

Japan Economic Comment

Will PPP/PFI projects take off in Japan?

Economics

Japan

Summary

The government is in the midst of talks about new reforms to income and expenditure towards restoring a healthy budget, and one highlight is the drive to maximize the use of PPP/PFI to build efficient social capital, starting with sewerage/waterworks utilities and housing. If the government can actively adopt PPP/PFI schemes, they could not only improve confidence in restoring fiscal health by downsizing the public sector and by expanding private sector business but also create an industrial structure grounded in market principles that could lead to a favourable view of the Japanese stock market.

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Japan's current PFI/PPP at a glance

PFI projects in Japan expanded to reach about ¥4.5trn at the end of FY14, after the relevant legislation was put in place in 1999. In June 2014 the government said capital value was to expand to ¥2–3trn by the end of FY16, with specific targets set for the number of projects. However, PPP/PFI as a proportion of public investment over the past 10 years works out at a mere 1.6% in Japan compared with 8.4% in Australia and 12.3% in the UK.

Background to PFI business expansion in the UK

What the UK example shows is a dynamic state-level drive towards small government. The UK first decided to adopt PFIs in 1992. 'Universal testing' was then introduced in 1994, requiring PFIs to be considered for all public sector projects, leading to growth in the use of PFIs. When the new Blair labour government took office in May 1997, it introduced Public Private Partnerships (PPP) to generate public-private sector collaboration on a broader front and to breathe fresh life into PFIs, and set up the Treasury Taskforce as a government bureau to encourage the use of PFI. This lifted the number of PFI contracts above 100.

Issues and topics in Japan

Key points in the June Growth Strategy will include whether the ¥10–12trn business project target through FY22 is increased still further, whether PPP/PFI projects are in principle made compulsory and systems are geared up to encourage PFIs, and whether efforts are made to put them on equal footing with local authorities in terms of subsidies and tax treatment. If the Japanese government shows serious intent to commercialize and streamline the bloated public sector, this will likely be welcomed as the Third Arrow of Abenomics.

One key focal point for the government for the near term will be its new income and expenditure reforms towards restoring a sound budget. A further ¥9.4trn improvement is needed in the primary balance to achieve the target of a surplus in FY20, even under the government's economic revival scenario. The question is how to improve income and expenditure to cover this shortfall. In the social security segment the Council for Economic and Fiscal Policy is debating measures such as (1) encouraging the commercialization of social security services using medical and other data; (2) increasing incentives in areas such as preventative medicine, and (3) returning assets and inheritances to society and levying social security and taxation charges in line with incomes and assets. One further major topic of debate in terms of building efficient social infrastructure is maximizing PPP/PFI in construction investment to deal with aging infrastructure, starting with waterworks/sewage utilities and housing, and centralizing and recycling state-owned assets.

In particular, the CEFPP has proposed increasing the current ¥2–3trn target for PPP/PFI concessions through end-FY16 and enhancing the ¥10–12trn in projects planned through FY22 (envisaging either increasing the amount or front-loading projects). Consequently, there is debate about prioritizing the use of PPP/PFI projects in areas such as sewage/waterworks utilities, public housing and airports, by (1) adopting PPP/PFIs as a matter of principle by local public bodies covering, for example, more than 200,000 people if PPP/PFIs can reduce public service costs, and (2) creating a framework for granting all the subsidies currently given to local authorities for water utilities to the owner of the operating concession (equal footing in tax and fiscal terms). If PPP/PFI schemes are actively adopted through these policies, they could not only improve confidence in restoring fiscal health by downsizing the public sector and expanding private sector business but also build an industrial structure based on market principles that could lead to a favourable view of the Japanese stock market.

Japan's current PFI/PPP at a glance

PFI business in Japan expanded to reach 489 projects worth about ¥4.5trn at the end of FY14 after the relevant legislation was put in place in 1999. PPP/PFI projects were classified into four categories in June 2013, with a target of a total of ¥12trn in projects over the 10 years through FY22 (Figure 1). In the same year The Public-Private Partnership Infrastructure Fund was established through public-private investment (securing ¥50bn in capital for loans and investment, and access to ¥364bn in government-guaranteed borrowings). In June 2014 the target for concessions (PFI business using rights to operate public facilities and others; one of four business types) amounting to ¥2–3trn was brought forward to end-FY16, with specific goals set for the number of projects at six airports, six waterworks, six sewage works, and one road (Figure 3). Plans for a concession-style PFI for Kansai International Airport and Sendai Airport are well underway at present. However, PPP/PFI as a proportion of public investment over the past 10 years works out at a mere 1.6% in Japan compared with 8.4% in Australia and 12.3% in the UK (Figure 4). This will rise to only 4.6% even if Japan reaches the FY22 target figure, still small compared with the UK. If Japan intends to bring its PPP/PFI business up to match that of the UK, it will presumably have to increase its project target through FY22 still further and launch policy measures to reach its goal.

