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Chair

Mr. Pat Martin

Standing Committee on Government Operations and Estimates

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● (0850)

[*English*]

The Chair (Mr. Pat Martin (Winnipeg Centre, NDP)): Good morning, ladies and gentlemen.

Thank you for being with us here today. We're opening the 56th meeting of the Standing Committee on Government Operations and Estimates.

This will be the first public session of a new study we're undertaking on public-private partnerships. We believe there's a great deal of interest on the part of the general public, and certainly of members present, to measure and examine the efficacy of the public-private partnership programs that governments are engaged in.

We're very pleased to welcome four knowledgeable witnesses to make representations today: from the C.D. Howe Institute, Mr. Finn Poschmann; from the Conference Board of Canada, Mr. Vijay Gill, associate director of public policy—welcome, Mr. Gill; from the Canadian Centre for Policy Alternatives, Hugh Mackenzie, research associate—welcome, Mr. Mackenzie; and from the Canadian Council for Public-Private Partnerships, Mr. Mark Romoff, president and CEO, and Mr. Michael Marasco, a member of the board of the administration.

Mr. Poschmann was to be the first presenter, but I think we're going to change the order up briefly and ask Mr. Gill if he will present first.

Normally, gentlemen, we ask people to limit their presentations to five to ten minutes. There are four of you today, and we want to have adequate time for the committee members to put their questions.

Mr. Gill, if you're ready, the floor is yours.

Mr. Vijay Gill (Associate Director, Public Policy, Conference Board of Canada): I'd like to thank you for having me today.

I'm from the Conference Board of Canada. We're a not-for-profit research think tank. We've published research on this very topic in the past, and continue to be interested in the topic, because we think infrastructure delivery and obviously infrastructure services have important implications for the competitiveness of the country.

In terms of the key mechanisms and the drivers of efficiencies for P3s relative to traditional procurement, I think there are a couple of things to flag. One is that there's been kind of an ongoing debate...or actually, the debate hasn't even been had on this: it's not always clear what is and what is not a P3.

I think the CCPPP has done pretty well in terms of defining, within the space of P3s, a whole degree of different types of projects, and different levels of risk transfer, and different types of bundling of operating and maintaining phases. I think anytime we're going to be involved in a discussion of what is optimal, we have to consider the specific structure of the P3 we're talking about.

Just briefly, there is also this issue of private financing. Obviously it's going to come up. You've probably heard about it already. I think this is also an ongoing debate in terms of how strong a mechanism private financing is in terms of providing some discipline to the project and how necessary it is for the P3 structure to succeed. I think you're going to see that there's obviously a debate raging about that now as well.

Just to back up a little bit, in general when we talk about infrastructure and when the public thinks about infrastructure, we often think about public infrastructure to begin with. But it's important to note that, if we look at total investment in fixed assets, the public sector portion is a small minority. Gross fixed capital formation in the country—public sector speaking—is 16% on an annual basis, approximately, in Canada. Even if we limit that infrastructure investment on the private side to non-residential fixed structures, the private sector investment in this is over twice of what the public sector investment is.

I think it's important to keep in mind, when we're looking at the maintenance record of public infrastructure, that there is something to be learned from the large investments that are ongoing in the private sector in terms of thinking about how we could capture some of those efficiencies. How we actually do it is one thing or another, but I think it's one point that's often lost.

I'll make just one point on the breadth of P3s in Canada. We've heard a lot about them over obviously the last 10 or 15 years. There's been a large shift in terms of P3 delivery in Canada.

Just to give you a rough idea of how large it is in terms of total government expenditures on capital, if we look at P3 transactions as a percentage of government spending on infrastructure or gross fixed capital formation, we're looking at roughly 12% to 14% a year. This isn't a 75% or 80% thing. You can take that information however you want, but that's just to give you a rough idea of what the scope is.

In terms of where we are internationally, this places us in the top handful of countries. Even trailblazers like the U.K. and Australia are at 15% or 18%. They're not at that 70% or 80% level and they never will be, primarily because we have, obviously, a large number of small projects that aggregate up to be a large portion of the whole.

I'll stop there for now. I'm looking forward to the discussion.

● (0855)

The Chair: That's very good. Thank you very much, Mr. Gill.

Mr. Finn Poschmann has now arrived, the vice-president of research for the C.D. Howe Institute. Mr. Poschmann, if you are ready, you may give your views on public-private partnerships. We invite witnesses to speak for five to ten minutes.

Welcome.

Mr. Finn Poschmann (Vice-President, Research, C.D. Howe Institute): Thank you for your welcome. I am very glad to be here, and my apologies for being late. With that, I'll not apologize for the infrastructure between here and the airport. It's getting better all the time, I'm sure.

Good morning, Mr. Chairman, members of the committee. Thanks very much for inviting me to appear before you today. It is an absolute delight to speak on this important topic.

I'll not refer to numbers but rather to some first principles, and how we or I think about public-private partnerships.

First, by way of introduction and for those here who don't know me, I run the research and publications branch or division of the C.D. Howe Institute. We manage the research agenda. We are a public policy think-tank, a charity with an educational mandate. I'm here because of my interest in the topic, and I've written a number of articles and chapters in the field.

As we know, governments and their political leaders like public-private partnerships, P3s, for a number of reasons. First, P3s bring private sector capital, money, to the table, and even for governments, money can sometimes be in short supply.

Second, what comes attached to private sector money, assuming a well-written P3 contract, is an important element of risk sharing. Private partners to a P3 are expected to absorb a significant share of project completion and operational risk, the risk of failure, and because their own money is at stake, the private partner normally has, or should have, appropriate incentives to manage this risk well.

Third, P3s are more likely, as compared with traditional procurement, to be completed on time and on budget, and that tends to make political leaders pretty happy.

Those are some high-level reasons to be interested in P3s, but it's important to look at some of the specifics of the contracting process and the risk sharing embodied therein.

P3s are most commonly used for large infrastructure projects: highways, bridges, hospitals, schools, whatever. That's because these projects soak up capital, they tend to be long lived, and they embody risks of the sort that do not arise when governments procure a box of pencils or some new staplers or whatever. Large infrastructure projects involve financial risks, design risks, construction or building risks, and operational risks, among others. The idea underpinning a P3 is that the private partner undertakes some of these risks, in return for an appropriate financial reward.

It takes a good P3 contract to specify the division of risks and rewards. Contracts are necessarily imperfect and incomplete because they are human constructs. Contracts are entered into under conditions of risk and uncertainty, imperfect and asymmetric information, and potential moral hazard. That is what makes contracting, and getting it right as best we can, very important to the P3 process.

P3s have their limits, and we should be clear about those. I like to express this by using the old aerospace saying: faster, better, cheaper —choose any two.

Let's say a provincial or federal government wants to get an overpass built and puts out an ordinary tender that generally describes the overpass and awards the construction contract to the lowest bidder. The bridge will probably get built—probably—and built cheaply, but it might not be built on time and it might not be built terribly well. It might get done late, and bits of concrete might start falling down after a few years and hitting cars below. That's a bad outcome.

Suppose instead we write a contract that lays off some completion risk to the winning bidder. We have financial rewards for finishing early, financial penalties for finishing late. This is fairly standard procurement contracting in infrastructure, but now you're embodying within the contract some of the completion risk. The overpass will still get built, likely on time, and it will likely be built at relatively low cost, but you still don't know when or if chunks of concrete are going to fall off. It might be faster and cheaper, but not better.

Now consider a more complete contract that embodies more risk sharing. The private partner agrees to take on operational risks, say, that the overpass will maintain the capacity to move a certain number of vehicles per day for the next 20 years, and to transfer ownership of the overpass to the government, in good condition, after that time. In the last circumstance, the government is likely to produce an overpass that is delivered faster and works better than in the case of ordinary procurement. It is faster and better, but not necessarily cheaper, because the financing partner, the private partner, has taken on the completion risk, the operational risk, and the long-term financial risk. These are good risks for governments to lay off by way of contracting, but it takes money to manage those risks, and there's no guarantee that in that circumstance the project will be delivered cheaper, at least in the short or medium terms.

● (0900)

There's another risk too that government cannot easily lay off: the long-term financial risk the private partner takes on exposes it to the risk of bankruptcy. The project may fail and project proponents will lose their investment. Much of the cost of that failure will inevitably redound to government.

