



**METROPOLITAN HALIFAX
CHAMBER OF COMMERCE**

*Strong Business. Strong Community.
Since 1750.*

Private Public Partnerships Discussion Paper - A Synopsis

February 18, 1999

Private Public Partnerships Discussion Paper - A Synopsis

Background & Objectives:

In 1995, the Metropolitan Halifax Chamber of Commerce advocated the use of public-private partnerships (P3) in a letter to the Province of Nova Scotia. Now, with a number of P3 projects up and running, the Chamber felt that it was an appropriate time to evaluate the P3 process and to determine whether there are some common guiding principles for this process that could help governments.

Analysis:

Our approach was to focus on the Maritime experience with P3's to add relevance to our task, and to limit our evaluation to infrastructure projects. Our reason for choosing infrastructure projects was that information is more readily available on these projects and good historical data is available for comparative purposes. However, it is our view that the P3 process lends itself well to partnerships in the service sector and other sectors as well.

We identified a number of infrastructure projects in the Maritimes and evaluated them in terms of what we called the “myths and realities” of the P3 process. The “myths” are the issues that appear to resonate with the public and the “realities” are our attempts to objectively evaluate and, if possible, quantitatively analyse the myths. We narrowed our list of myths to five key issues, as follow.

- a) **P3 projects cost more than traditional procurement methods.**
From our limited survey, with one exception, it appears that the costs under the P3 process are about the same as the traditional method. Also, it appears that where the costs are or will be significantly higher, the P3 approach is not used.
- b) **P3 projects are vehicles for political patronage.**
This procurement approach should be much less susceptible to patronage than the traditional procurement process because of the extensive public consultative process.
- c) **P3 projects cause job loss in the public sector.**
In our survey, there was no evidence of job loss due to the P3 process. However, our survey was limited to infrastructure projects as opposed to other types of P3 projects.

- d) P3 projects cause loss of control over core activities of government.**
There was no indication of loss of control over core activities of government. Government officials consistently stated that the construction and management of these infrastructure projects was a non core activity of government. In fact, by having these non core activities taken care of by others, they were better able to focus on their core activities. However, it should be noted, if ceding of control over core activities may result, greater transparency is needed.
- e) The pursuit of profits in the private sector will interfere with public interests.**
Through the P3 process and the legal agreements, the government is able to ensure that the public interests are protected under the P3 process.

Recommended Principles:

As a result of our study, we make the following recommendations regarding Public Private Partnerships:

- 1) The objectives of employing public private partnerships in the delivery of public services should be broadened and clearly communicated.**

If governments publicly stated their objectives in using the P3 process, this would:

- a) provide government officials from all departments with a common message which would lead to greater commitment and comfort by top government officials,
- b) lead to better communication with the public, the media, the private sector and various interest groups- a single message with a consistent theme.

- 2) Government should develop and communicate a clear protocol for evaluation of projects and services for delivery through public private partnerships.**

These protocols should clearly state: (1) the types of projects and services which are best suited for public private partnership (ie - where the core and non-core aspects can be separated) (2) what are the financial and other considerations; (3) do the projects proposed for P3 meet these clear protocols? (4) Communicate the protocol to all stakeholders - politicians and public sector staff, and the public.

3) P3 projects should have a consistent and transparent process for financial evaluation.

The financial objectives of government should be clearly defined and analysed through financial models:

- a) for those projects that require an evaluation of the off balance sheet criteria, a model should be developed to determine whether a lease satisfies the requirements of an operating lease under the CICA Handbook .
- b) for all projects, value-for-money models should be developed that would evaluate whether the government is obtaining good value for money under the P3 process as opposed to the traditional procurement methods. A clear understanding of the risk being transferred should be included in these models.

4) P3 projects should be extended to other non-core government activities when appropriate.

The concept of seeking the best solutions by combining public sector and private sector skills can lead to better management and delivery of government services. As a society, it is becoming increasingly important to find the best possible means of meeting our common goals. We believe that one of the best means is public private partnerships.

Conclusion:

While the costs of P3 projects are about the same as traditional procurement methods, there are considerable benefits to be seen from P3 projects that can provide better value for these costs: better design and higher quality, higher end user satisfaction through consultative process, more flexibility through leases in meeting government objectives, better operation of non-core activities, better focus on core activities, the ability to get projects done, and the most heard about - the benefit of off-balance sheet financing.

If the objectives of P3 are viewed through these benefits and value, and P3 proposals evaluated with clear and transparent principles, P3 proposals can bring the strengths of both the public and private sectors together to provide benefit and good worth for service to taxpayers. A win-win situation for all.

A complete copy of the Chamber's P3 report is available by calling the Chamber office at 468-7111 or on our website at www.halifaxchamber.com.



