PPPs: issues and alternatives

By David Hall
halldj@gmail.com

Visiting professor
Public Services International Research Unit (PSIRU)
University of Greenwich, UK
https://www.gre.ac.uk/business/research/centres/public-services ,
www.psiru.org

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Summary

- History
- PPPs: global issues
- UK: the gradual collapse of PFI/PPPs
- Alternatives

PPPs: definition and history

- PPP definitions
  - private company finances, builds and operates some element of public service
  - Revenues from
    - (a) end-user charges = "concession"
    - (b) government payments = 'modern', 'PFI-style' PPP

- Concessions for infrastructure: ancient history (Weever 2013)
  - France water concessions 19th century
  - Indian railway companies, returns guaranteed by India
  - trams and street lighting concessions
  - committee for Ottoman debt: rail etc concessions
  - Lenin, NEP and concessions

- UK, Europe, other OECD
  - UK introduces PFI schemes 1990s
  - Key attractions are: off-balance-sheet keeps within fiscal rules, + extra business/returns
  - Other EU countries eg Portugal, Germany follow; EU encourages
  - Other OECD develop PPPs eg Australia, Canada, S Korea, USA

Developing countries and global promotion

- Promotion by IFIs
  - from 1990s via loan conditionalities
    - E.g. water privatisations, energy IPPs
  - 2009 chasing Keynesian infrastructure spend response to crisis
  - Incorporated into climate change, SDG policies
  - resistance by civil society organisations to costs and social and environmental impacts

- Cross-sectoral
    - Roads - toll roads, ‘shadow tolls’
    - Water – concession contracts, lease contracts, BOTs
    - Electricity - IPPs
    - Transport: rail, metro, ports, airports
    - Hospitals
    - Schools

Promoters

TYPE	AGENCIES	
IFIs	World Bank, ADB, IADB, EBRD, EIB	Loan specs, conditionalities, promotion
	IFC	Direct investments
Other global	OECD, G20, WEF	Promotion
Other regional	EU, UNECE	
National govts	Eg Brazil	Legislation
Consultants	McKinseys, PWC, KPMG, etc	Promotion, advice
Finance	Private equity, special funds	

- Note also widespread resistance: NGOs, unions, etc

PPPs: Selective, small and declining proportion of infrastructure investment

- PPPs only deliver small proportion of infrastructure investment
- In rich countries:
  - PPPs deliver **3.1%** of infra investment; even big users, only 5-10%
  - Most investment comes from public or private utilities own funds, plus government spending

- In developing countries
  - PPPs deliver **6.4%** of infra investment, a **decline** since 2010

Source: McKinseys 2016 Bridging Global Infrastructure gaps (figures exclude health, education, housing)

Developing countries	2010	2011	2012	2013	2014
PPPs as % of all infra investment	8.9%	8.8%	8.5%	5.5%	6.4%

PPPs: impacts on public finance etc

1. Higher cost of capital

- IMF 2004: “when PPPs result in private borrowing being substituted for government borrowing, financing costs will in most cases rise. **Then the key issue is whether PPPs result in efficiency gains that more than offset higher private sector borrowing costs**.”
- OECD 2008: “the cost of capital of the private partner is usually higher than that of government…**If the efficiency gain of a PPP falls short of the additional interest cost, the minimum unit price at which the private partner can deliver the service will not be lower than the price government will pay in the case of traditional procurement.”**
- But multiple cross-sector/country studies show no private efficiency gain (Hall 2018)

- Alaska: abandoned a PPP plan for a bridge across Knik Arm, in favour of commissioning and running it publicly: “An analysis by the state’s department of revenue analysis showed that the public-private model was unlikely to work and attract private investors without very high costs or government guarantees for potential liabilities of $2.5 billion. Having the state, rather than a private developer, fund the project could save hundreds of millions of dollars”.
  - https://www.alaskadispatch.com/article/20131218/parnell-wants-abandon-public-private-partnership-let-state-build-knik-arm-crossing ; Anchorage Daily News 21 Dec 2013 Alaska Gov. Seeks to Abandon P3 for $2.5B Bridge Project, Switch to Public Funding http://enr.construction.com/yb/enr/article.aspx?story_id=193523370