The key message is that P3s can do things faster, they can do things better, and they can do things cheaper than in the case of ordinary procurement, but they cannot likely achieve all those three goals. Governments can and should write good contracts that lay off risks in exchange for suitable rewards, but they cannot expect to lay off all risks. Governments should write good contracts and understand them, but they must also understand that contracts are necessarily imperfect because they are human endeavours and they cannot anticipate every circumstance. Generally, where governments can privatize, they should, because governments don't need to do everything. Where privatization is inappropriate, we should recognize that this is often the case. Governments can and should embrace P3s, but they should do so with open eyes and a firm grasp of the risks they retain.

Thanks for your time.

The Chair: Thank you very much, Mr. Poschmann.

You made very good use of five minutes. Thank you for being so concise.

Next we have the Canadian Centre for Policy Alternatives, Hugh Mackenzie.

You have five to ten minutes, Hugh.

Mr. Hugh Mackenzie (Research Associate, Canadian Centre for Policy Alternatives): Thank you, Mr. Chairman, and thank you to the committee for the invitation to appear. Having reviewed the list of participants here, I think I'm the official skunk at this garden party. I'm going to try to play that role as best I can.

Let me start with a general proposition right off the top. First of all, I'll give a clarification of terms. We use the term “public-private partnerships”, which in itself is a little bit misleading because a partnership implies a confluence of interest between the parties. In fact, if you look at even the most sophisticated of the kinds of contracts that Finn has been talking about, there are two parties to these contracts, often multiple parties to these contracts, each of which have different interests. I think it's probably more accurate to call these things agreements rather than partnerships. That helps to centre it in a more neutral environment. Partnership implies something that doesn't really reflect the underlying business reality that's in operation here.

The second point I'd make is that I suspect people might be expecting me to spend most of my time talking about how much more noble it is to be doing everything in the public sector than in the private sector. That's not what I'm going to talk about. What I'm going to talk about is the economics. For me, the fundamental issue and the fundamental challenge that P3s have to meet comes to bear when you introduce the concept of private financing of public projects. The reason I say that is because these agreements work best when they take full advantage of the strengths of both parties to the agreement.

Let's think about what are the strengths that government brings to these kinds of arrangements. Probably the most important one is that governments can borrow money more cheaply than anybody else can in our society. This is not a philosophical proposition; this is an observation of market outcomes. If you look at the rates of interest that are paid on public borrowing as opposed to private borrowing, you see significant differences in the interest costs. Those differences, even a difference of 1% or 2%, can make a significant difference in the lifetime financing cost of a project. A rough example is that a 20-year project with a 1% difference in financing costs, which would be low for the difference between P3s and public, has an effect of about 15 percentage points on the lifetime financing cost of the project. Relatively small-sounding differences in borrowing costs can make a big difference.

The second advantage the public sector has in borrowing is that for some of the same reasons that are implied by Finn's comment about contracts, the transaction costs associated with public borrowing are substantially lower than the transaction costs associated with borrowing through P3s. My experience from looking at these things, and granted there's very little really useful information out there about the actual finances of public-private partnerships, is that the general rule of thumb is that somewhere between 3% and 4% of the total project cost per party is about what you pay to put the paper and the agreements and due diligence all together. That's kind of a dead weight cost. Just going into the gate, you've got pretty significant cost disadvantages on the financing side that a P3 project that includes financing will bear.

● (0905)

Another strength that governments have is because governments represent the entire population and are responsible one way or another for all of the infrastructure projects that are taking place in the public sector, they have a much broader base over which to pool risk than any private operator is going to have. Basic insurance principles tell you that the broader the universe over which you can spread the risk and the more diverse the universe over which you can spread the risk, the lower the cost is going to be of bearing that risk. So risk is going to be more expensive for private operators to bear than the public.

The third thing that governments do, and this is not a trivial point, is that governments are in principle best equipped to reflect the public interest. That translates in concrete terms to everything from the amount of information that's disclosed about how P3 projects actually work, right through to the other end of the telescope, where, for particular kinds of P3 projects, it becomes much more difficult for governments to enact changes in public policy because agreements lock them into a certain way of doing things and a certain provision of the service.

Some of the obvious complexities that you run into there are, for example, when you do a P3 for a garbage contract and then you try to implement a waste reduction program. You find yourself committed to pay for a certain volume of garbage, whether or not you're actually generating it.

My basic point, and I'm going to conclude with this, is that there are a lot of strengths that go with the implementation of infrastructure financing through P3s, but they have a lot more to do with forcing the public sector to be better project managers and a lot less to do with the particular form in which that's delivered. I think about, for example, the province I'm most familiar with, Ontario. Infrastructure Ontario does a fabulous job of project management. It does a much better job of managing a project for a hospital in Timmins or North Bay than the North Bay hospital board is going to be able to do or the Timmins hospital board is going to be able to do because Infrastructure Ontario is involved in literally dozens of projects. They get really good at it.

One of the things that people who are involved in delivering major projects in pretty much any organization will tell you is that project management is critical to getting what you want and when you want it.

My basic point is that I think it is possible to get those advantages, including many of the things Finn has been talking about, without throwing the baby out with the bathwater. In other words, we can negotiate better agreements, more comprehensive agreements, with the private sector without giving away the store in terms of the huge differentials in financing costs.

The last thing I would say, in conclusion, is that on the risk issue there's actually a fair amount that has been written. I think committee members will probably have seen the article that appeared in the “Report on Business” in the *Globe and Mail* yesterday, making reference to a study out of UBC that goes into risk issues in a fairly significant way.

Another study done by that well-known socialist body, the Institute of Chartered Accountants in England and Wales, has looked in detail at the issue of risk transfer in P3 projects in hospitals and roads in Britain. What they find is that in general in these contracts there is a lot less risk transfer taking place on a day-to-day basis than actually appears on the surface.

What is probably more important is this. The nature of the beast is that it creates a risk because the project is in the hands of a private operator that can fail, which didn't exist before. We see many examples of that in Canada.

Finn talks about incentives—and I'll conclude here. Because the government has an overriding commitment to provide the service, the government will ultimately always have to pick up the pieces if the project fails. What that means is that there's a strong incentive on P3 proponents to telescope the risk they bear and load it on to the back end, in other words to underprice the risk during the life of the contract, knowing that if they get caught in their underpricing, they have the ability to walk away.

I'll leave it at that. Thank you.

● (0910)

The Chair: Thank you very much, Mr. Mackenzie.

Finally, we have the Canadian Council for Public-Private Partnerships, Mr. Mark Romoff and Michael Marasco. You have five to ten minutes, gentlemen.

Mr. Mark Romoff (President and Chief Executive Officer, Canadian Council for Public-Private Partnerships): Good morning, and thank you, Mr. Chair.

It's a pleasure for me, of course, to be here this morning to appear before this committee on behalf of the Canadian Council for Public-Private Partnerships and to speak a little bit about three things: I want to talk about the P3 market in Canada; I'd like to talk about the role of the council; and I want to talk about the opportunity to take Canada's growing P3 experience and expertise global.

As you mentioned, Mr. Chair, Michael Marasco is here with me. He is a director of the council and the CEO of Plenary Investments. He'll have a few minutes to speak in just a moment.

As you all know, today all countries of the world are facing large infrastructure deficits at a time when they're also confronting financial constraints. This is true, of course, in Canada as well. At the same time, sound and modern infrastructure is key to Canada's productivity and economic growth, and ultimately to a prosperous and globally competitive Canada.

With regard to public-private partnerships, or P3s, in particular, these are not new to Canada. Over the past 20 years, there has been more than $58 billion invested in more than 180 projects across Canada across a wide variety of sectors, notably in the areas of transportation and health. These projects are taking place right across Canada, although a great proportion of them are in Ontario, and after that British Columbia, Alberta, Quebec, and New Brunswick. Of the 180 projects, more than half are now operational. The remainder are either under construction or in procurement.

Over this time, this period of 20 years, Canada has become a global leader in P3s, attracting P3 developers and partners from around the world to invest in Canadian infrastructure. If you have a look at the landscape in Canada, you'll see a large number of companies from the United Kingdom, Australia, the U.S., Spain, France, and Japan. They are all attracted to the Canadian market-place because of the nature of the Canadian infrastructure pipeline and the model that has been adopted in Canada. Over this period, we have developed a model that has incorporated best practices and lessons learned from around the world, and today the Canadian P3 model is recognized internationally as best in class. That's quite remarkable, given that this is an approach to infrastructure development that began in the U.K. and Australia. Today both those countries are coming to study the Canadian approach to learn how they might improve their own approaches to P3s.