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EXECUTIVE SUMMARY

In 1995, the Metropolitan Halifax Chamber of Commerce advocated the use of public-private partnerships (P3) in a letter to the Province of Nova Scotia. Several P3 projects are now up and running. Over the last year, widely divergent points of view, both for and against, have been expressed about P3s. Our committee felt that it was an appropriate time to evaluate the P3 process and to determine whether there are some common guiding principles for this process that could help governments.

Our approach was to focus on the Maritime experience with P3's to add relevance to our task, and to limit our evaluation to infrastructure projects. Our reason for choosing infrastructure projects was that information is more readily available on these projects and good historical data is available for comparative purposes.

We identified a number of infrastructure projects in the Maritimes and evaluated them in terms of what we called the “myths and realities” of the P3 process. The “myths” are the issues that appear to resonate with the public and the “realities” are our attempts to objectively evaluate and, if possible, quantitatively analyse the myths. We narrowed our list of myths to five key issues.

We analysed each project in terms of the five myths. Where possible, we compared the costs of each project to similar projects completed under the traditional method. We interviewed key people in the P3 process to see what their views were, and we researched the P3 literature to ensure we addressed these issues from as many points of view as possible.

Our five myths and the conclusions of our findings are as follows:

- a) **P3 projects cost more than traditional procurement methods.**
From our limited survey, with one exception, it appears that the costs under the P3 process appear to be about the same as the traditional method. Also, it appears that where the costs are significantly higher, the P3 approach is not used.
- b) **P3 projects are vehicles for political patronage.**
This procurement approach should be much less susceptible to patronage than the traditional procurement process because of the extensive public consultative process.

- c) P3 projects cause job loss in the public sector.**
In our survey, there was no evidence of job loss due to the P3 process. However, our survey was limited to infrastructure projects as opposed to other types of P3 projects.
- d) P3 projects cause loss of control over core activities of government.**
There was no indication of loss of control over core activities of government. Government officials consistently stated that the construction and management of these infrastructure projects was a non core activity of government. In fact, by having these non core activities taken care of by others, they were better able to focus on their core activities. However, it should be noted, if ceding of control over core activities may result, greater transparency is needed.
- e) The pursuit of profits in the private sector will interfere with public interests.**
Through the P3 process and the legal agreements, the government is able to ensure that the public interests are protected under the P3 process.

Recommended Principles

As a result of our study, we make the following recommendations regarding Public Private Partnerships:

- 1) The objectives of employing public private partnerships in the delivery of public services should be broadened and clearly communicated.**

If governments publicly stated their objectives in using the P3 process, this would:

- a) provide government officials from all departments with a common message which would lead to greater commitment and comfort by top government officials,
- b) lead to better communication with the public, the media, the private sector and various interest groups- a single message with a consistent theme.

Besides the benefit of off-balance sheet financing, we have seen a number of other P3 benefits : better design and higher quality, higher end user satisfaction through consultative process, more flexibility through leases in meeting government objectives, better operation of non-core activities, better focus on core activities, and finally, the ability to get projects done. If the objectives of P3 are viewed through these benefits, governments will better understand the process and will be able to target government problems that are best solved by combining the strengths of the public sector with those of the private sector.

2) Government should develop and communicate a clear protocol for evaluation of projects and services for delivery through public private partnerships.

These protocols should clearly state: (1) the types of projects and services which are best suited for public private partnership (ie - where the core and non-core aspects can be separated) (2) what are the financial and other considerations; (3) do the projects proposed for P3 meet these clear protocols? (4) Communicate the protocol to all stakeholders - politicians and public sector staff, and the public.

3) P3 projects should have a consistent and transparent process for financial evaluation.

The financial objectives of government should be clearly defined and analysed through financial models:

a) for those projects that require an evaluation of the off balance sheet criteria, a model should be developed to determine whether a lease satisfies the requirements of an operating lease under the CICA Handbook .

b) for all projects, value-for-money models should be developed that would evaluate whether the government is obtaining good value for money under the P3 process as opposed to the traditional procurement methods. A clear understanding of the risk being transferred should be included in these models.

4) P3 projects should be extended to other non-core government activities when appropriate.

The concept of seeking the best solutions by combining public sector and private sector skills can lead to better management and delivery of government services. As a society, it is becoming increasingly important to find the best possible means of meeting our common goals. We believe that one of the best means is public private partnerships.

Introduction

In the 1990s, partnering between governments and the private sector has been heralded as a new approach to “getting government right.” Deficits and debts had forced government officials to look at how they were delivering services. The problem facing governments was how to reduce spending while at the same time maintaining or increasing the level of service expected by the public. Public-private partnering (P3) grew out of the perception that a solution could be found by combining the strengths of the private sector with those of the public sector.

