

# Public Private Partnerships and the Search for Value

By Patricia Lam

Public Private Partnership (PPP), or the involvement of the private sector in providing public services and infrastructure, was introduced to the UK in 1992. In the initial years it generated much controversy as it was a new method of procuring non-core services which the public sector needed. Since then the UK government has clarified the aims and benefits of PPP, focused on obtaining value for money, and refined the associated policies and processes. The UK's experience of PPP offers valuable lessons for Singapore. Beyond the financial and management benefits PPPs can offer, they are also significant for the fundamental questions they raise about governance.

## Public Private Partnership

**P**ublic Private Partnership (PPP) is a generic term coined in the UK which encompasses any form of private sector involvement in the provision of public services and infrastructure. Outsourcing rubbish collection, the sale of public assets such as utilities, and the use of joint ventures to build roads are all different types of PPPs.

The most developed and well-known form of PPP is one in which the private sector designs, builds, finances and operates an amenity to provide services needed by the public agency. Under this scheme, the public sector contracts to purchase services, with defined outputs, from the private sector on a long-term basis. The services purchased include maintaining or constructing the necessary infrastructure. The public sector then pays for the services at regular intervals provided that the contractor meets performance standards. At the end of the contract, which may be 20-30 years

later, the asset may or may not revert to the government with or without compensation, depending on the economic lifespan of the asset.

## The 1990s: Early PPP Problems in the UK

**P**PPs were introduced to the UK in 1992 by the Conservative government and continued after Labour came into power. The impetus for PPPs in the UK was born out of pragmatic as well as ideological considerations. First, there was a need to provide infrastructure while maintaining a tight fiscal stance and not raising taxes. PPPs allowed costs to be spread out over a longer time period instead of being paid upfront. It also enabled alternative sources of funds to be tapped. Next, the 1990s were also a time when public sector reform was actively being promoted, especially through the use of private sector management practices. Finally, there was an ideological commitment by the government to increasing the role of the private sector.<sup>1</sup>

The government moved swiftly to promote PPP and 1994 saw the introduction of "universal testing for private finance", which required all capital projects to explore private funding in order to be approved. There was public outcry about PPP, both at a philosophical and a practical level. During this period, there was a general climate of public dissatisfaction with the low standard of public services. Against this backdrop, PPPs were seen by some as an attempt by the government to withdraw from its basic responsibility to provide essential public services.

Poor management of PPP projects added more fuel to public objections. For instance, in the early privatization exercises, senior management and private shareholders reaped disproportionate gains. Later reviews found that there had been insufficient competition to provide the private

<sup>1</sup> Jane Broadbent et al., "The Origins and Operation of the PFI" in "Public Private Partnership: Saviour, Villain or Irrelevance?", working paper by the Commission on Public Private Partnership, Institute of Public Policy Research (IPPR).

sector with enough incentives to provide better services and that compensation had not been tied to performance. The public sector had yet to develop the necessary skills and knowledge to manage PPPs to the greatest advantage. A strong regulatory framework had not been put in place and procurement and accounting issues had not been sufficiently addressed.

### PPPs Reconceived: Getting Value for Money

The failures and shortcomings of the early PPPs led to two major reviews in 1997 and 1999. In 2000 the Government issued a paper which explained its new approach to PPPs.<sup>2</sup> While the broad ideological and financial arguments remained largely the same, this document provided a clearer enunciation of objectives and benefits of PPPs and of the principles behind them. It discussed the lessons learnt from the early attempts at PPPs and described the new systems and structure that would be put in place to facilitate them.

The paper states that PPPs have three main aims:

“First, PPPs seek to deliver better public services through increases in the quality and quantity of investment. This will add to and complement existing government funding. PPPs will be designed to provide better value for money.

Second, PPPs will realise the full potential of public sector assets and nationally owned enterprises so as to provide better value for the taxpayer.

Finally, PPPs will ensure that all stakeholders receive a fair share of the benefits of PPPs.”