The Canadian Council itself was formed in 1993, at the same time that the concept of P3s was being explored as an alternative to traditional procurement for infrastructure development. We will be celebrating our 20th anniversary at our annual conference this year in November in Toronto. Our conference, too, is recognized internationally as the premier gathering of the P3 community. Over 1,200 leaders from both the public sector and private sector across Canada and internationally, combining all the talent brought to bear on the P3 market, will be brought together.

With respect to the council itself, we are a not-for-profit, non-partisan, member-based organization. Some 450 organizations now make up the council. That includes broad representation from the public sector—governments at the federal, provincial, and municipal levels right across Canada. About 20% of our membership comes from the public sector. The remaining 80% reflect the cross-section of players in the construction sector: consulting engineers, the financial community, lawyers, architects. They reflect the full range of players in typical P3 projects.

The council conducts research, provides education, hosts events around the country, and also delivers on its mandate by promoting the successes that have been achieved by Canada in the P3 space.

● (0915)

With regard to research, I've brought some examples of what we have undertaken over the past year. I will leave them for the committee. As an example, I have a P3 guide for municipalities. You may be aware that municipalities across Canada are becoming increasingly interested in P3s, so we've produced this document and have distributed 1,200 copies across Canada.

We also produced a report in the last year on Canada's activity in the health sector, particularly in hospitals. Since 2004, 50 hospitals in Canada have been built using the public-private partnership model, for a value of some $18 billion.

We also undertake an annual survey of the general public to test their perceptions of P3s. In the last survey, conducted last November, 70% of those surveyed indicated support for the public-private partnership approach to infrastructure development.

Let me finish off, Mr. Chair, by saying that in our view, the P3 is an effective vehicle for renewing and growing infrastructure and for delivering strong value for money for Canadian taxpayers.

I think you'll appreciate Mike Marasco's comments now, because he will bring a private sector perspective to this important area.

Thank you again for your time and attention.

● (0920)

The Chair: Thank you, Mr. Romoff.

Mr. Marasco, you have about four to five minutes remaining, if you like.

Mr. Michael Marasco (Member of the Board of Administration, Canadian Council for Public-Private Partnerships): Thank you.

Unlike my colleagues who have spoken before me, I'm not a researcher; I'm a practitioner. I spent 26 years of my life in the public sector involved in real estate and large capital projects. I left five and a half years ago to become CEO of Plenary Concessions with the Plenary Group, and I now know why: when I was a loyal public servant, we couldn't possibly replicate what the private sector does.

What I want to share with you, as a starting point, is my tale of two projects. I was with the Province of B.C. at the time when these projects were done, on the public sector side, and had an in-depth knowledge of them. Subsequent to joining Plenary, I learned why and what the outcomes were and how they occurred. It's a practical demonstration. I think research is great, and a lot of it is done in theory and on spreadsheets, but the practical examples are the ones I want to draw your attention to.

These two projects were done in the same market at the same time in the greater Vancouver area. One was done using P3 procurement, a design, build, finance, maintain model. The other one was done using traditional construction management. The interesting part about these projects.... For the Vancouver trade and convention centre, which was done using traditional construction management, the government set up a very robust governance structure because they didn't want another failure, another embarrassment. They set up a separate corporation and appointed a board. Some of the best project managers in Canada were assigned to the project.

It started in 2004, at the same time that the Abbotsford hospital was started. The Abbotsford hospital was done as a design, build, finance, maintain project, and it finished on time and under budget. The Vancouver trade and convention centre was six months late and 55% over budget, despite all of the efforts from government. I know a lot of the people who were on the convention centre project—some of Canada's best talent.

Interestingly enough, and this is where the irony is, both of them had the same architect. Both projects had the same construction company. So you have to ask yourself how that could be—same market, same construction company, same architect. Having been brought in to look at those projects to try to help government resolve the issues, I have a good understanding of why. You can't replicate the alignment of interests that we bring to bear and the pressure that we bring on project partners to perform in the public sector. It just can't be done.

A lot of it is about risk transfer, clearly. You've heard my colleagues talk about that.

I want to take you on a little journey that's going to open your eyes to something that hasn't been talked about. That's with respect to the value for money. It goes well beyond risk transfer. I would also argue that public-private partnerships are not about finance. Finance is the catalyst for the risk transfer as well as what I'm about to share with you.

In a value proposition that any agency goes through...and this speaks to the point about strong project management offices. If you have them in place, you can actually balance these four bubbles: the capital expenditures, the maintenance and repair costs, the life-cycle refurbishment, and the utilities costs. I've sat on many project committees in my 26 years where we had the operators, we had all the partners at the table, with the objective of trying to optimize the whole-of-life costs. Then we got the capital cost estimates and we summarily dismissed the people who were there from the operations side, saying thank you, but we can't afford to spend that extra $20 million to achieve $100 million cost savings over 30 years because we're constrained by our capital cost inputs. Consequently, we went on and we derived a project solution that actually was more detrimental to taxpayers.

The objective and the value proposition around PPPs is to make that box smaller. This is the thinking about it. I'll draw your attention to the chart. If you look at the facility costs of operations over a 40-year period, you'll see that 8.7% of those costs relate to the cost of first-in construction costs; 29% relate to life-cycle refurbishment; and 58% to the ongoing operations and maintenance. I'd ask even the Government of Canada where they make all their decisions around capital budgeting. I'm sure they don't approve the 29% for life-cycle refurbishment at the time they approve a capital project.

● (0925)

In some cases, they may actually approve a one-year operating budget, but no one is looking at it as a whole. The whole focus and drive behind a DBFM are to optimize the size of this entire circle, not 8.7% of the total whole-of-life cost of that asset. Consequently, what happens is that typically as public servants we were always driven to dealing with deferred maintenance and all the aspects that run down Canada's infrastructure much more quickly.

Under the DBFM approach, the objective is to make the balls in the box smaller. As you can see by this example, the capital expenditures were more up front, but the ongoing maintenance and operations costs were reduced. The beauty of this is that the outcomes are guaranteed by the private partner because it is a performance-based contract. It isn't an exercise in theory of well-meaning people sitting around the table thinking about how to save money. We actually guarantee it. The financing returns are the vehicle that enforce that guarantee.

We talk about savings. These are examples of the P3 projects across Canada—I encourage you to look at the charts when you get them afterwards—and these are all from value-for-money reports, some of which have been reviewed by Auditor General, of the savings that have occurred in these projects. When you look at it on a percentage basis, you can see that the average savings are just under 20%.

I will conclude by saying that for the Vancouver trade and convention centre the government borrowed at 75 basis points over long-term Government of Canada bonds at the time. The Abbotsford hospital borrowing was somewhere in the neighbourhood of 195 basis points over long-term Government of Canada bonds. The difference is something like a 1.2% increase in costs, but the government had to borrow $365 million more for the Vancouver trade and convention centre, and because of the focus on first costs, the price is as yet unknown for the long-term whole-of-life costs and refurbishment.

Thank you very much.

The Chair: Thank you very much, Mr. Marasco.

I know the committee members have many questions, so we'll jump right into it.

First, from the New Democratic Party, we have Linda Duncan for five minutes, please.

Ms. Linda Duncan (Edmonton—Strathcona, NDP): Thank you, Mr. Chair. It's hard to do five minutes on such a large panel. I'll do my best.

In a number of papers, in particular the C.D. Howe one, which I skimmed and hope to read in greater depth—but thank you all for all the materials—the point was made that left-wing-leaning thinkers are against P3s for ideological reasons. I would ask you whether it is not equally the other way around, that those who are pro-P3 tend to lean towards private as always being better?

We've heard here about a number of examples of successes, including the one in the case study shown here, but we need only look through various articles written about studies to see lots of examples of how in fact P3s cost a lot more and about how in the end a lot of the costs were downsized.

I'll give another example. In British Columbia, for west coast highways, taxpayers had to pay $200 million more out of their pockets than was estimated.

We heard from the agency, the government P3 office that is managing these. They raised the point with us that part of the problem has been the varied expertise, ability, and capacity across federal agencies and departments to actually manage these projects, which in many cases got them into trouble when they were trying to manage or even write these contracts. So in theory the P3 office is now assisting with that.

You all seem to be raising the issue that projects are much better managed when you use P3s, but is it not equally possible that instead of having a P3 office, we could have an office that did the P3 work but also helped departments and agencies better manage these projects and determine how better to proceed with the project and costs? Essentially I'm still not convinced that the P3 is the only way to go. I guess my question is whether there are circumstances in which the government could also manage projects better rather than necessarily going to P3s.