In Canada, the governments of the Maritime provinces have been among the quickest to embrace this concept, probably because of the severity of their financial situations. High profile projects such as the Confederation Bridge and the toll highway in Nova Scotia have come about through the P3 process. The concept has been extended further to new schools, correctional facilities, water treatment plants, sewer treatment plants and hospitals. Services that were traditionally the domain of government such as airport management, waste disposal, etc. are now being run by the private sector. The P3 concept gained such popularity that governments started calling everything they did with the private sector, public/ private partnerships. This seemed to be the way to go for governments. Increasingly, over the last year however, concerns have and are being raised over the P3 process - whether this process costs more than traditional methods, whether job losses will result, whether the quality of the services will deteriorate and so on. Governments are being forced to defend their positions. This year, the rhetoric has reached new heights especially in the media where a variety of differing opinions have been reported.

In 1995, the Metropolitan Halifax Chamber of Commerce took a position that public-private partnering was good for business and good business for government. Now that several P3 projects are up and running, the Chamber felt that this was a good time to evaluate the P3 process and to determine whether there are some common guiding principles for this process that could help governments, the private sector and other interested parties in the future. This paper summarizes the work of a P3 Committee formed earlier this year to analyse the process and to report on its findings. The focus has been primarily on the Maritime Provinces and in particular, the Province of Nova Scotia. More than any other government, the Province of Nova Scotia has adopted the P3 concept.

Definition and Objectives

Public private partnering is a term that has been used for everything from cleaning contracts to large scale design-build-own-operate infrastructure projects. In its simplest terms, it is any activity whereby the private sector meets the needs of the public sector. But it is intended to be more than simply contracting out the needs of government. P3s are intended to bring together the strengths of the private sector (e.g. efficiency, innovation) with the strengths of the public sector (e.g. social responsibility) so that the highest quality service is provided by governments at the lowest possible cost. It is intended that the P3 process develop solutions to business problems facing governments by using an open, cooperative partnership involving complementary skill sets. The perceived benefits are reduced public sector risk, reduced costs, maintenance or increase of services, reduced project implementation time frames, and economic development. The potential risks are loss of government control, increased costs, job loss and public perception.

While the idea of using the P3 process appealed to many governments because of the perception that the benefits would far outweigh the potential risks, most did not define what they hoped to achieve in practical terms from this exercise. The Province of Nova Scotia, having adopted the P3 concept as a method of government procurement more so than any other government in Canada, published a document titled "Transferring Risk in Public/Private Partnerships", which established in further detail what their objectives of the P3 process were; these objectives are defined as follows:

Primary Objective: To enable Nova Scotia tax payers to get better value for their tax dollars by shifting the responsibility for the operations and/or financing of non-core activities to the private sector.

Secondary Objectives:

- a) To increase the efficiency of the public sector by letting it access , in an orderly and disciplined manner, and benefit from private sector expertise with respect to the efficient execution and administration of projects.
- b) To enable the government to live within its means and thus avoid the need for tax increases.
- c) To reduce risk and allow for the better utilization of public sector resources.
- d) To create opportunities for local entrepreneurs to gain experience, and achieve critical mass, in new fields of endeavour, and thus to create new employment opportunities for Nova Scotians by promoting the development of exportable or import-replacing skills within the Province.

Current Status

In the Maritimes, P3 has been used in numerous projects to date including the Confederation Bridge, toll highways, water and wastewater projects, schools, correctional facilities, and long-term health care facilities. Nova Scotia has used the P3 process more extensively than either of the other two provinces. In Prince Edward Island, the government has made a decision not to use this method for the procurement of new schools, although they are looking at P3 as a possibility for the proposed new hospital in Summerside. In Nova Scotia, an additional thirty-one schools are being negotiated with the private sector and the Province is also considering whether to use this process for the development of other new infrastructure projects across the province.

In Nova Scotia, the P3 process for the new schools became a major issue in the March, 1998 provincial election. The Liberal government made the development of new schools via the P3 process one of the main planks of its re-election platform. Many claims and counterclaims were made about the P3 process, most of which seemed to be made with very little substance to back them up. The rhetoric continued into the early summer but appears to have subsided somewhat since that time. What seems to be the problem is that there is no serious evaluation of the pros and cons of the P3 process, which results in widely opposing views on the benefits and risks of the process.

Methodology

In the course of this P3 task, we decided to focus on the key issues surrounding the P3 process and the attendant controversy. Initially, we were going to evaluate the process through the benefits and risks of P3 but decided we would be better able to evaluate P3 through an evaluation system that we called the “myths and realities” of the P3 process. The “myths” are the issues that appear to resonate with the public and the “realities” are our attempts to objectively evaluate and, if possible, quantitatively analyse these myths.

We narrowed our list of myths to five key issues:

- a) P3 projects cost more than traditional procurement methods.
- b) P3 projects are vehicles for political patronage.
- c) P3 projects cause job loss in the public sector.
- d) P3 projects cause loss of control over core activities of government.
- e) The pursuit of profits in the private sector will interfere with public interests.

