

***PUBLIC-PRIVATE PARTNERSHIPS:
A Review of Literature and Practice***

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FORWARD

This study was undertaken in the latter part of 1999, on behalf of a contract-research client of the Institute. The client has concluded that the study should receive wider circulation, and the Institute is therefore pleased to make it available both on our website (www.uregina.ca/sipp) and as a Public Policy Paper. The latter, however, does not include the several case studies that were included in the original report to illustrate the many forms that public-private partnerships have taken during their relatively short period of intensive development. For access to these, it will be necessary to visit the website.

The report was prepared by Dr. John R. Allan, a Senior Policy Fellow at SIPP. Michael Trottier and Jeffrey Maguire—then both Research Assistants at the Institute—prepared the case studies, which were edited by Dr. Ken Rasmussen, a Visiting Fellow at the Institute.

Public-private partnerships represent an extremely dynamic form of inter-sectoral co-operation, one that is being rapidly adopted and exploited by many jurisdictions in many countries. With such burgeoning activity, much has occurred in the period since the study was first completed. No attempt has been made, however, to include either these developments or the literature that have appeared in the year-and-a-half since the study's first release: these may be the subject of a future, expanded study. We do believe, however, that the present study will prove to be very valuable in providing an understanding of the nature of public-private partnerships and the benefits obtainable by both the public and private sectors from what is now clearly the most significant form of alternative service delivery.

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PUBLIC-PRIVATE PARTNERSHIPS

Executive Summary

In the course of the last two decades, governments everywhere have experienced increasing and largely irresistible pressure for change. Severe and continuing fiscal constraints, social and technological change, and growing scepticism—which has not always been warranted—regarding the efficiency of the public sector have all combined to persuade citizens that government has become unnecessarily cumbersome, unresponsive and costly. The classical hierarchical bureaucracy is perceived as ill-adapted to meet the complex and rapidly changing demands of modern societies, and there have been calls for government to “reinvent” itself. In particular, it is suggested that government should shift from a primary emphasis on the direct provision of public goods and services to an emphasis on its role as a procurer and regulator of services from the for-profit and third sectors. The underlying assumption was that the stronger incentive systems available in these sectors to support and reward cost-efficiencies and innovation could be exploited indirectly by the public sector adopting appropriate administrative structures.

Governments have adapted in many ways in response to these pressures. Some have increased managerial autonomy with the objective of facilitating public-sector innovation and responsiveness, while many have placed greater reliance on non-conventional delivery mechanisms, initiatives frequently subsumed under the heading “alternative service delivery” (ASD). The essential characteristic of these is that they seek to improve the delivery of services by sharing governance functions with other entities. If they have not already become the most significant ASD initiative, public-private partnerships (P3s) are well on their way to achieving this status.

P3s have now been implemented in at least twenty-five countries and by all Canadian provinces and territories. Their variety makes generalisation difficult, but the Canadian Council for Public-Private Partnerships defines such a partnership as “a co-operative venture between the public and private sectors, built on the expertise of each partner, that best meets clearly defined public needs through the appropriate allocation of resources, risks and rewards.” The characteristics that are central to public-private partnerships are the co-operative pursuit of shared or compatible objectives; their operation for mutual benefit; an emphasis on risk-sharing and value for money; and, finally, the joint investment of resources and a sharing of authority within the partnership.

It should be noted that a public-private partnership differs both from conventional contracting-out arrangements and from privatisations. A typical contracting-out involves a private-sector party providing commercially a service previously provided by the public sector itself. There is little if any transfer of responsibility and control to the private sector, and no substantive involvement in decision making, both of which are typical in a P3. Additionally, in the latter, the private-sector partner would also likely be a provider of capital assets as well as a provider of services. A public-private partnership is differentiated from a privatisation by the fact that, in the former, the public sector retains a substantive role, whereas, in the case of a privatisation, subsequent government involvement is minimal unless regulation of the post-privatised entity is necessary. All three policies—contracting out, privatisation, and public-private partnerships—are

similar in that in each the public sector changes from being a direct provider of services to the public to being a procurer of services and, possibly, a regulator.

In part, the expansion in the use of P3s may be explained by the broadly environmental changes alluded to above. Complementing such factors are the various advantages or benefits intrinsic to such partnerships. While certainly not all present in all P3s, these potential benefits would include the following:

- *Leveraging of public funds:* By serving as a vehicle for the injection of private-sector financing, P3s can augment the resources available for the provision of public goods and services.
- *Better management and allocation of risk:* Public-private partnerships typically involve the formal identification, quantification, and allocation among the partners of the risks associated with the partnership project. Since risk is a real project cost, this structured approach to its management is likely to result in greater economic efficiency than is traditional public-sector procurement, in which risk is frequently ignored as an element of cost.
- *Improved effectiveness:* Partnerships facilitate the co-ordination of efforts and systems and typically provide a broader base of expertise. Additionally, partners who are free from bureaucratic “red tape” and isolated from political intervention may be able to operate more flexibly and effectively than a government department or agency.
- *Alternative revenue sources:* Partnerships may serve as vehicles to introduce tolls or other user-charge systems, while still permitting government to distance itself from these developments.
- *Access to economies of scale or scope:* A private-sector partner may undertake the activities required of them in the P3 for other clients or partners. The resulting scale of their total operations may therefore be considerably greater than the scale of the partnership. This may permit them to maintain and make available to the P3 highly specialised expertise of a sort that would be uneconomic were the P3 project considered in isolation.
- *Encouragement of multi-use infrastructure:* A private-sector partner in a P3 may have incentives to attract secondary users, possibly in the form of ancillary commercial development, thereby stimulating more intensive usage of the partnership capital assets.
- *Improved service responsiveness:* P3s can be useful vehicles for increasing interaction and familiarity with clients, thereby permitting government to better determine, understand, and meet their needs.

Drawing on very extensive experience with public-private partnerships in the U.K., the Private Finance Panel stated that there are only two *fundamental* requirements for a private-finance or P3 project, namely (1) the private sector must bear part of the risk of the project; and (2) from the perspective of the taxpayer, as client, the project must demonstrate value for money (VFM).

As experience has been gained with P3s, it has come to be appreciated that what is important is not risk transfer *per se*, but rather the effective management of risk. This requires that each risk be allocated to the partner best able to manage that particular risk. One of the sources of gains from the use of P3s is that such arrangements typically require the explicit identification, quantification, allocation, and management of major project risks. This is in sharp contrast to traditional public-sector procurement, from which any formal analysis of risk is typically absent. This omission may result in projects being undertaken that, on the basis of a more comprehensive analysis, ought to be rejected.

A prerequisite for implementing a P3 is evidence that the project provides superior VFM than does the “public-sector comparator”, by which is meant a public-sector alternative for delivering the same services. This comparison should involve a whole-life analysis, in net present value terms, of the costs and benefits of the proposed P3 and those of traditional procurement. If the partnership option does not demonstrate superior VFM, then traditional procurement should be used.

There are several sources of superior VFM in P3s. These include the benefits from efficient risk management; the gains that result from giving the partnership a mandate to achieve a broadly defined objective—rather than the narrowly defined technical specification typical of traditional procurement—which encourages innovative solutions; and integrating in the partnership responsibility for the design, construction, operation, and maintenance of the relevant assets. The combination of this integration of functions and a requirement that life-cycle costs (including construction, operation and maintenance) be minimised, has the potential to greatly increase operational efficiency. Reported savings (improved VFM) of twenty or more per cent relative to traditional procurement are not unusual in the P3 literature. The first phase of the Highway 407 project in Ontario, for example, is claimed to have lowered costs by 17 per cent, and to have advanced the availability of this much-needed highway by at least three years. It also added almost \$1 billion to the General Revenue Fund of the Province for use in other, high-priority areas.

Several factors have been identified as being crucial to the success of P3s. These include, most importantly, transforming the roles, responsibilities and thinking within the affected public service, to reflect the change from being owners and operators of assets to becoming astute purchasers of long-term services. The provision of the skills necessary for this transformation may necessitate the initiation of appropriate training programs and the recruitment of some specialised personnel. While the PFI in the U.K. has found it important to have a P3 unit in each of the departments involved in partnerships, they have also found it expedient to have a central taskforce with the expertise necessary to approve and co-ordinate all P3 initiatives. Perhaps the most important source of success is insuring the early involvement of all the stakeholders in each P3. It is particularly important to involve in the planning processes employees who may be affected, together with the unions that represent them. The B.C. Online project, for example, provides clear evidence of the gains from so doing.

The experience with public-private partnerships is now international in scope and has involved literally billions of dollars of investment. Many governments have utilised this form of alternative service delivery to advance appreciably the availability of

necessary social infrastructure, to achieve significant cost savings, and to increase the funding available to meet other budgetary priorities. In many instances, the ability to achieve these objectives without impairing borrowing capacity and even, in some cases, to be a net source of new funds, has been critical to the adoption of P3s in some jurisdictions. While clearly not a panacea for all public-sector problems, the advantages offered by public-private partnerships have now been demonstrated beyond any reasonable doubt. Indeed, the potential gains from their adoption and use are now so firmly established that it is incumbent on virtually every jurisdiction to explore how they can best use this significant public-sector innovation.

We are pioneering new ways of doing things. New partnerships between the public and private sector. A new understanding that improved public service and value for money go hand in hand

Alan Milburn
Secretary of PFI
Treasury Task Force

I Introduction and Overview

In the course of the last two decades, governments everywhere have experienced increasing and largely irresistible pressure for change. Severe and continuing fiscal constraints, social and technological change, and growing scepticism regarding the efficiency of the public sector have all combined to persuade citizens that government has become cumbersome, unresponsive and costly. As governments have moved to eliminate deficits and reduce indebtedness—and, concomitantly, have moved from providing more, to providing appreciably less, than a dollar of public goods and services for each dollar of taxes paid—disenchantment with the public sector has grown, together with demands for better service. Interacting with these developments were the ideas of the Virginia or Public Choice School, which applied the economic models of market behaviour to that of politicians and bureaucrats. This provided a putative intellectual rigour to arguments of government overload and over-extension, and contributed to widespread acceptance—particularly by the New Right and conservative governments—of the view that government failure is both as real and prevalent as market failure.

