

## EPSU Briefing on Public-Private Partnerships (PPPs) “10 facts about public-private partnerships (PPPs)”

November 2011

### INTRODUCTION

This briefing from the Public Services Internal Research Unit (PSIRU) highlights the serious financial and operational problems that have arisen with PPPs.

The information draws on a wide range of empirical studies and evidence, and refers in particular to evidence from parliamentary enquiries on PPPs in the UK, which accounts for a very large percentage of European PPPs and the longest period of experience of PPPs.

The conclusion is clear: PPPs do not supplement public spending – they absorb it.

### The context

The European Commission is proposing a number of measures which promote PPPs. These include:

- the Communication on ‘innovative’ finance, encouraging PPPs (see [Innovative financial instruments](#))
- the proposed EU project bond, to guarantee and finance PPPs (see [Europe 2020 Project Bond Initiative](#));
- a reported proposal from the Polish presidency to avoid PPPs becoming classified on-balance sheet (see <http://www.europolitics.info/europolitics/public-private-partnership-european-model-debated-art312167-46.html>)
- expected legislative proposal on concessions

For more detail critique of PPPs published by EPSU see:

- [More public rescues for more private finance failures PSIRU 2010](#)
- [Critique of PPPs PSIRU 2008](#)
- <http://www.epsu.org/a/7661>

### Glossary of terms

**PPP** – public-private partnership, where a private company invests money in return for payments, over a long period such as 20 years, from governments (or, in the case of concessions, from user charges)

**Concession** – a type of PPP where the income comes from user charges rather than government payments

**Institutional PPP** – a company which is partly owned by government (often local government) and partly by private shareholders

**PFI** – ‘private finance initiative’, the major UK programme of PPPs

### 10 FACTS ABOUT PUBLIC-PRIVATE PARTNERSHIPS (PPPS)

#### 1. The private sector does not assume the risk

Eurostat rules say that a PPP can be treated as not increasing government debt as long as ‘construction risk’ and ‘availability risk’ are transferred to the private sector. This just means

that the asset has to be built and stay in working order. These are very weak tests: the IMF says that the “Eurostat decision on accounting for risk transfer gives considerable cause for concern, because it is likely to result in most PPPs being classified as private investment. The recent decision ... thus could provide an incentive for EU governments to resort to PPPs mainly to circumvent the Stability and Growth Pact (SGP) fiscal constraints.”<sup>1</sup> In practice this means that if a school is built under a 30 year PFI, and after 10 years it is no longer needed, the public authority has to keep paying the company for the next 20 years, regardless. This has actually happened in the UK, in a school in Northern Ireland.<sup>2</sup>

‘Demand risk’ is often a more substantial risk than ‘availability risk,’ and it should be transferred. However, risk cannot be transferred to private companies for nothing. Companies will always require extra payment to accept extra risks: “one should certainly not expect profit-maximising private sector firms to assume this risk without compensation, and indeed they do not...the more risk that is transferred, the more expensive it is likely to be....risk is transferred, not necessarily reduced.”<sup>3</sup>

The UK Government, in spite of so much experience with PPPs/PFI has not built up any expertise of its own to assess risk and deal effectively with PPP contracts: “Departments should have developed commercial experience from using PFI but we still see some examples of projects and contracts which are clearly lacking in commercial awareness.”<sup>4</sup>

PPP units do not have any responsibility for evaluation. They promote PPPs, but have no responsibility for the results.

## 2. PPPs don’t guarantee better value for money

The Eurostat rules are only a way of deciding whether the asset and debt of a PPP is scored on the government’s balance sheet. Eurostat does not carry out a value for money assessment of PPPs. These are different issues: “whether PPPs offer better value for money than conventional procurement is a quite separate question from that of accounting treatment”.<sup>5</sup> PPP proposals are normally compared with some ‘public sector comparator’ before being authorised, but these comparisons have been the subject of much criticism by academics, auditors and parliamentary committees.

UK parliamentary reports have found that these comparisons have been badly done, not exposed to proper challenges and debate, and been systematically biased in favour of PPPs: “The use of PFI has been based on inadequate comparisons with conventional procurement which have not been sufficiently challenged.”<sup>6</sup> ; “we are concerned that the value for money appraisal system is biased to favour PFI. Assuming that there will always be significant cost over-runs within the non-PFI option is one example of this bias. ....The Treasury should seek to ensure that all assumptions in the value for money assessment that favour PFI are based on objective and high quality evidence.”<sup>7</sup> Public auditors in the Netherlands and elsewhere have also questioned whether such comparators are adequate.

