Public–private partnerships: The road ahead

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PPPs are now being used throughout both the developed and the developing countries of the Commonwealth. The objective is to construct an institutional arrangement that draws on the defining characteristics and strengths of the public and private sectors, respectively. Although the evolving world of the New Public Management (NPM) has resulted in vast improvements in management techniques in the public service, it is still deemed by many to be comparatively inefficient. Therefore, there has to be a means of converting the delivery of services to private hands while retaining public accountability and the maintenance of public standards, not to mention respect for fiscal restraint. Accordingly, PPPs are often promoted as the new magic formula to accomplish that objective.

Although we now have considerable experience, we cannot yet be certain about the validity of such arrangements. In practice, the marriage of public policy direction and private sector delivery expertise demands a thorough appreciation of the differences between the sectors, the management of unpredictability or unforeseen circumstances, and the exposure to fundamental change in both sectors as a result of external forces.

Those who design PPPs must give careful consideration to the planning, execution and nurturing of projects. Fortunately, the more experience we have, the more skilled we will become. In Canada alone, as listed by the Canadian Council for Public–Private Partnerships, there are more than 100 projects in place. These cover a variety of public projects for which there is a huge accumulated need. Similarly, the UK has been a leader in the nature and methodology of PPPs, while the European Commission has more recently become a champion of the cause.

What is essential is very careful due diligence before embarking on the creation of a PPP. Because circumstances are often such that a government is under extreme pressure to deal with a demanding situation, it is vital that the government can assure itself that a PPP is the appropriate mechanism. At the very least, this involves addressing the following issues, but then only as guidelines since each case is unique and must stand on its own merits.

(1) Is the delivery system truly more efficient than it would be within government?
(2) Can the public sector retain public policy control as the delivery arm of the PPP becomes more dominant in the relationship?
(3) Does the public sector (i.e. the taxpayer) end up with a larger financial burden in the long term?
(4) To what extent does the private sector actually assume the risks?
(5) In the light of these issues, is there a danger that we produce a system that results in the privatisation of profits and the socialisation of costs? If not, what then is the incentive for the private sector to partner with government in the first place?

In assessing the appropriateness of a PPP, the critical issue is the apportionment of costs and benefits between the public sector (both citizens and taxpayers) and the private sector (entrepreneurs and shareholders). The time period over which the PPP exists will determine the ultimate social costs and benefits in terms of reliability of services, capital maintenance and service improvements. Yet, it is strange how little information exists on this fundamental issue.

It is important to remember that the efficiency generated in the marketplace is the product of competition. Too often, the cost of infrastructure, the limits of technology and the nature of the product mean that a public monopoly is merely replaced by a private monopoly, or a series of regional monopolies, such as the experience following the privatisation of British Rail. Where, then, is the incentive to achieve greater efficiency and how can one assume that citizens’ interests are protected?

Competition may be the source of efficiency, yet the creation of a PPP is the very denial of competition – not just at the time of formation but, more importantly, in the future. If a PPP is designed by contract to exist for, say, ten years, then the private delivery system has no incentive to improve its operations and become more efficient. And if it does become more efficient, then it will enjoy windfall profits unless there is some form of profit sharing built into the arrangement between the government and the private firm. Once again, if the firm is successful, it takes the profits; if it is not, the government covers the losses and absorbs the related social costs.

By the same token, if the firm finds that it cannot provide security of service at a level that meets policy guidelines, then the government faces an unhappy choice: either it renegotiates the deal with the private firm or it cancels the contract and looks for a new partner. Therefore, the case for a PPP must be based on the guarantee that two basic objectives can be met:

(1) Government policy must be respected in terms of over-riding legislation, regulations and standards
(2) There must be no financial disadvantage to the taxpayer (both in terms of taxes and fees), nor should private costs be transferred to the citizen as a customer in terms of a de facto reduced level of service

These two objectives must be assessed against the five questions posed earlier.
(1) Is the delivery system truly more efficient? Without the benefit of a long-term laboratory experiment, you can never be sure because it will not be tested by competition. Therefore, as well as due diligence, the government must write a huge number of fail-safe provisions into the contract and insist upon a reasonable number of guarantees. At the same time, the challenge is to avoid having the private partners build in so many cushions that the government cannot be truly convinced that it will be better off in a PPP than delivering the service directly.

(2) It is absolutely essential that the government retain public policy control to ensure that the objectives are fully met and that standards are maintained. Over time, this can raise a vexatious dilemma. If the delivery system is turned over to private hands, gradually there may cease to be sufficient experts or practitioners in government to act as inspectors and to ensure adequate oversight and quality control. Even good intentions will not be sufficient; there is little incentive for first-class practitioners to remain in government when the action is all on the outside.

(3) The political appeal is obvious – greater efficiency should lead to savings for the taxpayers. However, all the practical obstacles that have been described here lead to the prospect of a rich financial package for the private sector. For a government with a four-year electoral framework, it is tempting to provide a financial arrangement that is highly favourable to the private firm. Meanwhile, the taxpayer has difficulty assessing the true financial burden if the costs are amortised over a number of years; consequently, current transparency is difficult to achieve. Therefore, new forms of accounting and financial reporting are required, yet there is little evidence that such changes have occurred. This must be a high priority for those who are expert in the design of PPPs.

(4) The fourth – and perhaps the top priority – issue is the assumption of risks. A great deal of attention has been devoted to this central issue, both in the creation of PPPs and in their ongoing assessment and evolution. However, in the nature of their relationship, it is much easier for the public sector to deal with risks than a single private sector firm. For example, if the recent BP oil well spill had been associated with a PPP, notwithstanding its responsibility for risks, could the private firm have assumed responsibility for the clean-up costs and the private and social costs of environmental damage? The answer is: not very likely.
(5) In each of the previous points, it is clear that the most likely beneficiary of the arrangement and its operation is the private partner. Unfortunately, the lessons governing the PPP relationship cannot be learned from theory or a textbook; they will only be learned on a case-study basis over a number of years and as the result of experience with a variety of PPPs. We are far-removed from that point. Therefore, two requirements are essential. First, a government should not enter into a PPP unless it can assure itself of substantial prospects of success. Second, we urgently require major research into the experience of a variety of PPPs, with a view to establishing a series of guidelines for the future. PPPs have acquired a degree of mythology which urgently requires demystification.

Our judgement of the success, or otherwise, of PPPs cannot be based on narrow, linear criteria. Rather, the extent to which they are successful – not just in meeting their specific objective, but in contributing to the betterment of the economic and social environment – must enter into the assessment of most PPPs. We still have a long road to travel in arriving at that destination and Commonwealth governments must be prepared to make that journey in a studied and responsible manner.

PROFESSOR IAN MACDONALD has had a distinguished career in academia and government. In 1965, he entered public service in the Government of Ontario as chief economist. He became Deputy Treasurer in 1967, Deputy Minister of Treasury and Economics in 1968, and Deputy Treasurer and Deputy Minister of Economics and Intergovernmental Affairs in 1972. In 1974, he was named president of York University, a position he held for more than ten years, following which he served as director of York International from 1984–94. Professor Macdonald is now president emeritus of York University. He is also professor of public policy and economics, and director of the master of public administration programme. He was Chair of the Commonwealth of Learning from 1994–2003. He is the recipient of many awards and honours including Officer of the Order of Canada; is widely published; and has served as chairman, director or member of numerous boards and commissions. In June of 2012, he was awarded the Queen’s Diamond Jubilee Medal.

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