The Challenge for Public-Private Financing of Transport: Aligning Benefits, Costs and Sustainability

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Value creation and privatisation

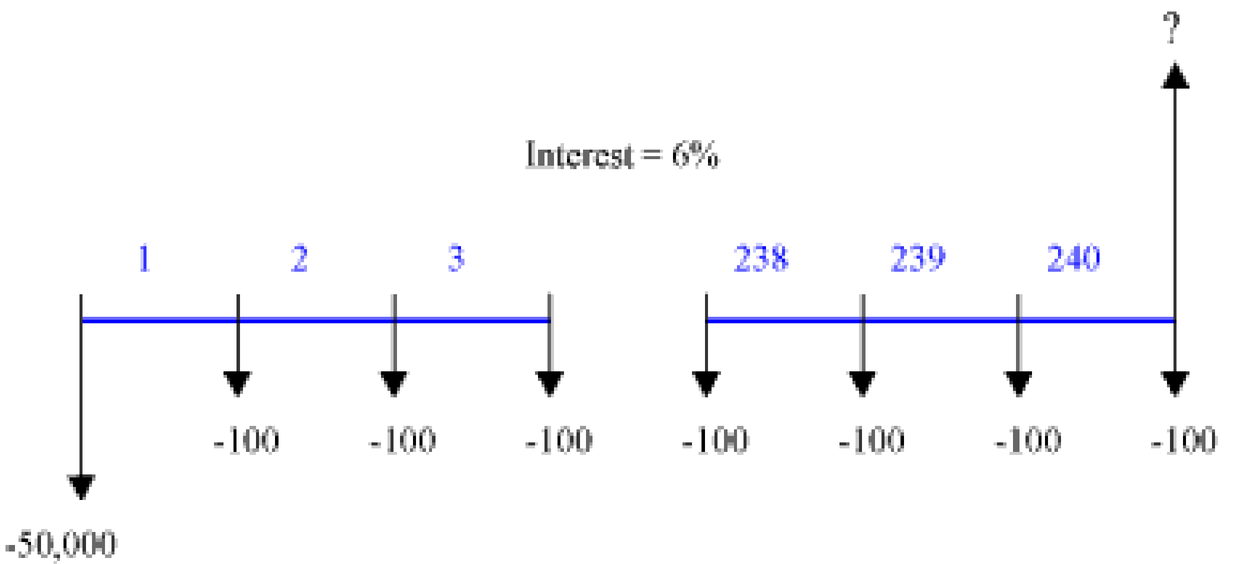
The main, perhaps primary, justification for PPP’s is that they create value that public ownership is often unable to tap into. Value comes in forms such as:

- delivery of projects on time and on budget;
- Reduced procurement costs;
- Improved project management;
- construction innovation and new technologies;
- Improved service outcomes.

Private value: free cash flow

- Value for private business entities is generally said to be based on the notion that the free cash flows generated by a business are capitalized into a single figure for the value of the underlying commercial activity as a going concern.
- These cash flows are either distributed to the owners of the enterprise or plowed back into the business so as to generate more retained earnings, and serve as the basis of creating new wealth through privatisation.

