1 The PPP phenomenon

In April 2004 The European Commission issued a green paper entitled; *'On Public-Private Partnerships and Community Law on Public Contracts and Concessions'* in which Public Private Partnerships (PPPs) where referred to as 'a phenomenon.' Alternative definitions of phenomenon are; 'marvel' and 'miracle' which one suspects was not quite what the Commission had in mind when searching for a term to describe the spread of this form of procurement. Rather it is a case of 'bewilderment', 'panic' and 'confusion' on the part of the Commission at the rapid growth of PPP's in Europe and which currently operate, in a state of EU regulatory limbo.

Public Private Partnerships bring public and private sectors together in long term contracts. According to Zitron, in its widest sense a public private partnership (PPP) can be defined as *' a long term relationship between the public and private sectors that has the purpose of producing public services or infrastructure'.* In the context of the above definition the public sector, or service purchasers, are agencies such as; National Health Service hospital trusts, local authorities and central government departments, for example the Home Office. On the other side of the equation, the private sector, or service providers, can be defined as; profit making organisations which, for the purposes of PPPs, form multi-disciplinary companies and can include a range of expertise, depending on the nature of the PPP, from financial institutions, construction companies, designers and facilities managers. Although these private sector multi-disciplinary companies (the structure of which will be discussed in detail in Chapter 2), are usually unique to a single PPP project, PPPs are not unique to the construction sector and are being used by government to procure a wide range of services from information technology systems to military hardware. However, for the purposes of this book PPPs will involve the delivery of a public service, or the provision of new infrastructure will normally take the form of a built asset, for example; a hospital , school or motorway, which traditionally has been financed and operated within the public sector. PPPs are now one of the three preferred procurement strategies recommended by the Office of Government Commerce (OGC) for public sector projects, the other two being; Prime Contracting and Design and Construct in a move away from the traditional strategies that have resulted in sub-optimal performance. At the same time there has been a realisation by the public sector that value for money is not lowest price, instead it is to be found in the optimum combination of whole life costs and quality to meet users' requirements.

Partnership is the key word in Public Private Partnerships, but what should the partnership deliver for the parties? A partnership in the generally accepted business sense is a form of business enterprise and exists where there is a voluntary association of two or more persons engaged together for the purpose of doing business as a partnership, for profit. Partnerships are assumed to exist where the partners actually share profits and losses proportionately, even though there may not be a written partnership agreement signed between the partners. In cases of partnership creation, most lawyers will advise their clients to have a written partnership agreement in place. When no written agreement exists a partnership will be implied by the law when two or more people are in a business relationship together with the view to making a profit.

The essential elements of a partnership are:

All individuals share the risks and rewards of the business;

Each partner is entitled to share the net profits of the business. A contract need not provide for equal shares which may depend upon how much the partner has invested;

Partners are jointly and severally responsible for all the debts and obligations of the business without any limit, including loss and damages arising from wrongful acts or omissions of their fellow partners and potential liability to third parties;

Partners have equal rights to make decisions which affect the business or the business assets; and

All individuals share the ownership of the assets of the business, although they may have agreed that the firm will use an asset which is going to buy one of the partners individually.

PPPs cannot then be said to be partnerships in the generally accepted definition of the term and indeed the Institute for Public Policy Research (IPPR) defined PPPs as *'a risk sharing relationship based on an agreed aspiration between the public and the private sectors to bring about a public policy outcome.'* Never the less the focus of partnerships and partnering in construction has developed a significant profile in the UK during the past ten years. It was the subject of a series of reports in the early 1990's and then further impetus came from the publication of Sir Michael Latham's report; *Constructing the Team* in 1994 and Sir John Egan's *Rethinking Construction* in 1998 where strong emphasis was placed on long term partnering agreements between the supply and demand sides of the construction industry. Although the distinction should be made between partnerships and partnering the lines sometimes become blurred and several of the PPPs described later in this book, NHS ProCure21 for example, are very firmly based on Latham and Egan partnering principals. More than a decade after the Latham Report there are many within the construction industry who believe that a 'them and us' culture is still strong when it comes to procurement. Despite the best efforts of Latham & Egan and a whole series of government lead initiatives to improve efficiency in 2005 an National Audit Office (NAO) report; *Improving Public Services through better construction*, claimed that £2.6 billion a year is still wasted because of the poor management of public sector construction projects.

The Great Debate

Whilst this book attempts to steer a course away from being a political polemic on the ethics of PPPs it is not possible to totally ignore the many public debates that have raged and continue to rage on this approach to public procurement. To some within the public sector, the concept of a PPP, in which the private sector is given a long term licence to deliver public sector services for profit, is an anathema and over the ten years or so from its first introduction the debate continues about the ethics and suitability of this method of asset procurement. In the various debates one fact is often overlooked namely; that PPP's are primarily a method of procurement; however to some they have also been seen as;

- a method to raise finance off balance sheet – see Chapter 3;
- a strategy to achieve greater efficiency; and
- a politically motivated tool to engine social change.

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One of the most outspoken critics on PPPs has been the trade union UNISON which shortly after the introduction of PPPs launched its Positively Public Campaign in order to *'keep public services public.'* According to UNISON the reasons why the PFI, for example, should be opposed are:

1. The death of the public sector ethos with the introduction of private sector contractors.
2. The PFI is driven by a political motive to control public spending rather than to deliver better public services.
3. PFI schemes actually cost more than conventionally procured assets due to a range of factors including, higher finance costs and high fees for professional advisors,etc.