● (0930)

The Chair: Are you directing your question to a particular witness or just asking it generally?

Ms. Linda Duncan: It is directed to whoever would like to answer it.

The Chair: Mr. Marasco, could we have a brief answer, please?

Mr. Michael Marasco: I think the best example of what we tried to do was in British Columbia, where we created that project office of excellence in the Vancouver trade and convention centre case. We had the best project managers in the country. We had a great governance model. Despite that, the inability to make timely decisions as a result of all of the concerns for political and public transparency, along with, I guess, the fear of making timely decisions, caused that project to end up where it did.

You couldn't ask for a better model in terms of governance and competency with respect to project managers. That would be my example.

The Chair: Hugh, did you have your hand up to respond to that?

Mr. Hugh Mackenzie: I will.

As a general proposition, I would say, speaking to government, that if you can't manage a project yourself, you're probably not going to be successful at managing a P3 arrangement either. One point made, which I think is really important, is that a number of the arguments that are advanced for P3s identify really dumb ways governments go about running long-term infrastructure projects. Maybe I'll be generous and say that it's an open question as to whether government is capable of doing a better job of this or not.

As an example, managing over a life cycle, making provisions for life-cycle maintenance of a project that you built—those are the kinds of things that anybody, any home owner or anybody who has responsibility for an asset, automatically does.

Governments have a tendency to panic cyclically when it comes to their budgets. The first thing to go when the economy turns down is infrastructure spending; the second thing to go is maintenance. It's simply a matter of pushing those costs out into the future.

I guess I'm enough of an optimist about the ability of the public sector to fix itself to say that I don't think we should necessarily be prepared to pay the kind financial penalty that we end up paying simply because, as a public sector, we're not able to manage these large infrastructure assets sensibly.

The Chair: We're out of time, but Mr. Romoff wanted a brief comment.

And then, Linda, I will give you a chance to do a supplementary if needed.

Mr. Mark Romoff: I just wanted to add that while the role of the council is to promote greater uptake of public-private partnerships and innovative approaches to infrastructure development and service delivery through public-private partnerships with all levels of government, the reality is that P3s are not the be-all and end-all. It's not the right approach in every instance. It is certainly a very valuable tool, an arrow in the quiver, if you like, of approaches to infrastructure development.

Value for money is a key factor in deciding whether you go down the P3 road or have traditional procurement. What I would add, too, is that if we could bring the same discipline and oversight to traditionally procured projects as is brought to P3s, I think you would find that those traditionally procured projects would also be far better delivered and with far better outcomes.

Ms. Linda Duncan: I have a quick follow-up question.

The Chair: Be brief, please.

Ms. Linda Duncan: It occurred to me, while I was sitting here listening to the presenters, that it appears that there are now... actually, you could call them lobbyists for P3s.

Obviously this is an area for business, where businessmen think they can make money. There are probably some projects that are ideally suited for that. In other words, certain corporate entities would like to get into some big projects.

A lot of the infrastructure deficit in this country right now is in the crumbling roads and sidewalks. I'm wondering if you could say if there are some areas where P3 works and others where it does not, and therefore the government should also be paying attention to how we can more effectively deliver the rest of the infrastructure.

● (0935)

The Chair: Finn, would you like to participate?

Mr. Finn Poschmann: Thank you.

It's a very good question, Mr. Chairman and Madam.

P3s are probably unnecessary in a range of circumstances. Let's divide up projects into ones where you have a really good idea of how to specify how to do the thing. For example, I know how to make coffee cups. I know how to make coffee cups on an industrial scale.

It's really easy to specify. There aren't a lot of ways to go wrong once you have the general idea. The transaction costs associated with negotiating a contract and risk sharing and the production process—they're not really worth it. You can just specify that you want some coffee cups and I'll deliver them, so it's not a good P3.

Let's suppose you want to build a fairly complex system, like a hospital, and you don't know, as a public partner, the right mix of capital that should go in up front, how much you're going to have to set aside for operating costs down the road, what bits of machinery or operational repair, capital expenditures, or costs you're going to bear down the road—you don't know all of that stuff, and you don't have to. What you do know is that you want a running piece—a running building, a running hospital system—for *x* number of years. You can leave that to your private partner to deliver on, and to take on the risks of delivering. When you don't know a lot about how to get there but you know what you want, then you write the contract that specifies the outcome and let the partner manage the risks to get there.

The Chair: Thank you very much, Mr. Poschmann.

We're well over time.

I'll be generous with all of the parties, with more like seven minutes or so, Jacques, if you would like.

Mr. Jacques Gourde, for the Conservatives.

[*Translation*]

Mr. Jacques Gourde (Lotbinière—Chutes-de-la-Chaudière, CPC): Thank you, Mr. Chair.

Thank you to the witnesses for being here this morning.

I have questions about public-private partnerships, P3s. I think there are advantages, as all of the witnesses say, when it comes to management and design. Witnesses have also said that Canada already has 20 years of expertise.

For my part, I have a question about long-term management expertise, after design, regarding the maintenance of the infrastructure. Year after year, new infrastructure managed by P3s are added, but do we have the necessary human resources to add more infrastructure that will require long-term maintenance? Over the first 20 years, expertise has been developed in human resources for long-term maintenance management, but new infrastructure is added year after year. In the future, there will be more new infrastructure. We know that expertise can always be developed, but do we have the capacity to do so in terms of human resources?

I would like to hear from the witnesses on that.

[*English*]

Mr. Michael Marasco: First of all, developing that expertise—there is a tremendous talent pool in Canada of people who have that long-term expertise. I think the challenge we often face in the public sector is this budget balancing exercise that you referred to. When you get into tight budget circumstances, the first thing that gets cut is maintenance. Once you get into that deferred maintenance cycle, it ends up costing taxpayers so much more money.

In our case, we have examples of projects where we've taken people out of the public sector who come to work for us to provide maintenance on the private sector side. We say, "Boy, it must be tough doing your job, because you're subject to abatement if you fail." You know what they say? They say that actually it's the easiest job they've ever had because they have the resources available for them to do their maintenance on time and to ensure that the facility is going to operate at optimum performance.

We've been in business in Canada and Australia. We don't have any problem bringing those resources to bear to serve, develop, and maintain these assets for the long term.

Mr. Hugh Mackenzie: I have just one quick comment. I would agree, but maybe cast it slightly differently. The issue that we confront in the long-term planning for infrastructure in Canada is not an issue related to the availability of financing and it's not an issue related to the availability of people; it's an organizational issue, a mindset issue.

The inevitable consequence of making your maintenance expenditures subject to the budgetary cycle, to the extremes that we have in this country at all three levels of government, is that you end up with maintenance backlogs that gradually evolve into infrastructure availability crises. We can see that; there are examples of that all over the country.

The issue for me is, what's the answer? We've identified a problem with the way the public sector operates. One answer is to give up on it and to pay an enormous price in terms of additional financing costs in order to get around that problem. The other is to look more carefully at the way we actually do these things in the public sector. I guess I'm an optimist. The second approach can address the fundamental structural problems in the way we've traditionally managed infrastructure in Canada, while at the same time avoiding paying these enormous penalties up front that we end up paying.

One of the observations that I'd make about P3s that is an unfortunate consequence—it's not anything that I think anybody who's promoting P3s is necessarily underlining—is they tend to reinforce this sense of unreality in people, that somehow we can get something for free, that if we have a project done through a P3, we're not paying for it; somebody else is paying for it.

I'll paraphrase my sometimes acquaintance, John Tory, who, some of you may know, made the observation—specifically with respect to public transit funding in the greater Toronto and Hamilton area—that politicians at all three levels of government have been in a state of denial when it comes to transit in Canada. They've been trying to pretend that there's some way of getting this stuff built without anybody paying for it. On that issue, I'm pretty small "c" conservative. I don't believe you can get stuff that you don't pay for. Any two-year-old knows that.

I actually don't think we're going to be able to succeed in coming to terms with this infrastructure funding and operation issue until we're able to confront the reality that we're going to have to ask people to pay for things.

● (0940)

The Chair: Mr. Romoff would like an opportunity to respond briefly, Jacques. You still have one or two minutes left.

Mr. Mark Romoff: I just wanted to pick up on Hugh's point that there are some who believe that it's good to go ahead with a P3 because they won't have to worry about the funding, but in fact that's very much the wrong reason to go ahead with a P3, and we would never encourage that.