Background to PFI business expansion in the UK

The Japanese government is ramping up its use of PPP/PFI a notch, taking the UK as an example. At this point we look at efforts in the UK to promote PPP/PFI. What the UK example shows is a dynamic state-level drive towards small government, under which measures such as universal testing (making PFIs compulsory), the

adoption of PFIs and rationalization of procedures, and the creation of a task force functioned effectively.

In the first instance the Thatcher administration, which took office in 1979, sought to engineer a shift from the pre-existing welfare state to small government operating under market principles, and pushed ahead with measures such as (1) privatizing state enterprises, (2) outsourcing public services to the private sector, and (3) spinning off the executive branches of state institutions from policy planning organizations into agencies. This led to the privatization of areas including airports, telecoms, gas, oil, waterworks, electricity and steel, and two-thirds of public workers were transferred to agencies from 1988.

When John Major took over as prime minister in 1990 the move to bring private sector capital into public services came up to full speed. In 1991 the Citizen's Charter was unveiled as a vision for reforming public services, entrusting the construction and management of services and facilities hitherto provided by the public sector to the private sector, and setting a course for the government to be a buyer of services. The Treasury published guidelines based on the Citizen's Charter, but used value-for-money (VMF) to analyse and evaluate public services in advance. VFM is a metric for measuring efficiency in public services, and indicates the percentage by which total service costs can be reduced using PFI compared with the existing method. In November 1992 the government decided to introduce PFI for public services that were hard to privatize or outsource.

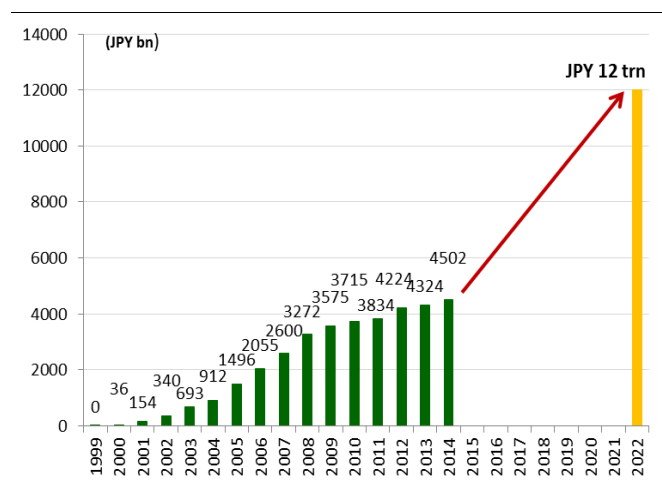
However, the response to PFI was lukewarm when it was first introduced. Consequently, 'universal testing' was introduced in 1994, requiring PFIs to be considered for all public sector projects. Despite increased use of PFIs after universal testing was introduced, problems emerged, such as the length of time taken for PFI businesses to be approved, so the number of contracts remained low, mainly consisting of large-scale PFIs. When the new Blair labour government took office in May 1997 it took further steps to breathe fresh life into PFIs such as (1) introducing PPP Public Private Partnerships (PPP) to implement public-private sector collaboration on a broader front, (2) rationalizing procedures, including scrapping universal testing, and (3) setting up the Treasury taskforce as an organization to encourage the use of PFI. This led to a large number of relatively small PFI service contracts being agreed, with over 100 such contracts signed. The results of this string of initiatives towards small government restored the UK government's primary budget balance to a surplus in the mid-1990s, while the pace of improvement has been considerably faster than in Japan following the Lehman Brothers collapse (Figure 5). Thereafter the Treasury Taskforce set up (1) the Treasury PPP Policy Team (whose remit includes drawing up major PPP/PFI policies and guidelines), (2) Partnerships UK (now integrated into Infrastructures UK; supports multiple research projects and invests directly in PPP projects), and (3) Crown Commercial Service (services include drawing up overall governmental purchasing reforms, assessing the state of purchasing), putting in place the structures to support the process of drawing up policies and furthering the various projects, and spinning off purchasing management functions to encourage PPP/PFI business.

