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## CONCLUSION

### **PPPs in In-transition Countries: Prospects and Limits for the Improvement of Efficiency, Sustainability, Equity and Security**

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In the first chapter I explained why the choice of our four countries was based upon diversity rather than similarity: as the proponents of PPPs consider that this type of provision can be beneficial in all situations, a research like ours would be in a better position to test this hypothesis by choosing countries in a pre-PPP stage with large differences, rather than with close similarities. It is not therefore surprising that our research has revealed important differences. But, as we shall see, there are also some remarkable similarities.

For the purpose of interpreting the strategies of in-transition countries applied to introduce some market mechanisms, scholars have developed a variety of models. While it is not possible to present them here in detail, one model stands out, namely that of Ivan Szelenyi.<sup>1</sup> He presents three pathways out of command economy: *the Chinese path*, which is described as a path “from below” (i.e. with transition starting from the reform in the countryside) and led by a developmental state. By contrast to the Chinese model, the European post-communist countries adopted a strategy “from above”, i.e. the transition started with the privatization of the corporate sector, but without the lead of a developmental state. Two different models are used for interpreting the transition of these countries: these are the neo-patrimonial and the neo-liberal models. Thus, *the Eastern European neo-patrimonial systems*<sup>2</sup>, of which Russia is the most interesting case for our research, is

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<sup>1</sup> Ivan Szelenyi, « A Theory of Transitions », *Modern China*, Vo. 34, N. 1, January 2008, pp. 165-175. For a critique see Sun Liping, “New Issues in the Field of the Sociology of Development”, *ibidem*, pp. 88-113.

<sup>2</sup> Szelenyi uses the following categorization: Eastern Europe includes Russia, Byelorussia and Ukraine; Central Europe refers to the former Czechoslovakia, Poland and Hungary. For the other countries he remarks that “Arguably, as they join the European Union they are shifting from Eastern to Central Europe”, *ibidem*, p. 174, note 1.

qualified as “making capitalists without capitalism”, where “the transformation of property rights proceeded faster than the making of market institutions”, barter remaining an important form of exchange. Finally, the *neo-liberalism in Central Europe* model refers to a process where “the changes in economic institutions were faster, more radical (...) Public ownership was eliminated on short notice, and the economy, prices, and foreign trade were precipitously deregulated”. This third model is called “making capitalism without capitalists”, in which “the corporate sector was privatized mainly by turning it over to foreign investors”.<sup>3</sup> So this typology puts more emphasis on differences than on similarities.

Nevertheless, Szelenyi recognizes in his article (written in 2007) that he developed this typology around 1997-98 when differences in the transition paths followed by these countries were in fact quite important; moreover, he points out that during the following decade there have been signs of a certain degree of convergence, especially between countries of the second and third type, as institutionalization of the market has been developed in Russia, and a new class of capitalists has emerged in Central European countries. And, maybe even more important, Central European countries, like Poland, have become members of the European Union, and therefore must conform to the criteria of market economy and liberal democracy. Even Russia “shows signs of some institutional convergence with the liberal model (...) The role of barter has declined, market institutions have become more firmly established, and the oligarchs seem to be ready to make deals with the government about taxes and seem to realize that they need a more predictable environment if they want to attract badly needed foreign capital and technology”.<sup>4</sup> Nevertheless, Szelenyi maintains that some important differences persist, and that “there are still three worlds of post-communist capitalism”: it is true that in China little remains of “capitalism from below” (i.e. from the agriculture) but the State is still playing the role of a developmental state<sup>5</sup>. Russia has certainly developed market institutions, but patrimonial social relations still persist, and Central European states have adapted their institutions to the liberal model, but “with a clear neo-liberal bent”.<sup>6</sup>

What is the contribution of our research to the debate about the convergence or divergence of pathways out of command economy, and what are the prospects for the development of PPPs in this context? Let us first say that we have found both differences and similarities amongst our four countries. It is not surprising that the most important differences are based upon the particular history of each country (in spite of their common past as command economy under communist rule), which explains differences in attitudes towards western-style political democratization, as well as differences in political values and cultures, and institutional settings, not to forget differences in their physical size (in terms of surface and population) and geographical situation. The similarities appear first of all in their will to

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<sup>3</sup> Szelenyi founds this assertion on Lawrence King, « Foreign direct investment and transition », *European Journal of Sociology*, 41, 2, pp. 189-224.

