PUBLIC-PRIVATE PARTNERSHIPS: ONE ELEMENT OF GOVERNANCE REFORM

By Professor John Stuart Blackton

To many people today, both in the Arab World and in Western countries, the remedy for bad government is simple: governments should hand over their activities to the private sector, which will do a far more efficient job. Partnerships are not necessary, they say, only hand-over. I will suggest that this is only part of the answer, that governments will have a larger role to play in the future and that they will play that role increasingly in collaboration with the private sector. .

What is a Public-Private Partnership?

A Public-Private Partnership is a co-operative venture for the provision of infrastructure or services, built on the expertise of each partner that best meets clearly defined public needs, through the most appropriate allocation of resources, risks, and rewards.

In a public private partnership, the public sector maintains an oversight and quality assessment role while the private sector is more closely involved in actually delivery of the service or project.

Public-Private Partnerships can be categorized based on the extent of public and private sector involvement and the degree of risk allocation between the two. All partnerships have a unique risk/reward allocation. Public-private partnerships can take many forms:

A successful P3 builds on the experience of each partner to meet clearly defined needs and provide a net benefit (or value for money) to the general public through the appropriate allocation of resources, risks and rewards. It will involve unbundling the costs and the risks inherent in delivering the project and allocating them to the partner best able to absorb and mitigate them. This is different (and preferable) to not accounting for all of the real costs associated with a service and allocating all risks to either the public or the private sector partner. The ability of the public and private sector partners to efficiently and effectively mitigate each risk should govern the allocation of each risk.

Public-private partnership implies a common understanding of shared goals, a willingness to repartition responsibilities for their

achievement, a continuing public-private dialogue on what needs to be done to promote their realization, and a supportive policy and institutional framework. Partnership goes beyond business concerns, and extends into all policy areas, including education, health, human rights, immigration and citizenship, science and technology, foreign relations, arts and culture. There is a widespread trend to broaden participation in governance by strengthening the interface between the state and non-state actors.

This has important political dimensions. The UN general assembly affirmed more than a decade ago that democracy and transparent and accountable governance are indispensable foundations for the realization of social and people-centered sustainable development. Participation reinforces democracy by making the government more responsive to users of government services and to citizens generally, and making government more open, transparent and accountable. New machinery is set up such as administrative tribunals, ombudsman offices, joint committees, and charters of the rights of citizens (or users, “clients” or “customers” of government services), which tend to make the government agencies which have immediate relationships with the public more accountable and answerable to

those affected by their activities. This “direct” accountability complements the indirect accountability of agencies via the political directorate to legislative bodies and heads of State and, in democratic regimes, to electorates.

Where government is the dominant institution in a country, as is true in much of the Arab world, only the government can lead in envisioning and planning the policies and support institutions and infrastructure - physical and human - for businesses to thrive in an enabling environment conducive to private sector investment and growth.

Support institutions may include specialized agencies in fields such as finance, research and development, acquisition of technology, export promotion, market intelligence and human resource development, which may need government sponsorship pending the development of markets for their services.

Why P3s

In today’s economy, governments must foster competitive environments to attract citizens and businesses. Like business, government is increasingly working in an interdependent universe of

activity. Governments are looking for innovative solutions that involve collaboration with other jurisdictions and the private and not for profit sectors.

Faced with many competing demands and limited resources, governments are increasingly focused on higher-order tasks that set longer-term outcomes. This does not mean that challenges related to issues such as infrastructure and the delivery of services are unimportant. Rather, governments are using alternative means of delivering services, or delegating them to appropriate non-government partners.

Partnerships between the public sector and private companies for the financing, design, build, ongoing maintenance of infrastructure and delivery of associated services are one means of meeting the need for modern, efficient infrastructure and for reliable cost effective delivery of public services. Public private partnerships should not be considered a ‘silver bullet’ remedy, however they can offer innovative and competitive solutions when:

- Value for money is demonstrated
- Risk is allocated to the partner best able to manage and mitigate it

- Processes are open, fair and transparent.

Clearly, there are roles for both the public and private sectors. The challenge facing us is to determine the optimum mixture of public and private resources that will lead to the optimum method of providing public services at acceptable levels of quality and cost. To do so it is necessary determine whether the government can manage the risks associated with a particular Public Service at a lower cost than the private sector.

In some countries the government has interacted closely with the private sector and promoted a sense of partnership in the pursuit of national goals. This has applied particularly to partnership with the business community in order to promote export-led economic growth. Partnership is promoted (a) by setting up a structure of interactive interventions - business councils, consultative committees, ad hoc committees, advisory commissions, etc. and (b) by reorienting civil servants away from dysfunctional attitudes to business (characterized by arrogance, distrust, envy) and in favour of pragmatic problem-solving towards shared goals.