PPPs: impacts on public finance, services, efficiency

2. Burden on public finances, higher prices, lower revenues

- PPPs have left costly legacies e.g. in Ghana, Tanzania, Portugal and Hungary. (Eurodad http://www.eurodad.org/PPPs-dangerous-debts-developing-countries)
- 'Take or pay' agreements impose the cost of excess capacity on public: Water treatment plants under BOT PPPs > high prices or capacity payments, Energy IPPs inflate capacity payments for 25 years
- In the USA actual first-year revenue of 26 toll roads opening between 1986 and 2004 averaged one-third less than projected. All toll roads built in Australia since 2005 have less traffic and less revenue than forecast. (Bain 2013)
- Mozambican government secretly guaranteed US$2billion of loans from Credit Suisse and the Russian bank VTB to finance a PPP program of coastal protection - in breach of its own laws. The loans are now in default so the government is in financial crisis. Eurodad 04 Jul 2017 http://www.eurodad.org/g20-mozambique-loans

3. Crowds out spending on services

- a PPP hospital in Lesotho — supported by the World Bank — eventually swallowed up half of the country's health care budget while giving a high return of 25 percent to the private sector provider. (Oxfam 2014)
- A PPP project in Egypt to build 345 public schools told officials that after-school and weekend programs for students were no longer possible because investors wanted to expand their "revenue streams" by having "cultural events" at the schools at night.
- In the USA, PPP road contract clauses give companies "the right to object to and receive compensation for legislative, administrative, and judicial decisions."

PPPs: Global evidence

4. Fiscal dishonesty

- IMF:“projects have been procured as PPPs not for efficiency reasons but to circumvent budget restraints and postpone recording fiscal costs of providing infrastructure services” “there are significant fiscal risks, PPPs are not infrastructure for free”. Tao Zhang IMF dep director 2016:
- Mozambique guaranteed US$2bn loans to coastal protection PPPs. Project defaulted on loans so government is in financial crisis. Eurodad 04 Jul 2017

5. Transaction costs

- EIB study found that procurement costs averaged over 10% of the total value of each PPP contract.
- FT 2011: in UK “lawyers, financial and other consultants have earned a minimum of £2.8bn and more likely well over £4bn.” in fees for PFI projects

6. Upward renegotiation

- IMF: 55% of PPPs are renegotiated after about 2 years, 62% > higher prices

7. Corruption

PPPs and corruption: Odebrecht

- Odebrecht corruption scandal = bribes for PPP contracts
  - "Their main method was to win contracts by making low bids and then corruptly secure big increases in costs through addenda—in some cases when the ink on the contract was barely dry. This applied especially to contracts involving public-private partnerships (PPPs), which have become fashionable in the region and are typically used for big, complex projects, from highways to hydroelectric schemes." (Economist 2 Feb 2017)
- Commercial logic but anti-social (Kathryn Hochstetler LSE 2017)
  - "The chart shows how much Odebrecht paid to secure contracts and how much additional business Odebrecht secured for a given volume of bribe ….many of the funded projects are exactly those that have been the focus of civil society mobilisations in recent years because of their negative socio-environmental and human-rights impacts."

Country of bribery	*Amount of bribe (million USD)*	*Value of contracts secured (million USD)*	*Bribe multiplier*
Angola	50	261.7	5.2
Argentina	35	278	7.9
Brazil	349	1900	5.4
Colombia	11	50	4.6
Dominican Republic	92	163	1.8
Ecuador	33.5	116	3.5
Guatemala	18	34	1.9
Mexico	10.5	39	3.7
Mozambique	0.9	??	
Panama	59	175	3.0
Peru	29	143	4.9
Venezuela	98	??	

PPPs and corruption and Odebrecht and World Bank

- World Bank/IFC repeatedly backs Odebrecht PPPs 2011/2012/2017: (Social Watch 2017)
  - "**IFC** has designed an innovative partial-credit-guarantee facility under which the US$ 50 million guarantee will allow Construtora Norberto **Odebrecht** S.A. to obtain up to US$ 250 million in surety bonds, directly supporting up to US$ 2 billion in construction contracts in such sectors as power, water, roads, ports, airports, irrigation." (IFC 27 Oct 2011)
  - Belo Horizonte schools PPP 2012 "IFC proposed a 20-year concession to finance, build, equip and operate non-pedagogical services of 32 new preschools and five primary schools…. Odebrecht won the concession." (IFC 2012); **"A PPP to take pride in" (World Bank 2016)**

Political economy of PPPs: India energy policy and IPPs

- 2003 Electricity Act makes IPPs core method for new power generation
  - Ultra Mega Power Projects (UMPPs) from 2005
  - Envisaged 16, only 4 awarded to date

- Two major UMPPs at Mundra, Gujarat: shut down
  - Tata Power 4GW, Adani 4.6GW: both Indonesian coal
  - Tata wants price rise over PPA, Supreme Court says no
  - Adani wants start date earlier, Supreme Court says no

- ‘Over-invoicing’ for coal, equipment
  - E.g. Adani group over-invoices Rs 600 Crores for equipment
  - International scam for over-charging for coal

- Now 34 ‘stressed’ power plants, 4 GW total
  - Lack of finance, under-bidding, low revenues, no PPA
  - Govt of India sets up rescue scheme

Source: Private thermal power generation in India – boon or bane? Ashok Rao 2018

Not economically viable: EU public auditors

- **EU co-financed Public Private Partnerships (PPPs) cannot be regarded as an economically viable option for delivering public infrastructure, according to a new report from the European Court of Auditors.** March 2018

- The auditors assessed 12 EU co-financed PPPs in France, Greece, Ireland and Spain in the areas of road transport and information and communication technology (ICT), with a total cost of €9.6 billion and an EU contribution of €2.2 billion.