When you move ahead with a public-private partnership, the debt obligation is on your books right from the outset. There is no off-book accounting here for P3s in Canada. The reality is that if you don't think you're going to have to pay for it, that reality will come home pretty quickly when you move ahead. All the more reason why it's critically important to understand at the outset the conditions around moving ahead with a P3.

That's one of the reasons we've had such tremendous uptake on the P3 guide; it tries to address some of these issues that have been subject to interpretation. People need to understand clearly what the rules are going forward in order to design and develop a truly "well-architected" partnership that will get the outcomes we're talking about as the derivatives of really successful P3 projects.

Thank you.

The Chair: Jacques, I'm afraid you're pretty much out of time.

Thank you very much.

Next, for the NDP, Kennedy Stewart. Welcome to the committee, Kennedy.

Mr. Kennedy Stewart (Burnaby—Douglas, NDP): Thank you very much, and thank you to the witnesses.

I had the great pleasure of working in the U.K. for some time in units that were looking at private finance initiatives, PFIs, and P3s. They have a wealth of knowledge, so I'm glad we've referred to them here today. It's worth looking at their really mass experimentation with this model.

One thing I learned from being there, of course, is that it's not just contract conditions; it's monitoring. That's essential, and that's often where these projects seem to fall down. The contract conditions are probably not tight enough and the monitoring is also lax, and often companies are left to monitor themselves. But I know from my rational choice training that if monitoring costs more than doing the work yourself, then you probably shouldn't pursue these things at all. That's just my take on it.

Could I go back to your slide, Mr. Romoff, on the number of projects in Canada?

● (0945)

Mr. Mark Romoff: I think that will be possible.

Mr. Kennedy Stewart: I was struck by just how few projects you had on your slide.

Mr. Mark Romoff: There are 180 projects.

Mr. Kennedy Stewart: Right. We have the federal government and we have 10 provinces and three territories and 4,000 municipal governments in Canada. And we have how many projects?

Mr. Mark Romoff: We have 180 projects.

Mr. Kennedy Stewart: For me, the beauty of federalism is that it allows us to experiment. If we have that many governments, why do we have so few?

Mr. Mark Romoff: There are some governments that have been strong uptakers, if you like, of this particular model. What we're finding now is that the marketplace is growing. The provinces that have not been engaged in P3 approaches are now looking very seriously at this. Saskatchewan would be the most immediate case in point that is moving ahead with a number of P3 projects. You're also seeing greater interest from the territories in the north. For instance, you might know that Nunavut is going ahead with their airport in Iqaluit, and they've announced it as a P3 project.

Again, part of the role of the council is to heighten awareness of this approach to infrastructure development and service delivery and to enable those who are thinking about it to develop a level of confidence and understanding. It's a bit of a hockey stick. When you look at the past 20 years, the uptake at the outset was very modest, but over the last five years, the degree of interest in P3s has shot up quite significantly.

Mr. Kennedy Stewart: You have 180 projects out of all of these potential ones. What slice of all of the projects in Canada would be P3s?

I will ask Mr. Gill, through you, Mr. Chair.

Mr. Vijay Gill: I alluded to this at the outset, and Mark said that certainly uptake has been increasing. It's never going to be 50% or 70% or 80% of all projects. Part of this is related to the transaction costs and the upfront costs, which are not fixed as a percentage of the project. They vary a bit with the percentage of the project's value. But essentially these transaction costs eventually have to make your minimum project size $30 million or $40 million or $50 million before it's even going to be on the radar for P3s.

You mentioned 4,000 municipalities. Many of the projects are obviously in the hundreds of thousands of dollars range. When you put them all together, municipalities spend about as much money as the provincial governments on infrastructure, but there are many smaller projects.

Mr. Kennedy Stewart: That's precisely my question. If this is something we should be seriously considering, why has there been so little uptake? I mean, there are political stripes of all different kinds in municipalities and at the provincial level. Why has there been such a low uptake?

Mr. Michael Marasco: It's already been mentioned. The issue is transaction costs related to these projects. They're very complex contracts. You're right, we call them partnerships, but they're in fact legal agreements. There's a critical size needed to make these projects viable so that the transaction costs don't overtake the value-for-money proposition. Generally, we're looking at projects north of $50 million. I would argue that, first of all, if you look at these 180 projects, the majority have been built over the last five years, as Mark has indicated. Second, I would say that the majority of them are north of $100 million. Most small municipal projects are not good candidates, and there are a lot of complex renovation projects that are not good candidates.

As Mark said, P3 is not a panacea for all project delivery. As was the case in the U.K., it probably covers only 10% or 11% of the total capital projects inventory. It's just one arrow in the quiver, and when properly applied, it produces strong value for taxpayers.

The Chair: Hugh, could you respond briefly to that as well?

Mr. Hugh Mackenzie: I don't disagree with any of that. It's an issue of scale. There needs to be a lot of money at play to make people interested in doing these things. But it does trigger a thought in my mind.

Take as a given structural issues, such as life-cycle management and ensuring that maintenance is actually done on time and that sort of thing. If we take that as a given, as a problem with the way the public sector in Canada manages infrastructure, and given the fact that P3s are never going to be more than maybe 10% or 15%, even if the fantasy world of the P3 proponents descends on us, the way the market works means that there aren't enough projects big enough to consume that much more. It just seems to me that there's an enormous return to the public as a whole for making the way we manage, maintain, and operate infrastructure over a life cycle more effective. Even if I were to concede that those projects that are of interest to P3 proponents are going to go the P3 way, that doesn't eliminate the need to address the issues that underlie the argument for P3s.

● (0950)

The Chair: Mr. Romoff has a very brief comment, and then I'll allow you a supplementary and we'll be done.

Mr. Mark Romoff: I have just one final point. I think in the case of smaller projects there's also the opportunity to bundle them together, where it makes sense, so that in fact you do have a large enough overall project and a critical mass to enable you to go ahead with a traditional approach to P3s. I would add, and you may have seen this in the case of the U.K., that in fact it has had a number of very successful smaller P3s, smaller than the $50 million or $100 million we're talking about here. There is an opportunity here for us to explore how the U.K. has approached this in order to see whether there are lessons learned that we could bring back to our municipalities across Canada.

I think over time we're going to see a larger number of smaller projects looking to this approach, as to whether it's viable or not. I think that may also prompt a little bit of a recalibration of the traditional approach to P3s in Canada to enable that to happen.

The Chair: Thank you.

You can ask a very brief supplementary.

Mr. Kennedy Stewart: I don't know if I'll have another round or not, but I hope I do.

One thing I could ask you to think about is...we've heard a lot about the success side, but I'm wondering about the failure side, because that's also what we have to warn governments about. I'm wondering if in the next round perhaps we could look at a point where a contract has failed and the government has had to take over the entire contract on either an operational or a capital project.

Maybe I'll just let you think about that and we can come back.

The Chair: I'm afraid we don't have time in this round. I've got to tighten it up a little bit or we won't get opportunities for everyone.

We're going to move right away to Mr. Bernard Trottier with the Conservatives.

Mr. Bernard Trottier (Etobicoke—Lakeshore, CPC): Thank you, Mr. Chair.

Thank you, witnesses or guests, for being here today.

Mr. Romoff, you mentioned that Canada is now considered the best in class when it comes to delivering P3 projects and in terms of its P3 model, even though the U.K. and Australia were early trailblazers. Can you just expand for the committee the elements of the Canadian model that make it best in class?

Mr. Mark Romoff: There are several features that are really differentiators in the Canadian context.

First and foremost are our procurement agencies across Canada. The creation of those agencies is in fact a unique feature. There are no other countries that have subnational procurement agencies engaged in this space. That brings an approach and professionalism that is quite unique. More importantly, these agencies have really streamlined the process for P3 procurements to the extent that you get a far better disciplined and tight timeframe, and that's resulted in significantly reducing the time from a project going out to RFQ or RFP to financial close, such that in some cases—in fact in the Canadian case it's virtually half the timeline of the U.K., which is in great part why the U.K. is now looking at our approach to this sector.

The other thing I would say is that we are very open in Canada to international engagement in our infrastructure development and we put high value on the competitive process. That levels the playing field for all, and the outcome of that has been that you get much more competition in every project that goes out to bid. That tends to drive more innovative solutions, and it certainly drives down the cost, so it is a differentiator.

● (0955)

Mr. Bernard Trottier: Those are good practices on the procurement end. What about on the delivery end? Are the companies engaged in delivering on P3 projects also best in class?

