Inter-Sectoral Differences in the Procurement of PPPs in Ireland: Perspectives from Institutional Economics

Gerald O’Nolan and Eoin Reeves

Department of Economics

University of Limerick

email: eoin.reeves@ul.ie
Tel: +353 61 202401

Proposal for paper to Symposium on “Neither Public nor Private: Mixed Forms of Service Delivery around the Globe” Universtitat de Barcelona, May 2012.
Inter-Sectoral Differences in Procuring PPPs: Perspectives from Institutional Economics

1. Introduction

It is now over twelve years since a programme of public private partnerships (PPP) was introduced in Ireland. Since 1999 the PPP model of procurement has been either nominated or adopted for the purpose of delivering physical infrastructure and related public services in a range of economic sectors. As a consequence, the reach of the private sector in terms of its input into public service delivery has been greatly extended. This is particularly true in areas such as water services, school buildings management, roads and waste management.

The implementation of Ireland’s PPP programme has, however, encountered difficulties and there is evidence of inter-sectoral differences in terms of the extent to which procurement under PPP has been progressed. For example, in the roads sector, nine major PPP projects have gone through the procurement process and assets are in operation. However, in the health sector PPP projects have been initiated but have failed to progress (e.g. The National Plan for Radiation Oncology and the Co-located Hospitals). This paper focuses on these inter-sectoral differences. It looks at the adoption of PPP as an institutional change and it proposes to examine the inter-sectoral differences observed with the aid of perspectives from institutional economics. Specifically it seeks to answer the following questions:

- What is the nature and direction of the PPP procurement in the roads and health sectors?
- What are the key factors motivating these institutional changes in both sectors?
- What institutional factors explain the different experiences in the health and roads sectors?

The framework for analysis is based on a stylized schema adapted from Williamson (1993) and Eggertsson (1996) which depicts institutional change as originating from the dynamics of interactions between (a) the institutional environment, (b) institutional arrangements of governance structure (the combination of economic and political organisations), and (c) individual decision makers. Data is drawn from the extant literature on the PPP experience in
Ireland and semi-structured interviews with key players (politicians, government officials, private sector operators).

The paper is organized as follows. Section 2 provides details of Ireland’s PPP programme to date. Section 3 presents the theoretical framework for institutional change which is based on a three-layer schema that draws from aspects of new institutional economics, including transaction cost economics, embeddedness and path dependency. Sections 4 and 5 present the details of two case studies of PPP procurement in Ireland: roads and hospital co-location. In section 6 we analyse both cases in terms of our theoretical framework. Section 7 presents our conclusions.

2. Public Private Partnerships in Ireland

Over the last thirteen years, Ireland has followed the global trend towards PPPs for the provision of infrastructure and asset-backed services. The period of unprecedented growth in the Irish economy that commenced in the early 1990s placed heavy demands on the country’s underdeveloped infrastructure. As a consequence, successive governments sought to cooperate with the private sector in order to provide vital infrastructure and related services.

After the announcement of a small number of pilot projects in 1999, the PPP programme expanded rapidly in terms of the number of projects earmarked for procurement under the PPP model. Although reliable comparable data is difficult to source, Deloitte (2007) and the Irish Business Employers Council (2009) have both published reports that claim Ireland is a world leader in terms of PPP activity. Such claims are made on the basis of data made available by the Department of Finance, which in May 2010 (the last official update) indicated that there were 101 PPP projects at different stages of the procurement and project life-cycle. Table 1 shows that PPP is being adopted in areas including inter alia road and rail transport; waste management (including incineration); education (school and university buildings); health (a national radiotherapy network); social and affordable housing and courts facilities.

While the scale of PPP investment has been ambitious it can be noted that progress up to mid-2010 was slow with just fifteen projects (outside the water and wastewater sector) in operation. Since then the pace of procurement under PPP has further slowed in the face of
the global financial crisis and ‘credit crunch’. Due to constraints in the availability of private finance, as well, as increases in the cost of private sector borrowing a number of PPP projects have been put on hold (and effectively abandoned). These include high profile projects such as the planned Metro from Dublin city centre to the airport and a number of PPPs in the social housing and university sector.

Table 1: PPP Projects in Ireland.

<table>
<thead>
<tr>
<th></th>
<th>Pre-Tender</th>
<th>Procurement</th>
<th>Construction</th>
<th>Operation</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Roads</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>9</td>
<td>9</td>
</tr>
<tr>
<td>Rail</td>
<td>3</td>
<td>1</td>
<td>0</td>
<td>0</td>
<td>4</td>
</tr>
<tr>
<td>Waste Management</td>
<td>1</td>
<td>1</td>
<td>0</td>
<td>0</td>
<td>2</td>
</tr>
<tr>
<td>Courts</td>
<td>1</td>
<td>0</td>
<td>1</td>
<td>0</td>
<td>2</td>
</tr>
<tr>
<td>Education</td>
<td>4</td>
<td>0</td>
<td>1</td>
<td>4</td>
<td>9</td>
</tr>
<tr>
<td>Health</td>
<td>1</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>Arts</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>0</td>
<td>3</td>
</tr>
<tr>
<td>Prisons</td>
<td>2</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>2</td>
</tr>
<tr>
<td>Housing</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Harbour Re-Development</td>
<td>1</td>
<td>0</td>
<td>1</td>
<td>0</td>
<td>2</td>
</tr>
<tr>
<td>Water</td>
<td>-</td>
<td>8</td>
<td>1</td>
<td>2</td>
<td>11</td>
</tr>
<tr>
<td>Wastewater</td>
<td>-</td>
<td>16</td>
<td>15</td>
<td>24</td>
<td>55</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>14</strong></td>
<td><strong>27</strong></td>
<td><strong>20</strong></td>
<td><strong>40</strong></td>
<td><strong>101</strong></td>
</tr>
</tbody>
</table>