<sup>4</sup> *Ibidem*, p. 174.

<sup>5</sup> Nevertheless it seems that the Chinese leadership is « coming back » to agriculture, as the last Party Congress of November 2007, has decided, among other things, to reinforce public policies (both in hard and soft infrastructures) aimed at reducing the gap between urban and rural areas.

<sup>6</sup> *Ibidem*, pp. 170-171

introduce market mechanisms and complete or partial privatization of some State activities (although with strategies as different as the Russian- and Polish-style shock therapy of the nineties, or the incremental path to reforms Chinese-style); second, in the technical requirements these strategies must comply with. These similarities appear in spite of the fact that technical conditions may vary considerably, especially those related to laws and regulations, as well as the practices of managing the relations between central and local authorities, and between public authorities and citizens. More generally, we must not forget, especially when we formulate recommendations, that technical requirements must be implemented within the framework of the cultural values and institutions mentioned above. Finally, the analysis of our standardized questionnaires (Chapter 4) shows that when the respondents of one of the four transition countries manifest opinions close to that of the Western experts, this country is always the same: Poland. This should not come as a surprise, as Poland is a member of the European Union and as such, as we have already said in Chapter 1, has complied with the requirements of the Union concerning the adoption of the major features of liberal democracy and market economy (and we may add with Szelenyi, with a neo-liberal flavour) and is therefore, amongst our four transition countries the one that is most likely to accept the idea of implementing PPPs.<sup>7</sup>

Before we go any further, it must be stressed that the implementation of market mechanisms (of which PPPs are a special case) is a very complex endeavour. Our research has not dealt in depth with all the aspects of this complexity, and more particularly the technical aspects related to risk analysis, contract law, not to speak of the technicalities of infrastructures construction and management such as roads, railways, water plant and waste water treatment. Nevertheless, thanks to the analysis of the available scientific evidence and the interviews we conducted with experts in both Western and in-transition countries, it has been possible to draw a reasonably precise picture showing the similarities and differences that appear amongst our four in-transition countries in this very complex domain. Chapters 3 to 8 have presented the situation in the West and in each of the four countries. It is now possible to summarize our findings and to formulate some general conclusion and recommendations.

In the following pages we will summarize the findings presented in the previous chapters by taking into consideration information gathered from both standardized questionnaires (analyzed in Chapter 4) and by face to face interviews, official documents and

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<sup>7</sup> The cases of similar opinions between Poland and Western experts are the following: (1) corruption considered as an obstacle to PPPs (Western countries 45%, Poland 23%, whereas Russia 77%, Ukraine 80%, China 54%); (2) evaluation of public opinion towards PPPs (59,1% of people from both Western countries and 60% for Poland express a negative opinion, but only between 11,5% and 30% for the other countries that present moreover a higher percentage of neutral opinion, for more details see table 8 of Chapter 4); and (3) the existence of conflict resolution procedures for mediation: Western countries and Poland answered YES (73.3% and 63% respectively, only 4% for Russia, 28.6% for Ukraine and 33.3% for China). This last result for China is interesting as it shows that in spite of the fact that the Chinese legal system is not (yet) similar to the Western one, a third of it has nevertheless, at least in the opinion of the Chinese respondents considers that it possess conflict resolution procedures. We will come back later to the legal system of China.

other published materials (analyzed in Chapter 3 and 5 to 8). Let us start with six remarks about the way we will summarize our findings.

First, when dealing with the answers of our respondents we will most of the time summarize the opinions expressed through both standardized questionnaires and face-to-face interviews, and we will occasionally refer to the results of the the former (already presented in Chapter 4) only when they provide some additional insights.