4. PFI consortia profit from employing their workforce on inferior terms and conditions to those in the public sector and in some cases this has resulted in a two tier work force within the same organisation.

5. There is no evidence to support the claim that the private sector can deliver public service outcomes more effectively than the public sector and in fact many privately operated projects are underperforming.

6. Similarly, it has been suggested that the added value brought about through risks being transferred from the public to the private sector is nothing more than *‘pseudo-scientific mumbo jumbo where financial modeling takes over from thinking.’*

7. Private sector companies make unacceptably high profits from PPPs and in particular the practice of refinancing PFI deals at an early stage in the project’s life has been heavily criticized.

8. That many PPPs reduce the traditional accountability of public sector projects under the cloak of commercial sensitivity.

The above issues will be addressed in the following pages. In addition to the above comments PPPs have also been blamed variously for threatening the delivery of healthier school meals to reducing the numbers of acute beds in new hospitals as well as the spread of so called ‘super bugs’ such as MRSA in NHS hospitals. Seldom in the history of construction procurement can their have been such a controversial topic. However, despite the controversy one thing is clear – PPPs are here to stay and putting aside public policy issues, are of major importance, both financially and developmentally, to the UK construction industry see table 1.1. During the past few years construction related PPPs have risen from virtual insignificance, in terms of the £70 million per annum UK construction total turn over, to be of major importance to both contractors and construction professionals. Exact figures concerning the value of PPP construction contracts are difficult to calculate, due the number of contracts in the course of negotiation at any one time. However, figures compiled by the dti show that the value of PPP construction projects over the period 1992 – 2005 are as follows;

	£ Million
Education	2,346 (96 Transactions)
Transport	25,200 *
Office of Dep. Prime Minister	575
Dept. of Health	12,123 (117 Projects)
The Home Office	868
Local Authorities	1,275
Ministry of Defence	6,658 (46 Projects)
The Scottish Executive (All sectors)	2,204
Total	**£51,408** **

* includes £16,179 million for the modernisation and maintenance of the London Underground
** includes signed projects, projects under construction and ojeu announcements.

Table 1.1

Although the above figures in Table 1.1 cover the period 1992 – 2005 the majority of deals were struck after the 1997 Bates Review and construction related PPPs have run at approximately £4 - £5 billion per annum although by 2007/08 the level of expenditure is expected to drop to a more modest £2 billion per annum.

Although PPP has become a generic term to describe contracts in which the public and private sectors work together, there has developed in the UK, a wide variety of PPP procurement models and these are described in detail in chapter 2. In most cases however in PPPs arrangements private sector contractors become the long term providers of services rather than simply upfront asset builders, combining some or all of the responsibilities for the ;

design;

construction;

finance (which may be a mixture of public and private sources);

facilities management; and

service delivery,

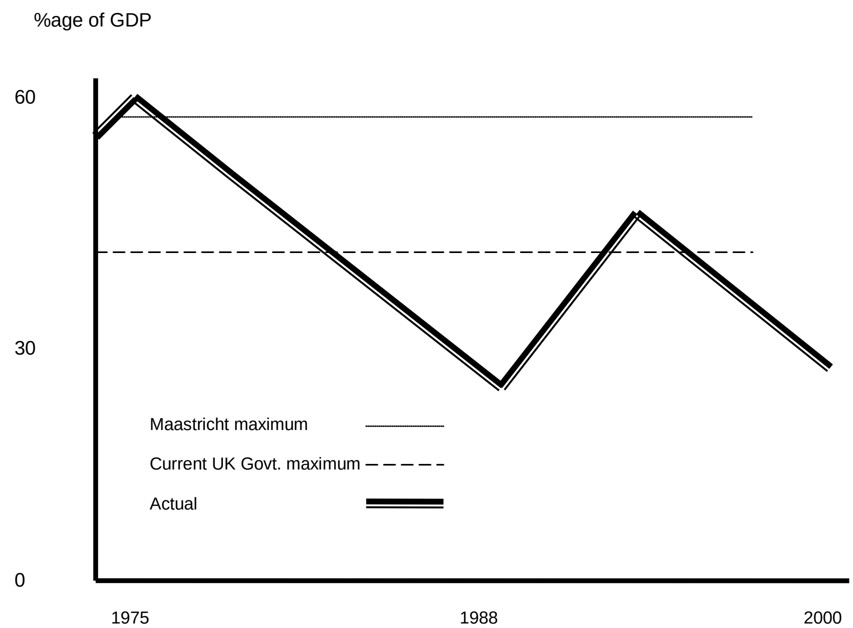
of a public service facility.

As with any form of procurement, to work efficiently PPPs depend upon a number of critical success factors, but fundamentally these are; true partnership, communication and commitment. The debate goes on however, a constant theme concerning the rationale for the use of PPPs is; that in the medium term, they take some of the strain off public borrowing and add much needed certainty to cost and the delivery of public sector projects, in fact to many cost and time certainty are the two biggest attractions to the public sector of PPPs. Compared with the traditional and often fragmented approaches to construction procurement PPPs , depending in the model used, offer the advantages of synergies between traditionally diverse processes in the delivery and operation of built assets for example;

> Synergy between the design and construction. This is not a new concept and buildability can also be achieved through other forms of procurement, such as design and build. Most PPP projects are able to deliver this well with designers working along side the contractor.

> Synergy between the construction phase and the operational phase. This is mainly to do with the suitability and reliability of the construction taking into account whole life costs over the expected life of the project as well as sustainability issues.