In such a setting, the classical “machine” bureaucracy, characterised by narrowly defined duties, constrained and hierarchical authority, and rigorously formalised procedures, systems and roles, has come to be widely perceived as ill-adapted to meet the complex and rapidly changing demands of modern societies (Armstrong 18). This has led to demands that government “reinvent” itself by moving away from a primary emphasis on the direct provision of public goods and services to becoming a regulator and a procurer of services from the for-profit and third sectors, that it “change from rowing to steering”.¹ Common to these views is the implicit assumption that the stronger incentive systems available in these sectors to support and reward cost-efficiencies and innovation and an inherently greater organisational flexibility could be exploited indirectly if the public sector were to adopt appropriate administrative structures. It is argued that, by so doing, the end result would be the provision of public goods and services at lower cost to the taxpayer or, alternatively, better value for a given level of outlay.²

¹ See David Osborne and Ted Gaebler, *Reinventing Government* (New York: Plume 1993); The National Performance Review, *Gore Report on Reinventing Government* (New York: Random House, Times Books 1993); and Michael Trebilcock, *The Prospects for Reinventing Government* (Toronto: C.D. Howe Institute 1994).

² There has been some movement in several public services to narrow the “reward gap” between the public and private sectors, with a view to stemming the outflow of high-performing public servants. The gap that remains, however, is still substantial, most particularly at senior levels. Even if this gap were narrowed

Even Saskatchewan, a jurisdiction with a long and distinguished history of leadership and innovation in public administration and public policy, has not been immune from some of these critical currents. While neither the public service nor the public sector have here fallen into the disfavour that characterises their counterparts in other jurisdictions, expressions of dissatisfaction and calls for change have certainly been heard. Moreover, the fiscal pressures that have been the source of much of the criticism and demands for change have, if anything, been more severe in this province than elsewhere. There is thus much to commend a willingness to consider some of the public-sector innovations that have, demonstrably, yielded significant cost-savings and new or augmented sources of revenue in, for example, British Columbia and several other Canadian provinces and some twenty-five countries internationally. It is in this spirit that this report proceeds.

In response to these pressures and forces noted here, governments have adapted in many ways. Some of these have involved increased managerial autonomy, to facilitate public-sector innovation and responsiveness. Still others have involved greater reliance on non-conventional delivery mechanisms, initiatives that are frequently subsumed under the heading of “alternative service delivery” (Ford and Zussman). This has been defined as a “creative and dynamic process of public-sector restructuring that improves the delivery of services to clients by sharing governance functions with individuals, community groups and other government entities” (Paquet 34). Of particular note in this definition is its emphasis on creativity, dynamism, service improvement from the perspective of the citizen as client and taxpayer, and the sharing of governance functions. It is tempting to argue that any public-sector innovation that possesses these qualities is deemed to be an ASD. As Langford has observed, however, the universe of ASD is so diverse that, for some, “alternative service delivery is pretty much anything different from the way we do government business traditionally” (62). Despite this catholicity—or perhaps because of it—there is general agreement that public-private partnerships (“P3s”) do indeed constitute one of the more significant forms of ASD.

That these organisational forms in fact satisfy the requirements of the more demanding of the definitions of ASD will become evident in the following sections of this paper, in which the characteristics of P3s will be examined in detail, and in the appended case studies. For the present, we shall simply note that a framework that may be used to locate various P3 initiatives in the ASD universe is developed by Langford (62 – 69).

Definition and Classification of Public-Private Partnerships

Before proceeding to a detailed consideration of P3s, it is necessary to note that, in recent years, in public-sector discussion, the use of terms such as “partnering,” “partnerships,” “consultative,” and “collaborative” has become virtually mandatory. For some time, governments and government agencies have wished to be seen as less directive and more consultative—and indeed, they have modified their behaviour to be less directive and more consultative. One consequence of these developments, however,

appreciably, the organisational flexibility of many private-sector companies would still be a source of potential gains from joining with them in public-private partnerships.

is that virtually every government initiative is now described as a “partnership,” a practice that trivialises the term. Indeed, and as Kernaghan has observed, “In the field of public-sector management, ‘partnership’ has become a close rival to ‘empowerment’ as the leading buzz word of the early 1990’s” (57). It is important to note, therefore, that this is not the manner in which “partnership” is used here: in this report, the term is restricted to those situations in which a substantive relationship exists between public and private entities, one involving meaningful sharing of roles, responsibilities, risks and rewards.

Another cautionary note is required: one thing that public-private partnerships rarely are is a formally constituted legal partnership. The reason for this will be self-evident: such an entity tends to be characterised by joint and several liability among the partners, and this would be totally unacceptable in the system of ministerial responsibility and accountability that characterises government. Even an implied partnership may be a source of difficulty since, should legal problems arise, the courts would seek to determine the nature of the underlying relationship, to establish whether a partnership exists in fact if not in name. In this context, it has been observed that “the best practice to minimize potential liability is to strive for a high degree of precision and clarity in the agreement or contractual arrangement that gives effect to the deal. It is also a good idea to include a clause in relevant agreements stipulating that the arrangement is not to be construed as a partnership” (Treasury Board Secretariat, *Citizen-Centred Service* 6). In consequence, and as we shall see, public-private partnerships invariably use organisational arrangements that are unlikely to be construed as actual partnerships.

Given the burgeoning literature on public-private partnerships, a multiplicity of definitions of P3s is available to the researcher. It is useful to cite several, to identify the elements they have in common and their shared emphases.

- A public-private partnership [is] a cooperative venture between the public and private sectors, built on the expertise of each partner, that best meets clearly defined public needs through the appropriate allocation of resources, risks and rewards (Canadian Council for Public-Private Partnerships).
- The broad working definition of a [public-private] partnership used here is a relationship involving *the sharing of power, work, support and/or information* with others for the achievement of joint goals and/or mutual benefits (Kernaghan 61).
- An arrangement between two or more entities that enables them to work cooperatively towards shared or compatible objectives and in which there is some degree of shared authority and responsibility, joint investment of resources, shared risk taking and mutual benefit (Treasury Board Secretariat, *Impediments to Partnering* 1).
- The term ‘partnership’, as used here, includes contractual arrangements, alliances, cooperative agreements, and collaborative activities used for policy development, program support and delivery of government programs and services (Armstrong 19).

- A partnership is an arrangement between two or more parties who have agreed to work cooperatively toward shared and/or compatible objectives and in which there is shared authority and responsibility; joint investment of resources; shared liability or risk-taking; and ideally, mutual benefits (Rodal and Mulder 27).
- [A partnership] is a relationship that consists of shared and/or compatible objectives and an acknowledged distribution of specific roles and responsibilities among the participants which can be formal or informal, contractual or voluntary, between two or more parties. The implication is that there is a cooperative investment of resources and therefore joint risk-taking, sharing of authority, and benefits for all partners (*Environment Canada* preface).
- The term “public-private partnerships” has taken on a very broad meaning. The key element, however, is the existence of a ‘partnership’ style approach to the provision of infrastructure as opposed to an arms length ‘supplier’ relationship. . . . Either each party takes responsibility for an element of the total enterprise and work together, or both parties take joint responsibility for each element. . . . A P3 involves a sharing of risk, responsibility and reward, and is undertaken in those circumstances when there is value for money benefit to the taxpayers (B.C., *Building Partnerships* 8).

Other examples could readily be cited, but these suffice to identify the primary characteristics with which we shall be concerned. An explicit element of most of these definitions is the co-operative nature of public-private partnerships: several specify the co-operative pursuit of shared or compatible objectives. Also common to several is the requirement that the partnerships yield mutual benefit. A particularly important common element is the emphasis upon risk-sharing and the associated value for money from the perspective of the taxpayer. Several also mention joint investment of resources, while still others place emphasis on the sharing of authority.

The relative importance of these several elements will, of course, vary from one partnership to another, depending on the purposes for which they were constituted and the needs and natures of the partners involved. Indeed, in some cases, one or more of these attributes may be totally absent from particular partnerships, if this facilitates their formation or functioning. A review of the relevant literature would suggest, however, that the indispensable constituents of successful P3s are an efficient allocation of risk among the partners and, from a citizen-centred perspective, value for money where this is defined relative to the standard government procurement process (HM Treasury, *Private Opportunity, Public Benefit* 12; Nova Scotia, *Transferring Risk*). Both of these are examined in greater detail in subsequent sections of the paper. Before preceding to these, however, it is useful first to give some thought to the classification of public-private partnerships.

It should be noted that a public-private partnership differs both from conventional contracting-out arrangements and from privatisations. A typical contracting-out involves a private-sector party providing commercially a service previously provided by the public sector itself. There is little if any transfer of responsibility and control to the private sector, and no substantive involvement in decision making. In contrast, to be a P3 an arrangement would typically be characterised by some devolution of control and

authority, and by participation by the private-sector partner in decision making. Additionally, the private-sector partner would also likely be a provider of capital assets as well as a provider of services (*Private Opportunity, Public Benefit 2*). A public-private partnership is differentiated from a privatisation by the fact that, in the former, the public sector retains a substantive role, whereas, in the case of a privatisation subsequent government involvement is minimal unless regulation of the post-privatised entity is necessary.

All three policies—contracting out, privatisation, and public-private partnerships—are similar in that in each the public sector changes from being a direct provider of services to the public to being a procurer of services and a regulator. As the Private Finance Panel has observed, “The logic of this transformation is to allow both private and public sectors to concentrate on doing what they are likely to do best” (*Ibid.*). In the case of the private sector, where the profit motive is dominant, the core activity is the provision of goods and service in the most cost-effective manner. In contrast, in the public sector the public interest is dominant, and the core activity is the provision of a range of essential services in a manner that safeguards that interest. By combining in a single partnership the incentives and rewards conducive to maximising efficiency with a directing concern for the public interest, it is possible, in effect, to have the best of both worlds: the advancement of the public interest together with the most cost-effective outcome and better value for money.

As one would expect in a province with an outstanding record of innovative public management, the possibilities inherent in partnerships have not been lost on Saskatchewan. This province already relies on inter-governmental partnerships in its restructured health-care system, with substantial delegation of authority to the several health districts. Moreover, one Saskatchewan P3—The Saskatchewan Multi-Party Training Plan—was singled out by the Canadian Council for Public-Private Partnerships in its National Awards for Innovation and Excellence competition (News Release, November 17, 1998), and the Premier has indicated his commitment to the partnership approach (Roy Romanow, “Constructive Entanglement: The Saskatchewan Agenda for Partnering”). The Regina and Saskatoon airport authorities provide further examples—in this case, involving the delegation of federal authority—within the province. But, significant as these examples are, they fall far short of exhausting the P3 possibilities in Saskatchewan, most particularly in the area of infrastructure.