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<sup>1</sup> IMF 2004 Public-Private Partnerships March 12, 2004 <http://www.imf.org/external/np/fad/2004/pifp/eng/031204.htm>

<sup>2</sup> BBC 2007 "Buy Now, Pay Later" [http://news.bbc.co.uk/1/hi/programmes/politics\\_show/6768083.stm](http://news.bbc.co.uk/1/hi/programmes/politics_show/6768083.stm)

<sup>3</sup> Boardman A. and Vining A. 2010 Assessing the economic worth of public-private partnerships; in International Handbook on Public-Private Partnerships edited by Graeme A. Hodge, Carsten Greve, Anthony E. Boardman p.238 <http://www.oecd.org/dataoecd/53/59/47814836.pdf>

<sup>4</sup> UK Public Accounts Committee 44th Report - Lessons from PFI and other projects HC 1201 01 September 2011 <http://www.publications.parliament.uk/pa/cm201012/cmselect/cmpubacc/1201/120102.htm>

<sup>5</sup> Heald D. and Georgiou G. 2010 Accounting for PPPs in a converging world in International Handbook on Public-Private Partnerships edited by Graeme A. Hodge, Carsten Greve, Anthony E. Boardman p.238 <http://www.oecd.org/dataoecd/53/59/47814836.pdf>

<sup>6</sup> UK Public Accounts Committee 44th Report - Lessons from PFI and other projects HC 1201 01 September 2011 <http://www.publications.parliament.uk/pa/cm201012/cmselect/cmpubacc/1201/120102.htm>

<sup>7</sup> UK Treasury Select Committee 17th Report - Private Finance Initiative HC 1146 August 2011 <http://www.publications.parliament.uk/pa/cm201012/cmselect/cmtreasy/1146/114602.htm>

Most assessments are flawed because they do not carry out a cost-benefit analysis comparing the proposed PPP, an alternative using normal procurement, and the third option of doing nothing. This requires including the external impacts, for example on employees. But: “as yet, no government has performed normatively appropriate analyses of PPPs.....evaluation of PPPs should be performed by arms-length analysts, either inside or outside government.”<sup>8</sup>

In the UK, the expected tax revenues are treated as an added benefit of PPPs, but in practice there is no monitoring, and many of the owners are based in tax havens: “Some PFI investors reduce their exposure to UK tax through off-shore arrangements. Yet the Treasury assume tax revenue in their cost-benefit analysis of PFI projects. The Treasury could not tell us if PFI investors had paid tax in the UK on profits and on equity gains, or whether corporation taxes had been collected from PFI companies...The public sector has insufficient information on the returns made by PFI investors and no mechanism for sharing in gains when the investors sell their shares.”<sup>9</sup>

Governments avoid spending money monitoring contractors. Even in the UK, which has the biggest and longest programme of PPPs, the Government has not carried out a systematic evaluation of results: “There has not been a systematic value for money evaluation of operational PFI projects by departments. There is, therefore, insufficient data to demonstrate whether the use of private finance has led to better or worse value for money than other forms of procurement.”<sup>10</sup>

### **3. The normal public sector option is not always considered**

In practice, normal public sector procurement is not an option because it would show an increase in government debt, whereas PPPs conceal this. So a PPP becomes the only option. In the UK: “For too long PFI has been the 'only game in town' in some sectors which have not been provided with adequate capital budgets for their investment needs. This problem is likely to get worse in the future with capital budgets cut significantly at the Spending Review. If PFI is the only option for necessary capital expenditure then it will be used even if it is not value for money.”<sup>11</sup> In Ireland, the government preference for PPPs : “led local authorities to reject its own value for money assessments or preliminary reports where they were found to favour traditional procurement methods.”<sup>12</sup>

### **4. PPPs are not better at finish buildings on time or on budget than ordinary contracts**

PPPs use ‘turnkey contracts’ which means no money is paid until the building is completely ready. These are much more expensive than ordinary contracts: a European Investment Bank (EIB) report found that PPP road contracts across Europe were on average 24% more expensive.<sup>13</sup> If it is important to transfer construction risk, this can be achieved by using a turnkey contract in normal procurement, without having a 30 year PPP.<sup>14</sup>

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<sup>8</sup> Boardman A. and Vining A. 2010 Assessing the economic worth of public-private partnerships; in International Handbook on Public-Private Partnerships edited by Graeme A. Hodge, Carsten Greve, Anthony E. Boardman p.238 <http://www.oecd.org/dataoecd/53/59/47814836.pdf>