- **The PPPs audited suffered from widespread shortcomings and limited benefits, resulting in €1.5 billion of inefficient and ineffective spending. In addition, value for money and transparency were widely undermined in particular by unclear policy and strategy, inadequate analysis, off-balance-sheet recording of PPPs and unbalanced risk-sharing arrangements.**

- The majority of PPPs audited were subject to considerable inefficiencies during their construction, with seven of the nine completed projects – corresponding to €7.8 billion – project cost incurring delays of up to 52 months and major cost increases.

PPPs: Value for money assessment of PPPs vs public sector

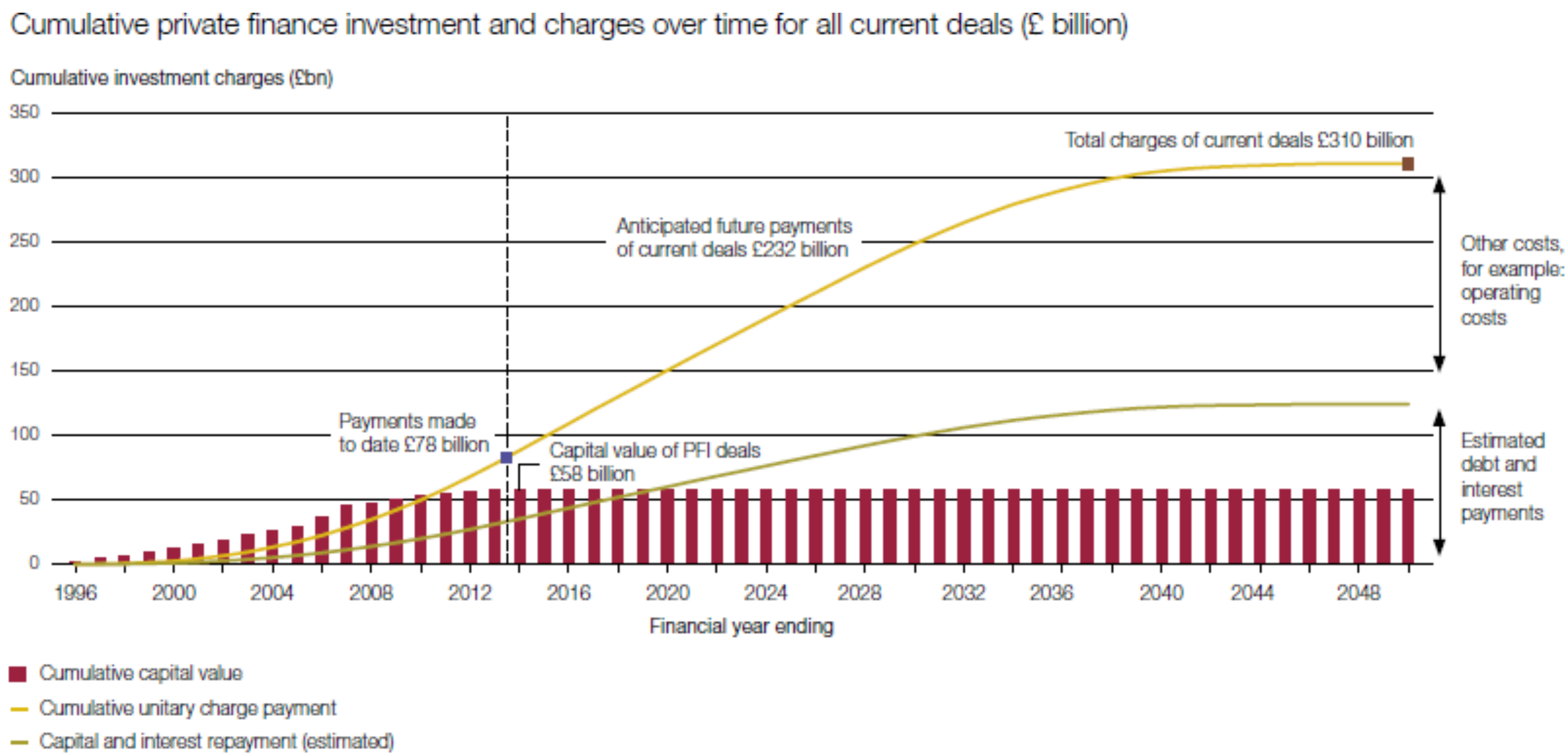
- Cost of capital :always higher for private sector
- Construction ‘on time’: costly ‘turnkey’ contract
- No efficiency savings
- Real transaction costs and uncertainty
- Corruption
- No reduction in public spending under PFI schemes: government pays

