

Chapter 1

What Are Public-Private Partnerships?

Since the early 1990s, there has been a growing trend in Canada towards the use of P3s in public infrastructure. This has occurred in two different ways. The first involves the private sector in more than one aspect of designing, building, financing, owning and operating “public” infrastructure. Usually, the public sector invites a private sector company to bid on a range of these activities, leasing the infrastructure back from the company over a specified period, usually twenty to thirty years, if the company ends up owning the asset. The lease payments allow the private partner to service the debt and make a profit on the financing, building and operation of the project. The private partner thus handles the finance and acts as contractor as well as operator. It often designs the project as it builds it (design-build), though this feature could be built into traditional procurement approaches. In this way, risks associated with construction are borne, it is said, by the private partner instead of the government.

The second way in which P3s have been used is in permitting the private sector to operate publicly owned infrastructure. In this case, the government simply hands over the operating budget, or a portion of it, to a private partner, who is then charged with the responsibility of running it.

The P3 approach contrasts with the conventional approach to public infrastructure projects, in which the public sector uses in-house expertise or enters into separate contracts with consulting engineers and architects to design the project and to supervise a construction company, also contracted separately. The construction company is selected on the basis of expertise and the best price, through a competitive bidding process, out of which a firm price results to build to a fixed design. The construction company hires subcontractors and, on larger projects, the labour is generally unionized. The consultants manage the process, serve as the interface for the public sector with the contractor and are responsible for quality and timely delivery on budget. The public sector owns the completed project and also operates it, again generally using unionized labour. The public sector pays for the design, construction and maintenance of the facility through government budget revenues or by raising longer term funds through the issue of fixed interest bonds, which are bought by banks, insurance companies, pension funds and other financial institutions, corporations and even public sector entities.

Definitions and Characteristics of P3s

Definitions of public-private partnerships (P3s)¹ range from broad to specific, and their nature varies according to who is beholding them. Many describe P3s as any kind of arrangement that entails the involvement of the private sector in some element of the provision of public infrastructure and services. Inclusive definitions such as this encompass a vast number of initiatives, some of which only entail a minor transfer of responsibility, decision-making and control from the public to the private domain (Allan, 1999, p.6).

Building on the Canadian Council of Public-Private Partnerships' (CCPPP) description of P3s,² a City of Winnipeg (1999, p.6) report defined them as "Cooperative/contractual business ventures between the public and private sectors, built on the expertise of each partner; to develop or improve facilities, infrastructure and/or operating services on behalf of the public, through the appropriate and fair allocation of resources, risk, rewards and responsibilities." "The essence of a truly beneficial [P3]" according to the report, "is the transfer or sharing of risk(s) between partners determined by their relative expertise and resources under their control" (p.6).

B.C.'s former Ministry of Employment and Investment defined P3s as a formal contractual arrangement between the public and the private sector partners "for some combination of design, construction, financing, operation and/or maintenance of public infrastructure which may rely on user fees or alternative sources of revenue to cover all or part of the related costs of capital (debt servicing and principal payment and return on equity if applicable), operations and capital maintenance" (British Columbia, 1998, p.2).

These definitions imply a rather involved form of collaboration, which includes the sharing of risks, investments and rewards, as opposed to arm's length supplier relationships. P3s in their most innovative and/or controversial forms have generally fallen within the bounds of these definitions.

Opponents of P3s, however, see them in a much less benign light: as a vehicle for the private sector taking over the provision of public services. The Canadian Union of Public Employees (CUPE), which has been the main critic of P3s in Canada, defines them as "ventures where the private sector becomes a lead actor in the provision of public services" and sees them as a means to contract-out public services over the long term (CUPE, 2005). To CUPE they are, in effect, "privatization by stealth" (CUPE, 1998a).