The second and third aims were formed largely with the chequered experience of privatisation in mind. The first aim reflects one of the major changes in the thinking about PPPs which was to emphasise obtaining value for money, especially in the long term.

### The Philosophy of PPPs

The underlying assumption about PPPs is that the public and private sectors have different roles and strengths, and PPPs are a good way

of harnessing the best in both sectors. In this context, the most significant difference between the sectors is that the private sector is subject to the discipline of the market and this drives certain positive practices and behaviours.

The relentless need to generate profits and to compete in the marketplace forces the private sector to be more efficient and innovative; to be more responsive to customer needs because of the need to compete with other providers; and to develop business management and expertise which the public sector does not have, or in which it does not specialize, such as project management and the assessment of the commercial opportunities of new businesses.

No matter what measures the public sector takes, it can never fully replicate this competitive commercial environment because it has to juggle multiple policy considerations. For instance, social considerations may outweigh the purely economic ones. A desire to safeguard the taxpayer's money also tends to promote a more risk-averse culture.

PPPs are one way of bringing market discipline and the benefits of private sector skills, knowledge and expertise to bear on public services. Together with incentive structures, these features will result in savings for the government in several ways. Value for money will come from lower lifecycle costs. Projects will have a greater likelihood of being completed on time and within budget, and construction should be more durable and of a higher quality. PPPs will also allow a better allocation of risk between the public and private sectors.

The flip side to maximising these private sector strengths is that PPPs also enable government to focus on the fundamental roles for which it remains accountable i.e. policy formulation, choosing between competing objectives, and safeguarding the broad public interest. In implementing PPPs, the government fulfils its role by ensuring that appropriate services are provided at a reasonable cost. Its responsibility shifts towards making sure that there are sufficient resources to pay for the services, rather than actually by providing the services itself. The government is responsible for the establishment and regulation of standards in safety, quality and performance.

<sup>2</sup> “Public Private Partnerships: The Government's Approach”, London: The Stationery Office, 2000. This section and the following one are based on this paper.

"Pursue PPPs to get better value for money. Projects should deliver both value for money and the quality of services desired."

### The Relevance of PPPs to Singapore

On many of the broader issues related to PPPs, such as public sector reform and the involvement of the private sector, Singapore's approach towards government is similar to that of the UK.

Since the 1990s, Singapore's public sector has actively engaged in reform efforts and has readily adopted and adapted best practices of both the public and private sectors. From this angle, PPPs are useful additional tools in the quest for a more efficient and better managed public service, much like the Balanced Scorecard and Best Sourcing Policy.

PPPs also strike a chord with the government's attempts to increase the role played by the private sector (and the voluntary sector) as seen in the privatisation of utilities like telecommunications and power plants, and in the provision of services such as step-down care. The role of regulatory agencies, such as the Info-communications Development Authority, the Energy Market Authority and the upcoming Competition Commission, is increasing in significance.

However, it is perhaps the value-for-money approach of PPPs that resonates most strongly with Singapore. In the UK, there was an urgent need to find alternative sources of funds for infrastructure due to years of under-investment. Although Singapore is not facing such immediate pressures, the financial situation has changed since the early 1990s. Having weathered the Asian financial crisis, terrorism and SARS, Singapore had to deal with budget deficits for the first time in 2003 and over the long term faces the prospect of shrinking budgets. The

potential of PPPs to provide value for money and alternative sources of funds make them an attractive possibility for select projects.

### Lessons from the UK

From the experience of the UK with PPP, the Ministry of Finance has identified three major lessons for using PPPs in Singapore.<sup>3</sup>

First, *pursue PPPs to get better value for money*. Projects should deliver both value for money and the quality of services desired. PPP should not be used just because an agency believes there are no other sources of funding.