Not unnaturally there is growing evidence that companies that can combine, design, construction and hard facilities management in house, are increasingly successful in the PPP market.



Public sector net debt as a percentage of GDP

Figure 1.1

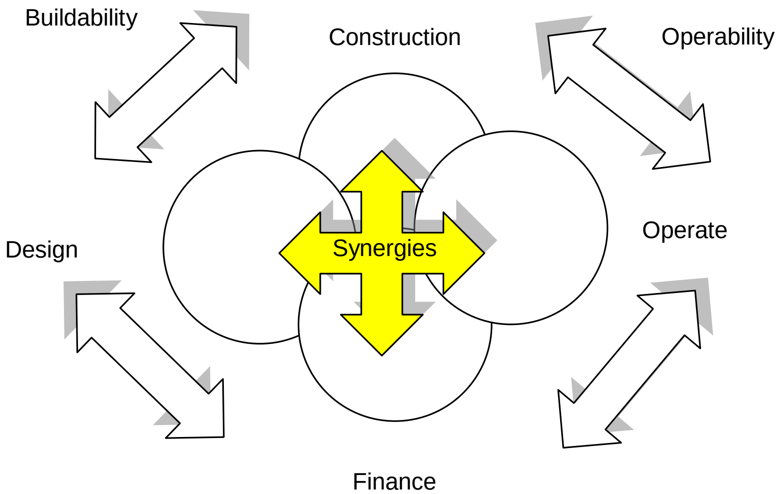


Figure 1.2

PPP Synergies

PPP Nomenclature

Within the construction industry the nomenclature used to describe PPPs is sometimes confusing and misunderstood and often the term PPP is used synonymously with the private finance initiative, although of course the PFI is only one of many PPP options available, see figure 1.3. The PPP concept covers a wide range of different types of partnerships and service delivery including the following broad categories;

- **divestiture** : the introduction of the private sector ownership into state-owned businesses, using the full range of possible structures (whether by flotation or the introduction of a strategic partner), with sales of either a majority or a minority stake, for example the UK privatisation programme of state owned monopolies during the 1980s and 1990s. In this programme, publicly owned and managed utilities such as gas, water and electricity were valued and then sold to the private sector with the UK government retaining a so called 'golden share' in the organisation, giving them a final say in any major decisions and shielding the newly privatised companies from hostile bids, although subsequently in 2003, The European Court of Justice ruled that golden share arrangements were illegal. In the UK over the years since the privatisation programme, the golden shares have been given up, although the government still retains them in; BAA, BAE Systems, British Energy and Rolls Royce. The two major characteristics of this form of PPP therefore are; public sector part-ownership of the service providing organisation and greater flexibility and uncertainty about investment levels as compared with the PFI for instance, over the licence period;

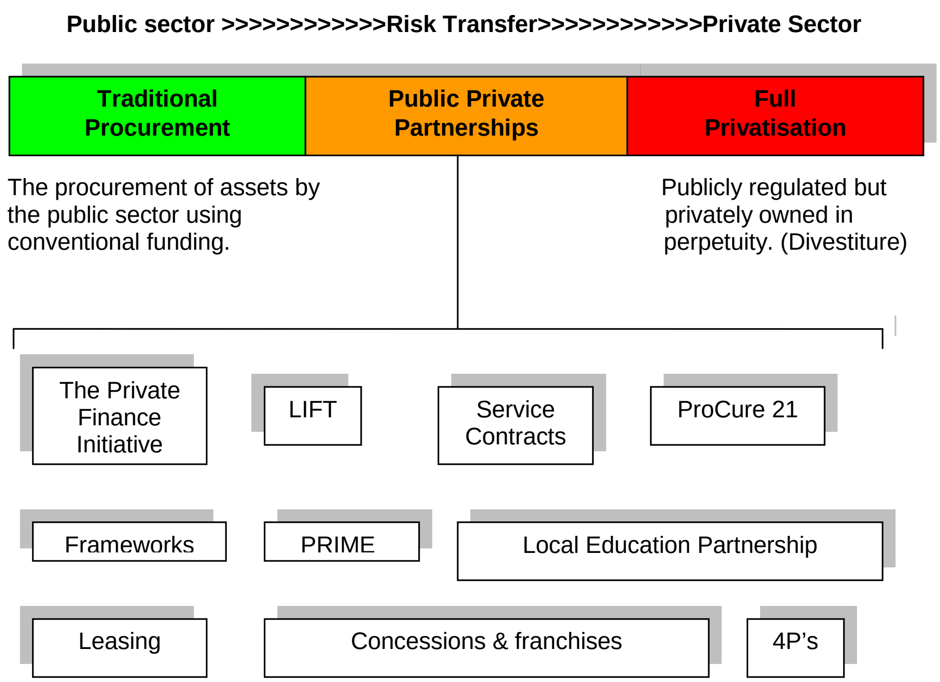


Figure 1.3

- **concession arrangements** where the public sector contracts to purchase services on a long term basis. These include; the Private Finance Initiative, and franchises, where a private sector partner takes on the responsibility for providing a public service , including maintaining, enhancing or constructing the necessary infrastructure; and

- **selling government services** into wider markets and other partnership arrangements where private sector finance are used to exploit the commercial potential of government assets.

As illustrated in figure 1.3 sectors are now developing their own PPP models to meet specific needs for example; NHS LIFT (Local Improvement Finance Trust) for new primary care and community based facilities and the Local Education Partnership (LEP) for schools. Given the record of construction procurement in the UK there is a growing realization that cooperation with the private sector in PPP projects, is able to offer a number of advantages, including;

- acceleration of project delivery;
- faster implementation;
- reduced whole life costs;
- better risk allocation;
- incentivisation of suppliers; and
- generation of additional revenues.