Governments have generally engaged in P3s in order to spin off some element of the financing, design, construction, operation and maintenance of public infrastructure and services. With P3s, the large up-front capital costs associated with infrastructure projects can either be offset and spread over a number of years through a lease or passed directly to the consumers in the form of user fees. Private firms can assume responsibility for things

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that may go wrong, such as project over-runs, problems resulting from poor construction, etc. These features can be very attractive to public sector organizations, particularly smaller municipalities with minimal capacity and large financial constraints. They might, however, threaten labour and, as we shall see, impose costs on taxpayers that may not always be evident.

The underlying logic for governments in establishing non-service type P3s is that they provide a way for the public sector to meet its responsibilities for the provision or rehabilitation of infrastructure without the up-front capital outlay and risk that accompanies conventional methods of procurement. Supporting this logic is the argument, frequently put forth by P3 advocates, that both the public and the private sectors have unique characteristics that provide them with advantages in specific aspects of service or project delivery. For example, a large private sector firm may possess superior technology and experience that it could bring to bear in a particular project while the public sector might possess a better ability to raise capital within a particular context. The challenge, say P3 advocates, “is to determine the optimum mixture of public and private resources that lead to the optimum method of providing public services at acceptable levels of quality and cost” (Akkawi, 2001). This is the sense in which the term “partnerships” is used and, put in this neutral way, with the suggestion of win-win situations all round, who could possibly object to them? On closer examination, however, questions arise about acceptability to whom and who is bearing the costs of these arrangements. It is at that point that P3s potentially become controversial, as not everyone involved may be a winner, and then the details of any arrangement become crucial.

The desirability and effectiveness of any P3, from the point of view of the various actors, is directly related to the specific content of the contract, the way it is implemented and the vision behind it. Each P3 contract is different and should reflect the particular needs and concerns of the parties involved. Generally, P3 contracts define the scope of a particular project, delineate the specific roles and responsibilities of each signatory, and set the terms, financial or otherwise. In addition to the public and private sectors, potential partners can include universities, colleges, employees, organized labour and other levels of government. In any P3 contract, there may well be winners and losers; hence, each of the parties, whether or not they be contractually involved, must be able to assess the potential impact of a partnership agreement on their interests. It is for this reason that careful analysis of P3 deals, as argued in chapters 2 and 4, becomes imperative.

P3s represent, therefore, a departure from conventional approaches to the delivery of public infrastructure and services by involving the private sector in directly financing and/or owning the assets or in managing and delivering the services. To illustrate the popularity of P3s in Canada, in 2000, there were over 300 projects in the areas of transportation, wastewater and

the environment as well as in the broadly defined area of civic services and facilities.³ This latter category includes arenas, museums, housing, schools, civic halls, casinos, fire fighting, police and correctional services. In Canada, all levels of government in all provinces and territories have engaged in some form of P3 over the past fifteen years, and, while we have no recent comprehensive data, the pace of involvement has picked up dramatically since 2006.

The Infrastructure Gap in Canada

In Canada, a principal reason why governments have turned to P3s in recent years is said to be the existence of an “infrastructure gap,” a considerable physical deficit in which publicly provided infrastructure is in urgent need of repair or replacement. This deficiency in the addition, maintenance and replacement of Canadian public infrastructure stock is widely acknowledged but difficult to calculate. That stock, which includes roads, water and sewage treatment facilities, and housing, education, health and recreation facilities, was estimated at between \$500–600 billion in 2004 (TD Bank, 2004, p.2). This number does not appear to include public buildings, land and public enterprise assets, such as public utilities, and must be taken, therefore, to be a very conservative estimate.