In our evaluation of these issues, we decided first, that we would focus on the Maritime experience, if possible, to add relevance to our task and second, to look strictly at infrastructure projects rather than all P3 projects in general. Our reason for choosing infrastructure projects was that we felt information would be more readily available on these projects, not only because a number of P3 projects had been completed this way but also because these projects are capable of good historical comparisons.

We identified a number of infrastructure projects in New Brunswick and Nova Scotia on which we decided to focus (we were unable to identify any PEI projects because their government has not used the P3 process yet). We analysed each project in terms of the five myths that we had identified. We compared the costs of these projects to similar projects done under the traditional methods. We interviewed key people in each infrastructure project to see what their views were in regards to these myths. We researched the P3 literature to ensure we addressed these issues from as many points of view as possible.

Having evaluated these myths, we summarized our findings and formed conclusions about the P3 process. Finally, we made some recommendations that we felt that the Chamber could make to government.

Analysis

1. P3 Projects cost more than traditional procurement methods:

The following infrastructure projects were looked at from a cost perspective to see if comparisons could be made between the P3 method and the traditional methods of procurement:

a) Schools:

Nova Scotia:	O'Connell Drive Elementary School
	Hants East Elementary School
	Meadowfields Community School
	Hants East Middle School

Findings: The cost of each of these P3 schools was benchmarked against previous schools that were designed and built by the Province. In each case, the P3 school was below the cost of the comparative school or the average of the comparative schools. It is too early to determine whether operating costs are more or less expensive with the P3 schools.

New Brunswick: Fredericton North High School
 Moncton North High School

Findings: The cost of the P3 Fredericton North High School was lower than the benchmark school that the Province used for comparison while the P3 Moncton North High School was determined to cost significantly more than the benchmark. It is too early to determine whether operating costs are more or less expensive with the P3 schools.

b) Correctional Facilities:

New Brunswick: Miramichi Correctional Facility

Findings: The cost of this P3 correctional facility was less than the benchmark facility that the Province used for comparison. It is too early to determine whether operating costs are more or less expensive than the traditional methods.

c) Water and Wastewater Treatment Plants:

Nova Scotia: Dartmouth Water Treatment Plant
 Halifax-Dartmouth Wastewater Cleanup Project
 Lunenburg Wastewater Treatment Project (cancelled)
 Annapolis County Wastewater Collection and Treatment

Findings: These projects are in various stages of predevelopment and therefore no concrete data exists on the costs comparisons. The Lunenburg Wastewater Treatment Project was cancelled because the municipality was not satisfied with the costs projected by private bidding.

New Brunswick: Moncton Water Treatment Plant
 Moncton Utility Distribution System

Findings: No data is available on these projects.

d) Toll Roads:

Nova Scotia: Highway 104 Western Alignment
Kings County Road Maintenance

Findings: The Highway 104 project required a combination of private and government funding to reach completion. Details of the costs have not been obtained. Kings County investigated the potential for privately provided road maintenance service but deemed private offers not to be cost competitive.

New Brunswick: Highway 114

Findings: No information was obtained on the cost of this project.

e) Fixed Link: This \$840 million project replaced the heavily subsidized ferry service. Cost comparisons are difficult because of the unique nature of the project.

Conclusion: From our limited survey, with one exception, it appears that the costs under the P3 process are about the same as the traditional method. Also, it appears that where the costs are or will be significantly higher, the P3 approach is not used.

In these cost analyses, the focus was on the comparisons of the costs of the infrastructure projects under the traditional versus the P3 methods. In discussions with the people who prepared these comparisons, two points became clear: 1) in all cases, it was difficult to line up costs so that an apples to apples comparison was possible (typically the government benchmark did not take into account the total cost of the project), and 2) comparisons should be based on ranges rather than fixed figures because of the inherent differences in construction costs between two different projects.

A significant difference between the Provinces of Nova Scotia and New Brunswick arose when the methods of determining the costs of a project were analysed. In Nova Scotia, the comparisons are based on the bricks and mortar costs, i.e. what the Province actually paid to have a similar infrastructure project built in the past versus what the P3 partner's bricks and mortar costs are. In New Brunswick, the province's bricks and mortar cost less the present value of the residual value is compared to the present value of the lease payments proposed under the P3 arrangement (this is a more recent method of analysis; with the Miramichi correctional project, New Brunswick previously did their analysis the same as the Province of Nova Scotia). This point is significant because when we say "P3 projects cost more than traditional procurement methods", we are presumably talking about the out-of-pocket costs to the province; in

other words, the lease payments. This is what the province actually pays over the lease term. This method reflects the business school model for analysing lease versus own situations.