For example at the start of the 1990's the Prison Service was viewed as an organisation steeped in traditional practices with a culture that did not respond to change. Traditionally, prisons were built by the private sector but to strict guidelines and standard designs and when completed were operated (staffed) by the public sector. A strong impetus for the move to the PFI to procure prisons was the wish to change attitudes within the service. In the US private consortia had been involved in the construction and operation of custodial services for about ten years. In 2003 Correctional Services in England and Wales were reorganised to take account of the increased use of private sector involvement see Figure 1.4

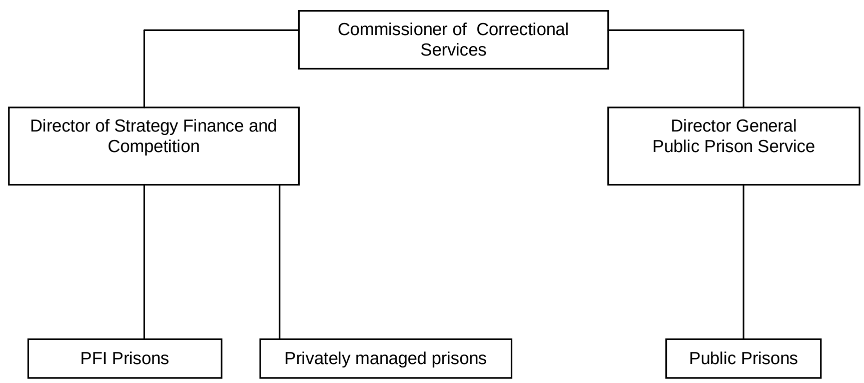


Figure 1.4

Prisons were therefore one of the first sectors to be procured using the Design, Construct, Maintain and Finance model. To date there are nine privately built and operated prisons in the UK. From a value for money perspective PFI prisons appear to be a success delivering custodial services at around 10% cheaper than using traditional models, with the construction phase being completed in about half the time (between 18 – 24 months) of a conventionally procured prison. Prisons are the jewel in the crown in terms of delivering value for money compared with traditional procurement routes.

Of all the PPP models the PFI predominates accounting for approximately 85% of all PPP deals but, which ever PPP model is selected it is important to remember that public bodies retain a critical role in the management and regulation during the design, construction and operation phases. For example, whether PPP or conventionally procured, prisons, schools and hospitals all have to comply with standard sector procedures for service delivery, etc. Therefore, measurement and assessment of performance is critical and central and local government agencies become increasingly involved as regulators and focus on service planning, performance monitoring and contract management rather than on the direct management and delivery of services. Whatever the motives for the increasing popularity of PPP arrangements, collaborative working between the public and private sectors is not a new concept.

Before PPPs became high profile in the 1990's the following approaches to allow private sector participation in public sector service delivery were and still are common;

Service contracts

Public agencies utilising private sector companies to carry out for example the maintenance and repair of equipment. This type of arrangement is generally awarded by competitive tendering and in PPP terms is relatively short and addresses short term technical issues with contracts being re tendered every five years or so, rather than overall strategy and management of a facility. The risk for investment remains with the public sector in the approach.

Operation and Management Contracts

Similar to above except that the private sector has the responsibility for both the service and management of a facility. Again short in PPP terms this type of arrangement can include incentive schemes where service levels or output meet pre determined targets. Incentivisation is thought to be one of the main ways in which PPP approaches can deliver added value. The commercial risk remains in the public sector

Leasing

More akin to PPPs, leases are suitable for systems or assets which generate independent revenue streams. The contracts are usually for longer periods than the two previous examples and can be up to 15 years and more significantly, the commercial risk is transferred to the private sector. Put simply, the private sector operates and maintains a system, for a lease payment that is paid to the public sector. Provided that service levels are maintained the lessor is free to reduce operating costs and increase profits.

As well as private involvement in the delivery of public services, similarly, there is nothing new in governments borrowing money from the private sector to finance the provision of public services and, in particular, the acquisition of capital assets. Nor is there anything new in governments using the private sector to deliver public services.

Indeed, all public services are delivered by private persons, who may, or may not, be public sector employees. There has always been a mixture of in-house and bought-in provision. What is new is that long-term contracts, typically 25 – 35 years with the ownership and management of dedicated assets left within the control of the private sector. Public Private Partnerships bring public and private sectors together in long term contracts. The uniqueness of PPPs lies in the partnership of two sectors; public & private, which have during the last sixty years or so, in the UK at least, followed very different paths, with very different objectives. In broad terms the benefit for the private sector includes the predictability of guaranteed long term income streams and for the public sector, cost and time certainty in the delivery of a new or refurbished built asset. In addition, given the unenviable track record of the UK construction industry, the public sector client does need to start paying for the facility or service until it is ready for use.

At the other end of the procurement spectrum illustrated in figure 1.3, the private sector assumes all of the responsibilities (full privatisation). In the centre of these two extremes are PPPs with risks and responsibilities shared between the public sector and its private partners according to their strengths and weaknesses. With PPP schemes the risks are shared more equitably between the public sector client and the private consortia. The reasoning being:

risks are apportioned on the basis of the party best able to manage them;

the extra costs that accrue to raising finance in the private sector are off set when the private consortium accepts the financial consequences of accepting the responsibility certain risks.