Estimates of the infrastructure gap are even more tenuous as they include not only shortfalls in past maintenance and replacement but also the amount by which new infrastructure growth has fallen behind some, necessarily subjective, view of “need.” The TD Bank argues that estimates of this gap are “all over the map” as a result of different methodologies and assumptions, but concludes that “the consensus is that the gap is massive — as high as \$125 billion or 6–10 times annual investment flows” (p.4). The problem is not that public spending on infrastructure has not increased in recent years. On the contrary, public spending on buildings, machinery and equipment increased from \$1.3 billion per annum in the early 1960s to \$18 billion in 2002, or to \$3 billion in real, 1960s terms. Public spending on civil engineering rose from \$1 billion to about \$9 billion over the same period, or to \$1.4 billion in real terms. The problem is that these increases have not kept pace with maintenance needs and with population and income growth. In fact, as a percentage of GDP, public investment fell from the 2–3 percent range in the 1960s and 1970s to only around 0.5 percent in the 1990s, so that the capital stock as a percent of GDP is some \$180 billion lower than it was in those early years (Mackenzie, 2004). The gap is, therefore, real and large and is acknowledged both by those advocating P3s, such as TD Bank, as well as by those opposing them, such as the Canadian Union of Public Employees (CUPE, Ontario Division, 2004).

The existence of an infrastructure gap is not, in itself a sufficient reason

to pursue the P3 route. In theory, the gap could be filled simply by devoting more resources to infrastructure and by using traditional procurement and operating methods, without recourse to arrangements by which the private sector becomes involved in owning, leasing or operating these facilities. The infrastructure could also be financed in the traditional way through taxes, user fees or regular government bond issues, without necessitating the raising of private equity or loan finance, which characterizes many P3 arrangements.

The following are the three main motivations for the promotion of P3s as a means of filling the infrastructure gap.

1. The Fiscal Challenge

Governments at all levels have for some years been coping with the challenge of meeting rising public expectations within the context of growing fiscal constraints. Since many of these constraints are self-induced, the fiscal argument for P3s is in many respects a self-serving one, as governments are in large measure responsible for the fiscal straightjacket they claim they face. Governments have adopted neo-liberal economic and fiscal policies that constrain state spending, budget deficits and public debt by equating them with financial mismanagement. Several governments at the provincial level have, for instance, adopted balanced budget legislation, which severely restricts their ability to borrow for capital projects and often places constraints on the ability to raise taxes (see Loxley, 2003, ch. 6). The same governments have been aggressively reducing taxes, further impeding their ability to finance capital projects. This creates an environment in which P3s become particularly attractive, as private financing reduces up-front budget expenditures, replacing them with annual lease payments. In this way, P3 infrastructure projects can be delivered through off-balance-sheet financing, seemingly reducing public sector debt and improving the looks of the government's books, though usually at a higher cost of financing than if the government had borrowed directly.

In recent years, however, the implementation of generally accepted accounting principles (GAAP)⁴ and the movement towards summary accounting⁵ have made it more difficult for governments to use this form of off-book financing. However, GAAP aside, as is argued in chapter 2, all forms of lease payment are in effect debt, regardless of how they are treated in the books of the government. Using P3s for fiscal purposes is, therefore, no longer as attractive in Canada as it once was. P3s may still generate beneficial fiscal impact, however, if they shift risk to the private sector, a factor discussed in chapter 2.

2. The Ideological Preference for the Private Sector

Neo-liberals, who have been very influential in policy-making in recent decades, argue that the role of the state should be reduced, in the belief either that the private sector can deliver services more efficiently or that, regardless of efficiency, the private sector should, on ideological grounds, be the preferred deliverer of services. P3s reflect, therefore, a shift in the ideology regarding the role of the state. Thus, while P3s are commonly presented as having arisen out of the growing fiscal constraints faced by governments, one can trace their origin back to the pro-privatization policies of the late 1970s and 1980s, when governments in North America and the U.K. pushed heavily for deregulation, policy decentralization, cutting the size of government, outsourcing public services and privatizing important utilities such as gas, electricity and communications.

At this time, government was called on, by neo-liberals, to “reinvent itself by moving away from a primary emphasis on the direct provision of public goods and services to becoming a regulator and procurer of services from the for-profit and third sectors, that it ‘change from rowing to steering’”(Osborne and Gaebler, 1993, p.25). During this period, right-wing political circles also helped to spawn the notion of the private sector being superior in terms of efficiency and effectiveness. To an extent they were successful in generating a sense of disenchantment with the public sector, which served to fuel and justify calls for privatization, but the cuts they themselves inspired in spending on public services were partly responsible for that disenchantment.