Of the definitions cited above, perhaps the most inclusive was that of Armstrong which embraced contractual arrangements, alliances, co-operative agreements, and collaborative activities used for policy development, program support and delivery of government programs and services. Also extremely inclusive was that of Kernaghan which would contain virtually any relationship involving “the sharing of power, work, support and/or information with others for the achievement of joints goals and/or mutual benefits.” Given the diversity of organisational structures compatible with these definitions, it is useful to comment briefly on some of the classification systems that have been used to impose some order on the range of included entities or to categorise individual partnerships.

Several principles of classification are found in the public-private-partnership literature. Kernaghan, for example, classifies P3s on the basis of the amount of power

sharing, using this criterion to differentiate *collaborative partnerships*, in which there is real power sharing, with each partner exercising power in the decision-making process; *operational partnerships*, which he characterises as sharing work, rather than decision-making power; *contributory partnerships* in which one of the partners provides support, usually in the form of funding, for an activity in which it will have little or no operational involvement; and *consultative partnerships* in which a public organisation receives advice in respect of a particular policy field or issue (Kernaghan 61 – 65).

Somewhat similar in its coverage is one of the classification systems used by Rodal and Mulder, which situates partnerships on a continuum ranging from consultation—which they view as playing a central role in partnership arrangements—through consultative, advisory partnerships to operational and collaborative partnerships, to “devolution”, which they use to denote the transfer of functions or responsibilities for the delivery of programs and services from government to another entity (“Partnerships, devolution and power-sharing” 28). They also note that partnerships may be classified with respect to their purposes or objectives, distinguishing among partnerships intended to achieve service responsiveness by facilitating client input; those for which the primary objective is empowerment of clients and stakeholders; those directed at improved effectiveness; and, finally, partnerships designed to achieve risk-sharing, cost savings, or the leveraging of scarce public funds. They also observe that classification is possible by reference to the central activity undertaken—for example, policy development, program design, program delivery, etc.; the identity of the partners; and on the basis of the mechanisms involved, *e.g.*, voluntary arrangements or legally binding ones, project-specific or long-term, etc. (*Ibid.* 31 – 33).

The classification system used by the Private Finance Initiative (“PFI”) in the UK is relatively simple, distinguishing as it does only three fundamental types of PFI projects. First, there are financially free-standing projects, which are those undertaken by the private sector with cost-recovery by means of user-charges imposed on the final user. Second, there is the class of PFI projects that involve the sale of services to the public sector, with costs being recovered from the relevant public body or bodies by these sales or lease proceeds. Examples would include privately financed prisons and the provision of rolling stock to state railroad lines. The final category of PFI projects are joint ventures, where the cost of the project is met partly from public funds and partly from private sources, with overall project control resting with the private sector (*Private Opportunity, Public Benefit* 1 – 2)

A rather detailed partnership typology that is predicated upon specific outcomes has been proposed by the Treasury Board Secretariat (*Citizen-Centred Service* 10 – 11). This identifies nine distinct classes of outcomes or objectives, which include such things as partnerships “to create, replace, refurbish or maintain public infrastructure” and those “to reduce the overall cost of government procurements/expenditures”. Since the diversity of public-private partnerships would suggest that some variant of this organisational form could be used to achieve virtually any outcome, and given that the range of possible objectives is practically unlimited, it is not evident that this approach is particularly useful. In consequence, while we are concerned about what may be accomplished by the use of public-private partnerships, we shall not make use of an outcomes-based classification.

A final system for ordering or classifying public-private partnerships, and one that has been used quite extensively for infrastructure projects, is that used by the Canadian Council for Public-Private Partnerships and by the B.C. Taskforce on Public-Private Partnerships.³ This approach also situates the partnership variants on a continuum, the dimension of which reflects the degree of risk transferred from the public sector to the private sector. The continuum thus runs from a “contribution contract”—which involves a private-sector contribution to a public facility, and minimal risk-transfer to the private sector—to a “buy-build-operate” partnership (BBO) in which the private partner purchases an existing public facility, upgrades it, and owns and operates it in perpetuity, thereby assuming all the risks formerly borne by the public sector. The other partnership forms are established by situating at appropriate positions on the risk continuum feasible combinations of the functional activities in which the partnership is engaged. Thus public-private partnerships may undertake some combination of the following functions: Design (D); Build (B); Finance (F); Operate (O); Maintain (M); Own (O); Transfer (T); Lease (L); Develop (D); and Buy (B) (*Report 9*). The relevant combinations, and their locations on the risk-transfer continuum, are shown in Table 1, with the risk transferred from the public sector, and that assumed by the private sector, both increasing as one moves down the table.

Table 1
Public-Private Partnerships
and the
Risk-Transfer Continuum

	Risk Transferred to private Sector	Contribution Contract Operation and Maintenance Contract Design Build Design Build Major Maintenance Design Build Operate (Super Turnkey) Lease Develop Operate Build Lease Operate Transfer Build Transfer Operate Build Own Transfer Build Own Operate Transfer Build Own Operate Transfer to Quasi-public Authority Buy Build Operate (BBO)
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Examples of these various types of public-private partnerships are examined in the Case Studies presented in Part V of this report.

Perhaps the most important observation that may be derived from this consideration of the several classification systems used in the P3 literature is that there is no single typology that can be identified as the most useful or informative. For some

³ CCPPP, *Public-Private Partnerships: Canadian Inventory – 1998 2*; and B.C., *Building Partnerships: Report of the Taskforce on Public-Private Partnerships* 8 – 9. Since neither indicates in their documentation any indebtedness to the other, it is not clear which organisation—if either—originated this system.

purposes, one system may be best, while for other purposes alternative classifications may be more informative. In any given context, it is necessary to consider which dimensions of P3s are of greatest concern, and then choose the particular classification or classifications that best illuminate those dimensions. Since the focus here is primarily on the use of P3s in the provision of “hard” and “soft” infrastructure projects, most of the case studies are illustrative of the various P3 structures identified in the CCPPP/B.C. Taskforce classification. Where it is useful to do so, however, other systems of classification are used.

Reasons for Using Public-Private Partnerships

As indicated above, there has been an enormous expansion in the use of public-private partnerships. Over two thousand such initiatives have been developed in the UK PFI program alone, and both the number and scale of P3 developments in Canada are increasing rapidly. In particular, the use of P3 arrangements for such highly visible projects as the PEI Link and the Highway 407 project in Ontario has done much to focus attention on the potential benefits to be gained by enlisting, in the provision of public goods and services, the private-sector’s capacity for innovation and efficiency.

In part, the expansion in the use of P3s may be explained by the broadly environmental changes alluded to in the introductory paragraphs of this report: the changing public attitudes towards government and the demands for better services at lower cost; the increased complexity and inter-connectedness of issues; the severe and continuing fiscal pressures to which governments have been subject, with resulting insufficiencies of resources, knowledge and expertise; and, very importantly, the increased willingness on the part of government entities to rethink the role of the private sector in the provision of public goods and services.⁴ Also significant in this context have been the breakthroughs in information technology. By hugely increasing the accessibility and value of information, these have made possible totally new forms of service delivery and facilitated many P3 initiatives. Finally, each successful P3 initiative has increased the awareness and appreciation of the synergistic nature of the linkages provided by partnerships, and so paved the way for yet further partnerships.

Complementing these environmental factors are the various advantages or benefits intrinsic to public-private partnerships. While these will vary from project to project, there are several benefits that characterise a broad range of P3s. Some of the more important of these are discussed in this section.⁵

Leveraging of public funds: By serving as a vehicle for the injection of private-sector financing, P3s can augment the resources available for the provision of public goods and services. This supplementary financing has several advantages. It may permit projects to

⁴ A powerful stimulant of P3 growth has been the period of relative neglect in many public jurisdictions of their social infrastructures. As the World Bank has noted, the failure to maintain existing basic infrastructure has proved more costly in some countries and regions than the failure to invest in new infrastructure, particularly in respect of the return on the investments involved. With much infrastructure deteriorating rapidly, the attractiveness of private financing has increased dramatically, and with it the willingness to use public-private partnerships.

⁵ For a fuller discussion of the possible benefits of partnerships, see Rodal and Mulder, 31-33; *Private Opportunity, Public Benefit* 2-4; and B.C. Taskforce Report 13-14.

proceed when public finances are not available for their implementation. Moreover, the acceleration may occur without any impairment of the borrowing capacity or rating of the government or government entity involved. Some P3 arrangements may permit governments to realise the capital value of infrastructure assets they already possess, thereby obtaining revenues that may be devoted to other, high-priority areas of expenditure.⁶ Such partnerships may also provide new investment opportunities for the private sector, permitting greater diversification and lower risk than would otherwise occur.

Better management and allocation of risk: Public-private partnerships typically involve the formal identification, quantification, and allocation among the partners of the risks associated with the partnership project. Since risk is a real project cost, this structured approach to its management is likely to result in greater economic efficiency than is traditional public-sector procurement, in which risk is frequently ignored as an element of cost. Certainly any risk transfer to private-sector partners will tend to reduce that borne by the public sector. More importantly, by involving partners, it becomes possible to allocate particular risks to the partner best able to manage that risk. The costs associated with risk management may thereby be minimised.

Better incentives to perform: Where private-sector partners assume some of the risk, there may well be incentives for better performance. This would be the case, for example, if payment were to commence only with the initiation of the actual provision of service, or is conditional upon the quality of the service provided. This is considered very important in the case of the UK PFI (*Private Opportunity, Public Benefit 3*). Additionally, a private-sector partner typically has access to a range of performance-based remuneration arrangements seldom available in the public sector.

Improved effectiveness: Partnerships facilitate the co-ordination of efforts and systems and typically provide a broader base of expertise. Additionally, partners who are free from bureaucratic “red tape” and isolated from political intervention may be able to operate more flexibly and effectively than a government department or agency. All of these conditions have the potential to contribute to the efficiency and effectiveness of the partnership.

Alternative revenue sources: Partnerships may serve as vehicles to introduce tolls or other user-charge systems, while still permitting government to distance itself from these developments. The investment of the capital of the private-sector partner may increase the tolerance of such pricing initiatives. By accessing revenues from third parties, a public-private partnership may be able to proceed with a project when this would otherwise be impossible; the net result may thus be an acceleration of the availability of valuable services.