Notes: (1) Data derived from the PPP website housed by the Department of Finance and updated in March 2010 (2) Data for water and wastewater provided by the Department of the Environment, Community and Local Government in November 2011 (3) Data for roads projects provided by the National Roads Authority in April 2012 (4) Pre-tender projects are at various stages of the appraisal procedures for investment under PPP.

Notwithstanding these setbacks the scale of Ireland’s PPP programme has been extensive. Although independent and reliable analysis of the PPP experience has been scarce there is evidence to suggest that the procurement of PPP projects has been smoother in some sectors (e.g. roads, schools, courts services) compared to others (e.g. health and social housing). This raises questions about the factors that determine the successful procurement or otherwise
of PPP projects. To examine these questions we adopt an institutional perspective which draws on the concepts of transaction costs (Williamson, 1975), property rights (Eggertsson 1996) and risk but are constrained by issues of embeddedness, path dependency and asset specificity.

3. Institutions and Institutional Change

The objective of this paper is to enrich our understanding of the factors that determine whether the implementation of the PPP model of procurement is successful or otherwise in terms of bringing projects through the procurement cycle and to the point where assets are built and in operation. We purposefully choose two cases, roads and hospitals, with contrasting experiences in terms of progressing procurement. Our starting point is to consider the introduction of PPP as an institutional change and we ask whether the success or otherwise depends on the level of institutional change and the distribution of risk. We look at different strands of what constitutes New Institutional Economics (NIE) to see where they are applicable to the cases we examine.

What is an institution and why does it change?
North (1991, p.1) gives us a simple definition: ‘Institutions are the humanly devised constraints that structure political, economic and social interaction’. The constraints can be formal or informal. Informal constraints are constantly changing as society develops. Formal constraints i.e. the institutional environment, are contained in laws and property rights. Changes in formal constraints are effected by deliberate acts sometimes prompted by substantial movement in informal constraints over time. Institutions exist and function where the actors involved follow the rules and are positively served by it. Institutional change can be prompted by the necessary and unavoidable interaction between political organizations and economic organizations. Both sets of organizations impact on each other. Individuals who are part of these organizations may drive change when they see a potential for an improvement in the position of their domain. Cultural change, as a necessary prerequisite for institutional change, may seep from one jurisdiction to another, particularly where there is an existing degree of common culture such as in the English speaking countries. Institutional change demanded by individual actors may be motivated by the belief that their interest is no
longer being fully served by the existing position, or because new ideas or new technology has presented a vision of a superior situation. These actors may become institutional entrepreneurs where they seek to adopt ideas from other cultures and other sectors and apply them to improve their sector (Groenewegen and De Jong 2008). Change originates from the interaction of the institutional environment, the political and economic organizations and their governance structure, and individuals. These three elements are described in the Three Layer Schema.

**Three Layer Schema**

Institutional economics is concerned with the way in which economic activity is organized. Coase (1937) posed this question and argued that the minimization of transaction costs was fundamental. In turn, transaction cost economics (TCE) is concerned with the governance of contracts (Williamson 1993). Saleth and Dinar’s (2004) Three Layer Schema (see Figure 1) is a synthesis of Williamson’s schema together with elements from Eggertsson (1996). It puts governance as the object of analysis but it does not exist in isolation. The effectiveness of governance depends on the institutional environment represented as a macro feature and the individual as the micro feature. The institutional environment defines the rules of the game and is the focus of change. This is where shift parameters, or changes in this environment change the cost of governance. Some shifts may originate with the underlying assumptions of the individuals whose behaviour feeds into governance and affects the cost of governance.

The main effects of the schema are shown by the solid arrows. Changes to the environment or the thinking of the individuals may lead to changed transaction costs. Changes in these areas are influenced by the development of technology. Feedback effects are shown by dashed arrows. These are refinements to the main causal relations depicted by the solid arrows. Strategic feedback from governance to the institutional environment may include changes in laws which improve contracting or uphold property rights and could also involve changes in government regulation which affects the course of trade. Feedback from governance to the individual or ‘endogenous preferences’ refers to advertising or education in its various forms which affect the formation of an individual’s behavioural assumptions. These endogenous preferences can also be a product of the environment in which the individual lives and so that environment feeds back to the individual. The dynamic interaction between the three parts gives rise to institutional change. Recognition must also be made of the embeddedness of social and cultural impacts on economic activity when considering the schema. It shows the
New Institutional Economics and Transaction Cost Economics Framework