I will choose a non Arab Muslim country, Malaysia to frame some of the issues. In Malaysia, public-private interaction, in a formal sense, dates back at least to the establishment of the Industrial Advisory Council of 1979 but took off in 1983 under the banner of “Malaysia Incorporated”. The country’s impressive growth since then has been widely attributed to this policy. The benefits have been: (a) wider understanding of government strategies, policies

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and procedures, (b) private sector “voice” in the determination of strategies, policies and procedures, which in turn has promoted democratic consent, transparency in the decisions and actions of government, and market efficiency (through lower transaction costs), and © an appropriate balance between stability and change in government policies.

Stereotypes and misconceptions of business (“we work to serve the public: they work for profit”) have been replaced by positive attitudes, such as Prime Minister Mahathir expressed to Malaysian civil servants: “Why shouldn’t civil servants help the private sector make money? Who really pays the salaries of the civil servants ... if not the business people?”

At the same time, the business clamour for subsidies and tax breaks has been replaced by attitudes of self-reliance. These changes were achieved in Malaysia by sustained strong political leadership, massive training, and an administrative reform programme which proceeded in parallel.

The process depends, as in any partnership, on the prospect of gain by all participants. Though there is frequently great stress on common goals and values, in fact business and government representatives may have differing goals and values, particularly on regulatory issues, and different perceptions of how they are to be achieved, and yet reach mutually beneficial agreements. Where panels or committees do not have agendas of interest to all participants, or where little useful change can be expected, attendance drops away. The majority of ad hoc forums in Malaysia have not continued after a couple of meetings

The P3 machinery in Malaysia is extensive. There are consultative panels in most ministries and departments at Federal, State and district level. Lower level structures parallel the Federal structure, which was the first to be developed. Mostly they are created by administrative direction on the initiative of the Government, though

some, such as the Industrial Advisory Council, were created by statute, and some (mainly informal) meetings are called by the private sector. Their origins and constitutions do not matter so much as their membership and agenda.

On the government side, the highest council, the Business Council, is led by the Prime Minister, the annual budget dialogue is led by the Minister of Finance and annual dialogues with industry by the Minister for Trade and Industry.

The private sector is represented by employer associations for each of the main ethnic groups, and State-owned enterprises, while foreign investors are represented by transnational corporations. In some important fora, such as the Business Council, the media and academic institutions are also represented.

One issue facing P3s is the limit to cooperation. Where the government performs a balancing role, looking after the interests of other groups (such as customers in the area of utility tariff regulation) as well as business, the relationship should be at arm's length rather than cosily cooperative. The reverse side of the partnership coin is the risk that civil servants and big business collude in their own interest at the expense of the general public, or at the expense of groups such

as small and medium-sized enterprises which are left out of the mainstream of collaboration

Connections with the right people may be used to secure contracts, licences, import permits, etc. It should also be remembered that many of the regulatory personnel and many of the managers of the privatized State-owned enterprises were former colleagues in the same departments. This danger is recognized in Malaysia where General Orders and two circulars in 1993 have prescribed the acceptable standards of behaviour by public officials.

Common Misconceptions

Public-private partnerships are often not considered due to erroneous information based on misconceptions. The most common of these misconceptions are:

Misconception #1: “The principal reason for governments entering into public-private partnerships is to avoid debt”

Response: The principal reasons for government becoming involved in public-private partnerships are to benefit from increased efficiency, shorter implementation time, greater innovation and ultimately better

value in the delivery of services brought about by increased competition. The ability to finance a project so that the debt is “off book” should not be the prime motivation for entering into a public-private partnership in that the government and the ultimate users of the service are still responsible for servicing the debt in one way or another. The emphasis should be on structuring creative and cost-effective ways of delivering services, not on creative accounting.

Misconception #2:”Government can finance the cost of services at a lower cost than the private sector”

Response: Municipal or provincial governments can often finance projects at a lower cost than the private sector can. However, this may not always be the case. It is the total cost of providing the Public Service, not the cost of funds that matters. It is more appropriate to ask whether the government can manage the risks associated with a particular Public Service at a lower cost than the private sector. The objective of government should be to focus on the overall advantages of the public-private partnership arrangement.

Misconception #3: “By entering into a public-private partnership, government loses control over the provision of services”

Response: The government establishes the ground rules and has the ability to shape the public-private partnership to reflect its own objectives, policies and regulations. The government should actually have more control, since it has well-defined contractual remedies in a public-private partnership arrangement that may not be present with its own management and staff.

Misconception #4: “Government staff will lose under public-private partnerships”

Response: Both union and non-union staff often fear public-private partnerships because of potential job loss or reduced wages and salaries. Any public-private partnership agreement will need to reflect the labour laws of the province and existing collective agreements. The Labour representatives should be included at an early stage of the process to discuss options for service delivery.