<sup>9</sup> UK Public Accounts Committee 44th Report - Lessons from PFI and other projects HC 1201 01 September 2011 <http://www.publications.parliament.uk/pa/cm201012/cmselect/cmpubacc/1201/120102.htm>

<sup>10</sup> UK National Audit Office 2011 Lessons from PFI and other projects: summary of the five PFI reports April 2011 [http://www.nao.org.uk/publications/1012/lessons\\_from\\_pfi.aspx](http://www.nao.org.uk/publications/1012/lessons_from_pfi.aspx)

<sup>11</sup> UK Treasury Select Committee 17th Report - Private Finance Initiative HC 1146 August 2011 <http://www.publications.parliament.uk/pa/cm201012/cmselect/cmtreasy/1146/114602.htm>.

<sup>12</sup> Reeves E. 2011 The Only Game in Town: Public Private Partnerships in the Irish Water Services Sector The Economic and Social Review, Vol. 42, No. 1, Spring, 2011, pp. 95–111

<sup>13</sup> EIB 2006. Ex ante construction costs in the European road sector: a comparison of public-private partnerships and traditional public procurement. Economic and Financial Report 2006/01 Blanc-Brude F., Goldsmith H. and Vällilä T. <http://www.eib.org/attachments/efs/efr06n01.pdf>

<sup>14</sup> UK Treasury Select Committee 17th Report - Private Finance Initiative HC 1146 August 2011 <http://www.publications.parliament.uk/pa/cm201012/cmselect/cmtreasy/1146/114602.htm>.

Also, if you take account of the whole process including negotiating the contract, then PPPs often take much longer than traditional procurement. In the UK: “there is no convincing evidence to suggest that PFI projects are delivered more quickly and at a lower out-turn cost than projects using conventional procurement methods. On the contrary, the lengthy procurement process makes it likely that a PFI building will take longer to deliver, if the length of the whole process is considered.”<sup>15</sup>

Furthermore, the construction phase is only one part of a PPP, which often lasts 30 years. Whatever the contract says, it will often be renegotiated, and the expected costs can increase significantly: “In the UK, renegotiations occurred in 33% of PFI projects signed between 2004 and 2006. The changes amounted to a value of over \$4m per project per year equivalent to about 17% of the value of the project”<sup>16</sup>.

## **5. The rules on PPPs don’t ensure complete transparency**

Private companies insist that many aspects of PPPs are kept secret, including the contracts themselves. For example, the contract for the water services PPP in Berlin was kept secret until a referendum forced its disclosure.<sup>17</sup> In the UK: “Transparency on the full costs and benefits of PFI projects to both the public and private sectors has been obscured by departments and investors hiding behind commercial confidentiality”.<sup>18</sup>

## **6. Any competitive tendering associated with PPPs does not guarantee savings**

PPP tendering procedures take longer and cost more than normal procurement, and so create additional transaction costs for both governments and companies. The complexity of PPPs means that there are very high legal and accountancy expenses involved for both government and companies, with tendering periods lasting an average of 34 months.<sup>19</sup> A study by EIB researchers of projects across Europe found that the procurement costs averaged over 10% of the total value of each PPP contract<sup>20</sup>. The procurement costs for the Metronet PFI in the UK represented only 2.8% of the project value – but the project itself was so costly, these procurement costs amounted to £455million. The Financial Times estimates that on all PFI deals in the UK: “Consultants and lawyers have earned at least £2.8bn and probably well over £4bn advising on the deals”.<sup>21</sup>

The complexity leads to the use of negotiated or ‘competitive dialogue’ procedures, and the cost of bidding means that few companies can afford to bid for PPPs. As a result, there is less competition: in the UK, a recent parliamentary report observed that: “The nature of PFI means that competition is likely to be less intense compared to other forms of procurement. We believe the barriers to entry to be too high, resulting in an uncompetitive market. The long, complex and costly procurement process limits the appetite for consortia to bid for projects and also means that only companies who can afford to lose millions of pounds in failed bids can be involved.”