Issues and topics in Japan

Only about a tenth of Japanese local authorities use PFIs, and the majority have not recognized the future infrastructure and budget crisis they face. Local companies have a sparse track record, while some local assemblies are opposed to PFIs. Further reasons cited for the delayed adoption of PPP/PFI are likely that there is no relevant knowhow among local authorities, it takes time to commercialize PFIs, and there is a large task load on the public authorities, and reform will likely be needed in these areas. Key points to watch in the June Growth Strategy from the Council

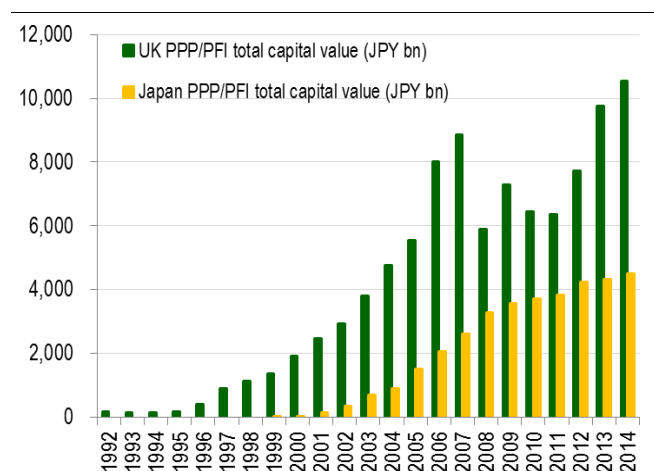
for Economic and Fiscal Policy's current proposals will include (1) whether the ¥10–12trn project target through FY22 is increased still further, (2) whether PPP/PFI projects are in principle compulsory and systems are put in place to encourage PFIs, and (3) whether efforts are made to put them on equal footing with local authorities in terms of subsidies and tax treatment. If the Japanese government shows serious intent to commercialize and streamline the bloated public sector, this will likely be welcomed as the Third Arrow of Abenomics. With infrastructure ageing rapidly, commercializing the public sector and making use of private funds are also important in terms of preventing snowballing public expenses and fostering new industries such as waterworks.

Figure 1: Japan's PPP/PFI total capital value, FY22 target (from ¥4.5trn to ¥12trn in FY22)



Source: Cabinet Office, UBS

Figure 2: Total UK and Japanese PPP/PFI capital value



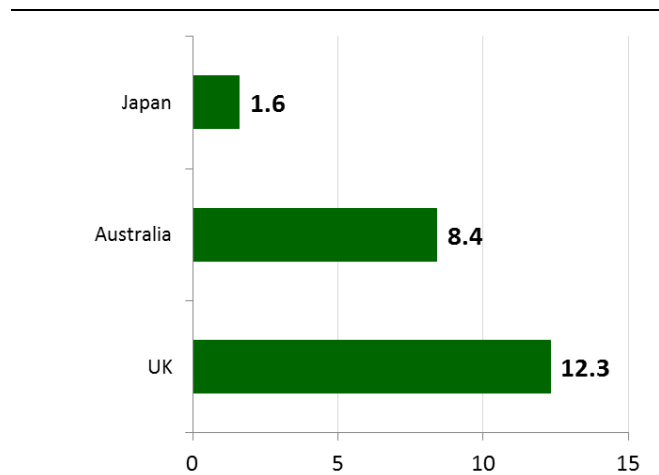
Source: Ministry of Internal Affairs and Communications, UBS

Figure 3: Policy for concentrated drive to gear up PPP/PFI in Japan (decided in June 2014)

Target Periods	FY2014 – FY2016
Priority Areas	Airports, Water works, Sewer services, Highways
Numerical Target	1. Capital Value Target : JPY 2-3 trn
	2. Project Number Targets : Airports (6), Water works (6), Sewer services (6), Highways (1)

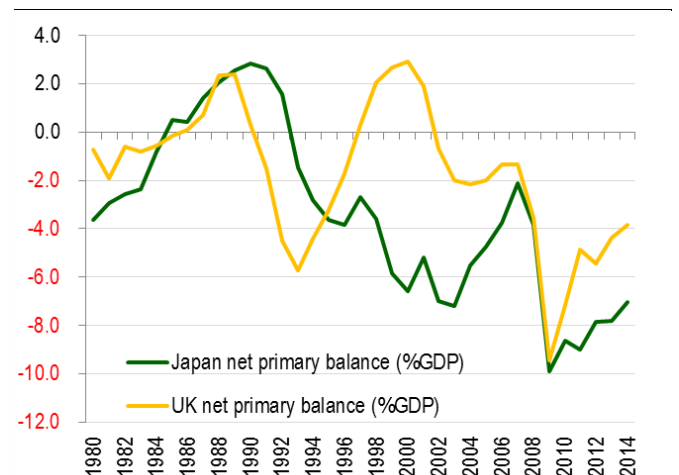
Source: Cabinet Office, UBS

Figure 4: PPP/PFI as a proportion of public investment over the past 10 years (%)



Source: Excerpt from Development Bank of Japan materials

Figure 5: Japanese and UK primary budget balance



Source: IMF, UBS

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