Institutions exist to reduce the uncertainty in trade and exchange which keeps transaction costs to the minimum. Institutional change is indicated when the perceived benefits exceed the costs involved. A broad view may be taken of what constitutes a benefit and a cost. Transaction costs may be defined in the narrow strict financial costs of doing business such as taxes or transportation costs. This has been defined as the ‘neoclassical’ approach to transaction costs (Allen 2000). The NIE approach adopts a wider view. Coase (1937) described transaction costs as the ‘costs of the price mechanism’ but did not give a precise definition. The price mechanism or Smith’s ‘invisible hand’ ([1776] 1952) has a cost and the most efficient use of this cost determines the shape of the institution. Some economists envisage circumstances where there are no transaction costs – the ‘one-man Robinson Crusoe economy’ (Cheung 1992). We argue that when you widen the scope of what constitutes a cost
there are transaction costs in all human activity. Wallis and North (1986) point out that even Crusoe incurred transaction costs because he had a problem keeping mice out of his bread. There are many ways in which transaction costs are incurred. There is the cost of finding partners to trade with and executing transactions. It may be the costs of monitoring the market and staying informed or the difference between the price paid by the buyer and the price received by the seller – the difference between gross profit and net profit. There are also the costs of negotiating, monitoring and enforcement of contracts in the event of opportunistic behaviour on the part of one party. This may arise due to the inevitability of incomplete contracting. The certainty of legal enforcement of contracts and strong property rights may reduce the level of uncertainty.

Transactions involve the exchange of property rights. These rights do not assume exclusivity but can be apportioned in different ways. Demsetz (1967, p347) tells us that: ‘property rights are an instrument of society and derive their significance from the fact that they help a man form those expectations which he can reasonably hold in his dealings with others. These expectations find expression in the laws, customs, and mores of a society’. Of course de facto property rights can be held illegally as well. Coase (1959) examined the implications of externalities created by the exercise of property rights affecting other’s ability to vindicate their property rights.

Introducing market-based aspects to institutions which had previously been exclusively hierarchical, government-managed entities, creates a hybrid organization that has the characteristics of both markets and hierarchies and therefore the potential hazards of both forms of governance (Park and Russo 1996). Property rights in the private sector in a democratic society are controlled and regulated by the constitution and the courts. Public sector property rights are formed by politics. It has been argued that government assets are insufficiently protected leading to failure of services (Foss 2010). It may be that public governance is too widely diffused. Mixing the two requires analysis of the governance of contractual relations especially the distribution of risk. The efficiency of different types of governance will depend on the institutional environment and the characteristics of the economic actors (Williamson 1993). TCE proposes that these economic actors are subject to bounded rationality rather than utility maximizing envisaged in neoclassical economics.

Apart from bounded rationality economic behaviour is not independent of social relations which have an impact on the pure pursuit of self-interest, or what Granovetter (1985) calls
‘embeddedness’ i.e. economic life is embedded in social relations. This is also related to trust, where judgement on the reliability and predictability of a business relationship is enhanced by repeated dealings. The need for judgement and trust can be replicated by substitutes such as contracts and robust property rights. Individuals and organizations are enmeshed in social relationships and networks that have a direct bearing on their economic behaviour. Granovetter argues that NIE is overly dependent on the construction of institutional arrangements to maintain good relations and discourage malfeasance. It can be discouraged by institutional arrangements which raise the costs of such practice and acts as a substitute for trust. Within integrated hierarchies difficulties can be resolved through decisive action by management order. But Granovetter argues that this view underestimates the extent to which personal associations and the inherent obligations that go with them equally discourage malfeasance. Positive working motivation may be related to supporting colleagues as much as to personal gain.

Institutions are greatly influenced by their history. Formal rules and traditions together with tacit knowledge shape the institutional environment. Path dependency is often seen as self-reinforcing feedback which causes institutional lock-in. Some of the cumbersome bureaucracy inherent in public institutions can be the result of path dependent maintenance of what Williamson (1993) refers to as ‘tosh’, that is superfluous rituals. Path dependence may create difficulties when the need for change arises. North (1991) argues that it is more than a simple evolution in which yesterday’s institutional framework provides the structure and context for today’s organizations. The dependent path is maintained by increasing returns creating the incentive for the formation of further organizations seeking profits. Page (2006) suggests that path dependency can also be affected by externalities. Externalities can change incentives. Constraints impose negative externalities which can cause path dependency. Competing technologies such as the case of the battle between Betamax and VHS video recording in the 1970s is an example. As more VHS machines were sold, positive externalities were created for VHS but negative externalities were created for Betamax owners. This pull and push accelerated the eventual dominance of one technology over the other. The QWERTY keyboard has often been quoted as an example of the same phenomenon (North 1991, Williamson 1993, David 1985). A distinction could be drawn here between technological and organizational path dependency. Path dependency may give rise to sub-optimal institutional solutions.
The institutional framework acknowledges certain solutions that deliver ‘sub-optimal’ results even though institutional arrangements tend to form in ways which minimize transaction costs. However there are multiple equilibria to be balanced in order to arrive at the optimal institutional solution. There may be the consideration of the financial efficiency, allocative efficiency, equity and political feasibility. If any of a number of components is unbalanced the institution may be considered ‘sub-optimal’ in some respect. In a democratic system it is important that proposed changes are politically possible. There is little point in propositions which have no chance of legal sanction or practical implementation. Attempts to solve these different and often competing elements may not lead to a fully socially efficient institution. Institutions which range from those that are less than perfect to the downright perverse may continue to exist over long periods because they work satisfactorily for those actors who have the bargaining power to create and maintain the rules (Saleth and Dinar 2004). They may persist because the cost of change is greater than the perceived benefit. Therefore it cannot be said that reform or change will necessarily make improvements. The reformed institution may end up worse.