Access to economies of scale or scope: A private-sector partner may undertake the activities required of them in the P3 for other clients or partners. The resulting scale of

⁶ Depending upon the actual structure of a P3, it may provide a net infusion of private-sector funds or merely an inter-temporal reallocation in which up-front private-sector funding is matched to a flow of future public-sector payments or repayments. Even this latter case, however, may permit major projects (such as the New Brunswick Fredericton to Moncton Highway) to proceed much more rapidly than would otherwise be possible.

their total operations may therefore be considerably greater than the scale of the partnership. This may permit them to maintain and make available to the P3 highly specialised expertise of a sort that would be uneconomic were the P3 project considered in isolation. Economies of this nature provide a major justification for the Hamilton-Wentworth wastewater management P3 (Case 2).

Encouragement of multi-use infrastructure: A P3 may stimulate more intensive utilisation of capital assets, by endeavouring to attract secondary users, *e.g.*, a gymnasium in a school owned by the P3 may be rented to community users after school hours. Multiple users may mean multiple income streams, and thus greater profitability to the private-sector partner or lower lease costs to the public-sector partner.

Improved service responsiveness: P3s can be useful vehicles for increasing interaction and familiarity with clients, thereby permitting government to better determine, understand, and meet their needs.

Again, because of the tremendous diversity of P3s, the benefits they yield are likely to be similarly diverse. In most cases, however, the benefits will be captured by one or more of the categories identified above. As the Private Finance Panel has observed, by exploiting the full range of private-sector management, commercial, and creative skills, P3s should make possible the provision of quality services at lower cost than would be possible by means of traditional procurement (*Private Opportunity, Public Benefit 4*).

Risk Transfer and Value for Money

It is of considerable interest that, based on very extensive experience with public-private partnerships, the Private Finance Panel concluded that there are only two *fundamental* requirements for a PFI project, namely:

- i. The private sector must assume some of the risks of the project; and
- ii. Value for money, from the perspective of the taxpayer as client, must be demonstrable for the project (*Private Opportunity, Public Benefit 12*).

Given the centrality of these two concepts, they will be examined in greater detail.

Risk Transfer

In the earlier stages of PFI, the emphasis regarding risk analysis was upon the transfer of risk to the private sector; this was considered a prerequisite for a public-private partnership. As experience was gained in this area, it came to be realised that, while a *transfer* of some risks to the private sector enhanced the incentives required to promote efficiency and economy, the key concept was *risk management*, *i.e.*, achieving the optimal allocation of project risks among the partners, so that each risk became the responsibility of the partner best able to manage that particular risk. The requisite allocation would be specified in the contractual agreements governing the partnership. By managing risk in this manner, it was frequently found that mitigation could be achieved simply by an appropriate allocation: a partner which was familiar with a particular risk and accustomed to dealing with it may require an appreciably smaller uncertainty premium than one to which the risk was unfamiliar.

More generally, risk management requires the identification, analysis, quantification, allocation, and mitigation of the risks associated with a particular public-private partnership. The analysis process may be complex, possibly requiring considerable research, including simulations of various possible outcomes associated with the project. Quantification of risks typically requires identifying the various outcomes, attaching probabilities and costs to each of them, and incorporating these in the cash-flow analysis of the project, to ascertain the impact on its net present value (NPV) or on its internal rate of return (IRR).⁷

Given the diversity of public-private partnerships, it is difficult to be exhaustive regarding the risks they may involve. At the peril of oversimplifying, and considering at this time only infrastructure projects, the major categories of risk are as follows:

- Design and construction risks;
- Commissioning and operating risks respecting availability, operating costs, performance, and maintenance;
- Demand risks relating to utilisation;
- Risks respecting residual values;
- Risks resulting from obsolescence or changes in technology;
- Regulatory risks, including changes in taxation; and
- Financing risks.

Once project risks have been identified and quantified, they should be allocated to the partner best able to manage them. This management process may involve their reduction or elimination; their transfer to a third-party, possibly a contractor or insurance company; or they may be absorbed or pooled (The Institution of Civil Engineers and the Faculty and Institute of Actuaries 33). Reduction or elimination may involve altering the design of the structure in such a manner as to reduce or remove the possibility that a particular event, *e.g.*, a structural failure, will occur. In this instance, additional costs would clearly be incurred. Similarly, if the risk is transferred to a third-party, they will require compensation for the resulting exposure; *e.g.*, an insurance company will require the payment of a premium related to the actuarial value of the risk assumed, or a bank or other financial institution will adjust the interest rate charged to reflect the financing risk. The very fact of using a partnership for an infrastructure project will tend to result in some pooling of the project risks among the partners, thereby reducing the risk absorbed by each. By assigning different risks to the participating partners, no one partner may be burdened with a level of risk that would prevent the project from proceeding.

It must be kept in mind, however, when risks are transferred or pooled, the entity involved is likely to adopt a very conservative view—possibly using a “worst case scenario”—when the risk in question is one with which they are unfamiliar. In consequence, when risks are being allocated among relevant parties, it is necessary to consider both their ability to bear a particular risk and the value each party attaches to

⁷ A short-cut approach may involve the use of a risk-adjusted discount rate, but, if the risk adjustment factor is to be determined with any degree of precision, an analysis of the sort indicated in the text must first be undertaken.

carrying that risk. It has been observed, for example, that the financing of the early public-private partnerships in Canada required the payment of significant premiums *vis-à-vis* government bonds, including those of the government partner in the project. Indeed, in the case of the Highway 407 project (Case 4), the potential premium was sufficiently great to cause the provincial government to abandon its original intention of having the private-sector partner undertake the financing.⁸

Such premiums tended to reflect the limited, non-recourse character of project-based financing; the more complex credit assessment required on the part of investors; and the lesser liquidity of project-issuer securities relative to government bonds. Also, public-private partnerships frequently present unusual corporate governance structures to the market. The net result of these factors has been spreads that, for investment-grade projects, have been of the order of 50 – 60 basis points relative to bankers' acceptances. In the case of private-placement financings—most of which have involved insurance companies—the spreads for such projects, relative to Government of Canada bonds, have been of the order of 110 – 140 basis points (Greene 14).

In assessing the risk premiums that capital markets are likely to require for P3 financing, it should be kept in mind that, all too frequently, public-sector projects are not subjected to comprehensive risk analysis. In some cases, this may be attributable to the governmental practice of self-insurance, a practice that militates against the discrete and explicit costing of project risk. It may be argued that the cost of general government borrowing reflects the market's overall assessment of the risks involved in lending to a particular government, and that advantage should be taken of this in considering the optimal financing for infrastructure projects.

The counter argument is that efficient-resource allocation requires a comprehensive analysis of all the costs and benefits associated with a project. Whatever the risks associated with a project, their acceptance is a real cost that governments may ignore only at their peril: to use as a proxy for such risks the general risk-premium embedded in the government's normal borrowing cost (*i.e.*, the rate of interest that the government in question must pay to sell its general obligations) may result in the acceptance of projects that, on the basis of a comprehensive and explicit risk analysis, should in fact be rejected. It is one of the advantages of public-private partnerships that they typically require the identification, quantification and pricing of real project risks. They thus have the potential to achieve a more efficient utilisation of resources than would result where the cost of general-obligation financing is applied indiscriminately to all government projects.

In allocating risks among the partners, it is important to keep in mind that the allocation may dictate the accounting treatment of the P3, a consideration that may be vital if one of the objectives is the achievement of "off-balance-sheet financing." In determining whether the borrowing for a particular project should be reflected in the financial position of the participating government, provincial auditors may look to the

⁸ It may, of course, be argued that the premium reflects the relative illiquidity of the debt instruments of a P3 *vis-à-vis* sovereign debt, but this too is reducible to differential risk: to the risk that it may be necessary to liquidate the investment prior to its maturity, and the associated risk that, in a shallow market, the liquidation may involve a significant discount.

relative risks borne by the principals to the P3 contract. For example, should a government partner retain too much risk itself, possibly by minimising or eliminating the risks of “ownership” for the private-sector partner, an auditor might conclude that true ownership resided with the government, and insist that it be accounted for accordingly.⁹

Alternatively, should the public-private partnerships involve a lease arrangement, with lease payments flowing from the government partner to the private-sector partner (as is typically the case in the Nova Scotia school-construction P3s), if these are large enough to permit the lessor to recover essentially all of their capital, they may prompt auditors to conclude that the lease is a capital, rather than an operating, lease, with the resulting adverse tax consequences that would follow upon such a decision. The nature of the public-sector partner may also be important in determining the manner of accounting for the debt of a particular P3.¹⁰

A further observation that should be made respecting risk management is that the public-sector partner may use its authority to confer a monopoly status on a particular P3, thereby minimising or reducing demand or utilisation risks. For example, in the case of the PEI Link (Case 9a), the agreements governing the arrangement require the federal government to eliminate the existing ferry service and to refrain from establishing any competitive link within twenty-five kilometres of the project link. As is typical in such monopoly situations, it is necessary to provide some safeguard to the Link users. This has been done by limiting annual price increases to the increase in the CPI for the first five years of the project, and to the increase in the CPI minus two percentage points thereafter (See also Cases Nos. 7b, 10a, and 10b.).

Before leaving this discussion of risk management, it should be noted that there is a very close relationship between the structure of a partnership and the allocation of risk between the partners. In other words, the specification of the desired allocation of risk will largely determine the structure of the partnership. It will be recalled from the discussion of the classification of public-private partnerships that infrastructure projects typically will consist of some combination of the following functions: Design (D); Build (B); Operate (O); Maintain (M); Own (O); Finance (F); Transfer (T); Lease (L); Develop (D); and Buy (B). Each of these functions has its own associated risks; in consequence, the decision to assign particular risks to one partner is also a decision to allocate to that partner the associated functional responsibilities, thereby determining the structure of the partnership. The range of possibilities was arrayed in Table 1 above. Achieving the optimal allocation of risk, however, may require a project of sufficiently wide scope. Where project scope is in fact limited, significant risk transfer may be severely hampered.

Value for Money

⁹ In this context, it is informative to note that the guaranteed subsidy provided by the federal government to the consortium involved with the PEI Link, together with the various risks assumed by the government, caused the Auditor General to insist on capitalisation of the government’s obligations and their inclusion in the government’s financial statements for the relevant year.