Most partnership agreements that have been negotiated in Canada require the private partner to take on public staff and guarantee job security and salary levels. Any changes in staffing levels are generally consistent with labour contracts and can occur through attrition rather than layoffs. Many of the benefits of public-private partnerships, such

as increased efficiency and higher quality of service, have been accomplished through former employees of government. Reasons for increased productivity include increased investment in employees through training, technology transfer and skill diversification.

Misconception #5: “The quality of service will decline under public-private partnerships”

Response: The government has the ability to stipulate the quality of service to be provided and ensure it can enforce provisions of the contract dealing with quality control. It is in the private partner’s interest to invest in the service, become more efficient, enhance the quality of service to attract more customers or provide additional services to customers.

Misconception #6: “The cost of service will increase to pay for the private partner’s profit”

Response: While the private partner will need to make a profit, the profit must be earned within the existing or a lower price for the service. Presumably, the government would only enter into a public-private partnership if the price of providing a given service was lower

than if provided by the government, or if a higher level of service could be provided for the same price by the private partner. This assumes that the government is not subsidizing the cost of providing the service. The private partner's profit can only be realized through increased productivity or expansion of service, not through higher prices.

The task of promoting P3 development involves essentially two main strategies: they can be loosely characterized as a top-down/indirect approach and a bottom-up/direct approach. The top-down approach seeks to create an enabling or "fostering" environment, which provides the right incentives for small firms, together with enough positive support and protection (e.g. against unfair practices of larger competitors) to allow such firms to make the best of their potential.

The top-down approach seeks to improve the business environment by operating on macroeconomic variables such as prices, government regulations and policies, by providing legislation and enforcement, and by building up the physical infrastructure. The second strategy, the bottom-up

approach, aims at supporting P3s directly by mobilizing indigenous resources, creating or reinforcing local institutions and support systems, and

with the active participation of beneficiaries. Central and local governments, decentralized government bodies, financial institutions, business and industry associations, chambers of commerce, universities, international organizations and donor agencies have worked, independently and together, in both the creation of an enabling environment and the provision of direct support to Public Private partnerships.

In the past, most P3 policy has focused consciously on fostering timely access to the factors of production and to markets, with the

involvement of state development banks, public sector technical assistance, etc. Rather than complementing and cooperating with private entities in, say, the financial and technical assistance areas, governments have substituted for what was felt to be the inadequate performance of the latter. Part of the challenge at present is to find ways which make private markets work better rather than replacing them. One view gaining widespread acceptance is that governments should concentrate on creating the enabling environment, including

macroeconomic policy-making, legislation and enforcement, catalytic promotion and regulation and that direct support to the sector should be provided by

private individuals, firms and non-government organizations.

Application of public-private partnerships to various types of government services:

Many services provided by government could benefit from bringing the strengths of the private and public sectors together. Public-private partnerships may be less suitable for government services to which access cannot be restricted. This may include services with “public good” characteristics, including bylaw enforcement, environment protection and social services. They may also be less suitable for essential services such as policing, fire protection and other emergency services. Government officials and public groups tend to be more receptive to the provision of more specialized recreation facilities, solid and liquid waste management or utilities through public-private partnerships.

Many aspects of service delivery lend themselves to public-private partnership, including: project design, project management,

construction and procurement, financing, operations and management, maintenance, marketing of services and communications.

When to partner with the private sector?

Governments can consider partnerships with the private sector where any of the following circumstances exist:

- the service or project cannot be provided with the financial resources or expertise of the government alone
- a private partner would increase the quality or level of service from that which the government could provide on its own
- a private partner would allow the service or project to be implemented sooner than if only the government were involved
- there is support from the users of the service for the involvement of a private partner
- there is an opportunity for competition among prospective private partners
- there are no regulatory or legislative prohibitions to involving a private partner in the provision of services or a project
- the output of the service can be measured and priced easily

- the cost of the service or project can be recovered through the implementation of user fees
- the project or service provides an opportunity for innovation
- there is a track record of partnerships between government and the private sector, and there are opportunities to foster economic development

If none of the above conditions exist, public-private partnerships should not be considered.

It is important to understand that the benefits of privatization may be wide ranging and include cost savings, which average 17% in some major British cases, assumption of risk by a partner more capable of dealing with them, improved service levels, enhanced revenues, more efficient implementation, and wider economic benefits such as exportable expertise. These benefits are explained in detail in the Public-Private Partnerships: A Canadian Guide.

Many practical examples of P3 projects, along with detailed analysis of their benefits, can be found in the Research and Analysis section of our Resource Centre.

Keys to Successful P3s

The experience of P3 practitioners points to a number of key factors that contribute, in varying degrees, to successful public-private partnerships. While each P3 project is unique, these critical components are inevitably found to be integral to a successful outcome.