Joskow (1988:97) writes that: ‘specific institutional arrangements emerge in response to various transactional considerations in order to minimize the total costs of making transactions’. Site and equipment specificity provide the possibility for opportunistic behaviour or hold-ups. Once a party to an agreement has committed to an investment which is specific to one other party relationship then the second party possesses the ability to take advantage of the situation knowing that the first party is ‘locked in’. In these circumstances it is likely that the contractual arrangements will need to be quite prescriptive in the areas where hold-ups are liable to happen. Due to the imperfection of contracts it is likely that both parties will try to develop strategies to prevent hold-ups or other opportunistic behaviour or recognize that there will be an economic cost to the arrangement (Klein 2009). Where the contract proves to be overtly advantageous to one party it is likely that the facilities will ultimately come under the ownership of that party. Where these parties are public (government owned) and private respectively the perception of where the advantage lies may determine the outcome – government may buy out a private partner under political pressure but at an enormous cost.
Changes in the procurement process in Irish public management can be examined through the lens of these theoretical approaches including transaction costs, property rights, risk, embeddedness, path dependency and asset specificity which give adequate explanatory scope to elucidate the factors which propel success in institutional reform or doom it to failure.

The following sections present details of two cases of PPP procurement in Ireland. The cases of roads and hospital location are carefully selected in order to compare different procurement experiences using the PPP model. This is followed by an interpretation of these cases with reference to our theoretical framework.

4. Public Private Partnerships for Procurement of Roads

The adoption of PPP for the construction and operation of roads has been a major component of Ireland’s PPP programme which can be traced back to the announcement a suite of pilot PPPs in 1999. This followed a period of rapid economic growth from the mid-1990s that put enormous strain on Ireland’s stock of physical infrastructure. As the country had the lowest level of motorway coverage in Europe it was not surprising that four road PPPs were included in the initial set of eight pilot PPPs. Thereafter a total of nine major inter-urban routes covering a total roadway length of almost 300 km have been procured (see table 2 for details)

All PPP road projects have been procured as concession contracts. The private consortia are responsible for the design, build, operation and finance elements of the projects. Payment is secured via a combination of direct tolls and unitary payments by the public sector. The National Roads Authority (NRA) is the primary authority for the day-to-day delivery of roads strategy on behalf of the government. According to information provided by the NRA the PPP roads programme has attracted over €2.2 billion in private finance.
Table 2: PPP Projects in the Irish Roads Sector

<table>
<thead>
<tr>
<th>Project Name</th>
<th>Km</th>
<th>Date of Contract Award</th>
<th>Date in Operation</th>
<th>Initial Cost Estimate €m</th>
</tr>
</thead>
<tbody>
<tr>
<td>N1/M1 Dundalk Western Bypass</td>
<td>11</td>
<td>Feb-04</td>
<td>2005</td>
<td>340</td>
</tr>
<tr>
<td>N4 Kilcock Kinnegad</td>
<td>11</td>
<td>Mar-03</td>
<td>2005</td>
<td>550</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>(2003 Prices)</td>
</tr>
<tr>
<td>N8 Rathcormac-Fermoy Bypass</td>
<td>18</td>
<td>Jun-04</td>
<td>2006</td>
<td>320</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>(2003 Prices)</td>
</tr>
<tr>
<td>N25 Waterford Bypass PPP</td>
<td>37</td>
<td>Apr-07</td>
<td>2009</td>
<td>600</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>(2006 Prices)</td>
</tr>
<tr>
<td>N6 Galway-East Ballinasloe PPP</td>
<td>57.6</td>
<td>Apr-07</td>
<td>2009</td>
<td>605</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>(2007 Prices)</td>
</tr>
<tr>
<td>M7 Portlaoise-Castletown/M8 Portlaoise-Cullahill</td>
<td>42</td>
<td>Jun-07</td>
<td>2010</td>
<td>n/a</td>
</tr>
<tr>
<td>M3 Clonee to Kells Road PPP</td>
<td>85</td>
<td>Apr-07</td>
<td>2010</td>
<td>n/a</td>
</tr>
<tr>
<td>N7 Limerick Southern Ring Pase II / Limerick Tunnel</td>
<td>10</td>
<td>Apr-06</td>
<td>2010</td>
<td>660</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>(2006 Prices)</td>
</tr>
<tr>
<td>M50 Motorway Expansion (build extra lane)</td>
<td>24</td>
<td>Sep-07</td>
<td>2010</td>
<td>n/a</td>
</tr>
</tbody>
</table>

Source: (Department of Finance 2012)

The NRA has conducted the procurement process in the case of all PPP projects and it acts as the contracting party in contrast to conventional contracts, which are signed by the local authorities. The procurement of all nine PPP projects was conducted over the period 2000-2010 and all nine projects are now in operation. The completion of these roads projects contrasts with similar efforts to adopt PPP in sectors such as water and health services where bringing projects to the point of delivery has proved difficult. The relatively smooth implementation of roads PPPs can be attributed to a host of factors which we identify on the basis of interviews with officials involved in the delivery of projects.

(i) Wider Economic Context – The Acute Infrastructure Deficit
One factor relates to the wider national economic context which provided fertile ground for experimentation with the PPP model of procurement. The acute nature of Ireland’s deficit of
roads infrastructure meant that the announcement of private sector involvement in order to speed up the delivery of much needed projects was easily justified by policymakers. An added advantage was the involvement of private finance which was presented as a means of circumventing the fiscal rules that applied to members of the single European currency. Both factors contributed to broad acceptance of PPP as a means of serving an important economic and social imperative.