¹⁰ See British Columbia, Department of Finance, “Definitions and Guidelines,” *passim.*; CICA Handbook 3065; and relevant sections of the Public Sector Accounting and Auditing Standards. For a general discussion of issues relating to risk transfer, see Nova Scotia, Department of Finance, *Transferring Risk in Public/Private Partnerships* (Halifax: November 1997).

The second fundamental characteristic of a public-private partnership is value for money (“VFM”) considered from the perspective of the taxpayer, as client. This characteristic is not unrelated to the first, the transfer of risk to the private sector. Indeed, as the Private Finance Panel has observed, the transfer of risk is one means of achieving VFM, one that may be expected to increase VFM (at a diminishing rate) with increasing risk transfer until the optimum point has been reached, at which juncture all risks have been allocated to the partner best able to manage them and any alternative allocation would involve diminishing returns. The various types and amounts of risk that have to be transferred to achieve optimum VFM will vary from case to case, and will largely be determined by the competitive bidding process that is an essential step in establishing a P3. VFM, on the other hand, is established by looking at alternative ways of providing the same services, including, most importantly, a comparison of Net Present Value (“NPV”) over the life of the project with the NPV of the traditional procurement process (*Private Opportunity, Public Benefit* 12). This latter process is referred to as the “Public Sector Comparator,” about which more is said below.

Essentially, the best value for money is yielded by the optimal combination of the whole-life costs and benefits of the project under consideration. Much of the potential advantage of public-private partnerships is attributable to this longer-term analytical framework: if a private-sector partner is aware that they will be responsible for the design, building and operation of a project (a DBO project), features that contribute to the minimisation of operating costs will be designed and built into the structure. This may add to the construction and financing costs, but the resulting operating economies more than compensate for this. Considerations of this sort have been extremely important in the United States in achieving economies in the construction and operation of prisons by means of public-private partnerships.

The VFM calculus that should be a prerequisite for any P3 attempts to answer two questions: First, should the project proceed at all, *i.e.*, does it yield over its lifetime a positive NPV that is greater than those of alternative and competitive uses of the funds involved? Second, should it proceed using a P3 or traditional procurement? If a P3 is warranted, then a third issue will be that of selecting an appropriate partner. Answering the first of these questions will clearly require a comprehensive economic analysis, and many governments now have detailed manuals setting forth in considerable detail how such an analysis should be conducted.¹¹

In the case of the PFI, the government department or agency undertaking the review is required to prepare a “business case” to establish that an affordable investment option exists. Details on how this should be done are set forth in “A Step by Step Guide to the PFI Procurement Process” (HM Treasury, July 1997). If the project in question is “financially free standing,” *i.e.*, where the private-sector partner will design, build, finance, and then operate the project, recovering costs entirely through charges to third parties, no public-sector comparator analysis is required. In all other cases—that is, those involving some payments from the public sector—public-sector comparator analysis is

¹¹ See, for example, Canada, Treasury Board, *Benefit-Cost Analysis Guide*; and HM Treasury, *The Green Book*.

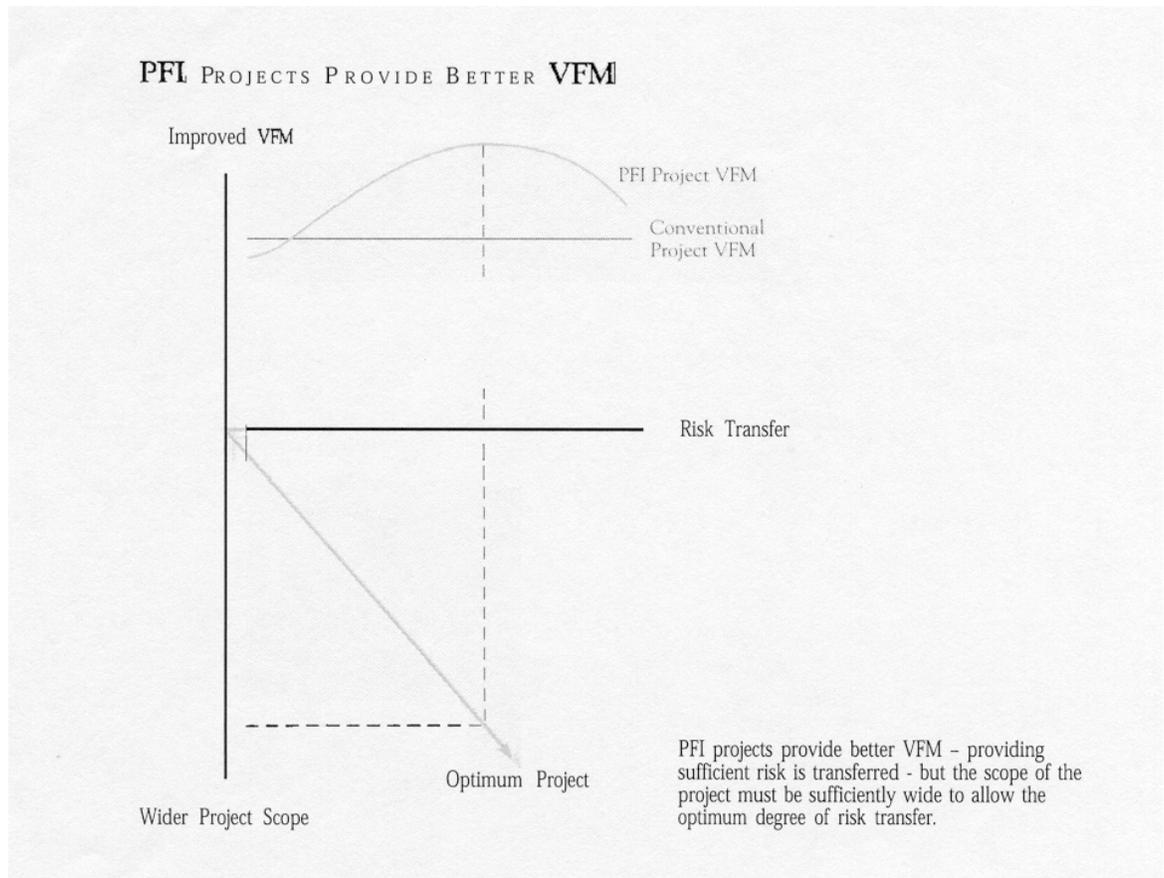
required.¹² The comparator methodology is discussed in some detail below. Before considering it, however, it is necessary to first give some attention to the sources of VFM.

There are many ways in which a private-sector contractor can augment VFM in a public-private partnership. Without attempting to be exhaustive, these include the following:

- Integrating operational needs in the basic design, thereby contributing to operational and maintenance efficiency;
- Facilitating the introduction of user-charges, thereby achieving a better balance between supply and demand;
- Providing innovative designs and avoiding over-specification (“gold-plating”);
- Exploiting economies of scale from multiple operations;
- Utilising knowledge of and experience with new technologies;
- Designing the asset so as to exploit possible usage by third-parties or to increase residual value or flexibility in use; and
- Making possible the transfer of some risks from the public sector to those better able to manage the risks transferred.

The relationship between improved VFM, risk transfer, and project scope is shown in the following diagram, borrowed from *Private Opportunity, Public Benefit* (18).

¹² Where comparators are available from other, similar projects, these may be used in lieu of constructing another unique comparator (see Case 5).



In the top part of the diagram, the improvement in VFM relative to conventional procurement is demonstrated, the magnitude of the improvement in VFM being a function of the amount of risk transferred to the private sector (as shown on the horizontal axis). In turn, risk transferred is a function of the scope—*i.e.*, scale or complexity—of the project, a greater transfer requiring larger scope. Initially, as scope increases—and therefore the capacity to transfer risk—project VFM first increases, reaches a maximum, and thereafter diminishes as further risk transfer and increased scope are subject to diminishing returns. The point at which VFM achieves its maximum value determines both the optimal amount of risk transfer and the optimal scale for the project. While conceptually simple, the underlying economic and risk analyses may be extremely complex in practice. An evident danger here is that the analyses themselves may be subject to diminishing returns, an outcome for which there is substantial evidence in the literature discussing the PFI. This suggests that analysts with solidly pragmatic approaches are highly desirable for this process.

Based on extensive experience, the PFI indicates that the projects offering the greatest potential gains in VFM are likely to be those (1) that, in addition to providing an infrastructure asset, maximise the associated services—such as maintenance and operation—provided by the private-sector partner; (2) that have the greatest potential for transferring risk to the private sector; and (3) that generate additional revenues from sales to third parties. Perhaps the most important source of VFM in P3 projects is competition (*Private Opportunity, Public Benefit* 18). Competitive bidding should be used wherever

possible in establishing public-private partnerships, most particularly in those cases where the use of a public-sector comparator is extremely difficult.

Public-Sector Comparator

A “comparator” is a benchmark created for the purpose of demonstrating VFM. As used in the PFI, it is a detailed benchmark the compilation of which may require the investment of considerable time and effort. This characteristic has led to it having a somewhat chequered career: initially, it was required of all PFI initiatives, but the time required to prepare the comparators contributed to substantial delays in being able to respond to private-sector bids. The strict requirement for it in all cases was therefore relaxed, particularly in circumstances in which strong competitive bidding was operative. Most recently, however, the Private Finance Treasury Taskforce has reiterated the requirement that a public-sector comparator be prepared as part of the preparation of a PF initiative, except in the case of “free standing projects” in which there is virtually no contribution of public funds (Treasury Taskforce, “Comparators in Public Procurement” 2.3.2). Additionally, in situations where the public sector is not the major supplier of funding, the comparator analysis may be dispensed with, although VFM will still have to be demonstrated *vis-à-vis* alternative uses for those public funds that are invested in the project.

As utilised in the PFI, the preparation of the comparator is a two-stage process. An early requirement in the PFI process is the compilation of an “Initial Business Case”, the purpose of which is to demonstrate the likely viability of the initiative. A component of this is the “Reference Project”, which is used to demonstrate that an affordable investment option exists. This involves a basic costing of one possible solution to the procurement need. The second stage involves the preparation of a detailed public-sector comparator (“PSC”) which, in practice, is likely to be a refinement of the reference project. While related, the two steps are distinct and serve different purposes: the reference project is a critical step in demonstrating that the project is *affordable*, while the PSC will provide the necessary evidence that a particular option represents *good VFM*.