This difference between the two provinces reflects the problem that people are having on the cost issue in regard to lease versus own options. Typically, utility and utilization of the infrastructure project do not match the lease term. Therefore comparing an ownership position to a leasing position becomes more difficult and estimates must be made of residual values and/or renewal costs and terms. Using a financial model such as that used in New Brunswick gives the ability to compare on a proper basis the cost of one versus the other.

One other point about cost that was raised by individuals working on these P3 arrangements was the policy in regard to costs being higher under P3 arrangements compared to traditional methods. In New Brunswick, a political decision was made that the cost of any P3 project must be less than what the government would pay to do it itself; if it does not meet this test, it will not be done by P3. In Nova Scotia, the government has taken the position that the P3 cost can be higher than the traditional approach because of the risk transfer; transferring the project risk (developmental, operational, financial, residual) to the private sector justifies paying a premium over what the government would pay if it retained these risks. Through discussions, it appears that the value of this risk transfer and thus, the premium, is difficult to evaluate and quantify for government officials.

In business, expected return on investment is proportional to expected risk on investment.. Therefore, the greater the risk, the greater the return, and vice versa. Because governments are transferring substantial risk to the private sector in the P3 projects, it should expect to pay more than under the traditional method whereby the government retains the risks in-house. When governments are assessing P3 projects in terms of value-for-money, this should be a key parameter in their evaluation.

A further complication of this issue becomes apparent in those infrastructure projects which are leased to governments on a long term basis (in effect, the only source of income for the private sector). From an accounting perspective, governments want these leases to be classified as "operating" leases per the guidelines of the Canadian Institute of Chartered Accountants(CICA) Handbook. These leases are defined as ones in which substantially all of the benefits and risks of ownership remain with the lessor (private sector). In order to meet the guidelines to qualify as an operating lease, the rate of return on the investment over the term of the lease must be substantially less than the rate governments are prepared to pay on their own bonds. The only potential increase in this return on investment for the private sector is if the government renews

the lease at the end of the term or purchases the infrastructure. However, there is no guarantee of either of these options in the lease. At the end of the lease term(typically 20 or 25 years) , the government may walk away from the project, leaving the private sector with a structure that is virtually worthless (e.g. schools, correctional facilities). Obviously, this is a significant risk for the private sector. It begs the question “ why invest in a project that gives a lower return than fixed-income, government bonds while at the same time, assuming all the development and operational risks associated with the project”.

For governments, the classification of these leases as operating leases is seen as critical to the process. The alternative classification, capital lease, would require that the government record the infrastructure project, from an accounting perspective, as if it owned the project. As with any capital projects for governments, these expenditures are expensed in the year incurred, not set up as an asset and depreciated over the useful life like for-profit enterprises. The result is that, if a government builds \$100 million worth of schools in a year, then the surplus/deficit for that year is affected by a similar amount. For the governments of the Maritime provinces that have little or no surpluses, recording expenditures of this magnitude would automatically cause significant deficits. The effects of significant deficits are twofold:

- a) In the nineties, large government deficits are perceived by the public as being the result of poor management by the government in power; as we have seen, these governments do not stay in power.

- b) Large deficits can affect credit ratings. Should the credit rating of a province be lowered, its interest rate cost of new borrowings and rollovers of existing debt will be increased. For a province such as Nova Scotia with more than \$8 billion of debt, substantial savings can be achieved by maintaining or bettering its credit rating.

Therefore, for governments, it has become absolutely critical that these leases be classified as operating leases. In fact, for the infrastructure projects in which governments enter into a long-term leases, it appears this off-balance sheet requirement has become virtually the sole criterion on which the P3 arrangement is evaluated.

2. P3 projects are vehicles for political patronage.

In this section, we have attempted to compare the traditional procurement methods (e.g. sole sourcing, public tender process) versus the P3 approach.

In the traditional approaches, once the decision had been made to go ahead with an

infrastructure project, contracts would be put in place for the various components of the work (e.g. architectural, engineering, construction,etc.) by either a sole source process or by a public tender process. In the sole source process, one individual or company is selected and contracted without competitive bids. In the public tender process, a tender document detailing the requirements is issued to the public and bids are submitted, evaluated and awards made to the successful bidder. For both the sole sourcing and the public tender processes, recommendations are made at the bureaucratic level to cabinet for approval. Once cabinet approves the choice, the award is made.

Similarly with the P3 process, final approval is made at the cabinet level. However, the process prior to the cabinet level is much different than traditional procurement methods. Typically, the P3 process involves a two or three stage selection process, in which a number of different interest groups have input into the final decision. For instance, with the P3 schools in Nova Scotia, there has been a two step process in which the first step was basically a qualification stage and the second step required a full proposal response. The evaluation committee for these school proposals was comprised of 15 individuals from various interest groups including the Departments of Education, Finance, and Transportation and Public Works plus members of the School Board of the district in which the school is to be built. By the time the successful proponent has been selected by this group and submitted for approval by cabinet, the selection was virtually final. Any politician trying to overcome the decision of such a diverse group would take an enormous risk in terms of his/her political career. Indeed, it is quite possible that the decision could not be overturned.