(ii) A Single Procurement Authority in the Roads Sector
For the nine projects procured to date, the NRA has been the sole sanctioning authority for procurement under PPP. This distinguished the procurement of PPPs from other sectors such as health, education and environment where procurement was the responsibility of the relevant government department but ultimate sanctioning authority resided with the Department of Finance or the National Development Finance Agency (after 2005). The centralized model of procurement that applied in the roads sector was described as advantageous in terms of resolving difficulties, thereby speeding up the procurement process.¹

(iii) Establishment of a PPP ‘Champion’
The appointment of a manager with sole responsibility for procurement of road PPPs was identified as an important factor in providing the programme with momentum. Moreover, the manager in question was described as particularly effective in his role and a ‘force’ who ‘made things happen’ and ‘championed’ the development of the PPP model in the sector.

(iv) Learning from the UK Experience
As the private finance initiative (PFI) in the UK dated back to 1992 and included a number of road PPPs, there was scope for learning from the pioneering UK experience. The NRA benefited from access to officials from the Highways Agency in the UK who were willing to share experiences as well as documentation they had developed to facilitate the procurement

¹ Interview with senior NRA official, April 2012
process. The NRA has indicated that this documentation was easily adapted to the local context and that its adoption reduced uncertainty among market participants that were familiar with the PFI.

Notwithstanding these factors giving impetus to the procurement of PPP contracts in the roads sector, a number of obstacles were also encountered with the NRA drawing particular attention to the demands of managing requirements with regard to public consultation and the management of archaeological risks.

The introduction of new toll roads inevitably led to a degree of opposition on various routes. Mechanisms adopted to deal with citizen concerns included a public consultation process with regard to the tolling schedule published by the NRA and the appointment of an inspector to deal with disputes. The merit of such mechanisms in terms of achieving effective governance has been open to question and the NRA acknowledges that it was open to charges of acting as ‘judge and jury” because the reporting structure only required inspectors to report to the board of the NRA.

The issue of archaeological risks posed considerable challenges for the procurement of road PPPs. In some cases (e.g. the Waterford bypass) the discovery of archaeological sites on the relevant routes caused significant delays to project progression. The question of risk allocation in this regard also created difficulties with private contractors demonstrating reluctance to accept such risks. The NRA responded to this difficulty by engaging in ‘test-trenching’ which was described as an ‘innovative technique’ involving the construction of a trench along the middle of the route with off-shoots at regular intervals. As the NRA took responsibility for these tests prior to the commencement of construction the risks to the private contractor were significantly diminished.

The fact that all nine road PPPs have been completed and are in operation demonstrates a degree of success with the PPP programme to date. Although it has taken over a decade to complete the programme, the NRA point to the fact that markets for contracts have remained competitive and the length of procurement periods has averaged a ‘respectable’ 18-19 months. It should be recognised that completion of the planned programme provides very limited grounds for judging Ireland’s roads PPPs as ‘successful”. The question of success versus failure does not however command the focus of this paper. Rather, our concern is with gaining an understanding of the factors that determine whether PPP projects or programmes progress through the stages of the project life cycle. Whereas the evidence from
the Irish roads sector is positive in this regard, it contrasts sharply with the area of health services where PPP projects have failed to progress along the lines planned.

5. Health – The Case of Hospital Co-location

In June 2005 the Irish Department of Health circulated new guidelines on the development of private hospitals on the grounds of public hospitals. The co-location concept had been developed with some success in Australia (Browne and Barnett 2004). The idea had been put forward by doctors and market research had been carried out to test the viability of the proposal\(^2\). When testing the market several private property developers were consulted and expressed an interest in getting involved. Importantly, the political climate was favourable as Mary Harney, the leader of the Progressive Democrats, a pro-market liberal party, was Minister or Health and a strong advocate of the co-location proposal.

**Perceived Benefits**

The co-location policy was sold to the public as a simple way to create more public capacity by moving private patients out of public hospitals and into adjoining private facilities (Houses of the Oireachtas 2006). The total amount of beds in public hospitals was 11,500 and 20 per cent of these were designated for private patients (PA Consulting Group 2007). However the level of private admissions to public hospital for elective procedures can be far greater than 20 per cent. This means that at any given time a large number of public beds are taken up by privately insured patients. This in turn impacts on the ability of public patients to access public hospital beds and exacerbates waiting lists. The groups who were the successful bidders at the tender stage emphasized the positive effects on the public system which would flow from the development. Additional bed capacity would be accompanied by extra operating theatres, radiology, ‘state-of-the-art’ ICT systems and financial management systems. This aspect was attractive to the management of the existing public hospitals:

‘....when it came to selection we were interested in the costing model, we were interested in the infrastructure they brought on to the site, the new opportunities it gave to improve the campus but also what we could gain from them in terms of patient

\(^2\) Interview with hospital CEO, 2010
management, hospital management, finance and IT systems as well, you know we could piggy-back on some of this stuff" (interview with public hospital CEO, 2010).

The private hospital would also be prepared to invest in equipment or other infrastructure if there was seen to be a deficit in the public hospital. The co-located hospitals were also obliged to accept all privately insured patients no matter how they were admitted, including through Accident and Emergency (A&E). The contract allowed for fines and possible termination and eviction of the private partner in the event that breached the terms of the agreement.