In most cases, the two most likely alternatives to a PFI procurement process will be (1) conventionally funded provision of the same level of service; and (2) conventionally funded provision of a lower level of service, the actual level being determined by the funds available. Whichever is used, the PSC must reflect the *full* cost of providing the services. In the absence of a fully articulated comparator process, it is unlikely that a full costing would be achieved: governments rarely measure the cost of providing services in-house. Many overheads—such as the costs of central agencies and those of financing—are seldom allocated, and, as noted above, self-insurance tends to militate against any proper costing of risks.

The construction of a PSC is seldom straightforward. It will typically be based on a set of hypothetical contracts to design, build and manage a public-sector facility, based on recent experience of actual costs. It must provide for the fact that outcomes are frequently more costly than anticipated. Estimates will be required both of the likely costs and the risks associated with acquiring and then operating an asset to provide a service that meets specified standards. Where the service in question is a new one, one for which

no readily available comparisons are available, it may be necessary to construct a proxy measure or benchmark. This is likely to require an initial identification and costing of risk, a process that may be unfamiliar to relevant staff in the government department or entity involved. It must be appreciated, however, that private-sector submissions on a prospective P3 project will price and include the costs of carrying and managing transferred risks; it is essential, therefore, that the PSC for the project also include these costs.

More generally, in using a PSC it must be appreciated that private-sector bidders are bound by the financial consequences of their bids in a way that government officials seldom are. This can result in excessive optimism in the PSC analyses, and this must be guarded against. It must also be appreciated that large-scale public-private partnerships may generate significant externalities that will benefit an entire regional economy, but which cannot be captured by the partnership through charges imposed on the users of the project. Such externalities should be reflected in the PSC and may warrant the infusion of public funds to supplement the revenues that can be generated directly by the project.

The UK experience with the PFI would suggest that there have been difficulties resulting from attempts at excessive refinement of PSCs. Such attempts are subject to diminishing returns and have contributed to excessive delays in responding to private-sector bids on PFI projects. This was considered unfair to private-sector bidders, most particularly when the refinements went appreciably beyond the information that had been conveyed initially to the private sector. In consequence, the Private Finance Taskforce has mandated that attempts to refine PSCs must be constrained by the incremental value that results from the additional efforts and by the availability of comparators from prior similar procurements (Private Finance Taskforce, “The Complexity of the Comparator,” 4.1.2).

Standard procedure in the UK PFI would see bids from the private sector sought when the preliminary option appraisal has been completed and the scope of the project defined, but prior to the detailed refinement of the PSC. The Taskforce is of the opinion that vigorous competition between potential suppliers is the surest method for obtaining the best possible offers from the private sector. This increases VFM and also the probability that the best PFI bid will in fact provide better VFM than the PSC. It must also be recognised, however, that the preparation of PFI bids may be an extremely expensive process, particularly in the case of very large-scale projects. In consequence, the Taskforce and the Government are committed to minimising the costs incurred under the PFI. Pre-qualification and limiting the number of potential bidders to no more than is necessary to sustain competition are among the techniques used for this purpose.

The PF Taskforce also encourages government departments and agencies to be as open as possible with bidders (Taskforce, “Other Policy Issues” 5.1.3). This helps private-sector bidders avoid incurring costs unnecessarily and minimises misunderstandings respecting required levels of service and operative budget constraints. The implication of this is that information regarding the conceptual basis of the relevant comparator should be disclosed, together with technical information on the methodology of its construction. Indeed, where competition is strong, the Taskforce is of the view that it may be appropriate to share the full outcome of the PSC exercise with the bidders (*Ibid.*).

II Experience with Public-Private Partnerships

Considerable experience has now been gained in the use of public-private partnerships by national governments, provinces and states, municipalities, and various other governmental entities. In this section we survey this experience, with the intent of identifying the different approaches that have been used to implement public-private partnerships, while also noting any practices or lessons that may be useful to other jurisdictions interested in considering this form of alternative service delivery. Given the extremely extensive experience gained by the United Kingdom, we commence with that country.

United Kingdom

While the Private Finance Initiative was formally announced in 1992, the UK experience in using private finance to fund public-sector bodies predates this by more than a decade. For example, a set of rules to govern private funding was announced by a Treasury Committee under Sir William Rylie in 1981. Two basic principles were enunciated: First, privately funded solutions had to be tested against publicly funded alternatives and shown to be more cost-effective. Second, although Ministers had some authority to determine otherwise, privately funded projects would result in a compensating reduction in the provision for public funding. Not surprisingly, this second requirement tended to dampen the enthusiasm of potential public-sector partners to exploit private funding, and it was generally criticised as being too restrictive. It was relaxed in 1989 by then Chief Secretary of the Treasury, John Major, who decreed that, in future, the Treasury would not require reductions in public expenditure commensurate with privately funded projects.

The introduction of PFI in 1992 was accompanied by a new set of principles, ones that specified that self-financing projects undertaken by the private sector need no longer be compared with publicly funded counterparts; that the private sector should be actively encouraged to take the lead in joint ventures with the public sector; and that the public sector had to be provided greater opportunity to use leasing when this would achieve both a transfer of risk from the public sector and good VFM. Still further stimulus was provided in 1993, when the Private Finance Panel was established with a mandate to encourage greater participation by both the private and public sectors. The focus also was broadened from private funding to include as well the private sector in designing, building and operating the capital assets required by public-sector service providers.

Many of the early PFI projects focussed on transportation, but in 1993 it was announced that National Health Services entities would not be given access to public funds for capital projects unless they could demonstrate that PFI options were impracticable, an approach to PFI that was generalised for all capital projects by all departments in 1994. This change in policy increased significantly the scope of the PFI.

Prior to the PFI, many local authorities had entered partnerships with the private sector. This was further encouraged under PFI, and, under its aegis, there is now an annual fund for which local authorities compete to partially fund public-private partnership initiatives.

PFI initiatives have now been used very extensively in the UK. The list of affected areas includes Transport, Health, Defence, Accommodation, urban regeneration, information systems, prisons, higher and further education, water and sewerage, among others. By the end of 1995, more than 1,000 projects with a capital value of £25 billion had been completed (Private Finance Panel 8 – 11). Since being elected, the Labour Government has undertaken a review of the PFI, and have since reaffirmed their commitment to it. A senior business executive (Malcolm Bates) was appointed to provide detailed recommendations respecting what should be done in this area, and all of his proposed institutional and policy changes to streamline the PFI have been implemented.¹³ Total projects undertaken pursuant to the PFI are now in excess of 2,000 and further projects, with a capital value in excess of £7 billion, are currently under way.

The UK experience highlights the importance in PFI projects of the ability to integrate a number of companies with different skills into an effective partnership. Integration in design, procurement and construction for the full useful life of the development is essential for success, together with some very sophisticated financial engineering. Another lesson from the British experience is that the entry price for private firms is high, and it is very costly to retain the integrated teams of professionals essential to any company's continuance in the PFI "marketplace." Despite these difficulties, the PFI projects have effected a tremendous cultural change away from confrontation and contention and towards integration and partnership.

Canada

The use of public-private partnerships in Canada is now well established at the federal level and in several provinces, most notably Ontario, British Columbia, New Brunswick and Nova Scotia. This is evident in the case studies discussed in Part V of the paper, and from many of the sources identified in the Bibliography.¹⁴ Since comprehensive material describing federal policies and initiatives is readily available, no survey will be attempted here.¹⁵ Rather, attention is focussed on the four provinces which have most actively pursued public-private-partnership initiatives, with particular attention being paid to issues of governance and responsibility: *i.e.*, what organisational structures have been put in place to deal with P3s; and which agency or agencies are responsible for contract approval, monitoring, and—if necessary—enforcement? It will quickly become evident that the answers to these questions differ from province to province, depending upon a number of issues relating to a particular government's commitment to the use of P3s, the areas in which they wish to use them, the nature of the partnerships that are developed, and a host of other variables. Not surprisingly, the provinces active in this field have developed a variety of different ways of organising their oversight and governance mechanisms in the pursuit of their P3 objectives, and have proceeded in substantially different directions.

¹³ A summary of Bates' recommendations is available in Private Finance Taskforce, "Bates Report – PFI to be Re-invigorated."

¹⁴ In particular, see CCPPP, *Inventory 1998* and Nairne & Strait Crossing, *Worldwide Survey of Public-Private Partnerships*.

¹⁵ See Treasury Board Secretariat, *Citizen-Centred Service and the Partnership Option and Alternative Service Delivery: Impediments to Partnering and the Role of the Treasury Board*; and Armstrong and Lenihan.

Ontario

Although previous governments had pursued various P3 initiatives, public-private partnerships became a high profile issue in Ontario in 1996, with the creation of the Office of Privatization. This office is headed by a minister without portfolio, who has responsibility for privatization and related issues. A secretariat for the Office of Privatization was also created, and it is led by a high profile CEO drawn from the private sector, rather than a career public servant.

The Office has a mandate to look at a whole host of options including “improving efficiency while retaining ownership, to *public private partnerships* (emphasis added), to joint ventures, to sales and divestitures” (Office of Privatization 1). It is thus evident that the Ontario government has taken a very broad view of privatisation, one which, in addition to selling assets to the private sector, encompasses a whole host of alternative service delivery mechanisms, including using the not-for-profit sector, franchises, and long-term leases. In a context in which “privatisation” has this very broad meaning—including establishing a public-private partnership—the Secretariat of the Office of Privatization is responsible, with the assistance of external advisors (*i.e.* consultants), for the following:

- A complete analysis of the business risks, challenges and opportunities associated with any candidate for privatization;
- Public consultation on the privatization options available to the Government, including leases, and other P3 options;
- An assessment of relevant options and implications for possible privatizations, including such matters as: valuation, restructuring opportunities, human resource implications, level of private-sector interest, feasible transaction structures, marketing opportunities, and legislative and regulatory matters; and
- Recommendations on feasible privatizations and the associated transaction parameters required for implementation.

Once the privatization review is completed, the Secretariat reports to the Cabinet Committee on Privatization, which then decides which of the recommended options will best improve service to the consumer and value to the taxpayer. Cabinet will then instruct the Office of Privatization to proceed directly to implementing the approved option. In the course of the implementation process, the Secretariat will address such issues as organisational and financial restructuring; legislative amendments; the preparation of offering documentation; a bidding process; the negotiations to effect the transaction; and, finally, the Secretariat will complete the sale.