Valuing an infrastructure asset

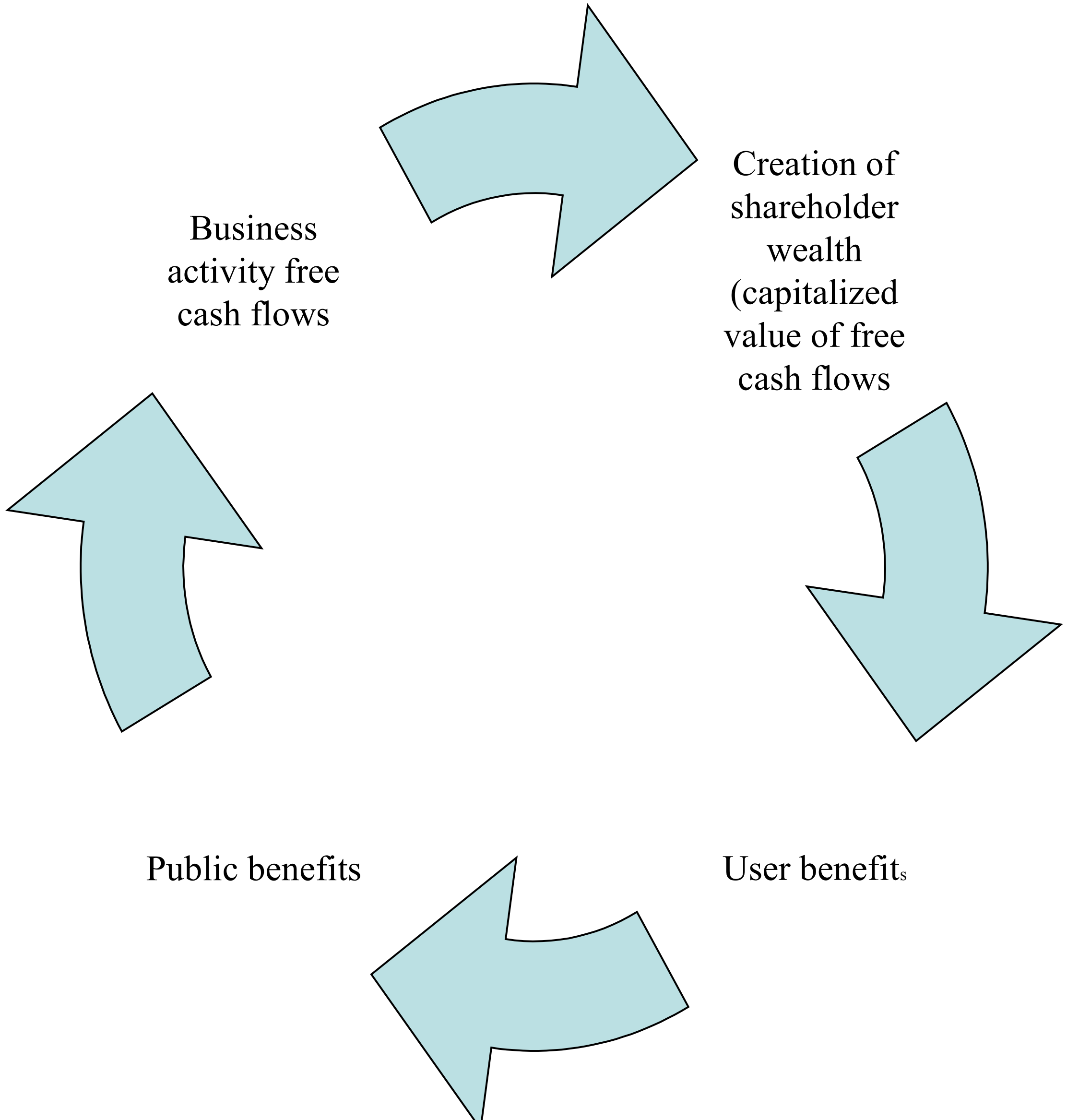


- With any infrastructure asset the key aspect is to break down all the potential cash flows that asset might generate.
- Assets with monopoly positions with a good operating history, steady traffic and growth potential are attractive to investors: they promise good cash flow.

Public value: user benefit and associated policy goals

- Of course the public sector will tend to look at user benefit more broadly.
- User equity, at least in some cases, may be equal in importance to efficiency.
- Service provision may be valued above cost-recovery.
- And external costs, such as environmental cost, may be very important. Sustainability of outcomes, both practically and environmentally, is paramount.

The ideal: A Public-Private Value Chain



Breaking the chain

- While this model is conceptually fairly simple, in practice there can be trouble.
- Private investors need to ask questions about how cash flows and income are measured to ensure they will get maximum returns for appropriate risk.
- But the public owners of the asset need to balance maximisation of shareholder value with maximum user value and value for the overall public.
- In effect it is possible for links in the chain to be ‘broken.’
- If this occurs, the privatisation may not deliver the desired or promised outcomes to shareholders, users, the general public or all three in the worst case scenario.

- To avoid 'breaks' a systematic and formal evaluation framework is needed to continually assess how well public-private contracts and arrangements are serving to achieve expected goals.
- Such a framework can serve three objectives: (1) to assure that projects will be effectively designed, (2) with resulting services that will be efficiently implemented, (3) providing reasonable benefit or return to all intended parties. This third purpose refers to the creation of benefit in the value chain.

Performance Measures Associated with the Objectives for Key Groups

	(1) **Project Design and Operation**	(2) **Service Provided and Obtained**	(3) **Benefit or Impact Value**
Private Business and its investors	***Financial Performance:*** investment, revenue, ongoing cost, cash flow	***Service Provided:*** construction, management, operation, maintenance and/or administration	***Net Revenue:*** return on investment

Users	***Service Design:*** areas served, types of transport served, capacity, service features and fee structure	***Service Obtained:*** speed or travel time, fare or fee, service frequency, comfort, safety, security, reliability	***User Benefit:*** value of time, cost and productivity savings; increased mobility and access (to jobs, schools, shopping, health care); freight access (to markets, labor, materials)
Public (including government)	***Government Finances:*** tax revenues, fees collected, expenses debts, asset ownership (land & infrastructure), in-kind contributions	***Change in Requirements:*** Burden or relief of expected public infrastructure investment, government workforce, and provision of government services	***Sustainable Economic Development Impact:*** business activity, productivity, income creation, employment ***Sustainable Quality of Life:*** environment, community, safety

Nonfinancial considerations

- Even with a 'good' PPP value chain, the public operator needs to consider the timing of project cash flows (e.g. whether to have a lump-sum front transfer payment or to retain direct control of an asset with an annuity stream of income).
- Other policy considerations include equity, environmental impacts and overall system performance, which single deals may not cover.
- Finally, private monopoly providers generally do not provide superior low-cost service (though there may be instances where movement from a public monopoly to a private monopoly does result in improvements to users). With monopoly, rate and other regulation should be considered.

- Finally, it must be recognized that PPPs are not a cure-all for transportation infrastructure or policy challenges.
- They are seen as promising not because the private sector is inherently more competent or efficient than government, but because each has distinct strengths, and projects can be managed more effectively if the strengths of each can collaborate at the table.
- Indeed, successful PPPs – like successful transportation investments of any kind – *require* an engaged and strong public sector.