The land on which the co-located hospital would be built was to be leased from the Health Service Executive (HSE) at full market value. The HSE at that time ran the day-to-day operations of the health services and was the procuring agency in the co-location project (C & AG 2011). The successful bidders claimed that this represented a gain for the state as previously this land was not currently being used. Another argument put forward was that the Net Present Value of each co-location contract was worth €600 million to the state. This figure included the rent paid for the site, employment taxes paid by 500 hospital staff and also including VAT, Corporation Tax and Stamp Duty less the tax foregone in Capital Allowances. In addition to these on-going payments there would be the instant benefit of job creation and commercial activity in the building and equipping of the hospitals.

Details
The co-location programme was the first public procurement process in Ireland to be negotiated using the Competitive Dialogue process. This was a new procurement procedure introduced for public sector contracts in an EU Directive (2004/18/EC). The rationale behind this procedure was that most PPP or PFI contracts were too complex to use traditional methods of tendering. Dialogue is commenced with suppliers who can demonstrate their financial and technical ability to identify and define solutions for the authorities. The tender is awarded to the bidder who can demonstrate the greatest economic advantage. The awardees are referred to as ‘preferred bidders’. Dialogue is progressed in continuous steps and there is explicit allowance for post-tender negotiations (OGC 2006). One of the features of this system was that after tenders had been submitted, bidders could fine-tune their

---

3 Interviews with Preferred Bidders
proposals and in particular seek to establish the level of risk to which they would be exposed in order to satisfy their potential financial backers. Preferred bidders were selected for four co-location projects. The Beacon Medical Group was awarded the projects in Beaumont Hospital in Dublin, Cork University Hospital and the Limerick Regional Hospital while Synchrony Healthcare was awarded the project at St James’s Hospital in Dublin. Project agreements were signed and planning permission was sought and granted for these four projects.

The Beacon Medical Group (BMG) claimed that if the private partner could not complete its side of the project then the state would have the right to confiscate the asset but would have to compensate the partner up to the extent of their borrowings. The Minister for Health, Mary Harney, claimed that to do that would be to provide a guarantee which would allow the private partner to avoid their proper portion of the risk:

‘A core principle underlying the co-location initiative is that the private sector should bear all normal business risks. It is a matter for each successful bidder to arrange its finance under the terms of the relevant project agreement. The co-location initiative, like other major projects, must deal with the changed funding environment’ (Harney 2010).

The preferred bidders and their potential financiers believed that they were taking on an unsustainable risk whereby opportunistic behaviour could be exercised with relative ease resulting in the complete loss of all of their investment without compensation. The issue of risk transfer was pertinent for the government at the time the project agreement was being drafted because the government was engaged in a costly buy-back of the M50, a toll road surrounding Dublin, from the private operators who had been running it since it was built in 1990. The drafter of the agreement was instructed to write it in such a way as it could not come back and embarrass the government at some time in the future. The perception of private firms accruing financial windfalls from poorly executed agreements needed to be avoided.

The successful bidders, BMG and Synchrony Healthcare signed the project agreements and became ‘preferred bidders’ on the understanding from the HSE that the clause would be amended under the principles of the Competitive Dialogue process. As it stood the projects could not be financed. At this stage other bidders were excluded by reason of an unsuccessful bid or having voluntarily withdrawn due to financing difficulties. Provision was
specifically made in the project agreement that if any term in the agreement meant that the private partner could no longer obtain funding for the project the public partner ‘in its sole discretion’ could amend the relevant term\(^4\). The preferred bidders were confident that once planning permission was granted for building on the sites, the agreements would be modified to allow for greater comfort for the financiers in the event of future difficulties of the operators. When planning permission was in place the preferred bidders were informed by the HSE that they would need evidence of a refusal from the banks before the contract could be altered. This represented a significant amount of uncertainty for the operator and resulted in prolonged negotiations which ultimately proved fruitless.

The government was under political pressure not to grant any alteration in the agreement lest it looked like they were overtly favouring the private sector. Moreover, the real problem was that the under-bidders (those who had failed to become ‘preferred bidders’) got wind of the proposed change and threatened to sue. This situation created problems for the co-location Project which ultimately proved intractable.

A further complication for the successful bidders at this time was that the VHI, the state-owned health insurance company, stated that they would not cover the co-location hospitals claiming that there was already sufficient, if not surplus, private hospital capacity in the country. Considering that the VHI is under the direct control of the Minister for Health who was promoting the co-location Initiative, this seemed a curious position to take. The problem for the VHI was that 50 per cent of the population are covered by private insurance and the VHI had a market share of 80 per cent, so any increase in private capacity would result in a greater claims pay out for the insurance companies with little prospect of any increase in premium or market share. Like other actors in Irish health care the VHI is producing its own perverse incentives against progress in improving the system and the health of the nation. Currently it is also facing regulatory difficulties with the EU which will require a large injection of government funds. Overall, any expansion of capacity in the Irish health system

\(^4\) The Project Agreement Clause 3.2  Revisions Prior to the Effective Date

‘In the event that, prior to the Effective Date, the Private Partner make a representation to the Public Partner that any term of this Agreement (or any other Project Document to which it is required to be party) solely and directly means that the private partner can no longer obtain funding for the Project, the Public Partner shall consider such representation and may (subject always to receiving consent from the Minister foe Health and Children) in its sole discretion (provided that the Public Partner is under no obligation to make any such amendment), amend the relevant term of this Agreement or the Agreed Form agreements referred to herein provided that such amendment is not a material change to the scope of the Project.’
may result in greater financial pressure on the VHI. Its best option is to maintain or reduce the level of activity and they are in a position to influence this by refusing to cover new entrants to the market.