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<sup>15</sup> UK Treasury Select Committee 17th Report - Private Finance Initiative HC 1146 August 2011

<http://www.publications.parliament.uk/pa/cm201012/cmselect/cmtreasy/1146/114602.htm>

<sup>16</sup> Iossa E. and Martimort D. 2011 Risk Allocation and the Costs and Benefits of Public-Private Partnerships CEPREMAP Working paper no. 1104 <http://www.cepremap.ens.fr/depot/docweb/docweb1104.pdf>

<sup>17</sup> Global Water Intelligence Vol 12 No. 3 March 2011 New hurdle for RWE in Berlin

<http://www.globalwaterintel.com/archive/12/3/general/new-hurdle-rwe-berlin.html>

<sup>18</sup> UK Public Accounts Committee 44th Report - Lessons from PFI and other projects HC 1201 01 September 2011

<http://www.publications.parliament.uk/pa/cm201012/cmselect/cmpubacc/1201/120102.htm>

<sup>19</sup> Iossa E. and Martimort D. 2011 Risk Allocation and the Costs and Benefits of Public-Private Partnerships CEPREMAP Working paper no. 1104 <http://www.cepremap.ens.fr/depot/docweb/docweb1104.pdf>

<sup>20</sup> EIB 2005. Dudkin G. and Väilä T. Transaction Costs In Public-Private Partnerships: A First Look At The Evidence.

EIB Economic and Financial Report 2005/03 <http://www.eib.org/Attachments/efs/efr05n03.pdf>

<sup>21</sup> Financial Times August 7, 2011 Private finance costs taxpayer £20bn By Nicholas Timmins and Chris Giles

<http://www.ft.com/cms/s/0/65068d1c-bdd2-11e0-babc-00144feabdc0.html#axzz1YbE1rI9m>

## 7. PPPs do not ensure better design innovations

Experience in the UK suggests that PPPs may not generate better designs than normal procurement: “in the area of design innovation and building quality we have seen some evidence to suggest that PFI performs less well than traditionally procured buildings..... The fact that consortia are formed to bid for projects also limits choice and competition. For example an architects' firm may have the best design or there may be one contractor that has produced the best proposal, but unless these designs and proposals are part of the chosen consortium's bid they will not be used”<sup>22</sup>

## 8. The private sector is not necessarily more efficient at running services

PPPs are often justified by efficiency gains brought by the private sector: “The key basic rationale is greater private sector efficiency”<sup>23</sup> But a large number of comparative studies present a very mixed picture, which strongly suggests that there is no systematic difference in efficiency. As summarised by the IMF: “Much of the case for PPPs rests on the relative efficiency of the private sector. While there is an extensive literature on this subject, the theory is ambiguous and the empirical evidence is mixed.”<sup>24</sup> The UK evidence confirms this: the recent parliamentary committee report concluded that: “The price of finance is significantly higher with a PFI. The financial cost of repaying the capital investment of PFI investors is therefore considerably greater than the equivalent repayment of direct government investment. We have not seen evidence to suggest that this inefficient method of financing has been offset by the perceived benefits of PFI from increased risk transfer. On the contrary there is evidence of the opposite.”<sup>25</sup>

## 9. The private sector cannot raise money more cheaply than governments

Governments can nearly always raise capital at a lower cost than the private sector. The OECD advises that “the cost of capital of the private partner is usually higher than that of government”, and the IMF has stated that “when PPPs result in private borrowing being substituted for government borrowing, financing costs will in most cases rise”.<sup>26</sup> In countries in extreme crisis, the private sector cannot raise money more cheaply through PPPs than governments, because the income of the PPPs depends on payments by the government itself.

The difference is large. The representative of the UK private companies involved in PPPs estimates that the average extra cost of private sector capital over conventional borrowing has been 2.2 per cent a year. The Financial Times calculated that this means that the UK taxpayer: “is paying well over £20bn in extra borrowing costs – the equivalent of more than 40 sizeable new hospitals – for the 700 projects that successive governments have acquired under the private finance initiative....”<sup>27</sup>

The crisis has made the problem worse, for example in the UK: “the difference between direct government funding and the cost of this finance has increased significantly since the financial crisis. The substantial increase in private finance costs means that the PFI financing method is

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<sup>22</sup> UK Treasury Select Committee 17th Report - Private Finance Initiative HC 1146 August 2011 <http://www.publications.parliament.uk/pa/cm201012/cmselect/cmtreasy/1146/114602.htm>

<sup>23</sup> Boardman A. and Vining A. 2010 Assessing the economic worth of public-private partnerships; in International Handbook on Public-Private Partnerships edited by Graeme A. Hodge, Carsten Greve, Anthony E. Boardman p.238 <http://www.oecd.org/dataoecd/53/59/47814836.pdf>

<sup>24</sup> IMF 2004 Public-Private Partnerships March 12, 2004 <http://www.imf.org/external/np/fad/2004/pifp/eng/031204.htm>