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

UK and PPPs

- UK important for PPPs because:
  - Biggest user of PPPs amongst high income countries
  - UK used as model for other countries eg PPP Units
  - Widely quoted as example and model to follow
  - UK/DFID is key promoter of PPPs through
    - World Bank entities (PPIAF etc)
    - own financing structures: CDC
    - Promotion of PPPs in development programmes eg FFD
- Bad experience and critical public policy debate
  - High costs, rigidity, problems, termination rate (20%+)
  - Criticised by all parties and media
  - huge financial collapse of major PFI/PPP company Carillion
  - Labour Party now says will not support or encourage PPPs in developing countries

UK: Private Finance Initiative (PFI) (= PPPs)



Notes

1 Capital and interest repayment is estimated to be 40% of the unitary charge.

2 Capital value of all current PFI deals is £58 billion. If more projects are signed, anticipated charges would increase.

Source: HM Treasury PFI database (updated 15 December 2014)

NAO The choice of finance for capital investment March 2015 https://www.nao.org.uk/wp-content/uploads/2015/03/The-choice-of-finance-for-capital-investment.pdf

UK PFI: Much higher cost of capital

- “the effective interest rate of all private finance deals (7-8%) is double that of all government borrowing (3-4%)”
- “over the longer term, as the original investment is repaid, additional public spending will be required to repay the debt and interest of the original investment” (NAO 2016)
- Same point applies to privatised utilities (water, energy, rail): higher private cost of capital > extra £248 per year for all households in the UK
- Excessively high return on equity

	Effective interest rate	Annual cost	Lifetime cost all PFI > 2050
Total PFI payments		£10bn.	£310bn.
of which interest		£4bn.	£124bn.
PFI implied interest rate	7.3%		
Govt bonds implied interest rate	3.25%		
Extra cost due to PFI		£2.2bn.	£68.8bn.

UK PFI: other issues

- Selective
  - Even at peak in 2000, PFI/PPPs only finance 16% of UK public sector investment.

- Higher operational costs
  - sub-contracting e.g. Treasury Xmas tree: £900 via PFI or £40 in shop
  - "operational expenditure on private finance roads in 2013-14 was three times higher, in proportion to road usage, than similar spending on publicly financed roads" (NAO 2016)

- Crowding-out of other services including healthcare:
  - "Private finance provides a short-term cash flow benefit for a department. However, over the long term it will not have an advantage as it will have to spend its future budget (over a 25- to 30-year period) to repay the capital and interest of the debt and a return on the investors' equity" (NAO 2016)
  - 25 year contracts crowds out other spending on staff e.g. South London hospitals
  - Seven health trusts have PFI deals deemed unaffordable by Department of Health in 2012

- Longer procurement
  - "tendering and financing of PFI/PPPs slow and opaque" (FT); overall time elapsed between decision and financial close can be 5 years or more (NAO 2016

- Reduced public sector capacity and democratic control/accountability
  - E.g. Network Rail sub-contracting > loss of expertise to monitor tenders

Lessons from London: termination of £20billion transport PPPs

PFI project	Start date	sector		Value (£m)	Status	End date
Metronet SSL	2000	LU	Renovation	6700	Terminated	2008
Metronet BCV	2000	LU	Renovation	5400	Terminated	2008
Tubelines	2000	LU	Renovation	5500	Terminated	2010
Prestige	1998	LU	Ticketing	1300	Terminated	2010
Croydon Tramlink	1996	Light rail	Light rail	205	Terminated	2008
Powerlink PFI	1998	LU	Power system.	133	Terminated	2013
Woolwich DLR	2005	Light rail	Extension	177	Terminated	2011
City Airport DLR	2003	Light rail	Extension	147	Terminated	2011
Connect	1999	LU	Communications	475	continues	
Lewisham DLR	1995	Light rail	Extension	142	Built	
Total value				20179		
Value terminated				19562		
% terminated				97%		

Source: TfL evidence to HoC Treasury select committee 2011
http://www.publications.parliament.uk/pa/cm201012/cmselect/cmtreasy/1146/1146we05.htm; TfL news releases
http://www.tfl.gov.uk/corporate/media/3119.aspx LU=London underground.