Mr. Mark Romoff: That's probably a question I would turn over to Michael.

Mr. Bernard Trottier: The supplemental part of that question is this. Is that a unique expertise we're developing within Canada that can be exploited in terms of being able to sell that expertise internationally?

Mr. Mark Romoff: Let me just make one comment on the procurement models that are used. In Ontario, it's Infrastructure Ontario; in British Columbia, it's Partnerships BC. Those particular approaches to infrastructure development are highly sought after internationally. There are a number of countries around the world that are looking to move ahead with the P3 approach to infrastructure development, but they don't have either the capacity to do it or a good enough appreciation of how you put in place a framework to enable it to happen.

What we're seeing is that there is a considerable degree of interest, including from the U.S. and from states in the U.S., in what the approach is of Infrastructure Ontario or of Partnerships BC, with a view to taking that approach, adapting it to their particular environment, and moving ahead with P3s. That too reflects the view internationally that Canada has got it right and that it's a process that's adaptable in other environments.

Mr. Michael Marasco: To answer your question with respect to the Canadian competencies that have been developed, because of the fierce competition from international players, the Canadian companies that have formed have had to become much more competitive to survive. I would argue they're thriving because now we've got great examples of Canadian companies competing abroad on PPP projects. PCL, Canada's largest constructor, just won a major project in Australia for a $1 billion-plus cancer centre. EllisDon has operations in the Middle East. Aecon is doing airports around the world. These are all Canadian construction companies that have developed tremendous success records overseas as a result of the $58-plus billion of projects that have been done here. It creates more Canadian jobs, it exports Canadian expertise, and it is good for the economy here as well as for those entities.

Mr. Bernard Trottier: Good. Thank you very much.

I want to change the subject a little. You know that in the province of Quebec the issue of corruption in the construction industry is front and centre, and indeed that's a concern throughout the country. None of you really talked about it in your comments, but just in terms of the traditional versus the P3 model, in terms of their vulnerability to corruption, are there check points within the model within a P3 environment that might mitigate those kinds of points? I'll ask the other guests to weigh in, starting with Mr. Gill.

Mr. Vijay Gill: I think one good point that's been made is that in either case you're doing some sort of procurement for these large construction projects, so you're still sending out something to be bid. In many cases, you're still getting the same types of companies that might give some good examples of that.

At the very least, if there's a risk, the risk is still present in any type of procurement process. I think the potential mitigation the P3s may have is in the enforcement of the contracts. This may relate to the private finance issue. If it is financed privately and someone else is on the hook in case something goes wrong, it's much easier for the government to say they're just not paying them now. Sure, they're going to have to take over the project as it is now if they're committed to delivering the project, but they're not going to pay them. So they're not going to be able to pay back whoever gave them money in the first place. That is unique to something that is privately financed.

Mr. Bernard Trottier: Briefly, I know there's not a lot of time, but are there comments on that?

Mr. Finn Poschmann: I agree with Mr. Gill's comments.

I've never seen corruption in a P3 contract, which is not to say that it doesn't exist or will never exist. The risks are always there in the process. But one of the things that you can ensure, or look to ensure, is clarity in terms of the contract, and sunshine. Sunshine is a good disinfectant. This is something of a controversial issue when it comes to contracting.

I've seen a bad P3 contract. I'll point out a couple of things, and I'll have to leave parties nameless. The contract allowed the private partner to specify the terms of performance, the metrics by which performance will be measured, and to implement the systems that ran the metrics, that produced the performance measure, and the bonuses associated with the contract. That was a really bad idea. There is something else about it too. I sat in a room with a couple of project proponents and read through the contract. I wasn't allowed to leave the room with the contract; I wasn't allowed to take photocopies of any pages. I had a piece of paper and a pencil that I could make notes on, and that was absolutely it. The contract was not in the public domain.

If the parties knew early on the contract was going to be in the public domain sometime after it was let, after they'd been through the bidding process, probably there would have been more discussion about the terms of the contract early on and sunlight would have prevented at least that kind of problem. I won't call that corruption, but certainly it was a bad contract.

● (1000)

Mr. Bernard Trottier: Thank you.

The Chair: Thank you, Mr. Poschmann.

Hugh, you were waiting.

Mr. Hugh Mackenzie: I want to enthusiastically endorse the comment about sunshine. One of the real challenges for people who are outside the circle, as I am, in doing critical analysis of these things is the paucity of information that's available to evaluate these contracts.

Several years ago, for example, I did an analysis after the fact, after the contract had been let—a P3 contract to build the hospital in North Bay, Ontario—and literally every iota of that contract that had anything to do with money was redacted. It was impossible to tell what the terms of the contract were. Hundreds of pages were made available on Infrastructure Ontario's website, but not one number. It was as if somebody did a search and replace with a black line for anything that was a decimal. Transparency issues, I think, are really critical.

The Chair: Thank you, Hugh.

Mr. Marasco asked for a final comment, and then we're out of time —well over time, in fact.

Mr. Michael Marasco: I have a really practical example. I would argue that there is greater protection under a PPP procurement, and the reason is that there's so much at risk for proponents. There was a federal contract that we recently won for the Communications Security Establishment Canada project. It's a billion dollar plus project, and we had probably $4 million to $5 million of bid costs at risk. If you think I'm going to risk $4 million or $5 million of our own money by going and lobbying someone that I shouldn't be lobbying.... It's a huge deterrent.

I would argue that Canada stands above many countries in the world—we've looked at other countries around the world—and it is as clean as it gets, because you're just not prepared to risk that kind of money for the lobbying effort.

With respect to the sunshine and the transparency, there's an unknown little bit of information that I'll point my research colleagues to. All of these deals are publicly rated, because they're typically financed with bonds, and all of the detailed financials for the projects are available through S&P ratings directly, or whoever did the ratings report. So it's all publicly available if you dig deep enough.

The Chair: That's interesting.

Thank you, Bernard. That's well over time.

Now, finally, the Liberals and John McCallum.

Hon. John McCallum (Markham—Unionville, Lib.): Thank you, Mr. Chair, and thank you to the witnesses for being here.

I'm a little concerned that who I might call the four pro-PPP people didn't answer very directly the points made by the one less pro-PPP person, Mr. Mackenzie, in particular when he said that a one percentage point difference in interest rate can have a very large effect. Then I noticed in the *Globe and Mail* article yesterday by Barrie McKenna that he cited academic research regarding 28 Ontario PPP projects that says they cost 16% more than conventional ones.

I notice in this document by John Loxley that he refers to a Moncton water treatment P3 plant that has a lease equivalent to a 10% interest rate, when the city could have paid less than 6%.

So there seems to be significant evidence in various places that P3s often cost more. How would you respond to that?

The Chair: Mr. Romoff.

Mr. Mark Romoff: I will quickly defer to others, but what I would say again, with respect to the U of T research, and we know the researcher well, is that it comes back to Mike's point that the analysis around cost is done on the front-end construction costs as opposed to whole-of-life costs. If you look at Matti's work and his own recommendations, in fact what he's saying is that, done properly, and where value for money is demonstrated, P3 is the way to go.

The reality is it depends on where on the timeline you choose to do your analysis. I think the focus of our approach has been whole-of-life cost, and looking at that relative to—

● (1005)

Hon. John McCallum: Well, it would seem fairly evident that the research, then, is fatally flawed. Is that what you're saying?

Mr. Mark Romoff: I would say the research is excellent. The slice of it that was used to prepare that article would lend itself to interpretations of the kind that maybe you and others—

The Chair: Mr. Romoff, that was pretty good dancing.

We have lots of interest for comment here: Mr. Poschmann, then Mr. Mackenzie, and then Mr. Gill. I think that will probably take up our time.

Mr. Finn Poschmann: Thank you, Mr. Chairman, and thank you for the question. I was waiting for it and looking forward to it.

The yield at which, say, Triple-A federal government bonds are sold is typically going to be 1% or 1.25%. It would be foolhardy, however, to imagine that this represents the cost of borrowing that one should transport and carry over in comparison to a P3 contract.

First of all, the debt incurred if the financing is done in-house bears an opportunity cost. It's money that could have gone somewhere else; it could have gone to debt reduction. Here the Parti Québécois, in the course of its most recent election in Quebec, was on to something when they said that perhaps government ought not to be investing in risky assets on behalf of its residents, but reducing debt, because the risks associated with debt reduction are approximately zero and you have a known return: you have the interest costs avoided by reducing your debt instead.