When a public-private partnership is established by this process, the final stage is the subsequent monitoring to ensure that the approved option implemented by the Secretariat conforms and complies with the government’s privatization objectives and is in conformity with the terms of the agreement and relevant legislation and regulations.

British Columbia

B.C. was one of the few provinces to use a task force to investigate fully the use of public-private partnerships prior to making use of them. At the second of two joint industry-government conferences on the renewal of the B.C. economy, the Premier and

Minister of Employment and Investment spoke about the need for action in the province respecting infrastructure financing alternatives, and announced the establishment of a Task Force on Public-Private Partnerships. The Task Force was asked to make recommendations regarding an implementation strategy to assist the provincial government in the timely introduction of public-private management and finance into areas of capital investment traditionally undertaken by the public sector, and to facilitate the transfer of knowledge and skills between the private sector and government.

Delivered in October of 1996, the report of the Task Force (*Building Partnerships*) has been a highly influential document both within B.C. and in other jurisdictions in Canada. The report was very supportive of public-private partnerships, and recommended that the government establish a Ministry and Minister with a mandate to pursue the feasibility and implementation of P3s. The report also recommended that the government develop P3 experience by “implementing pilot projects in specified sectors so that the public and private sector in B.C. can study and learn from their demonstration effects.” (*Building Partnerships* 1.) More specifically, the report suggested that the government should develop a comprehensive framework and guidelines to direct the efforts of departmental officials. Finally, the report recommended that the “Government should seek to incorporate the lessons learned from the application of P3s into the processes used for traditional procurement and development of infrastructure . . . to ensure value for money is achieved in all capital investments” (*Building Partnerships* 1).

Initially, the Ministry of Employment and Investment was responsible for public-private partnerships in B.C., but this responsibility has recently been transferred to the Ministry of Finance and Corporate Relations, where it resides in the Capital Division. This is the Division that is responsible for recommending to Treasury Board and Cabinet overarching policies and priorities in the preparation and delivery of the province’s annual capital program. Its responsibilities encompass expenditures on capital projects (e.g., universities, colleges, schools, hospitals, courts and corrections facilities) and the capital expenditures of taxpayer-supported Crown Corporations (i.e. B.C. Ferries, B.C. Transit, B.C. Transportation Financing Authority, B.C. Buildings Corporation). The Division is also directly responsible for overseeing the implementation of all capital projects.

Regardless of the amount of public-sector risk transferred by means of a P3 to private partners, these arrangements are still subject to close scrutiny by the appropriate government agencies. In the case of British Columbia, the review process is rather extensive, involving as it does “Treasury Board Staff, Provincial Treasury, Ministry of Employment and Investment, Crown Corporations Secretariat and the Office of Comptroller General (on accounting treatment issues).” Throughout the process, the “Provincial Treasury will lead and co-ordinate all inquiries of prospective investors and financial advisors, acting on behalf of the Minister of Finance and Corporate Relations as the province’s fiscal agent” (“Guidelines for Alternative Financing Proposals” 7). Despite this rather cumbersome process, public-private partnerships have made rapid

strides in British Columbia, and several major developments are included among the case studies in Part V of the paper (see Cases 6a and 6b).¹⁶

British Columbia has also been active in encouraging its municipalities to utilise P3s when it is advantageous to do so. To this end, an extremely useful manual has been developed, one that provides information on the basis nature of such partnerships, the circumstances in which their use should be considered, and comprehensive information on how to proceed with a P3.¹⁷

New Brunswick¹⁸

New Brunswick is another province with well established policies and procedures respecting public-private partnerships. These encompass guidelines, protocols and acceptable processes. The public-private-partnership policy provides the following:

- Specific criteria against which all proposed public-private partnerships will be measured and approved, to ensure that the best interests of New Brunswickers are met;
- A consistent, fair and transparent review process to be followed for all public-private initiatives; and
- A high level of confidence to New Brunswickers that decisions made with respect to public-private partnerships are fully informed and justifiable, and have been found to be the best alternative (*Public-Private Partnerships*).

Public-private partnerships in New Brunswick must also ensure that the following objectives are met in a balanced way, to reflect the best interests of all stakeholders:

- That government services are delivered in the most economical, effective and efficient manner;
- That they contribute to the overall economic development of New Brunswick through the stimulation of competitiveness and initiative and create opportunities for private-sector growth; and
- That the best interests of the public, the business sector and the community are served through an appropriate allocation of risks and returns between partners.

The first step toward approving a P3 in New Brunswick is a detailed evaluation to determine whether the objective of the partnership is a government priority. In addition, a public-private partnership may be pursued only after alternative methods of delivering the project have undergone careful evaluation, and where a sound business case demonstrates that the partnership offers the best solution.

The province has determined that all public-private partnerships are to be based on the following guiding principles (*Public-Private Partnerships passim*):

¹⁶ A useful source of information on B.C. policies and procedures respecting public-private partnerships is Advisory Committee on Public-Private Partnerships, *Best Practices Guide to Public-Private Partnerships*.

¹⁷ British Columbia, Ministry of Municipal Affairs, *Public Private Partnership: A Guide for Local Government* (May 1999: <http://www.marh.government.bc.ca/LGPOLICY/MAR/PPP/>).

¹⁸ See New Brunswick, Department of Finance, "Public-Private Partnerships".

- project scope: the project must be of sufficient size or complexity to provide opportunity for the private sector to demonstrate its initiative, innovativeness and expertise in providing best value to New Brunswick;
- competitiveness within the private-sector market: sufficient qualified private-sector proponents must exist to ensure a competitive process;
- shared rewards: the public receives “value for money” from the initiative, while the private sector can reasonably expect to receive a fair return on its investment;
- premise of risk transfer: risks are allocated to the partner best suited to assume the risk;
- procurement process: this must be fair and transparent and be subject to due diligence;
- signed contract: the acceptance of a long-term relationship is established through signed, formal contractual arrangements; and
- communications: a proactive, ongoing and transparent communications plan designed to keep people informed must be implemented.

Nova Scotia¹⁹

Nova Scotia began its involvement in public-private partnerships with a strong commitment to the concept, but without a well-articulated policy. Such a policy has developed incrementally, however, as the province has gained experience with 3Ps since the mid-1990s.

To date, Nova Scotian public-private partnerships have focussed on school construction, always a controversial subject in that province. Although its policies and procedures respecting P3s were subject to considerable criticism, including that of the provincial Auditor General, the Government of Nova Scotia pursued its public-private partnership agenda, modifying its implementation in the light of earlier errors.

The Government adopted the policy that all future school construction would be undertaken without adding to the provincial debt, and chose a P3 model, with lease arrangements with the private sector, as the way to honour that commitment. This was announced in the April, 1997 Budget Address, in which the Minister of Finance stated that all future school construction projects would be built under public-private partnership arrangements. Committing itself in this manner approach would appear to preclude the government from considering other options for individual schools that might, in some circumstances, produce better VFM. However, the Department of Education and Culture stated that operating leases would only be signed if they represented value for the taxpayer, and that other options would be considered where appropriate.

The use by Nova Scotia of P3s for school construction is an interesting example of the manner in which such partnerships can be used to resolve acute fiscal problems. Unlike most other provinces, Nova Scotia is directly responsible for school construction,

¹⁹ A useful reference source on Nova Scotia’s approach to public-private partnerships is *Transferring Risk in Public/Private Partnerships*. Nova Scotia: Department of Finance, November 1997.

and years of public borrowing for new school construction had added significantly to the provincial debt. In the public education system, the response to financial restraint had been to generally curtail the construction of new schools, defer maintenance, freeze wages and hiring, and defer innovation (such as technology applications) in an effort to help maintain educational programs. In the face of an emerging need for a new generation of schools that incorporated new technologies, this approach was no longer considered viable. It was in this context that P3s emerged as an innovative solution to a continuing problem.

The goals of Nova Scotia's P3s and school construction agenda are straightforward: to build better schools through more school/community collaboration, linked with expertise in school design, facilities and technology; and to build more schools more quickly, without adding to the debt of the province. The program involves substantial risk transfer to the private sector. For example, the school must be delivered on time and on budget. Any cost overruns are the responsibility of the private partner, and penalties exist for late delivery. Moreover, the leases with the private sector partner must be operating leases, so risks associated with residual value or use are borne by that partner, as are the risks of insufficient demand, operational difficulties, and, most significantly, the risk that the venture will be adversely affected by changes to relevant legislation.

As a means of encouraging the use of public-private partnerships at the local level, the provincial government has also prepared an outstanding guidebook to assist municipalities in using 3Ps (*Strategic Public Private Partnering: A Guide for Nova Scotia Municipalities*). The premise of the guidebook is that both the public and private sectors have certain advantages relative to the other in the performance of particular tasks. By allowing each sector to do what each does best, public services and infrastructure can be provided in the most economic and efficient manner. The guidebook cautions, however, that while 3Ps can yield tangible benefits, they are not universally applicable. In particular, 3Ps are not deemed to be substitutes for strong, accountable, and effective governance.

In summary, it is clear that Nova Scotia proceeded initially in an experimental fashion, attempting to learn as projects were implemented, and evolving in the process a much more comprehensive policy on P3 school-construction projects that incorporates some of the valuable lessons learned along the way.

Other Jurisdictions

Neither space nor time permit a more exhaustive discussion of public-private-partnership developments in other Canadian provinces, but there is substantial evidence that every province and both territories have perceived the benefits to be derived from the use of such partnerships, and have started actively to exploit these possibilities. For example, the Canadian Council for Public-Private Partnerships lists projects that are underway or approved in all jurisdictions (*CCPPP Inventory 1998*). To date, developments are concentrated in the areas of transportation, environment, and civic or municipal structures and facilities, but the rate of proliferation is accelerating rapidly and it seems a safe prediction that, in very short compass, very few areas of government will be unaffected by the use of public-private partnerships.

Internationally, the pace of development in many countries is just as rapid. Included in the Case Studies section of the report are examples of public-private partnerships from Australia, Germany, Korea and the Philippines, but examples could have been provided from more than twenty-five countries (Nairne & Strait Crossing). The level and the nature of government involvement in P3s varies greatly from country to country, and this makes generalisation difficult. It would appear, however, that the emphasis on risk transfer to the private sector, which is so prominent a feature of North American and British P3s, is considerably weaker in Continental Europe and, most particularly, in Asia.