Recent UK developments

- PFI/PPPs discredited by parliament reports 2010, 2011, 2016, 2018
  - new critical report on PPPs from parliamentary committee [June 2018](#) : "The Treasury simply cannot support its assertion that PFI represents good value for money … This is unacceptable ... the UK needs to spend some £300 billion on infrastructure over the next couple of years. It is critical that taxpayers are not further lumbered with excessive costs arising from poor contracting."

Continuing major problems

- [Birmingham breakdown puts private prisons in dock](#) FT Aug 2018
- [Carillion shows 'fundamental flaws' in outsourcing](#) FT Jul 2018
- [Treasury seeks investors for Carillion hospital project](#) FT Jun 2018
- [Learndirect in talks on rescue sale](#) UK's biggest adult training provider loses government funding FT June 2018
- [PFI: hard lessons on cost of public-private deals](#) FT Feb 2018
- Remunicipalisation of failed £600million waste management PPP (Manchester) Sept 2017

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Private finance initiative + Add to myFT

PFI discredited by cost, complexity and inflexibility

Innovative model for providing public infrastructure has fallen out of favour

PFI was used to fund the building of hospitals, including the new Queen Elizabeth Hospital in Birmingham, and schools across the UK © FT montage; Getty Images

44 Saved to myFT

SEPTEMBER 26, 2017 by Chris Giles, Economics Editor

Labour party policy on PPPs

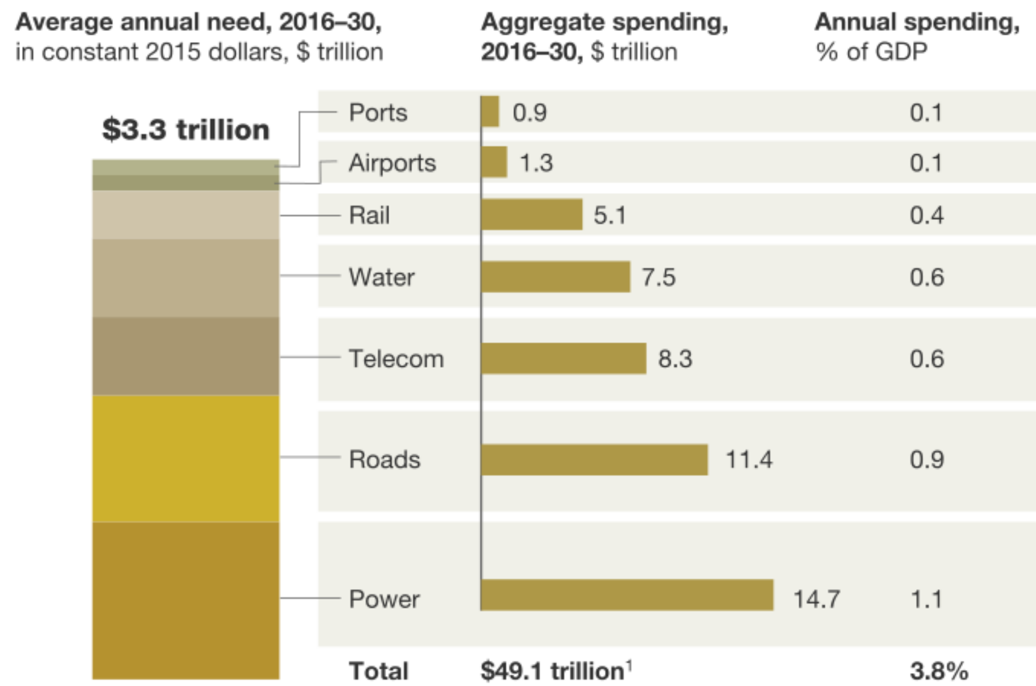
- No new PPPs; end all existing PPPs

- Deal with cost of compensation
  - not by terminating contracts, which risks huge compensation
  - nationalise the PPP companies: better for lower compensation - under UK law, maybe others (Mercer/Whitfield 2018)

- International development policy:
  - "End the UK's support for public-private partnerships overseas" (A World for the Many, Not the Few March 2018)
  - Potentially: active support for alternatives
  - call for comments on policy on public services/infrastructure

Alternatives: what financing gap?

