Concept Symposium 2016
Governing the Front-End of Major Projects

The impact of government failure on the selection and implementation of privately financed infrastructure projects.

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Theoretical research on public–private partnerships has emphasised their ability to address well-understood agency problems in the delivery of public infrastructure projects. Despite this, there is a substantial body of empirical research which documents the tendency of such projects, across multiple jurisdictions, to generate budgetary problems for the government authorities involved and/or affordability problems for service users. This paper seeks to explore how and why these problems occur. It shows how features of the project finance approach, when underpinned by regularly deployed forms of state guarantee, can encourage and facilitate strategic behaviour by government employees during economic appraisals, and draws on documented examples to explore how this: (i) undermines the quality of investment decisions, such that projects are approved that compromise the ability of governments to meet other socially valuable objectives; and (ii) gives rise to contractual structures that clearly fail to minimise the long-run costs to the government and/or service users. The paper suggests that economic appraisal processes need to be strengthened to take account of these issues.

Taking the fast road to perdition?

Government failure and the selection and implementation of public private partnerships

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background

- Theoretical research on public–private partnerships: highlights the model's ability to address well-known incentive problems in the delivery of public infrastructure

- And yet…a considerable body of empirical research has documented a tendency for such projects to generate **affordability problems** over the contractual period

There are, especially, well-documented problems in terms of:

investment decisions: projects are approved that threaten household finances and/or the ability of government to pay while meeting social objectives

- Such phenomena imply errors or strategic behaviour by decision-makers. Why?

affordability

"[There is a] need for the government and regulators to understand and manage the impact of infrastructure investment…including when the costs are not directly visible because they are not funded through the public finances."

National Audit Office, 13 November 2013

- No formal definition:

  - …for households: Can a household buy a pre-defined quantity of the good and be able to meet its other socially-defined minimum needs?

  - …for governments: Can a government buy a pre-defined quantity of the good and be able to meet its other socially-defined obligations?

a tale of two hospitals

(1) Peterborough and Stamford Hospitals Trust, United Kingdom

£441m	Capital cost of the scheme, including financing costs
194%	Capital cost of the scheme as proportion of turnover
22%	The size of the Trust's deficit in first year of operation
10 months	Period from onset of operation to breach of authorisation