It appears that there are two factors that make it difficult for political patronage to influence the P3 process compared to the traditional methods:

- a) the process is much more open and transparent than the traditional method not only because of the number of different groups involved but also because of the staging, which requires open disclosure and time for public input.
- b) the traditional processes were controlled much more by one department in government (typically, Transportation and Public Works), which narrows the opposition to political interference.

In discussions with government officials involved in the P3 process in New Brunswick and Nova Scotia, the position was the same. There is less political patronage than under the traditional procurement methods. In New Brunswick, the comment was that the process is so financially driven that it would be almost impossible to have political patronage while in Nova Scotia, a comment was made that politicians now complain that they no longer have any say in the decision-making but end up taking the heat if the project gets into trouble. Also, it was felt that the political climate is such today that politicians think twice before handing out political patronage; in fact, the politicians feel

more secure in their positions when announcing awards to successful proponents because of the amount of public input.

One other issue involving patronage and P3 is whether the politicians could influence where a project is located and when it is done (for instance, a new school or hospital being built in a government member's riding rather than a riding of the opposition parties). It was felt that this would still be possible on a single project basis but in a P3 process such as the schools in Nova Scotia it would be virtually impossible.

Finally, in the Maritime provinces, the perception of political patronage affecting all government activities is hard to change. So too, it is with the P3 process. Poor communication with the public may be the reason for this.

Conclusion: This procurement approach should be much less susceptible to patronage than the traditional procurement process because of the extensive public consultative process.

3. P3 projects cause job loss in the public sector.

Both proponents and opponents of P3 approaches often believe that privatization will result in job losses. Advocates frequently suppose that public organizations are overstaffed. One of the major reasons for proposing the P3 approach in their minds is to trim this fat and the attendant costs. Opponents, seeing this enthusiasm, assume that the primary objective of privatization is to undermine unions and eliminate surplus jobs. They tend to argue that this can only be achieved by reducing levels of service and/or putting undue pressure on employees.

The potency of this issue is demonstrated by the complete absence of any discussion of staffing in various inventories of P3 projects consulted by the team. These lists, many of which include detailed supporting descriptions, are produced by organizations disposed to P3 arrangements. They presumably understand the sensitivity of job impacts and avoid the subject.

Whether there are real job impacts is uncertain. Certainly, privatization allows new employer-employee relationships. Inasmuch as unions are an important feature of most public sector work environments, privatization may well reduce unionization. On the other hand, at least some P3 arrangements introduce new classes of work. Most obvious is toll roads, which require collection staff who are unnecessary on typical, "free" roadways. There is also, frequently, a need to have administrative staff to liaise with public partners.

These increased employment requirements are usually minor, however. More

significant is the role of public-private partnerships in leveraging infrastructure investment from both government and industry. In jurisdictions where governments are wrestling with public debt, P3 arrangements have provided the means to finance projects that probably would not have proceeded otherwise. Before the introduction of public-private partnerships for school construction, approval of new school buildings proceeded very slowly in Nova Scotia. Likewise, it seems improbable that Highway 104 could have been built as quickly as it was without private financing and toll revenue.

Every P3 project that has had this effect creates jobs, both short-term construction employment and long-term employment in operations and maintenance, and administration. Furthermore, the effect of these expenditures is felt throughout the provincial economy as payments to workers and respend on household goods and services, and further business investment. These multiplied expenditures also rebound to government through taxes on income and expenditures. In this way P3 initiatives have stimulated the economy and created jobs with far less impact on the public treasury than with traditional approaches.

We acknowledge, of course, that greater flexibility in hiring and reducing staff in private organizations will allow them to adjust staffing levels. To maximize net revenue, businesses obviously attempt to reduce payroll costs. Within the context of legal requirements and other business priorities (e.g. worker morale, public image), they do this by keeping salaries as low as the market will allow and by varying staff numbers in response to workload. Governments can do the same but evidence suggests that it is not as easy for them.

An important consideration, in any case, is the meaning of a “job.” To a considerable extent political discourse over the past 50 years has classified jobs as a commodity. Jobs are “saved” or “lost”, with the underlying belief that the retention of each existing job is a significant social benefit.

It could not be farther from the truth. Jobs are not an output. With land and capital they are one of the three basic inputs to every production process. It is the objective of every manager interested in efficient production -- whether they are in the public or the private sector -- to reduce all of these inputs. To do otherwise wastes resources.