- PPPs claimed necessary because of ‘financing gap’ between actual spend and spending needed
- McKinsey’s say world ‘needs’ $3.3tn., but only spends $2.5tn. per annum
- This ‘gap’ is $0.8tn: about 0.9% of global GDP
- Just needs a bit more tax, charges, aid, bonds?
- E.g. nearly all MDG for water and sanitation could have been met by <0.7% of GDP per year for 10 years, +existing aid



	$tn.	% of annual global GDP
McKinsey est of annual need	3.3	3.8
Actual annual spend	2.5	2.9
Gap'	0.8	0.9

Alternatives

COUNTRY	SECTOR	FINANCE MECHANISM	
Brazil	Water	Charges	Porto Alegre finances wwtp
Egypt	Canal/port	Bonds	Suez canal extension
India	Infrastructure/ roads	Bonds	AP bonds for capital Amaravati, NHAI bonds for roads
South Africa	Electricity	X-subsidy/tax	Rural electrification
SS Africa	Water, electricity	Taxes/charges/ aid	Most infrastructure financed through public finance/SOEs
Sweden	Infrastructure	Taxes/charges/ bonds	e.g. Øresund Bridge,100% public, AAA rating
UK	Transport +	Bonds	Refinancing London underground

- Note scope for tax increases:
  - IMF 2013 estimates potential extra revenues from taxes on high incomes, wealth, profits, financial transactions, and from land and property = huge increase in tax revenues: 33% in high income countries, 50% in middle income countries, 70% in low income countries.

Some questions for economists

- How do fiscal rules justify PPP finance above public tax and bond finance?
- Why do PPPs deliver such a small proportion of infrastructure investment?
- Is corruption just a normal marketing mechanism?
- Does the impact on services matter, economically?
- Why do IFIs/development agencies promote PPPs?
- Is infrastructure just a series of bankable projects?
- Is affordability global, national, political?

Further reading

- **WORLD**
  - Bayliss K. & Elisa Van Waeyenberge (2017): Unpacking the Public Private Partnership Revival, The Journal of Development Studies
  - Gottschalk R. and Poon D. UNCTAD Scaling up Finance for the SDGs 2017
  - Hall D. 2014 PPPs
  - Social Watch 2017 **Leveraging corruption - how World Bank funds ended up destabilizing young democracies in Latin America**
  - TNI June 2017 Reclaiming Public Services

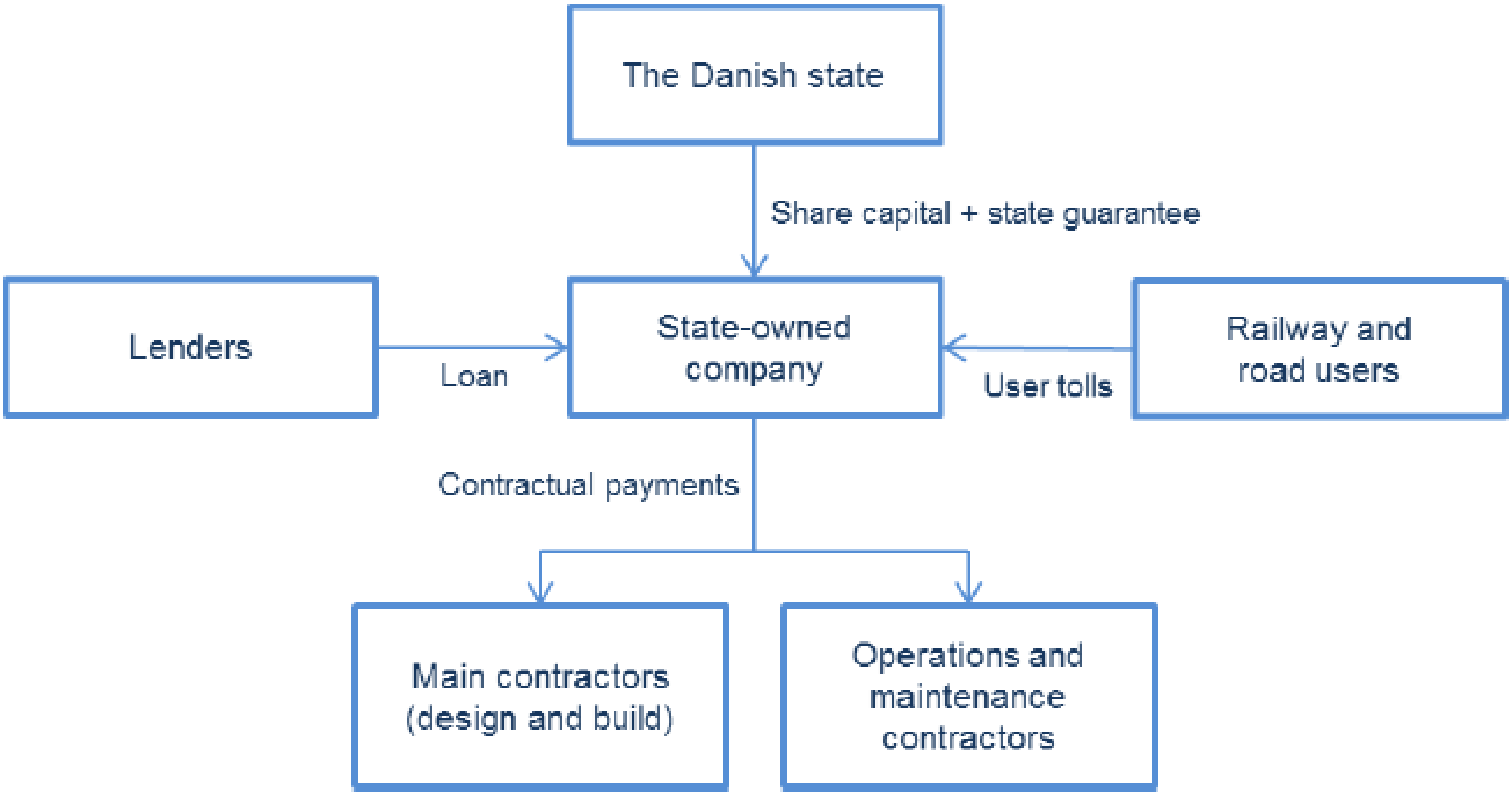
- **UK**
  - Labour Party March 2018 A World for the Many, Not the Few
  - Mercer, Helen and Whitfield, Dexter (2018) Nationalising Special Purpose Vehicles to end PFI: A Discussion of the Costs and Benefits.
  - NAO The choice of finance for capital investment March 2015 https://www.nao.org.uk/wp-content/uploads/2015/03/The-choice-of-finance-for-capital-investment.pdf
  - Public Accounts Committee report **Private Finance Initiatives** June 2018