On the first instance there's an opportunity cost associated with government taking on the financing. Second, there is of course the dead-weight loss associated with the implicit tax burden associated with debt. You have to do a little calculation after the fact to account for the fact that taxes cost money, they impose a burden on the economy, and the effective interest rate in net present value terms is much higher than the 1%, because there's a cost of taxation associated with it.

Then, of course, there's the financing risk itself. If government takes on full financing—

The Chair: I'm going to have to interrupt you. We want to give the others opportunities. You've made some good points.

Mr. Mackenzie?

Mr. Hugh Mackenzie: Yes, just briefly. I wasn't going to say anything, actually, but when Finn referred to the taxes as a factor that weighs on one side of this equation, of course taxes are paying for the ongoing costs of P3s as well. I don't see how that's not just neutral, as between the two.

Also, I really don't think it's an issue that it costs government less to borrow money than it does the private sector. I hope I'm not putting words in people's mouths, but the issue is, are there other benefits that come from this form of organization and management of infrastructure that offset those higher financing costs? My position is that if we have problems with the way we run infrastructure in Canada, we should design systems and redesign our way of accounting for things, so that there's an incentive in the public sector to do the right thing, not only on the 15% that we do through P3s but on the 85% that we don't.

The Chair: Thank you, Mr. Mackenzie.

We'll hear very briefly from Mr. Gill, and Mr. Marasco would like a brief comment, but then we have to move on.

Mr. Vijay Gill: I'll just say that part of the reason why this is very confusing is that there are two different measurements here. Finn was talking largely about the welfare measurement—the overall efficiency gain—and generally the VFM speaks to the government fiscal balance, to the government fiscal perspective, to how many dollars are coming in and out. They're two different things.

I won't elaborate on that right now, but maybe that's part of the confusion.

The Chair: Thank you.

Mr. Marasco, briefly.

Mr. Michael Marasco: Thanks. I'll be brief.

I keep hearing about this enormous cost of private sector financing. Again, I think you have to take it into the perspective of looking at that whole-of-life cost, because the reality of it is—as I said with that example of the Vancouver trade and convention centre —that the government borrowed $365 million more than it needed to, right? That was at a lower interest rate, at a lower cost.

As I said, I've wracked my brain against this problem for 26 years in the public sector, working with some of the brightest minds that I've come across—still—and you cannot replicate in the public sector what occurs on the private sector side of these projects.

I agree with you in that as a taxpayer I think there is a need to try to continue to improve those systems, but I'll tell you that after 30 years I can't think of a way that you can actually do it.

Thank you.

● (1010)

The Chair: John, I'm afraid that used up all the time, but it was a very good question and it generated a very interesting debate.

Ron Cannan.

Hon. Ron Cannan (Kelowna—Lake Country, CPC): Thank you, Mr. Chair.

Thank you to our witnesses for a very interesting discussion on a very important proposal and process as we move forward. As indicated, it's in its infancy in many ways.

Coming from British Columbia, I'm very familiar with Partnerships BC and the Okanagan Lake floating bridge.

Mr. Marasco, I'm sure you're familiar with that—as well as others who have studied a P3—and the success that has been for the community of Okanagan Valley in Kelowna—Lake Country, which I represent, and for all of British Columbia.

I just want to connect with Mr. Poschmann.

Finn, you're very passionate about your policies on this specific issue. Maybe you could elaborate. Specifically, my legislative assistant, in working on some research, found that the more detailed the contract or agreement, the better likelihood for a successful outcome. Is that your analysis?

Mr. Finn Poschmann: Yes, I think that would generally be the case. You can't specify everything, but you're always going to do the best you can. Each gap that's left in the contract will be an opportunity for error, oversight, or potentially asymmetric information, as between a proponent and the government.

Hon. Ron Cannan: Mr. McCallum made a good point about the article in the *Globe and Mail* that was referred to. One item—I picked it out right away—was this: how do you quantify risk and how do you establish risk premiums? You started to talk about it briefly and got cut off.

Maybe you can share that with us, the fact that the cost over an allocation is fixed in P3s specifically as an incentive to finish on time and on budget, which is very important, whether it's private or public sector dollars.

Mr. Finn Poschmann: How the private proponent goes about pricing risk will be specific to that proponent and the project. In economic terms, risk is a product of the likelihood of an outcome, and the harm or benefit associated without the outcome, if that occurs. This is what the private proponent will assess in pricing contracts or pricing their own cost at which they're willing to undertake the contract.

Maybe some of my other practitioners here will have comments on that as well.

Mr. Michael Marasco: I would just say that as a result of the intense competition in the Canadian market now, the risk premiums we would typically charge for these contracts have dwindled. It's a function of competition.

To quote the Auditor General in the U.K., value for money is a function of efficient risk allocation and competition. If you get those two things right, you're going to optimize your value for money, and I think we're seeing that in Canada right now with the tremendous amount of competition in the market.

Hon. Ron Cannan: Just to follow up, there's the statement:

> Set the value too high, and P3s become vehicles for governments to subsidize inflated profits of powerful and well-connected contractors and financial institutions.

I don't know if anybody wants to comment on that particular statement.

Mr. Michael Marasco: I wish we were one of those. That doesn't exist. There was a comment made earlier about private sector profits. Our economy is built around private sector entities making money so that we can pay taxes and fund government. That being said, the only way we make money is to get a reasonable return on equity, and we will earn a development fee if we do a good job of managing those risks.

As a little Canadian company that started in 2005, we've now built 12 projects, $6 billion in infrastructure in Canada, and not all of those projects are profitable. You are going to have winners and losers. If we do a great job of managing those risks, we're going to have more winners than losers.

Hon. Ron Cannan: Just following up with Mr. Marasco, coming from British Columbia, I know you had a wealth of experience with the Fraser Health Authority and the very successful Abbotsford hospital project. I was at the groundbreaking on Friday in my constituency of Kelowna—Lake Country for the Interior Heart and Surgical Centre. It's been a great success, and Plenary is one of the leading partners on that. Maybe you can expand on the success of the Abbotsford hospital and why the Cancer Centre partnership was awarded the *Project Finance* magazine 2004 PPP deal of the year for North America.

● (1015)

Mr. Michael Marasco: Thanks. Yes, I was on the government side for that transaction for the Abbotsford hospital project. It was a groundbreaking project not only for the government but for the industry. It was deal of the year because that project was the first hospital project in decades in British Columbia that had not been over budget and that came in on time, so for the government of the day it really solidified the model and the need for it to continue to implement that model.

By comparison, with the Jim Pattison Pavilion at VGH, the government built that project and it sat empty for 10 years because it didn't have the money to finish it. They had to re-roof it before they actually fit it out and started using it for patient care. In addition to the value propositions that come from these in terms of risk transfer, I think the fact that we built $50 billion worth of hospital projects in this country over the last five years speaks to the ability to get these things built and done.

Abbotsford spent 20 years in the planning process, with failed start-ups, and the thing never got done. We just can't afford not to have the infrastructure we need to serve Canadians.

Hon. Ron Cannan: Congratulations.

There was some comment about the Ontario government and P3s, but I understand there is an opportunity for a new leader in the provincial government there. One of these panellists might be interested.

Are you planning on immigrating?

Mr. Hugh Mackenzie: I'll leave that to you, thanks.

The Chair: I'm sure they would benefit from your experience, Ron.

That concludes our first round of questioning. The difficult thing about being in the chair is that I don't get to participate in these rounds of questioning. Some people view that as a good thing.

I have one question on a general policy level, if you don't mind taking it. I disagree, Mr. Marasco, about hospitals. The general conditions and specifications for hospitals are pretty standard. They are almost cookie-cutter buildings in a sense, whereas the convention centre in Vancouver is seven acres of sod roof cantilevered out over the ocean. Wouldn't we be better off considering P3s for the difficult, high-risk buildings and doing the cookie-cutter ones ourselves? Gary Doer always used to say there's a tendency to privatize the profits and socialize the losses. It seems to me we're handing out all the low-hanging fruit, all the easy stuff, and keeping the difficult, expensive stuff in our own public domain.

Mr. Michael Marasco: That's a great question.

Having built a convention centre ourselves on the waterfront in Melbourne, and several hospitals, I would argue any day that a hospital is much more complex and a much more critical environment than a convention centre. That's point number one.

Hospitals are anything but cookie cutter. In the case of the Interior Heart and Surgical Centre that Mr. Cannan referred to, that is built on a very unstable foundation, and it's a very complex building on a very complex site. It's way more difficult than any convention centre we've built.