The use of too many people to produce a service or product displaces resources that could be applied to beneficial purposes. It usually also increases the use of the other inputs such as land and energy resources. This has environmental consequences.

An efficient economy providing maximum production to meet societal needs and wants, cannot sustain superfluous employees in redundant positions. Opponents of job reductions will, of course, counter that the positions sacrificed will lower the quantity or

quality of output. They contend that many government functions do not result in discrete outputs like industrial processes. Much public sector output is services that are difficult to measure. It is, for example, difficult to assess the quality of an education or the efficacy of police protection.

There are two responses to this position. First, the public services most typically privatized are those most easily sold and, therefore, most easily quantified. These include water and sewer systems, roadways, transit services, and recreation facilities. Although the privatization of schools is currently in the forefront, it is not education that is being turned over to business but the construction and operation of school buildings. If education itself is privatized the second argument comes into play. It is, in fact, realistic to quantify, compare, and track performance. In education standardized testing in schools and evaluation of graduate performance at higher levels and in the job market are possible. These statistics are already kept and provide realistic measures of performance quality. For this reason benchmarking is a very important component of all P3 programs.

Provided that benchmarking indicated that the quality of goods and services produced by private providers is at least equal to that supplied by government, the issue of jobs is irrelevant. If the private sector can supply goods and services with fewer people, it is a benefit to the taxpayer and society as a whole. It is furthermore, arguably, a benefit to workers themselves. The morale of employees who perform meaningless tasks suffers. Employees laid off with equitable settlements often find productive, rewarding careers in entirely new endeavours, as former civil servants have demonstrated in the burgeoning Ottawa-based computer industry.

Conclusion: In our survey, there was no evidence of job loss due to the P3 process. However, our survey was limited to infrastructure projects as opposed to service or processing P3 projects.

4. P3 projects cause loss of control over core activities of government.

Discussions with various government officials involved with the P3 process resulted in a common response: that ownership and management of real estate is not a core activity of government and that partnering with private sector companies whose sole activity is real estate allows governments to focus on their core activities (e.g. education, health care, etc.) without the distraction of having to manage real estate issues. Therefore, the P3 process is seen as a means of gaining greater control and providing better services in their core activities.

In addition, lease arrangements and other documentation under the P3 process were seen as providing the following added benefits:

- a) flexibility in regards to planning for infrastructure; there is potential for expansion and downsizing in the lease; as well, should governments decide they no longer need the infrastructure at the end of the lease term, they can walk away with no residual risk.
- b) capital and operational risks are removed in the lease arrangement; pricing can be locked in for the term of the lease. This is important in organizations where expenditures drive the budgetary process and revenue requirements (i.e. taxes).
- c) an ability to get things done in the P3 process and lease arrangements that they may not be able to do if they owned or attempted to own the infrastructure themselves; because of the budgetary process in government and the debt load that governments now carry, it often becomes impossible to obtain approval for a large infrastructure project (would the \$840 million Confederation Bridge have become a reality if governments had undertaken the project in the traditional manner?). Also, when government owns a project internally, it is quite often very difficult to get even the simplest tasks done because of the time consuming and unwieldy approval process. By having a lease arrangement in place, it becomes much more convenient and timely to have the landlord look after the task.
- d) as these infrastructure projects are not core activities of government, most felt that the government is better served by having an organization whose sole focus is the particular activity (e.g. real estate, bridges, highways, etc.) looking after these non-core activities. Better management would result because these infrastructure projects would no longer be subject to the fiscal constraints of government (e.g. government- wide cutbacks, hiring freezes).

Related to the last benefit is the fact that the projects being produced by P3s are better designed and better quality than with the traditional route. For example, the O'Connell Elementary School in Porter's Lake has been widely acclaimed as one of the premier schools of its type in North America. It has won awards for design, technology and partnership process. As a result, there is a very high degree of end user satisfaction. And this has all been done at less cost than the Province's benchmark school. Client satisfaction is a key to success in the private sector and, as we are seeing, is becoming a key benefit in the P3 process.

A practical issue that arose in discussions is how does government ensure that the private sector meets the standards required for bridges, schools, wastewater plants or correctional facilities. It was felt that control was retained through the approval process and the legal documentation required by the P3 process. Ultimately, through these documents, the government has the ability to enforce certain standards during the development phase and restrict the private sector partner from abusing the use of the infrastructure project during the operational phase. For instance, in the lease

agreements for the schools both in New Brunswick and Nova Scotia, not only is the tenant (the government) entitled to quiet enjoyment of the space but also has the specific authority (and veto power) over any activity in the school.

Finally, leasing rather than owning is a very common business activity. If one looks at major corporations across the country, most of their real estate needs are met through leasing. They do this for a reason - real estate is not their core business. Similarly with governments, real estate is not their core business. In fact, governments lease significant amounts of their real estate needs at present. To extend this to schools, highways, correctional facilities requires no great leap of faith. However, as with any change, it takes awhile for people to adapt to the idea.