The development of Public Private Partnerships

There is nothing new with the involvement of the private sector in the delivery of public services. PPPs in the form of Build Operate and Transfer (BOT) was used as early as 1858 for the construction of the Suez Canal. This £19 million revenue producing water way was financed with a mixture of European and Egyptian financial support and was based on a concession to design construct and operate. La Compagnie Universelle du Canal Maritime de Suez was formed to construct the canal. The company, which was owned by both French and Egyptian interests, both build the canal, and administered it for 99 years after which time, the ownership passed over to the Egyptian government. According to Zitron in 1638 the Royal Navy considered, but subsequently rejected, the possibility of using a private consortium to store and provide meat for their men. The Canal du Midi in France was completed in 1681 with the use of private finance. In reality, all public services are delivered by private persons, who may, or may not, be public sector employees and there has always been a mixture of in-house and bought-in provision. Similarly, there is nothing new in governments borrowing money from the private sector to finance the provision of public services and, in particular, the acquisition of capital assets.In the second half of the nineteenth century many publicly accessible roads and railways in Europe and the US were developed using private finance on the basis of a concession, however, by the mid twentieth century the privatisation of public facilities experienced a downturn.

In 1979 the UK government introduced compulsory competitive tendering for local authorities and for both the UK and the USA the 1980's proved to be years of radical and political change. Traditional economic and political practices were replaced by new often controversial policies, although in theory many of the ideas, and market-oriented supply-side policies advocated were based on the old principles of laissez-faire capitalism. The two main elements of the economic strategy were first, on the demand side was a policy of firm monetary control in order to reduce inflation, and the second was the introduction of radical market-orientated policies. These policies were designed to encourage and reward individual enterprise and initiative, increase reliance on market forces and competition, remove and streamline outmoded restrictive legislation, red tape enabling a reduction in government and intervention.

Prior to 1989, governments were not keen to allow private capital in the financing of public sector projects. In the UK the position was set out in the so called Ryrie Rules. The Rules presupposed that some projects, such as road building, should be undertaken by the public sector and that, where private sector finance was involved, public expenditure cover would be required. The Ryrie Rules were formulated by a National Economic Development Council working party in 1981 under the chairmanship of Sir William Ryrie, then Second Permanent Secretary to the Treasury. The rules sort to establish criteria under which private finance could be introduced into the nationalized industries. The rules stated that;

> decisions to provide funds for investment should be taken under conditions of fair competition with private sector borrowers; any links with the rest of the public sector, government guarantees or commitments, or monopoly power should not result in the schemes offering investors a degree of security significantly greater than that available on private projects;
>
> such projects should yield benefits in terms of improved inefficiency and profit from the additional investment commensurate with the cost of raising risk capital from financial markets.

The Rules were revised in February 1988 to take account of the privatization of the previously nationalized industries and the introduction of schemes such as contracting out, opting out, mixed funding and partnership schemes. The two fundamental principles of the guidelines were;

> private finance could only be introduced where it offered cost effectiveness or value for money; and
>
> privately financed projects for public sector programmes had to be taken into account by the government in its public expenditure planning, in other words such projects had to have public expenditure cover as a guarantee.

The objective of the Ryrie Rules was to stop ministers from insulating private finance from risk so that it could be used to circumvent public expenditure constraints. The Ryrie Rules were formally retired in 1989. Subsequently, the Treasury promoted private finance as additional and not just as a substitute. In 1992 the Private Finance Initiative was launched which to many was seen as a natural progression to the programme of privatisation that was undertaken in the UK during the 1980’s and 1990’s. Initially a public relations disaster, universally criticised from all sides and in particular by the UK construction industry, the PFI spent several years in the doldrums until the incoming Labour government of 1997 gave the process more focus.

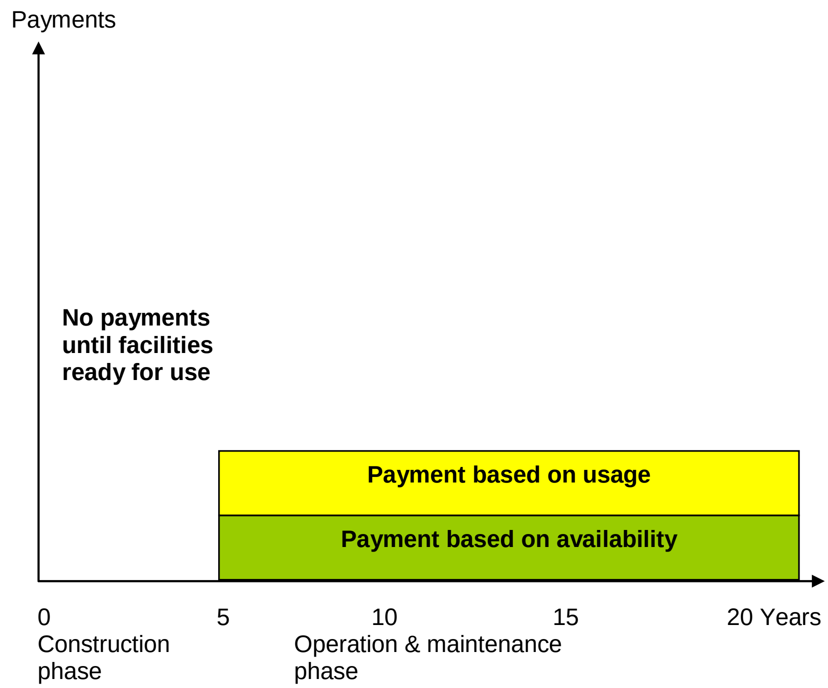
In 1999 Sir Peter Gershon was invited to review civil procurement in central government. The subsequent report highlighted a number of weaknesses in government procurement systems as follows;

- organisation;
- process;
- people and skills;
- measurement; and
- contribution of the central government.