It Starts with a Plan

The public sector must use its resources effectively and efficiently to achieve value for public monies. A good plan will not only increase the probability of success, it will minimize disputes. The public sector needs to define the business requirements and the private sector must design the solution. A plan is thus required to identify the outcomes that the public sector wants to achieve from a project and the specific outputs required to achieve them. How the latter are defined directly affects the bidder's ability to provide innovative solutions. A good plan includes the development of clear lines of responsibilities (e.g. council, staff, partners and stakeholders). The plan should eventually provide clear specifications and measurable

performance outputs for the intended project in order to effectively monitor performance and minimize disputes.

Communicate

It is vital from the outset to communicate openly and candidly with all stakeholders, not merely the partners to the project - the public receiving the service, any employees affected by the project, the press, labour unions, potential bidders, financial backers, and any relevant interest groups. See: Communications Toolkit for more information.

The Need for a Project Champion

As with most projects, no matter what their business form, P3 projects require champions who are determined to drive the process forward and to find solutions to obstacles. Among the most likely candidates are politicians who head a unit responsible for a project, such as the mayor of a municipality. Political leaders need to be well informed so they can play a critical role in minimizing misperceptions about the value to the public of an effective partnership. Champions must also

be found among the senior bureaucrats responsible for implementing a project.

P3s require substantial time, effort and skill to co-ordinate the input and support of elected officials and staff from within many departments. Failure to identify and empower a strong project champion is a key contributor to an unsuccessful P3 process. Conversely, the support and stewardship of a strong project champion can go a long way in overcoming many seemingly overwhelming barriers. This applies not only during project development but during the implementation and operation phases as well.

In general, accessing the required expertise from within a government agency to develop and implement a P3 proposal has proven to be a significant challenge. Most government agencies have not organized themselves nor have they developed policies and procedures to be able to facilitate effective implementation of P3 projects. Thus, a substantial up-front and ongoing effort is required to muster an effective P3. A senior staff project champion has to act as an overall project manager, coordinating the detailed work of a range of specialists while anticipating the requirements of outside

stakeholders. No one can do it alone; and all successful project champions have had the support of a strong Project Team. The Project Team may include a mix of government staff and external advisors.

Select the Right Partner

The intention of a public-private partnership is to enter into a long-term contractual relationship for the mutual benefit of the parties. The relationship is not merely financial in nature - the “lowest bid” is not necessarily the best choice. It is essential to consider the ability of each short-listed bidder to deliver over the life cycle of the project - what kind of experience and track record do they bring to the project? Will they be able to sustain a relationship within the terms and over the period of the contract? Will they be able to manage the opportunities and risks inherent in the project? From the private partner’s perspective, it is important that the public sector partner be willing to retain the risks that the private partner cannot control, quantify or ensure. It is also vital that the public partner’s administrative personnel have a sound understanding of P3s and alternative delivery methods.

Use a Life-Cycle Approach

The costing of existing and/or planned public services must be conducted on a full life-cycle basis. This is particularly important for the public sector partner. One of the main objectives of undertaking a public sector comparator (PSC) is to determine if a project is affordable to government. To this end, the public partner must ensure full life-cycle costing at an early stage, taking into account the full cost of the assets and risks inherent in undertaking a project.

Ensure Integrity in the Process

Sometimes bureaucratic procedures can cripple a project. Bidders need a precise description of what is required and a clear indication of any hurdles foreseen on the part of the public partner. The process must be fair, open and transparent, timelines must be respected, and negotiations undertaken in good faith. Both parties must understand the costs and risks involved in the process as well as in the project, itself. The process also requires sound contract management arrangements, with early identification of the people to be involved in contract administration.

Exercise Good Governance

In general, partnerships succeed because people have exercised due diligence in planning, have established and engaged in a fair, open and transparent process and have respected contractual obligations and performance output requirements. Good governance implies all of the above. It is not however guaranteed, rather it is a commitment from both parties to find and achieve a win-win solution for the taxpayer. With a responsibility to protect the public interest, the public sector partner must ensure that its monitoring, regulating and enforcement roles are effectively undertaken

There are a number of situations in which partnership between public and private sector institutions is the most efficient and effective mechanism, due to the presence of mutually reinforcing goals - which in the final analysis converge towards an equitable and sustainable economic development of the country - and to the complementarities of capacities and roles. Through partnership, governments and private entities assume co-responsibility and co-ownership for the promotion of P3s.

Through these novel modalities, the advantages of the private sector - dynamism, access to finance, knowledge of technologies, managerial efficiency, entrepreneurial spirit - are combined with the social responsibility, network of contacts, environmental awareness, local knowledge, and job generation concerns of the public sector.