The co-location project had support at political level but the preferred bidders suggest that officials in the Department of Health and the HSE were dragging their feet on fixing the contracts to make it bankable. The Department of Health had the problem that the unsuccessful under-bidders threatened to sue if the contracts were altered and the Attorney General advised that if they did so they would be successful. After due process, planning permission was granted for the four sites. By August 2010 BMG had spent €30 million on co-location between tendering costs, analysis, research and planning permissions and claimed to be ‘shovel ready’ to start building their first project – the Limerick Regional Hospital unit. But by that stage the financial recession was well entrenched, finance for the project was not in place and political sentiment was moving against it. Ireland’s financial crisis and the arrival of the IMF in November 2010 signalled the beginning of the end of the co-location project. The project agreements expired at end March 2011 when time allowed for the preferred bidders to secure funds had passed. Neither of the preferred bidders was able to fund the project within the specified time and all discussions ceased. The HSE stated that it had no plans to progress any of the projects (C & AG 2011).

6. Discussion

Engaging the private sector in the delivery of public infrastructure and services has been an emerging feature of public investment policy in recent years. Governments around the world have turned to the private sector for the purpose of financing, constructing and operating assets and related services for a number of reasons including: increasing demand for infrastructure, the need to maintain or replace run-down assets and constraints on public finances. The use of PPP has not however yielded the benefits frequently articulated by its proponents and the international experience is replete with examples of proposed PPPs that have had a difficult passage through the procurement cycle or in some cases been abandoned. In addition, where PPPs have reached the stage where projects are up and running, the empirical evidence indicates that many PPPs have had unsatisfactory outcomes (Boardman and Vining 2012, Hodge and Greve 2007).
The purpose of this paper is to examine the factors that influence whether or not infrastructure is successfully procured using the PPP model. We recognise that the notion of success has different meanings and that there are a host of criteria (e.g. efficiency, equity and effectiveness) that can be used to determine if an outcome is successful or not (Hodge and Greve 2011). In this context, we regard the procurement of a PPP project as successful if it is brought through the ex-ante stages of the procurement cycle and reaches the point where the asset is constructed and in operation.

To examine this question we consider PPP as a form of governance and the implementation of PPP as an institutional change involving a shift from traditional procurement methods to a new form of procurement involving extended private sector participation in the delivery of public services. Using the examples of roads and hospital procurement we conduct a comparative analysis to explore the factors that shape the implementation of institutional change in the form of PPP procurement.

The development of a PPP programme in the case of Ireland can be interpreted as a result of the dynamic interaction between the institutional environment, governance structures and individuals acting as agents of change (Saleth and Dinar 2004). The adoption of PPP as a form of institutional change was heavily influenced by the interaction between political (government) and economic organizations (e.g. Construction Industry Federation, Irish Business Employer’s Confederation) who justified the change as a necessary response to the deficit of physical infrastructure that reduced the prospects for sustaining the economic growth that commenced in the mid-1990s.

The Irish case also provides evidence of a ‘cultural shift’ - a pre-requisite for institutional change - which was strongly influenced by events in other jurisdictions. The extensive programme of private sector participation witnessed under the PFI in the UK and to a lesser extent in Western Europe, was frequently cited by Irish policymakers for the purpose of justifying the adoption of the PPP model of procurement. In international terms, increasing levels of PPP activity were particularly evident in the roads sector. In Europe (excluding the UK), the roads sector accounted for over 30 per cent of PPP projects and 45 per cent of value in the period 1995-99 (Kappeler and Nemoz 2010), whereas in the UK, 14 DBFO roads had been completed over the period 1994-2002 (Mackie and Smith 2005). The prevalence of road PPPs in Europe combined with the acute nature of Ireland’s deficit of motorway...
infrastructure provided grounds for policy makers to rationalize the adoption of the PPP model to procure roads in Ireland. In contrast there were few international examples of co-location initiatives (with the exception of Australia) along the lines of the proposed arrangements in the Irish health sector. Proponents of co-location initiatives in Ireland therefore had limited scope for justifying institutional change on the basis of international popularity or common international practice.

Governance of institutions is controlled by political and economic organizations. It is principally through the political organizations that the rules which govern the institutional environment can be changed. These institutional rules are both affected by and can affect the conduct of political and economic organizations. These organizations are also directed by the input of individuals who wish to influence change in the institutional environment. In the Irish case, the PPP programme in the roads sector was distinguished by a strong degree of goal-congruence between political (government) and economic organizations (construction industry). A crucial factor in delivering the PPP programme was the allocation of responsibility for procurement to a single agency – the national roads authority (NRA). As an independent procurement agency, the NRA was not required to defer to other authorities and this simplified the lines running from institutional environment to governance. In contrast, the development of the co-location initiative was inhibited by a distinct lack of cohesion between political and economic organizations. In particular there is evidence to suggest that the procuring authority (the Health Services Executive) was not fully committed to co-location. In terms of the three-layered schema this lack of cohesion broke the dynamic triangular interaction that is required to bring about institutional change.