Do you know what? I think to your point, and it speaks to the earlier questions about what works for PPPs, the reality is there is a stronger value proposition the more complex the project is. There's no doubt about it.

The Chair: Thank you very much. That's helpful.

We're going to start our next round of questioning. We have only 10 minutes left, so perhaps we could keep it to strictly five minutes each. That would give us time for one New Democrat and one Conservative, and then we'll cut it off at exactly 10:30 a.m., as we do have some business in camera that we need to do.

For the NDP, Jean-François Larose.

[*Translation*]

Mr. Jean-François Larose (Repentigny, NDP): Thank you to our witnesses for being here.

Thank you for the answers you are giving us, even though, personally, I find myself with more questions than answers.

In the arguments, it is always traditional contracts that are compared. We don't hear anything at all today about the public sector, quite simply, for undertaking work. Failures have been mentioned concerning the government, and P3s seem to be the solution. However, I have difficulty with the fact that we're not talking at all about correcting failures within government.

My question is for Mr. Mackenzie, whom I thank for being here today.

A major argument for promoting P3s gives the illusion that risks are shared with the private sector. However, in reality, when P3s run into major problems, it's the public that suffers the consequences. For example, in cases of bankruptcy or *force majeure*, it is the public that pays the bills.

Can you talk to us about what you call walk-away risks, and give us a few concrete examples of when costs for taxpayers and the public sector turn out to be much higher than expected?

● (1020)

[*English*]

Mr. Hugh Mackenzie: With respect to the last part of your question, there's a good inventory of a fairly large number of projects, and I'll put in parentheses that I'm sure my colleagues will say that many of those projects are from the bad old days when things weren't done as well as they are today. If committee staff or you or your staff look at the Boardman and Vining paper, that has a fairly careful review of a fairly large number of projects.

On the question of risk, risk allocation and risk transfer is an issue that is really in contention amongst people who study this; I will acknowledge that. The accountants' study that I referred to in Britain looked at an extensive list of P3 projects, largely in roads and hospitals, and came to the conclusion that when you actually drilled into the details of those contracts and looked at how they actually operated, there was very little risk that was transferred, and there were new risks that were created that were related to the survival of the entity, the viability of the entity that had the responsibility for operating the project.

I would further say, in regard to the issue of what value gets placed on the risks that are transferred, at least in Ontario, if you look at the way Infrastructure Ontario explains value for money, the overwhelming majority of the benefits associated with P3 projects in the Infrastructure Ontario model have to do with very large values that are assigned to risk transfer. Interestingly enough, their analysis does not highlight what I would have thought, given the comments that we've heard today, would be more important things, which are improvements in life-cycle maintenance cost, expected better performance at the end of the contract, and so on.

The Chair: Is there anyone else who would like to comment on Jean-François' point?

If not, you have about a minute and a half, Jean-François, for a second question.

[*Translation*]

Mr. Jean-François Larose: Okay.

The current problem is that the position always seems to be to say that P3s will be a magic bullet. However, P3s only started to be developed in Canada in the 1990s and, as you mentioned, there were a lot of problems.

It seems problematic to me that such a firm position is being taken, according to which P3s are a panacea. I heard you say that we had to be careful and that they weren't applicable in all cases. I think that is very good, as a matter of fact. Moreover, we need an adaptation period.

My problem is that I don't know what we will end up with at the end of the contract. At the end of the day, no matter what is said, the risk is still taken on by the public. Unless I am mistaken, we will be the ones who end up paying for the mistakes that will be made. Having a much more modest approach would be greatly appreciated, because after all it is our money being managed.

I don't know if you have comments on that.

[*English*]

Mr. Finn Poschmann: I can field that if you like.

The governments and proponents both go through a learning process. Some time ago, I wrote a chapter with Boardman Vining where we looked at North American P3s, some successes and failures. An example was a toll highway that I believe was in North Carolina. It was written with a contract under the expectation that toll volumes would be much higher than they were. The private proponent got in a bind with respect to bond financing, tolls went up, traffic went down, and they got into a worse bind and had to walk away. The government was left with a very expensive highway that nobody really wanted to use much. This was a failure. It was a bad contract design, and the governments and the proponents got it wrong in how they managed the bond issues and the financing terms around them. You learn. If you say, “Doctor, it hurts when I do that”, don't do that. You learn and get better.

● (1025)

The Chair: Thank you, Finn.

Mr. Marasco, comment very briefly, please.

Mr. Michael Marasco: In general terms, with respect to contract failures, I can give you some really good case study examples where when these projects fail, it's our equity at risk, it's the bond financing that's at risk. If that goes sideways, taxpayers are generally picking up an asset for cents on the dollar.

A good example is in Australia, Latrobe Hospital, where they did transfer revenue risk to the private partner, the private partner couldn't make it work, and after three years it went into receivership and bankruptcy. The government picked up a brand-new hospital that they said they needed—otherwise they wouldn't have procured it—for 85¢ on the dollar. That's not a bad deal for taxpayers. Yes, it was stressful for everybody, but generally that's what happens in these transactions.

The Chair: Thank you, Mr. Marasco.

Finally, we'll have Peter Braid for five minutes.

Mr. Peter Braid (Kitchener—Waterloo, CPC): Thank you very much, Mr. Chair, and thank you to the panel of experts for being here this morning.

To start with you, Mr. Poschmann, I'm curious about this. In your estimation, are there any differences in the level of private sector job creation when comparing traditional government procurement infrastructure projects with P3s?

Mr. Finn Poschmann: That's a good question. Thank you, Mr. Braid.

I'm not sure I have a clear view on that. Certainly if you do an in-house procurement and all the facets to go along with that—for instance, some highways departments have their own repair/maintenance facilities. Some municipalities are even considering acquiring equipment for their own construction. A lot of in-house jobs are going to be associated with that. Is that a good idea? It doesn't strike me as likely, because this is an area where the private sector demonstrates that it's very good at doing something and the public sector contracting agency doesn't have to take on the risks of acquiring equipment, doesn't have to build the processes, the payroll, and the constituency that goes with it when you do this in-house. So whether there are more or fewer jobs, I'm relatively unconcerned. The idea is that the jobs should be done by the party best able to do them and best able to manage the risks.

Mr. Peter Braid: Mr. Marasco.

Mr. Michael Marasco: I would argue that it ends up in the long run, because of the knock-on effect, generating more jobs. The case in point is when we develop this expertise in the private sector in Canada and are able to export that expertise abroad; it has a multiplier effect. The expertise, for example, that PCL developed in Canada around PPPs is exported to Australia, and likewise with other construction companies. They wouldn't have done that if these jobs had been performed in the public sector.

Mr. Peter Braid: Thank you.

Mr. Romoff, you mentioned that the marketplace for P3s is growing. What's causing that?

Mr. Mark Romoff: I think at the heart of it is a large infrastructure deficit in Canada. That's prompting a really serious look at how to address that issue, and again we're in a time of fiscal challenge, so that requires a really good look at possible approaches. Which are the most innovative ones? That's prompted a lot more interest in the case of P3s.

As I mentioned earlier, I think you're seeing this growth in the market reflected in provinces that haven't historically been active in this space—Saskatchewan is a case in point—and a growing interest on the part of municipalities that are looking at this approach.

Mr. Peter Braid: Thank you.

Mr. Gill, in your opening remarks I think you made reference to the fact that often with P3 projects there is bundling of the components. Why are the components of a P3 project typically bundled? What are the advantages and disadvantages of that?

● (1030)

Mr. Vijay Gill: I would say that they're not necessarily typically bundled, and this is the whole grey area of what a P3 is or is not. Many of the hospitals we're talking about in Ontario, for example, don't even have an ongoing operating or maintenance phase. There's simply the construction period. The reason we want to bundle the two is that if you are responsible for maintaining an asset for 30 years, you are probably going to take a little more care up front to make sure it lasts, so you will minimize your costs over the life cycle. The more you do that, the more you are probably going to pay up front, but the benefits should be stronger. I think we should be clear about what is and what is not bundled within a P3 space.

Mr. Peter Braid: Thank you.

My BlackBerry says it's 10:30.

The Chair: Thank you very much, Peter, for sharing that with us.

We've had a very interesting debate.

I thank all of the witnesses for points well made and well argued. This opens the first meeting of many as we study this issue. We thank you very much for your time and your presentations today.

We will suspend briefly to allow the witnesses to leave, and we will return in camera.

[*Proceedings continue in camera*]

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