Eurodad material

- Eurodad papers
  - ‘What lies beneath A critical assessment of PPPs and their impact on sustainable development’ by Maria José Romero Eurodad (2015),
  - Three compelling reasons why the G20’s plan for an infrastructure asset class is fundamentally flawed Eurodad July 2018
  - Public-Private Partnerships: Defusing the ticking time bomb By Mathieu Vervynckt and María José Romero • October 2017

- Eurodad articles
  - on fiscal costs of PPPs http://www.eurodad.org/fiscal-cost-PPPs
  - NGOs letter to the World Bank http://www.eurodad.org/ED-open-letter-PPPs ,
    a recent critical Parliamentary report in the UK http://www.eurodad.org/UKPPPsreport,
    a critical auditors report from Europe on PPPs http://www.eurodad.org/ECA-report-reaction

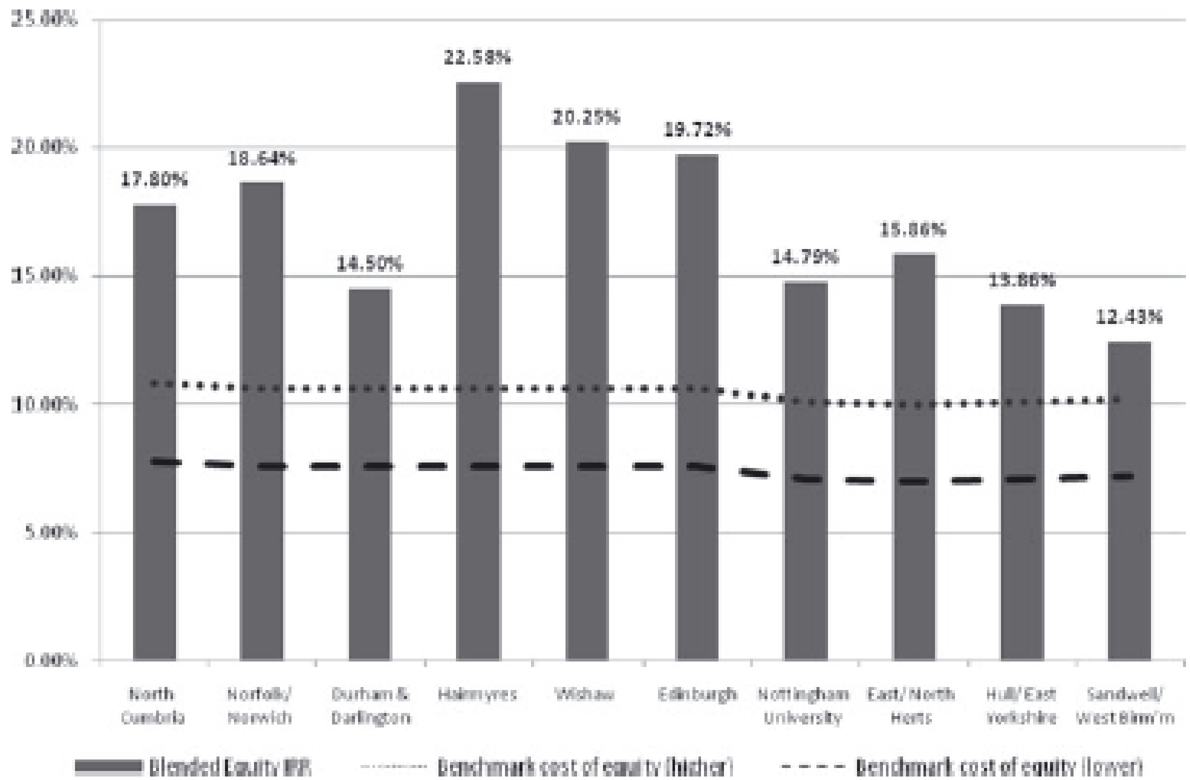
Danish 'state guarantee' model



UK: Excessively high return on equity

Figure 1

Pre-tax Blended Equity IRR versus the Benchmark Cost of Blended Equity Benchmarks (Higher/lower equity risk premium)



[Hellowell, M and Vecchi, V (2012), 'An evaluation of the projected returns to investors on 10 PFI projects commissioned by the National Health Service', Financial Accountability and Management, Vol.28, No.1, p.77-100]

UK: Lessons from the London transport PFIs

Public sector alternative	**Better public sector alternative was supported by elected politician but rejected in favour of PPP**	**“the first Mayor of London, Ken Livingstone, and his Transport Commissioner, Bob Kiley, championed an alternative method of raising money, via the issue of bonds secured against future fare revenues from London. This was rejected by the Treasury.” “In comparison [with Metronet], whatever the potential inefficiencies of the public sector, proper public scrutiny and the opportunity of meaningful control is likely to provide superior value for money…**
Public borrowing is cheaper	PPPs have now been replaced by public borrowing through bonds at much lower cost	“replacing private borrowing with public sector borrowing will bring ongoing savings of up to GBP £250 million over the remaining life of the concessions.”
Government guarantee	The bank loans raised by the PPPs were nearly all guaranteed by the government	“In terms of borrowing, the Metronet contract did nothing more than secure loans, 95% of which were in any case underwritten by the public purse, at an inflated cost— the worst of both possible worlds”