Gershon's aim was; to modernise procurement throughout government, provide a greater sense of direction in procurement and promote best practice in the public sector. Gershon's proposals for dealing with these deficiencies led to the creation of a central organisation entitled the Office of Government Commerce.

The uniqueness of PPPs is illustrated in figure 1.5 and is characterized by;

- long term contracts;
- the management of dedicated assets left within the control of the private sector;
- payments on the basis of delivery, availability and usage.



PPP procurement

Source: PricewaterhouseCoopers (2003) Figure 1.5

Since the establishment of the welfare state in the UK in the 1940's the public sector at national and local levels has retained the responsibility for the provision and delivery of a range of services such as healthcare, education, transport, etc. that impact on the daily lives of every citizen. Legislation such as the Education Act (1944) and the National Health Service Act (1946) extended and integrated existing state provision in their respective fields, creating national systems which were free at the point of delivery. Until recently, government departments and agencies relied with varying degrees of success on traditional high risk public procurement and funding models to provide the built assets necessary to deliver these public services. Typically, using traditional approaches government agencies draw up short and medium term plans, prioritizing needs and then attempt to arrange the finance, (from central government sources), design and the construction of individual projects. The public sector agencies commonly utilize the services of the private sector for the design and construction, with the award of individual contracts being determined by a competitive bidding process based on lump sum contracts, often on the basis of drawings and a bill of quantities. Once the built asset has been completed however private sector participation, with a few exceptions noted below, ceases and the new facility is then operated and maintained by the public sector agency, together with other assets under its care. The difficulties with this fragmented approach to procurement have been three fold;

- firstly, projects can only proceed once the public funding is in place and this can be problematic. Agencies have to bid annually, recently changed to three yearly, for funds from the Treasury and inevitably many projects fail to secure funding and do not go ahead. If funding is secured , design and procurement is usually on the basis of cheapest bottom line price rather than value for money, with little or no consideration given to long term running, maintenance or decommissioning costs;

- secondly, once funding is approved the project delivery is often unreliable both in terms of cost and time certainty. The reports on the inefficiencies of the procurement of prestigious public sector construction projects are legion, all of the examples are too numerous to list, but here are just a few notable ones;

Project	**Delay**	**Overspend**
Scottish Parliament	3 Years	£390 million
Trident Faslane	2.5 Years	£114 million
Jubilee Line Extension	2 Years	£1.4 billion

Table 1.2

- thirdly, the maintenance of built assets is also dependent on central government funding, which like the funding of capital projects is unpredictable. Often funds for capital building programmes have to be diverted to carry out essential maintenance or repair work.

One could be forgiven for coming to the conclusion that given the above examples, there is a prima fascia case for involving the private sector in the construction and delivery of public services. The legacy of traditional procurement and funding strategies can best be illustrated by examining the National Health Service hospital building programme over the past 50 years. The NHS owns one of the largest and most complex property portfolios in Europe, with standing building stock worth £23bn (disposal value) and £72bn (replacement value*,* much of which is old and have been kept in service much longer than was originally envisaged, against a background of increasingly rapidly changing clinical techniques. Using traditional approaches to procurement and funding; out of 45 NHS major district hospital construction projects built between 1985 and 1996; the original tender price was exceeded by 10% on 23 of these projects and by more than 20% on 14 of them. In addition 17 of the projects over ran on time by over 10% and in 10 of the projects by more than 20%*.* More specifically; Guy's Hospital Phase 3 was approved in principle in December 1986 at a cost of £35.5 million with a planned completion date of December 1993 – the reality was completion almost three and half years late and a final cost of £160 million, an increase of 450 %. The uncertainties of completion and final cost are one of the main difficulties of traditional procurement and makes even short term planning very difficult. It is clear therefore that the traditional approach to public sector procurement, of keeping clear blue water between the public and private sectors was not working efficiently. During the preparation of the outline business case for The New Royal Infirmary in Edinburgh, one of the first PPP hospitals; independent construction companies advised the Trust that if conventional procurement strategies were used, the project would take between 8 and 10 years, as compared with 4 years for a PPP design and build deal. Traditional procurement, has in many cases, not only delivered sub optimal performance in construction, but also in property maintenance. Take for example the costs associated with a modern hospital. The ratio of capital cost: building maintenance: staff costs over the life cycle are known to be 1:2:10, that's to say the costs involved in operating and running a hospital during its life are double the initial capital cost of construction and yet using traditional funding and procurement models, life time costs have been largely ignored, as has ways of mitigating the considerable impact of staff costs during the design and procurement. Prior to the redevelopment of West Middlesex University Hospital, using a PPP, the hospital trust estimated there was a backlog in maintenance of £22.8 million and in 1997 it was estimated that the bill for the backlog maintenance across the NHS as a whole was £3 billion.