Second, *maintain value for money over the life of the contacts*. One early criticism of PPPs was that the cost of private capital was higher than what public financing would be. This is countered by assessing value-for-money on a whole of life basis—the cost of private sector capital, which is typically 1-3% higher than public finance, must be offset by the lower running costs over the life of the infrastructure. The National Audit Office in the UK acknowledges the difficulty of estimating future costs, especially as PPPs are still at the very early stages and have a long lifecycle of 20-30 years. However, the estimated reduction in lifetime costs reduction ranges from 10% to 20% with an average of 17%.<sup>4</sup>

To maintain value for money over the long time period, appropriate mechanisms such as benchmarking and market testing must be in place. One unique and important tool developed in the UK is the Public Sector Comparator. This provides a way to compare the costs of a PPP project against what it would cost the Government to fund and manage the same project.

<sup>3</sup> The recommendations in this section and the one that follows are from the MOF study trip report on the Public Private Partnerships, October 2003. The information about PPP in the UK is from the IPPR report and "Public Private Partnerships: The Government's Approach".

<sup>4</sup> "Value For Money Drivers in the Private Finance Initiative", Arthur Andersen and Enterprise LSE, 2000. Cited in "Public Private Partnerships".

Third, *simplify and standardize the PPP procurement process*. Successful PPPs are inextricably linked with public sector procurement process in general and may require the development of new procedures. In the UK the issuance of Standard Contract Guidance in 1999 helped to reduce the legal fees and other costs of PPPs and the time needed for negotiations. In addition, standardization would improve consistency and provide greater transparency, making it easier for the private sector to commit to participate.

New structures may also be required to standardize the PPP processes. In the UK, a wide-ranging review of all procurement processes led to the establishment of the *Office of Government Commerce* in 2000. This brought together part of the Treasury Taskforce on PPPs and other related bodies such as the Procurement Group and the Buying Agency. The role of the Office of Government Commerce is to ensure consistency across government agencies in the procurement process and to promote best practices.

### Successful Implementation in Singapore

In addition to the need to resolve accounting and legal issues and to establish an effective procurement process, two more elements are essential to the successful implementation of PPP projects in Singapore.

First, there should be a minimum deal size. This should be high enough for the government to obtain value in view of procurement costs. At the same time it should not be so high that it would restrict competition. A deal size of \$50 million is a possibility.

Next, PPP deals should be technically simple in the pilot phase. This would increase the chances of success and would reduce the need to change requirements and re-negotiate during the life of the contract.

Some PPP projects in Singapore include the construction of a new desalination plant and NEWater plant. The Ministry of Defence has also already successfully used an innovative PPP for the construction of the Army Logistics Base and will be using PPPs for other projects (see box).

### Conclusion

In the UK, the controversy about PPPs seems to be abating to the point where it merely arouses occasional flare-ups in the media. While some of the ideological objections can never be fully overcome, there is a sense that, as one article put it, PPPs pass the pragmatism test.<sup>5</sup> It is also important to note that the vast of government projects in the UK will continue to be financed in the traditional manner. PPP projects have not exceeded 15% of total investment for any year since 1997.<sup>6</sup> It appears that selective, well-managed PPPs are the order of the day.

However PPPs are important because they touch on fundamental questions of governance. Where should the boundary between the public and private sectors lie? What is the role of markets in government? How large should government be? PPPs mark an important shift in the role of the government from being a service provider to being a purchaser of services.

An Economist Intelligence Unit report argued that, "The most successful government structure in 2010 will be one in which government focuses on policy and project/supplier management, allowing the private sector to deliver most traditional public services."<sup>7</sup> The questions for governments now may be how far they agree with this idea of what government is all about and how they can prepare themselves for it. ■

<sup>5</sup> "PFI Reforms Pass The Pragmatism Test", *Guardian Unlimited*, July 17, 2003.

<sup>6</sup> MOF PPP report, 5.

<sup>7</sup> MOF report citing *Vision 2010: Forging Tomorrow's Public Private Partnerships*", EIU and Andersen Consulting, 1999, 4.