III Determinants of P3 Success

With the extensive experience that has now been gained in public-private partnerships, it is possible to identify those factors that, on balance, have contributed to success, together with the various impediments that have been encountered by some of the pioneers in this area. In particular, given the very extensive use of such partnerships in the United Kingdom, many of the following observations derive from the experience of that country (HM Treasury, *Review of PFI (Public/Private Partnerships)*, the “Bates Report”).

To start with some of the impediments, the PFI experience clearly indicated that the institutional complexity of the process was, initially, too great. There were simply too many players and organisations on the public-sector side. One of the strongest recommendations of the Bates Report was therefore that the structure had to be simplified and responsibilities made clear. It was acknowledged that departments and agencies had to be accountable for their procurement decisions, but the complexity of many PFI transactions required a level of commercial knowledge and experience that was in short supply in the relevant public agencies. This suggests the importance of recruiting to the public service the skills necessary to exploit public-private-partnership arrangements, and also the need for appropriate training programs. It also suggests an immediate need for a strong central unit to assist departments and agencies in structuring effective transactions in the shorter term. This gave rise to the Bates recommendation—which has been instituted—that a new Private Finance Taskforce be established in the Treasury to become the focal point of all PFI activities across government, and that it should sign-off on projects as early as possible in the procurement process. It was also recommended that the Private Finance Units in each department or agency pursuing PF initiatives be suitably strengthened.

Another requirement evident in the early stages of the PFI was the need to transform roles, responsibilities and thinking within the public sector. The successful exploitation of public-private partnerships requires that government bodies change from being the owners and operators of assets into intelligent purchasers of long-term services. It is necessary that the capacity to undertake this transformation be both recognised and suitably rewarded.

Another view that was advanced most strongly in the Bates Report was that the processes associated with PF initiatives should be standardised wherever possible. Inter-agency differences in approach and independence contributed to delays and cost inflation, the latter for both the private and the public sectors. Coupled with this was a

recommendation that government clearly prioritise the areas in which it wished PF initiatives to proceed. The number of private-sector companies able to participate in larger-scale initiatives was, in some areas, limited; it was imperative, therefore, that their energies be directed to the priority areas of government.

Size also proved to be an impediment in the case of some PF initiatives. The costs of instituting a public-private partnership can be relatively large when the project in question is small. Bates therefore recommended that, where possible, similar smaller projects should be grouped and a single financing sought for the group. An initial tendency for contracts governing PF initiatives to be too short also contributed to difficulties. Shorter contracts, subject to re-negotiation, were favoured by departments, because they introduced more scope for competitive re-bidding. Shorter contracts also reduced some of the problems of anticipating future contingencies and endeavouring to reflect these in the contract provisions. From the perspective of the private-sector partners, however, the duration of a contract could be critical in influencing their willingness to accept the transfer of project risks, and excessively short contracts could therefore militate against optimal value for money. Tuning the duration of the contract to maximise VFM was thus recommended.

To assist all public-sector participants in the PFI, Bates recommended that successfully implemented initiatives should be reflected in a stream of case studies, to reduce the need for different agencies to “re-invent the wheel”. Also recommended was the compilation of a series of step-by-step guides to assist agencies embarking on their first PF projects. A library, since instituted, to contain all relevant PFI documentation was also recommended, as a reference centre.

The final Bates recommendations concerned ways to minimise the costs to the private sector of bidding for PFI projects. These included better “scoping” of project definitions; earlier sign-off procedures; constraining information required to what is strictly needed, and this from a short list of bidders; reducing the number of bidders to a maximum of four, and this before substantial expense is incurred; and ensuring competent project management skills in departments. Very importantly, it was recommended that, when a decision was made not to proceed with a project, and this decision was not related to the viability of the tenders received, contractors bidding costs should be refunded.

Of the factors contributing to the success of public-private partnerships, none is perhaps more important than achieving in a single firm or consortium the integration of some or all of the critical functions of financing, designing, building, operating and maintaining the project assets. With such integration, the private provider will have an incentive to minimise the life-cycle costs of the project. This can be particularly important where initial capital investments and ongoing maintenance, or the investments and operating costs, are substitutes for one another. If this integration is coupled with a loose specification of project *outputs*—rather than the rigid specification of *inputs* characteristic of traditional public-sector procurement—there is ample room for creativity and innovation in the private-sector responses to RFPs for P3 projects. It is this creativity that is the source of the very significant improvements in VFM that have characterised most successful public-private partnerships.

Yet another way in which integration of functions contributes to the success of P3s is by facilitating the managerial process of co-ordination. For large-scale infrastructure projects, the internal co-ordination of the integrated functions may be achieved at appreciably lower cost than could co-ordination by a government department dealing with several non-integrated suppliers.

The integration of project functions is also important in explaining why, despite the obvious rate advantage enjoyed by sovereign debt over specific-project financing, most projects are in fact financed by the private-sector partner.²⁰ Viewed in isolation, financing costs would suggest that it is always more advantageous to have the public partner undertake project financing (as was the case in the Highway 407 project in Ontario).²¹ In fact, governments finance very few projects because, while the cost of capital to the private partner is indeed higher, offsetting efficiency gains from the other functions integrated with the financing more than compensate for the higher interest rates. In particular, these offsetting gains depend critically on the incentive effects of the private partner bearing the financing risks. As a consequence of this and other sources of efficiency gains in public-private partnerships, it is frequently estimated that well-structured P3s may yield a VFM premium of 20 – 30 per cent over traditional procurement. For the Highway 407 project, for example, the estimated savings were 17 per cent (Greene 13) and the project contributed some \$1 billion to the General Revenue Fund for use in other high priority areas.

While integration of function is a primary determinant of P3 success, it must also be appreciated that, for very large integrated projects, there may be relatively few firms or consortia able to assemble all the relevant specialised inputs. In contrast, the number able to participate in the traditional discrete or disaggregated procurement may be appreciably larger. The evidence, however, is that economies flowing from aggregation or integration more than offset any diminution in competition arising from a smaller number of potential partners.

Also critical to the success of a P3 project is the manner in which project risk is managed. As indicated above, in early P3 initiatives there was an excessive emphasis on maximising the amount of risk transferred to the private sector, and an insufficient appreciation of the adverse effect on project VFM when private-sector partners required very substantial risk premia to compensate for carrying risks they were not comfortable managing. It is now much more widely appreciated that VFM is maximised when the objective is optimal risk allocation, rather than maximum risk transfer, and this change has contributed to enhanced success.

A successful public-private partnership will be one for which the partners are properly accountable. The public-sector partner, of course, is subject to the accountability requirements of the government of which it is part. In contrast—and apart

²⁰ Of course, where the *raison d'être* for using a public-private partnership is to avoid using public funds for the acquisition of capital assets, with the resulting adverse effect on borrowing capacity, this rate premium is of less or no concern.

²¹ The question of the interest-rate differential is one that must be approached with caution. While the private-sector partner will typically incur nominally higher rates, its *effective after-tax* rate may well be lower. The tax saving to the private-sector partner is, however, a cost to the government, and the practice in PFI is to consider the costs of such tax benefits as a reduction in project VFM.

from the accountability framework to which all legal entities are subject—the private-sector partner will be bound by the accountability mechanisms incorporated in the partnership agreement. It is therefore essential that the issue of accountability be addressed in the agreement governing the partnership. In particular, the public-sector partner must ensure that the agreement provides for all the informational and other requirements that will maintain the chain of accountability to the relevant legislature (Treasury Board Secretariat, *The Federal Government as ‘Partner’: Six Steps to Successful Collaboration* 14).

The success of public-private partnerships will also be affected by public attitudes towards such arrangements. Since many partnerships involve “core” public-sector activities, the possibility clearly exists that significant opposition may emerge, either on the part of public-sector unions or on the part of the public generally, the latter particularly where a P3 may involve the introduction of user-charges in areas from which they were previously absent. The B.C. Taskforce is of the view that, properly handled, the public interest can be safeguarded or actually enhanced (*Report* 20). What may be required is an emphasis on visible benefits and a clear indication that, in some instances, the alternatives may be a public-private partnership with user-charges or the failure to provide needed services.

With respect to labour concerns, the Taskforce believes that these too need not be an obstacle to successful implementation of a P3, most particularly when the unions representing potentially affected workers are involved as stakeholders in the initial planning processes. B.C. Online provides an excellent example of how the support of the staff involved may be enlisted, and is a model in this regard.²² Where a partnership would affect an existing labour force, it is essential that adequate consideration be given the workforce in place, including arrangements where those not absorbed by the new employer have at least qualified rights of access to their public-sector employer. But the new operator must be allowed scope to redeploy workers and implement new practices or procedures (*Report* 21).²³

Among the conditions for success identified by the B.C. Taskforce were the need for evidence of governmental support and commitment to public-private partnerships. It was necessary to create an environment that was receptive to innovation and change and administrative processes that are open and demonstrably fair (*Report* 27).

IV Conclusions

Based upon the now extensive experience with public-private partnerships in Canada and elsewhere, it is evident that these collaborative arrangements have the

²² The partnership agreement provides that the government employees affected are seconded to McDonald-Detwiller (MD) for five years, but with the option to return to government after six months, and annually thereafter. After five years, they will be offered employment with MD, or they may return to government. A considerable number of employees have already opted for positions with MD.

²³ It should be noted that several surveys have shown that two or three years after the employees of previously public entities had been incorporated into a public-private partnership, they actually preferred their new employment situation to its predecessor.

potential to provide major advantages when compared with traditional procurement processes. These include greatly improved value for money, the transfer of significant risks from the public sector, and, in many cases, new or increased revenues for the public sector. Just as important in many contexts as the efficiency gains are the benefits that may flow from being able to proceed with a project at an appreciably earlier date than would otherwise be possible, particularly if the jurisdiction in question would have to finance the project itself. There is also evidence that the public is more likely to accept the introduction of user charges in areas from which they have previously been absent when the service provider is a private entity which has invested heavily in the project in question. Finally, where existing infrastructure assets are incorporated in a public-private partnership, the government involved may be able to capitalise the transferred assets, thereby gaining significant revenues that can be used to meet other, high-priority needs, and this without in any way impairing its borrowing capacity.

Despite their evident advantages, it will be obvious that public-private partnerships are not a solution to all public-sector problems. Indeed, they have not been free of problems some of which are quite unique to them. But there is now enough evidence concerning the contribution they can make to improving the operation of the public sector that the possibilities for their use should be the subject of examination in virtually every jurisdiction.

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