<sup>25</sup> UK Treasury Select Committee 17th Report - Private Finance Initiative HC 1146 August 2011 <http://www.publications.parliament.uk/pa/cm201012/cmselect/cmtreasy/1146/114602.htm>

<sup>26</sup> IMF 2004 Public-Private Partnerships March 12, 2004 <http://www.imf.org/external/np/fad/2004/pifp/eng/031204.htm>

<sup>27</sup> Financial Times August 7, 2011 Private finance costs taxpayer £20bn By Nicholas Timmins and Chris Giles <http://www.ft.com/cms/s/0/65068d1c-bdd2-11e0-babc-00144feabd0.html#axzz1YbE1r19m>

now extremely inefficient. Recent data suggests that the weighted average cost of capital of a PFI is double that of government gilts.”<sup>28</sup>

## 10. PPPs are not necessary to solve the problems of countries in crisis

There is no evidence that countries making more use of PPPs are less likely to have fiscal problems. According to the EIB, the five countries which have made the greatest use of PPPs in recent years are Greece, Ireland, Portugal, Spain and the UK.<sup>29</sup>

In the case of Portugal, the IMF/EU package does mention PPPs, but as a major part of the problem, not the solution. The letter of intent requires Portugal to promise: “We will undertake a comprehensive review of PPPs and concessions to reduce the government’s financial exposure. The PPPs have exposed the government to significant financial obligations, and exposed weaknesses in its capacity to effectively manage these arrangements” and to set up a review which “will assess the scope to renegotiate any PPP or concession contracts to reduce financial obligations”: meanwhile Portugal must “suspend the implementation of all new PPPs and large infrastructure projects”. The entire framework and approach to PPPs has to be reconsidered: “The legal and institutional framework for assessing and entering into PPP or concession agreements as well as monitoring its execution will also be reviewed and strengthened under the supervision of the Ministry of Finance and in consultation with EC and IMF staff by end-2012. We will not enter into any new PPPs or concessions at the central or local government levels until at least the completion of these reviews and legal and institutional reforms.”<sup>30</sup> In its first review of the package, the IMF noted that one of Portugal’s PPPs has now failed, and urged Portugal to stop regional and local governments from creating PPPs.<sup>31</sup>

No. Rather than making more use of PPPs, public authorities are avoiding further PPPs and even renationalising existing ones: “Organisations which have the option of other funding routes have increasingly opted against using PFI and have even brought PFIs back in-house. Transport For London (TfL) cost of borrowing is higher than government’s, and yet it still considers this is overall better value for money than PFI.”<sup>32</sup>

The UK parliamentary committee has strongly recommended that the UK government adopt this policy, including taking over the financing of existing PPPs, with large *reduction* in costs: “The Treasury will need to consider using more direct government borrowing to fund new investment. .... The most straightforward way of dealing with current PFI contracts is for the government to buy up the debt (and possibly also the equity) once the construction stage is over. This would result in an increase in the headline level of government debt but it would not increase the structural deficit it would become more affordable to service the visible government debt rather than the hidden PFI debt. Every one percentage point reduction in the interest rate paid on the estimated £40 billion of PFI debt would realise annual savings of £400 million.”<sup>33</sup>

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<sup>28</sup> UK Treasury Select Committee 17th Report - Private Finance Initiative HC 1146 August 2011 <http://www.publications.parliament.uk/pa/cm201012/cmselect/cmtreasy/1146/114602.htm>

<sup>29</sup> EIB 2010 Kappeler a. and Nemoz M. Public-private partnerships in Europe – before and during the recent financial crisis. Economic and Financial Report 2010/04 July 2010 [www.eib.org/eppec/resources/efr\\_efr\\_epec\\_ppp\\_report.pdf](http://www.eib.org/eppec/resources/efr_efr_epec_ppp_report.pdf)

<sup>30</sup> IMF 2011 Portugal: Letter of Intent May 17, 2011 <http://www.imf.org/external/np/loi/2011/prt/051711.pdf>

<sup>31</sup> IMF 2011b [Portugal: First Review Under the Extended Arrangement](#)

<sup>32</sup> UK Treasury Select Committee 17th Report - Private Finance Initiative HC 1146 August 2011 <http://www.publications.parliament.uk/pa/cm201012/cmselect/cmtreasy/1146/114602.htm>

<sup>33</sup> UK Treasury Select Committee 17th Report - Private Finance Initiative HC 1146 August 2011 <http://www.publications.parliament.uk/pa/cm201012/cmselect/cmtreasy/1146/114602.htm>