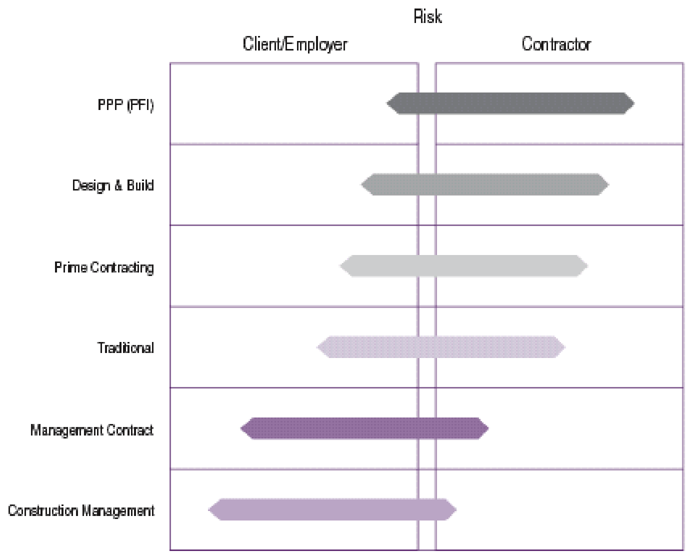
PPPs allow projects to be funded throughout the economic cycle, which is attractive to governments taking a long term view and anxious to keep public borrowing in check, whereas to keep within funding limits, traditionally public procurement, driven on by an ethos of public accountability, has had to focus on cheapest bottom line solutions, rather than whole life costs and value for money. In addition traditional procurement models leaves the public sector client vulnerable to high levels of risk which, it has been proved, it is ill equipped to manage. Figure 1.6, illustrates just some of construction procurement options that are available, including traditional procurement, in which the public sector client retains all the responsibility for financing, constructing, operating and maintaining assets together with the responsibility for a large percentage of associated risks. In addition to the procurement strategies shown in figure 1.6, there are a number of strategies with varying degrees of risk transfer and cost and time certainty, for example lump sum fixed price contracts, in which the contractor undertakes the whole of the work for a specific sum – the contractor carries nearly all the risks as in this form of procurement as:

- the client pays the same regardless of how much work is needed; and
- the contractor is motivated to obtain the most cost effective approaches.

At the other end of the spectrum are cost reimbursement / cost plus contracts where the client carries nearly all the risks;

- the client pays for work done plus a sum to cover for the contractor's overheads and profit; and
- the contractor may not be motivated to carry out work efficiently or cost effectively.

In reality, the majority of traditional public sector contracts have been based on models in the middle of these two extremes. even though conventional procurement is shown to share the responsibility for the management of risk fairly evenly, this approach has still caused problems for public sector procurement managers. With conventional public procurement, which is used in both the public and private sectors, the client bears the majority of the risk. For example; additional costs on top of the initial estimated capital cost or running costs are the responsibility of the client (public sector agency). The public sector project team is incentivised only to produce a project for the cheapest possible initial cost without regard for the long term costs of maintenance or running expenses. Note that PPP/PFI procurement results in a large proportion of risk being transferred to the contractor or private sector – the implications of this will be discussed in more detail in chapters 2 and 5.



Risk allocation and procurement strategies

Figure 1.6

In construction procurement terms, poorly managed risk most often manifests itself in delays in completion and additional costs to the client due to extra and unforeseen works or simply poor planning. Acceptance of a procurement strategy with high levels of risk is like not only to impact on the capital costs but also on life cycle costs too which are passed onto the client see figure 1.7.

In an attempt to explain the sometimes massive cost and time overruns in prestige public projects Mott MacDonald were commissioned by the HM Treasury to carry out an investigation as to why this might be so. The conclusion of the report was that in general the public sector procurement managers have been over optimistic and naive in their estimates of cost and time of large and complex construction projects. Faced with these patterns of inefficiency, the rationale for the introduction of alternative forms of procurement, with less risk for the public sector and that harness the expertise of the private sector, such as PPPs, seemed to need no explanation. Claims for the superior performance of non state (private) institutions have been cited in relation to two key values. First, private sector organisations are viewed as being more efficient than public sector ones as a result of being more disciplined by market forces and competition. By comparison public sector institutions are viewed as being excessively bureaucratic, controlled by administrative or professional interests and unresponsive to the pressures for efficiency which market based organisations faced. Yet the opinions as to why PPPs are proving to be so popular with governments, world wide are truly diverse. Government has an obligation to deliver public services, but government does not need to finance, build and maintain the infrastructure necessary to do this. Therefore at one level PPPs are a method of out sourcing the delivery of public services in which the government assumes the role of the purchaser of these services from the private sector supplier.