Conclusion: There was no indication of loss of control over core activities of government. Government officials consistently stated that the construction and management of these infrastructure projects was a non core activity of government. In fact, by having these non core activities taken care of by others, they were better able to focus on their core activities. However, it should be noted, if ceding of control over core activities may result, greater transparency is needed.

5. The pursuit of profits in the private sector will interfere with public interests.

The concern here is that the private sector will cut corners to make a profit or somehow use the P3 in a way that will run contrary to the public interest. In discussions with government officials, the following points emerged:

- a) during construction of the infrastructure project, quality control is assured through independent review and a requirement of adherence to standards set by government. The contract between the private sector and the government typically details the specifications, standards and guidelines under which the project is to be developed. Non-compliance by the private sector can terminate the contract. One additional safeguard that was mentioned was that the government prefers to have the contractor be the same entity as the owner; this gives the added assurance that long term quality is not compromised by short term cost cutting.
- b) during the operational phase of the P3, it was felt that legal agreements and penalty clauses would prevent the private sector from downgrading the service or any other activity that may be detrimental to the public interest. Typically, governments have the right to step in should the private sector not fulfill its obligations under the contract.

From a larger perspective, as a community, we have developed and sustained the concept of the mixed economy, a situation where the private sector and public sector operate side by side. The public sector is at a point where it cannot replace or create new infrastructure within their existing budgets. Increasing taxes is no longer an acceptable method of dealing with this situation. P3s are seen as a means of helping to solve this problem. By forming a partnership with the private sector, it is envisioned that the innovation and efficiency of the private sector will lead to a manageable solution.

The private sector is motivated by the profit objective. This objective drives the private sector to be more efficient and more creative in its operations. Competition with other business forces this process. Typically, the level of expected profit reflects the level of risk being taken in a project or operation. The P3 projects with government typically transfer differing amounts of risk; these risks are ownership risk, operational risk, financial risk, residual risk, etc. For the private sector to assume these risks, governments must be prepared to pay a premium over their cost to the private sector. To ensure that the level of premium is fair to both parties, these projects are usually tendered whereby the low price is a significant factor in the evaluation. Therefore, profit is a necessary, and positive, component of the P3 process. It drives the process and the process controls the profit.

Conclusion: Through the P3 process and various legal agreements, the government is able to ensure that the public interests are protected under the P3 process.

Recommended Principles:

As a result of our study, we make the following recommendations regarding Public Private Partnerships:

1) The objectives of employing public private partnerships in the delivery of public services should be broadened and clearly communicated.

If governments publicly stated their objectives in using the P3 process, this would:

- a) provide government officials from all departments with a common message which would lead to greater commitment and comfort by top government officials,
- b) lead to better communication with the public, the media, the private sector and various interest groups - a single message with a consistent theme.

Besides the benefit of off-balance sheet financing, we have seen a number of other P3 benefits : better design and higher quality, higher end user satisfaction

through consultative process, more flexibility through leases in meeting government objectives, better operation of non-core activities, better focus on core activities, and finally, the ability to get projects done. If the objectives of P3 are viewed through these benefits, governments will better understand the process and will be able to target government problems that are best solved by combining the strengths of the public sector with those of the private sector.

2) Government should develop and communicate a clear protocol for evaluation of projects and services for delivery through public private partnerships.

These protocols should clearly state: (1) the types of projects and services which are best suited for public private partnership (ie - where the core and non-core aspects can be separated) (2) what are the financial and other considerations; (3) do the projects proposed for P3 meet these clear protocols? (4) Communicate the protocol to all stakeholders - politicians and public sector staff, and the public.

3) P3 projects should have a consistent and transparent process for financial evaluation.

The financial objectives of government should be clearly defined and analysed through financial models:

- a) for those projects that require an evaluation of the off balance sheet criteria, a model should be developed to determine whether a lease satisfies the requirements of an operating lease under the CICA Handbook .
- b) for all projects, value-for-money models should be developed that would evaluate whether the government is obtaining good value for money under the P3 process as opposed to the traditional procurement methods. A clear understanding of the risk being transferred should be included in these models.

4) P3 projects should be extended to other non-core government activities when appropriate.

The concept of seeking the best solutions by combining public sector and private sector skills can lead to better management and delivery of government services. As a society, it is becoming increasingly important to find the best possible means of meeting our common goals. We believe that one of the best means is public private partnerships.

The P3 Task Force is a subcommittee of the
Government Affairs Committee
Chair - Peter Doig
Chamber Staff Liaison - Nancy Conrad

P3 Subcommittee Members

John Heseltine
Michael Eakin
John Sao Miguel
Joseph Strolz
Michael MacCormick, Chair

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