Risk transfer	Like other PPPs, these were said to ‘transfer risk’ to the private sector	“Given that public authorities are typically procuring essential infrastructure, they will need to step in if a PFI contractor fails. Thus risks cannot be truly said to be "transferred"… risk can be fully transferred only if the procuring authority could abandon a failing PFI concession, which is unlikely ever to be the case. … the private sector is willing to bear significant risk only if it is paid enough.” ; “it is difficult to lend any credence to the assertion that the Metronet PPP contracts were effective in transferring risk from the public to the private sector. In fact, the reverse is the case.”
Forecast cost savings from PPP	Consultant (PWC) forecast of savings was horribly wrong	“As the partnership was being put together, PricewaterhouseCoopers, a consultancy, predicted that the private sector could extract savings of up to 30%, a figure that informed the entire project. But the consultancy published no adequate evidential basis for that figure.”

UK: Lessons from the London transport PFIs

Operating efficiency	Private companies did not contain costs and relied on state subsidies	"Metronet's inability to operate efficiently or economically proves that the private sector can fail to deliver on a spectacular scale…" ; "The legacy left by Metronet's former shareholders was one of poor programme management and system integration, ineffective cost control, a lack of forward planning and inefficient fiscal management."
Competition	PPP companies favour themselves when awarding sub-contracts	"significant savings have been made through procurement and maintenance efficiencies, namely the re-procurement of maintenance outsourcing… The review and revision of supply chain contracts with the previous shareholders …led to an estimated saving of £0.5bn."
Incomplete contracts	Long-term contracts in PPPs for operation, maintenance and services are inflexible	"...PFIs are the least flexible form of contract, in many cases binding both client and contractor to a series of outputs that have diminishing desirability and/or affordability, with much less scope to negotiate change than under other forms of contract.""
Transaction costs	Tendering, monitoring and managing contracts creates additional transaction costs	"The removal of the need for contractual [management]….and elimination of duplication between LU and Metronet that was inherent in the PPP structure…full integration of back office and support functions activities …[and] procurement and maintenance productivities will enable a cost reduction of £1billion" ""the lawyers involved in the PPPs raked in £400m in fees over the course of the contracts."