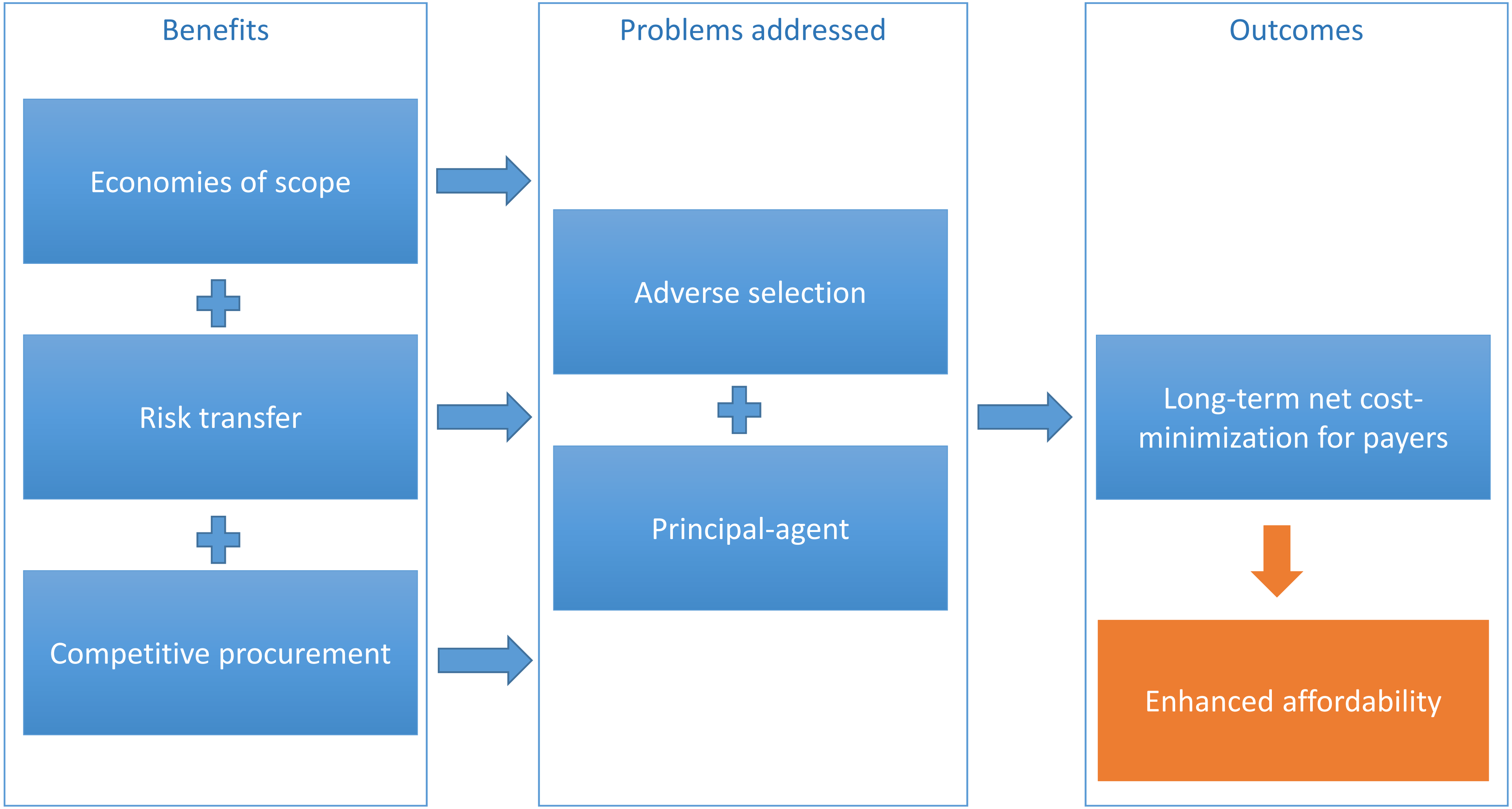
Source: National Audit Office, 2013

(2) The Queen 'Mamohato Memorial Hospital, Maseru, Lesotho

$104m	Capital cost of the scheme, including financing costs
$38.4m	Total unitary charge + other payments in 2011/12
41.2%	Proportion of MoH budget allocated to PPP in 2011/12
15 months	Period from onset of operation to 1st default on debt

