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BUSINESS FRONT LINE

Japan aims to catch up with U.K.'s PFI drive

By Ginko Kobayashi, Special to The Daily Yomiuri

Yakumomura in Shimane Prefecture last year built the nation's first school meal center to be set up under the private finance initiative(PFI), a new scheme in public sector procurement.

“We didn't have enough cash to build the center on our own, and subsidies from the central government were limited, so PFI was the only solution,” recalled village Mayor Norifumi Ishikura.

With PFI, the initial construction costs came to ¥30 million, instead of the ¥100 million it would have cost with conventional procurement. But the biggest benefits, according to Ishikura, were that the facility was built with the latest hygiene- and quality-control systems, which the village could not have afforded with limited subsidies, and the fact that private sector is now committed to maintaining these high standards for the next 30 years—the duration of the contract.

PFI was conceived in Britain 11years ago as part of a concept called private-public partnership(PPP), according to which the public and private-sectors work together to provide better public infrastructure and services.

Under PFI, a private consortium is formed—usually consisting of a construction company, a facilities management firm and banks—which then finances the costs of building and running public facilities and provides services for the duration of lengthy service contract.

The Public sector can spread the costs of such projects over an extended time period and can build whatever facilities are needed. The private sector partner, on the other hand, takes responsibility for the quality of the design, and construction, and for the long-term maintenance of the asset, to guarantee value for money.

The scheme had its greatest appeal in the late 1980s when a cash-strapped British government was determined to reverse the 1970s trend of underinvestment in the public sector, but had little cash in hand with which to do so.

In Japan, following the 1999 enactment of the private finance initiatives law, PFI projects have been rapidly on the rise, and the scheme has proven particularly attractive to local governments suffering from ballooning debts and declining tax incomes due to the prolonged recession.

The political climate also is pushing local municipalities to adopt PFI solutions. Prime Minister Junichiro Koizumi's message to local governments has been "Do what you can by yourselves."

Kazuo Ueda, an expert in project finance, said he finds at least a couple of PFI articles a day in construction business newspapers to which he subscribes.

Ueda, managing director of the Japan PFI Association in Tokyo, a nonprofit organization to help spread PFI, interviewed Ishikura, other local municipalities that have adopted PFI and construction companies, then compiled the interviews into a book "PFI de shisetsu ga dekita" (We built facilities using PFI)

So far, he has given more than 200 lectures on the scheme to about 20,000 eager-to-learn audiences, mostly local government officials.

In fiscal 2000, the total budget for PFI projects nationwide on an initial cost basis was ¥14.8 billion, which jumped to ¥181 billion in fiscal 2002. Ueda envisages the budget in fiscal 2003 will exceed ¥200 billion and the market will grow quickly to ¥1 trillion.

Currently, about 100 PFI projects are either under way or included in budgets, and think tanks are researching an additional 100 PFI projects.

In Britain, about 560 PFI projects with a total capital value of £ 35.5 billion have been carried out, including constructing, refurbishing and running schools, hospital and prisons.

On average, British taxpayers saved about 17 percent of the costs of government procurements with PFI. Costs and budget overruns, which were the norm in Britain's public procurement projects, were drastically reduced because, under PFI, the public sector can delay payment or even impose penalties on private sector firms in such cases.

About 60 countries are now trying to follow suit.

While PFI has become a good export for Britain, the private sector has cited concerns over high bidding costs and long procurement periods.

Stephan Harris, head of the international section of International Financial Services, London, a British think tank, said that due to the nature of PFI projects, which calculate benefits according to the costs of an asset over its life span, "the private sector has to do a lot of preparation" before bidding.

A bidding firm must be of a certain size to be able to write off the massive costs of research and feasibility studies if its bid is not chosen. This blocks new entrants or small construction firms from participating in PFI, observers said.

In its latest report on PFI, the British Treasury concluded that for a small project, costing less than £ 20 million, the PFI option may not provide value for money. Nor does PFI suit information technology projects, it said, because the speed of technical advances in IT is so fast that contracts need to be renegotiated frequently.

Currently, PFI projects make up about 15 percent of the total public works projects in Britain, although actual private sector involvement is much higher than this figure indicates as outsourcing has been extensively adopted.

Harris believes the most interesting feature of PFI is not cost reduction, but innovation because it allows the private sector to determine how to deliver services.

One example of innovation he cites is a Glasgow school project in which 10 percent of the money the private firm involved receives is based on academic results. “If students perform better, you’ll get more money. They’re performing better at exams because they have an increasingly better environment and equipment, and the company is getting more money,” he said.

He feels that people overemphasize the cost element. “Why does it have to be cheaper? It should just be better,” he said.

Ueda thinks Japan has a lot to learn from Britain’s PPP, such as how to make a good comprehensive design, which includes function, aesthetics and cutting down costs over the project’s life span. Standardized contracts also should be adopted, he said.

Japan’s public tender system limits the room to negotiate details once the bid is chosen, which also is a major problem, Ueda said.

More broadly, Ueda believes PFI can introduce the concept of project financing to Japan. For 20 years at Itochu Corp. and at Morgan Grenfell, Ueda tried in vain to do this.

“Up until now, Japanese businesses have not considered the profitability of each project to be very important. The common practice is for banks to lend money if borrowers have collateral, such as land, or have a business relationship with them,” Ueda said.

“But it’s about time this changed. People should gauge the future risks of a project and then decide on its financing, based on feasibility studies of the risk factors,” he added.

In May, major developer Mori Building Co. sued the government for not choosing its proposal to build a Diet member housing facility in Akasaka, Tokyo, using PFI. It insisted its plan for a 40-story housing facility that included more commercial space than other bidders’ proposals would bring better value for money in the long run.

Mori Building’s bidding price was higher than that of the other bidders, and the contract was awarded to the firm that tendered the lowest bid, prompting some observers to say public sector mentality has not changed. They accuse the public sector of automatically choosing the lowest bid, rather than assessing each bid with an eye to the long-term value and quality of services.

“We’re still in a trial-and-error phase,” Ueda said.

But he also said he had a hunch: “When Japan’s PFI has grown to a certain level and other Asian nations are interested in PFI, my feeling is that our neighbors will turn to Japan, rather than Britain.”

Banks seem to have been building up experience. According to Harris, Japan’s leading commercial banks top the list of major investors in Britain’s PFI.