Increasingly, however, the privatization project developed problems of its own, as is best illustrated by the woes that have befallen Britain’s privatized rail system. The private sector proved itself to be just as capable of the inefficiencies that were commonly imputed to the public sector. Indeed, a number of studies reveal that privatization is often no more efficient or less costly than conventional approaches to service delivery (Vaillancourt Rosenau, 1999, p.5). As Vaillancourt Rosenau states, governments discovered that an “unequivocal commitment to privatization in all circumstances may be too great a reaction to poor performance of the public sector and too naïve a trust in the private sector” (p.5). Others have gone further. Thus, in the area of utilities, Werkman and Westerling (2000) argue that research results show that there is no significant difference between public and private utilities in terms of quality of service.

Vaillancourt Rosenau argues that, today, P3s form a second generation of efforts to bring competitive market discipline to bear on government provision of goods and services. However, unlike the first privatizing efforts, partnering involves a sharing of both responsibility and financial risk. Accordingly, rather than shrinking government in favour of private sector activity, at best, P3s put in place collaborative arrangements where the differences between the sectors

become blurred. The question of whether or not they are superior to conventional arrangements for the provision of public services and infrastructure is one that should be put to an empirical test, but ideological predispositions either for or against P3s make that a difficult proposition in practice.

3. Private Sector Opportunism

The third motivation for the spread of P3s is that the private sector sees P3s as an opportunity to raise profits. Industrial corporations find new opportunities in the managing, servicing and operating of infrastructure projects that were previously the sole preserve of the public sector. They may also gain access to a portion of the state budget for running services previously offered by the state. Financial institutions are presented with new opportunities for profit in financing lease agreements between government and industrial capital in infrastructure P3s or in funding the working capital of businesses taking over service delivery. P3s are seen, therefore, as a relatively new vehicle for the accumulation of capital.

An essential element of this institutionalization of P3s as alternative delivery mechanisms serving to enhance private sector accumulation is the “commodification” of services hitherto provided free of direct charge by the public sector. This changes the nature of the relationship the public has with the service provided and introduces the possibility of user fees and charges. In order to provide a profit to the private sector such services have first to be put on the market and priced. Thus, a new revenue element may be introduced for services that were paid for out of general taxes and other revenues of governments. In some sectors, such as health, this may take many forms and many years to evolve, but it is an essential element in the opening up of public services to private delivery, as the U.K. experience shows so graphically (Leys, 2003; Pollock, 2004; Whitfield, 2006). Once the new revenue streams are in place, ability to pay becomes a consideration raising questions about affordability and equitable access to services. In cases where the P3 effectively gives a monopoly to a private company, these issues become much more controversial, especially regarding essential services such as health and water supply. But even the tolling of roads and bridges, where convenience and the avoidance of higher costs of alternative routes might easily be demonstrated, is not without controversy (chapter 6).

The P3 concept has benefited from the lobbying efforts of organizations like the Canadian Council for Public Private Partnerships (CCPPP), an increasingly strong lobby group, which was established in 1993 and draws its membership from both the private and the public sectors. In 2009, it had fifty-eight sponsors, fifty-seven of which were companies with commercial interests in P3s, such as construction companies, banks and their financial offshoots, bond houses and bond rating agencies, lawyers and consulting companies such as SNC-Lavalin, RBC Capital Markets, John Laing, Carillion, Deloitte

and Touche, Bombardier Transportation and United Water. The only non-corporate sponsor was the Government of Ontario (CCPPP, 2009a).

Through its sponsors, its 180 corporate members and 80 public/non-profit members, including departments of the governments of Canada, Alberta, British Columbia and New Brunswick and cities such as Winnipeg, Ottawa and Moncton, the CCPPP has a solid membership and financial base on which to promote P3s. It also holds a large annual conference, publishes extensively on P3s and has been able to attract prominent politicians and ex-politicians into its fold, such as Premier Gordon Campbell of B.C., who is currently the honorary chair. The CCPPP can be considered the main ideological proponent of P3s in Canada.

