue the private sector has no role in these things; that only the State should build a school, or a prison. It’s mixed up in that ideology of “public good, private bad”. What is unhelpful around that debate is that either side can point to failures, when in fact you can look at PPPs objectively and find failures and successes all around the world, using different models.”

Broader potential

O’Reilly also sees opportunities for PPPs that are not about big capital spends.

“I’m not sure that government or local government are as ambitious as they might be around the potential of these kinds of vehicles. Let’s not put a red line around PPPs as being about building a hospital or a road. That’s lazy thinking. Let’s start thinking in a broader sense; whenever the public and private sector co-invest in something that, effectively, is a PPP.

You could argue that charter schools, or the Salvation Army running social housing, are also PPPs, he says.

“Government did things in the past just because they always did, for example delivering the post. I think the big issue now is how can the public and private sector work together to make sure that citizen outcomes and provision of services are done by the best actor in the best way, using the best technology and investing once.”

O’Reilly says that, increasingly, long-running issues facing public policy in New Zealand and worldwide are resolvable only

by the public and private sectors working together.

“We could look at countries with economies that look like ours - the United Kingdom, Australia, the Nordics - and ask ourselves how creative are they being about citizen-centred benefit and about mixing up public and private investment, innovation and risk taking.

“I would argue that if you give private sector ‘skin in the game’ in some of these things, while yes, there’s economic payback, the capacity to get more actively soaked into successful outcomes is also a payoff that will occur. Increasingly you’ll see a desire from the private sector to be involved in that.”



Barbara Allen

Senior Lecturer in Public Management,
School of Government,
Victoria University of Wellington



“The Public Can’t be Expected” The public private partnership, New Zealand Herald, 24 October 2002, Alexander Turnbull Library, Wellington N.Z.

A degree of caution exists around PPPs within the academic community says Dr Barbara Allen. On the plus side, she believes that PPPs globally have evolved considerably in the past 25 years and New Zealand has learned from international experience.

Allen has had a long-term academic interest in government procurement, first in Canada, then during what she describes as an “interesting phase” in the United Kingdom during that country’s recovery from the global financial crisis. A number of PPPs were starting to show the fundamental challenges of this kind of procurement, she says.

“Depending on your perspective, it’s not so much that they completely failed;

after all, infrastructure was built. But they demonstrate the real risk over time to the public sphere in terms of costs.

Clearly, New Zealand has learned a lot from overseas and, coming quite late into the PPP space, has been careful about what could work and not work here, she says. "As a result we are also putting in place consistent standards and a whole package around how these things can work."

Nevertheless, Allen cautions that no matter how carefully PPPs are crafted, things can change.

"Contracting, at the root of PPPs, is of course imperfect. Over 20 or so years of a project interest rates change, stakeholders change, forms of inflation play a role and market situations change. New unmitigated risks emerge, for example contamination could be discovered under a building. You could say the investor will cover that risk and the investor will say that this wasn't in the equation when the contract was signed and that the government has to pay.

"So, getting into very long-term arrangements is not always the answer."

The benefit of traditional procurement is that the government retains more control in the face of unpredictable environments, says Allen. "However, advocates of PPPs will say traditional procurement doesn't give us the expertise and innovation of the private sector, and yes, in some cases that's true."

"There is a certain 'collective forgetting' around our experience of PPPs. It is really important to study the failures."

Allen also has questions how citizen benefits can actually be determined over the life of a project. "The holy grail is being able to know what the right outcomes are. With schools, education outcomes are tied in to many other outcomes across society. We also need a lot of work on the social investment cost to society of having

people in prisons. So, while there is a lot of talk about service outcomes, it is a craft as well as a science to determine what those outcomes are going to be, and how PPPs fit into that picture is yet to be well understood."

We should be wary of the rhetoric, she warns. "There is a certain 'collective forgetting' around our experience of PPPs. It is really important to study the failures."

PPPs have quite a strong ideological underpinning, says Allen.

Vested interests

"There is huge potential for vested interests. It's big money and a government that wants to be using the private sector more is going to want to be using PPPs. So a lot of criticism comes from that direction; people see more private sector, vested interests, and more, big, non-New Zealand companies coming in."

It's not necessarily only conservative governments which are keen on PPPs, she adds. "In the United Kingdom it was Tony Blair's Labour government that pushed PPPs massively. If you have constituents saying we need schools, where are the vast sums going to come from in a tight fiscal environment? I think any leader would ultimately be pragmatic about it, especially when it's schools."

Allen says there are certainly benefits from PPPs and they are a really interesting public management tool. "We just have to be aware of the realities. And they are not the be-all and end-all; PPPs are just one mechanism within a wider suite of possibilities."

From an academic point of view, being a procurement specialist in New Zealand is an amazing opportunity, she concludes. "It's all so fresh; 2017 is a moment in time of looking at PPPs with a short history. New Zealand has much to offer in terms of its contribution to the field of PPPs, such as what has New Zealand done that's different and what is particularly relevant to the New Zealand context?