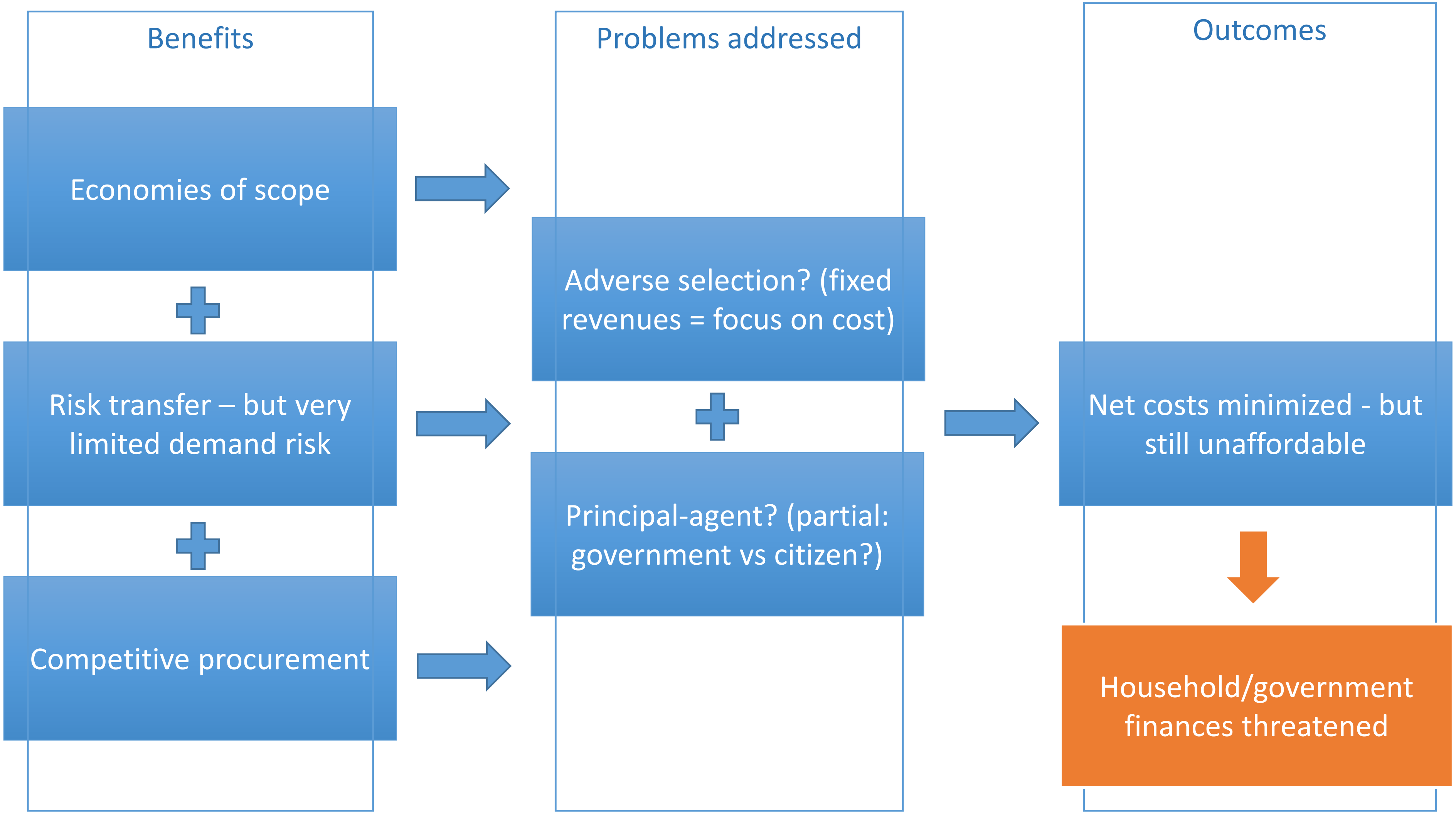
Source: Hellowell, 2013

a puzzle



Benefits
Economies of scope
Risk transfer
Competitive procurement
Problems addressed
Adverse selection
Principal-agent
Outcomes
Long-term net cost-minimization for payers
Enhanced affordability

an explanation



Softening budget constraints

- Budget constraints may be perceived by governments and regulators as *soft* - indeed, softer than is the case for most areas of their responsibilities:

  - assets can be bought now – gaining support from users or interest groups - without immediately raising taxes or borrowing (or reducing spending)

  - costs are deferred to future electoral cycles, and are borne by future politicians, users and voters - such costs are likely to be heavily discounted

  - in some cases, the discretionary proportion of the government's budget may be reduced, making it hard to attain social goals/ allocative efficiency

policy implications

- Governments and regulators need to better understand and manage the impact of infrastructure investment on households and their own agencies

- The need for change is *more, not less acute* where infrastructure costs are financed outside of the public budgets – and are therefore harder to trace

- Poor outcomes are/are likely to be a marked feature of infrastructure financing programmes where public scrutiny/accountability is inadequate

- Advocates of private financing need to consider how institutions of scrutiny/accountability may be strengthened to help mitigate the problem