P-P-Partnering

Commentary on public-private partnerships

Private financing for public service

by Michael Wilson

It should be simple: governments have limited financial resources, public infrastructure in Canada has been starved for funding, and domestic and foreign capital is pounding on the gates to invest in public infrastructure in Canada. However, all levels of Canadian government have been reticent to capitalize on this nexus of interests. This is especially perplexing when Prime Minister Tony Blair of the UK has successfully expanded Private Finance Initiatives (PFI) to police stations, hospitals, schools, community centers, air navigation systems and the armed forces, in addition to roads, rail and airports.

Private finance, in the context of a public-private partnership (P3), is financing raised by the private sector to deliver a public service. The debt and equity obligations are met through revenues generated by the activities of the project or enterprise with no recourse to the government, beyond specific covenants (if any) outlined in the financing or other agreements. Generally, the key issue raised in respect of private finance is why pursue it when governments can borrow more cheaply.

This is, and should be, one of the first questions asked when looking at private finance. The correct response is not to deny the low cost of government borrowing, but to demonstrate how this is irrelevant. Whether purchasing road salt or operating an airport, public officials should be concerned with overall cost, safety, ability to deliver on time, etc. The cost of debt to the producer of the road salt is of no concern to the public official ordering it, so neither should the cost of debt incurred by a consortium bidding to provide an airport rail link.

This article cannot explore all of the issues related to P3 financing, but it should suffice to note that the key requirement for a successful private financing is the allocation of risks to those best able to bear and cost them. Taxpayers would have benefited if projects such as Mirabel Airport, the Sprung Greenhouse and BC's fast ferries had been P3s. Governments did not properly take into account and price the risks associated with these projects. The public paid the price for that oversight.

The best example that private finance works is the Dulles Greenway Toll Motorway in Virginia. Followers of toll roads will question how the Dulles motorway proves the system works when the road had financial difficulties as soon as it opened and had to undergo a major financial re-engineering. That is exactly why it proves the point. The public got 14.7 miles of state-of-the-art road; the public sector did not have to pay for it; the private sector debt was re-structured by lenders (who understood they had to ensure the road stayed open if they had any hope of being repaid); and private equity lost money, not the public.

Concrete evidence that cost of debt is the wrong financial measurement tool is provided by a January 2000 UK study by Arthur Andersen and Enterprise LSE that concludes, "the average percentage estimated savings for our sample of projects (29) against the public sector comparator was 17 percent." The same report refers to a UK Audit Commission finding of an average 15 percent cost overrun in local authority (i.e., municipality) projects. The overall cost of the service and the appropriate allocation of risk are the financial measurement tools public officials should use.

Other factors also support the use of private finance for public infrastructure and services:

- *Access to capital* – Government revenues are limited. Private finance allows the undertaking of projects that would otherwise not be funded and the acceleration of other projects.
- *Accountability* – Public infrastructure projects historically run over-budget and over-time, largely due to the lack of a direct "ownership interest" (i.e., a bearing of risks and rewards) by the public officials involved. Private finance imposes a level of market discipline (i.e., perform or lose your investment). For example, the first eight shadow-toll roads undertaken in Britain under the PFI generated estimated savings of 17 percent over the public sector comparators for the life of the concessions. Contractual arrangements can further enhance the attentiveness to government and customer needs.
- *Public policy flexibility* – The transfer to the private sector of the infrastructure required to provide the public service allows the government to move more quickly in its regulatory role to change policy (i.e., it is no longer encumbered with the infrastructure). Additionally, by fostering a private sector capable of delivering public services, competition will develop that will lead to future service enhancements and a further reduction in costs.
- *Public Control vs. Ownership* – The ability to control the private sector provision of the public service through regulation, monitoring, payment for services and/or subsidy arrangements should be less expensive and allow the government to be more responsive to social and economic changes. The division of owner/service provider and regulator removes conflicts of interest, ultimately ensuring a sounder system.

When looking at private finance for P3s, the first step is to move from asking, "who can borrow at the lowest rate?" to "how best can the service be delivered?" To paraphrase a provincial cabinet minister's recent pronouncement, if the private sector can do it better (in terms of meeting public policy objectives), safer, faster and cheaper, governments have an obligation to pursue private sector delivery of traditional public sector services.

Michael Wilson is the Chair of the Canadian Council for Public-Private Partnerships, a non-profit organization that promotes the concepts of public-private partnerships in Canada. This article was prepared with expert advice from James Cowan, Vice-President and Director, Macquairie North America Ltd.