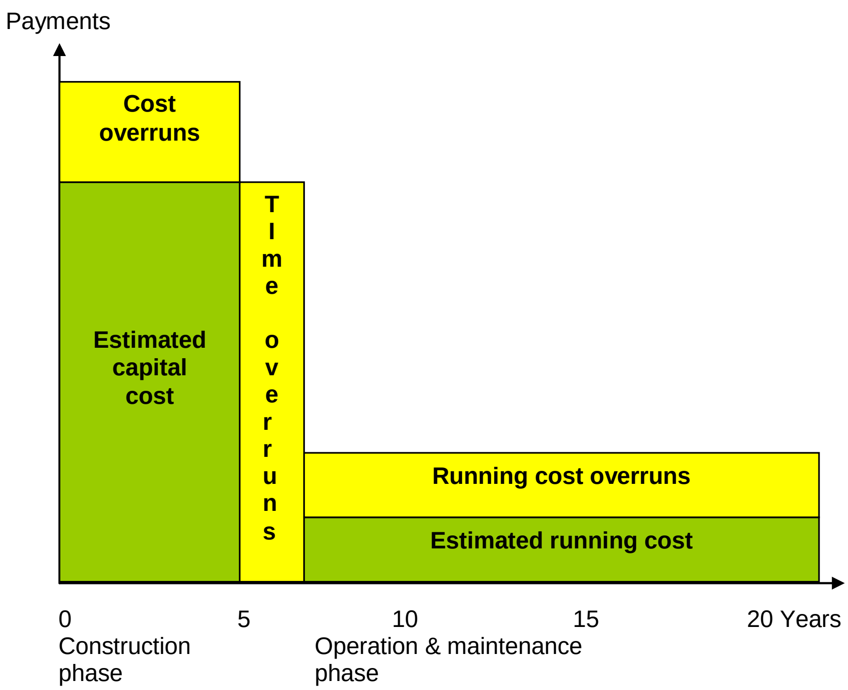


Figure 1.7

The European Commission takes a more pragmatic assessment, suggesting that PPPs are driven primarily by limitations in public funds to cover investment needs but adding that PPPs also boost efforts to increase the quality and roles for the private sector in PPP schemes;

- to provide additional capital;
- to provide alternative management and implementation skills;
- to provide value added to the consumer and the public at large;
- to provide better identification of needs and optimal use of resources.

The Institute for Public Policy Research in its seminal report ; Building Better Partnerships came the conclusion that the rationale for using PPPs instead of traditional approaches appeared to be confused, with muddled and contradictory statements by different government agencies.

Are PPP's privatisation?

The simple answer is no, privatisation is distinct from PPP, despite the claims made by organisations such as UNISON. Privatisation is the partial or complete sale or transfer of existing enterprises, assets or rights from public ownership to the private sector. A number of different terms are used to describe privatisation and these may include; liberalisation, restructuring and disinvestment. Over sixty companies valued at over £70 billion have been privatised in the UK since the early 1980's and this has taken place in three broad phases;

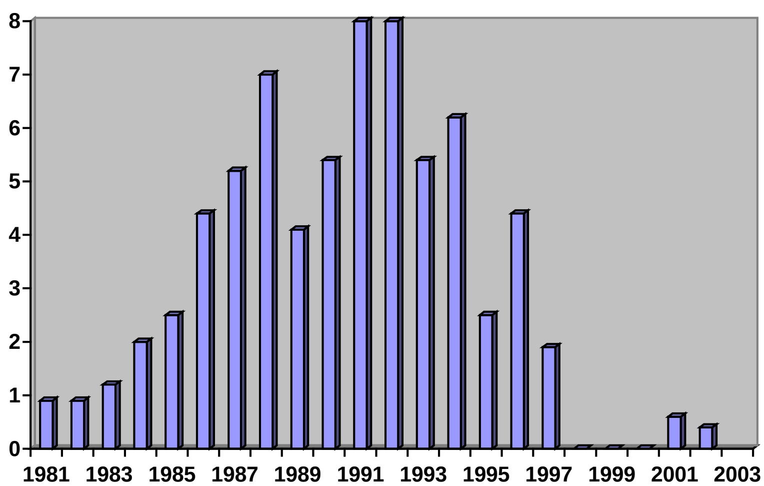
> free standing state owned companies already operating on a commercial basis, such as British Airways and British Airports Authority;
>
> utilities such British Telecom and British Gas; and
>
> less commercial industries, such as British Rail and British Energy.

In the UK the consequences of the privatization programme are generally accepted to have been;

Improvement in public finances, even though there is evidence to suggest that many of the public sector assets were under valued by as much as 50%, the £70bn the process raised was received gratefully by the UK Exchequer. At the same time the amount that publicly owned companies contribute to the UK economy decreased, see figures 1.8 & 1.9.

Enhanced market performance, greater efficiency and competition.

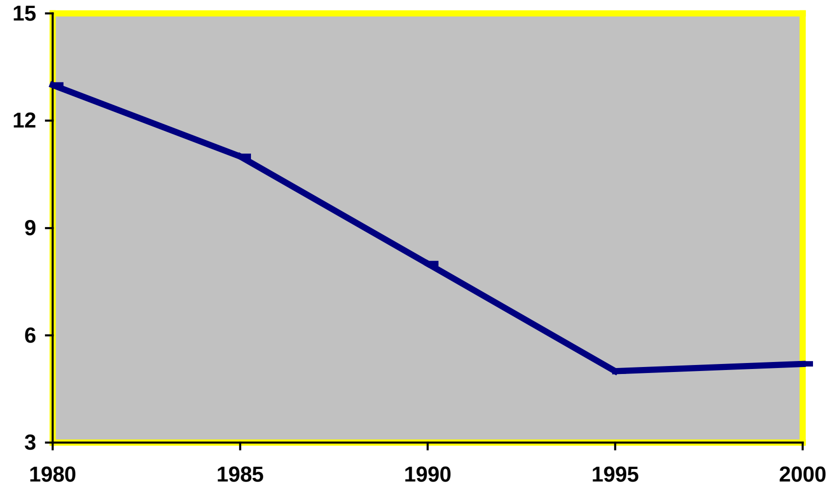
Widened of share ownership from 4m in 1979 to 13m in 2002.



£ billions

Source HM Treasury : UK privatisation revenue

Figure 1.8



Public corporations' contribution to UK economy - % share of GDP
Source: HM Treasury

Figure 1.9

Therefore, despite its sometimes turbulent history, PPP procurement has, in a comparatively short period, become an established procurement strategy that is becoming increasing adopted in international markets. The following chapters will review various aspects of PPP procurement as a deliverer of built assets for public sector service delivery.

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