Individuals and organizations are embedded in social relationships and networks which have a direct bearing on their economic behaviour. Social interaction between key people in different organizations linked to a project can be crucial in making the project work, particularly in a country with a small population like Ireland. Equally, obstruction and antipathy by individuals for a variety of reasons can have an adverse effect on outcomes. Reasons for these negative positions may never be fully known but may have their motivation in the maintenance of control by groups who have the bargaining power to do so. The cases of roads and health examined in this paper illuminate the role of individual actors within political and economic organizations as important factors in shaping the outcome efforts to adopt PPPs. In the case of road PPPs much importance was attached to the manager of the
PPP unit in the NRA who was identified as the principal driver of the development of the PPP method of procurement. In contrast efforts to adopt new procurement methods in the health sector (in particular hospital co-location) were stymied by powerful interests on the public sector side that were unprepared to cede power under the proposed governance arrangement.

The contrasting histories of the cases analysed can also be interpreted with reference to their governance and the different levels of transaction costs. In the case of roads a number of factors contributed to the reduction of transaction costs and ultimately smoothed the way for completion of procurement. These factors included the existence of a single procurement agency that built up experience with PPP procurement over a ten year period covering nine projects. In the early projects the NRA benefitted from access to expertise from the Highways Agency in the UK which shared procurement and contract documentation developed in its jurisdiction. On the private sector side a number of bidders had prior experience with PPP procurement abroad and were therefore familiar with the process developed in Ireland, which broadly resembled that in the UK. Also, because the NRA communicated a clear programme of PPP projects to be rolled out over a ten year period, bidders were incentivized to participate in tenders under conditions characterized by a high degree of certainty. Conversely, the procurement of hospital co-location was fraught with uncertainty which ultimately prevented the agreement of a final contract. The issue of risk transfer was a critical factor in this regard. A principal argument in favour of PPP is that risk can be allocated to the parties that are best suited to manage them. In this case the public sector required the private sector to bear what was considered to be an unsustainable level of risk for the then current political reasons. Moreover, the private sector was unable to provide financiers with an adequate level of assurance around risks concerning the confiscation of assets. This issue ultimately led to the abandonment of the agreement as the preferred bidders could not commit to an investment in specific assets where the risk of hold-up was deemed too high. In this case the economic organizations represented by the preferred bidders were cut adrift from the connection to the political organizations, the institutional environment and the possibility of changing the rules.

7. Conclusion
Since the late 1990s, successive Irish governments have embraced PPP as a means of addressing the country’s acute deficit of physical infrastructure. In international terms the scale of planned PPP activity has been ambitious and prior to the global financial crisis the PPP model was expected to account for over 13 per cent of Ireland’s public capital programme over the subsequent five year period.

The experience with implementing the planned PPP programme has been mixed in terms of bringing projects through the complex PPP procurement process to the point where assets are in operation. Whereas PPP has had an appreciable impact on investment levels in sectors such as roads and water services there have been a number of cases where procurement has been tortuously slow and in some cases projects have been suspended or cancelled. Examples of projects that have encountered serious difficulties include the proposed metro from Dublin city to the airport (suspended in 2011), the proposed incinerator project in Poolbeg, Dublin (suspended and under review), and a number of social housing projects (abandoned in 2008).

This paper examines the factors that have contributed to the completion of procurement in the case of some PPP projects and the suspension or cancellation of other proposed PPPs. A framework based on institutional economics is adopted to illuminate factors that influence whether or not PPP projects progress through the procurement process and contracts are signed. Our analysis is therefore confined to the *ex-ante* stage of contracting under PPP. Two contrasting cases are analysed for the purpose of exploring these questions. We find that the ‘successful’ procurement of road PPPs is attributable to the factors such as the relatively straightforward nature of procurement in this sector which is characterized by widespread international usage which in turn confers a degree of legitimacy on PPP procurement in the roads sector.

The three layer schema that captures the elements of the institutional economics framework emphasises the interaction of individuals, as well as economic and political organizations in the governance of institutional change. This has clear resonance in our cases of PPP success and failure. A stark contrast was evident between our cases in terms of the cohesiveness of these elements. Whereas the governance of road PPPs was enhanced by aspects such as goal congruence between contracting parties, the evidence in the co-location case suggests a strong degree of dissonance between parties especially on the public sector side of the
transaction. Transaction cost perspectives have particular relevance when we compare projects. The co-location case in particular shows the importance of dimensions such as uncertainty, fear of opportunistic behaviour and a failure to agree an appropriate model of risk-sharing (a vital element of procurement under PPP). We conclude that the relatively high level of transaction costs in the co-location case provides a plausible explanation for the eventual failure of governance that culminated in the cancellation of the procurement process.

In conclusion we suggest that the framework drawn from institutional economics elucidates some of the principal factors that determine whether or not the PPP can be effectively implemented. The cases analysed draw attention to institutional design issues that must be resolved if PPP projects are to be brought to fruition. These issues are multi-faceted and complex and their resolution poses serious challenges to policy makers. Unless these challenges are met the popularity of the PPP method of procurement is likely to decline.
References


Hodge, G. A. and Greve, C. (2011) 'Theorising public-private partnership success: a market-based alternative to government', in Public management research conference, Syracuse University, Syracuse NY, USA,


Smith, A. ([1776] 1952) *An inquiry into the nature and causes of the wealth of nations* *Great books of the Western World* Chicago: Encyclopaedia Britannica.