Corporate involvement in P3s in Canada extends well beyond membership of the CCPPP. There is an extensive array of companies that benefit from P3s (Hajer, 2006). In the financing area alone, of twelve projects identified by the CCPPP in 2009 as being in the works or under consideration, no fewer than twenty-six companies were potential sources of finance; some well known companies such as SNC-Lavalin, Bilfinger Berger and RBC Capital Markets are active in the CCPPP, but others, such as Armco Capital Inc. of Halifax, Morguard Investments and Zachry American Infrastructure, appear not to be (CCPPP, 2009a, 2009b).⁶

Convergence of Interests and Contested Visions

The convergence of interests of neo-liberal states and the private sector is, at root, the basis of the growing use of P3 arrangements as alternatives to conventional methods of delivering public services and infrastructure in Canada, the United States, the U.K. and around the world. Despite this growth and the often attractive characterization of P3s, Canada has yet to experience the kind of public sector, private sector harmony that proponents, such as the CCPPP, invoke. There is still considerable debate as to whether they are the panacea their proponents claim them to be. In addition to CUPE, the main opponents of P3s in Canada are the Canadian Centre for Policy Alternatives (CCPA) and the Council of Canadians. They argue that the record of P3s in Canada is inconsistent and frequently negative, which illustrates that they are far more problematic than their proponents recognize. Opponents charge that P3s are simply a more acceptable middle ground on the road to more widespread privatization in Canada. They see the increasing use of P3s as a signal by neo-liberal governments and politicians of their intention to gradually retreat from the provision of many public services. Opponents of P3s view this as short-term thinking, and there is concern that the long-term effects of this policy could ultimately prove harmful to the Canadian public. Nevertheless, P3s have shown themselves to be anything but a passing trend. They are a phenomenon that most governments in Canada have engaged

with in some capacity, they do have some support in the union movement⁷ and their use appears to be growing.

Types of P3s

The array of P3 options is best conceived of as a continuum, starting from minimal private sector involvement and ending in arrangements more closely resembling pure privatization. For example, outsourcing and contracting-out of services, such as janitorial services, constitute the low private sector involvement range of this continuum — in this case, the private sector merely provides workers for a service designed, overseen, etc. by the public sector. At the other end of the continuum, P3s can be public service projects in which the private sector undertakes design, construction, maintenance and operation of the facility. In such cases the private sector might also provide financing and could possibly even take ownership of the asset both at the beginning and at the end of the agreement term. In between these two extremes, there are a variety of arrangements with varying degrees of private sector involvement.

The differing roles of the public and private sectors in P3 arrangements can determine, among other things, the extent to which risk is allocated between the partners, the amount of expertise required on the part of each partner to negotiate contracts, reward structures and, not least, the potential implications for taxpayers. In theory, as one moves further along the P3 continuum toward greater private sector participation, the public sector's liability and exposure to risk should decrease. In turn, the private sector should assume greater risk and liability for what were previously public services or facilities. With greater private sector involvement, conventional public sector operations and management become superseded by contractual arrangements that dictate the liabilities and obligations of both parties.

As Allan (1999b) argues, P3s can be categorized in several different ways and the particular one chosen should reflect the dimensions that are of most concern for the purpose at hand. The P3 continuum begins with P3s that transfer the least amount of risk to the private partner and ends with full divestiture or privatization. The following section considers the typologies of the P3 continuum with the exception of privatization (chart 1.1).⁸

The following are the most common types of P3s:

1. service and operations and maintenance (O&M) contracts
2. design-build (DB)
3. design-build-operate (DBO)
4. design-finance-build-lease (DFBL)
5. design-build-finance-transfer-operate (BTO)
6. design-build-operate-transfer (BOT)
7. design-build-own-operate (BOO)