Second, we will distinguish the conditions that make it easy or difficult to adopt and implement PPPs and the contribution of PPPs to economic efficiency, sustainable development, equity and security. As we suggested in Chapter 1, PPPs must first exist before we can appreciate to what extent they contribute to these values: setting up PPPs does not necessarily contribute to any of these values. It is of course possible that some of these conditions make it possible not only to set up PPPs, but also to contribute to the realization of these four values. But there is not an *a priori* guarantee that this will be the case: we have seen in Chapter 1, and more in detail in Chapter 2, that very often it will be necessary to proceed to some trade-offs, for example between economic efficiency and equity. The research has shown that there might be some even more complex trade-offs, when the time factor is taken into consideration not only in the short run, but also in the long term. For example, if the Government considers that it is urgent to provide a certain infrastructure to the present generation of citizens, and if the financial capacity of the State is limited, it could decide to have recourse to private money, and this will enable the government to provide this service in a relatively short time. But, as this is generally more expensive than public borrowing (not to speak of transaction costs), this will result in the medium and long term in an additional cost, that will be paid by the next generation of citizens.<sup>8</sup> But on the contrary, one could also consider that this infrastructure may contribute to economic development, and when the repayment time comes, the economy (and the fiscal capacity of the State) may be in a better position to pay for that infrastructure. This example shows that efficiency and equity are at stake and that there is not necessarily an optimal decision that can satisfy all the stakeholders. In the first case, the choice of providing the infrastructure to the present generation at a higher cost can be considered as non-efficient (at least in the short and medium term) but equitable for the present population that may very badly need this infrastructure (as is often the case for in-transition countries), whereas it could be considered inequitable for the next generation that will have not only to pay a higher price, but most likely will inherit an old fashioned infrastructure. In the second case the decision is more efficient and equitable for the next generation, but not so for the present one.

Third, we will distinguish empirical findings on the conditions mentioned above from the opinion of the people we interviewed. We will also compare these findings with the

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<sup>8</sup> This will be the case if the government plans to finance the repayment by taxation. If on the contrary it is willing to allow the private partner to make the users pay a fee (e.g. for a toll highway) then the present, and very likely also the future users, will have to pay a higher price than if the government would finance the service by borrowing on the market.

empirical evidence and theoretical considerations available for other countries, both developed and in-transition. We must remind the reader that the experience of PPPs in these countries is rather new. As a consequence, the “expertise” of the people we interviewed in our four countries is not always very high, as many of them admitted either during the face-to-face interviews or in their responses to our standardized questionnaires (see Chapter 4). Therefore, we shall consider their answers and opinions with great care.

Fourth, we will distinguish ideological-political factors, technical conditions, and contextual ones. Fifth, sectors in which PPPs have been introduced in these countries are limited to physical (or hard) infrastructures, such as transportation (roads, railways, sea- and air-ports), water provision, waste water treatment.<sup>9</sup> We have not found cases of PPPs in soft infrastructure, such as education, health and safety nets, except if we consider, as we have done in Chapter 2, that water supply is considered as a soft infrastructure. Nevertheless, this does not mean that PPPs in other kinds of soft infrastructure may not be introduced in the future into these countries, as many respondents have mentioned.<sup>10</sup>

Sixth and last remark: as our research has been focused on PPPs, little information has been collected on the more radical forms of private intervention in the provision of public services, i.e. full privatization. As a consequence, we are not in a position to discuss and compare the merits of these two forms of private intervention, especially for soft infrastructures. Nevertheless, information already available in scientific journals, supported by information informally obtained in China shows that, at least for this country, several experiments of full privatization (or partial privatization with insufficient public control) especially in the domain of education and health, have produced some negative outcomes from the point of view of both efficiency and equity. Decisions to correct these negative outcomes have already been taken at the local level, and the central government has recently decided to take these situations very seriously, especially in the domains of health and social safety nets.<sup>11</sup> The available evidence (especially for health) puts some very strong doubts on

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<sup>9</sup> We have introduced and explained the importance of the distinction between hard and soft infrastructure in Chapter 2.

<sup>10</sup> May we add that this is the case for example for China, if we pay credit to John Adams, Alistair Young, and Zhihong Wu, “Public private partnership in China, system, constraints and future perspectives”, International Journal of Public Sector Management, Vo. 19, N. 4, 2006, p. 384-396. Although these authors admit that among the different types of Chinese PPPs “very few of these have been applied in the areas of health, education, social care or housing” ( p. 390), they consider as valid the use of PPPs with arguments that we have already presented in Chapters 2 and 3: “the key argument for the use of PPP is that it will reduce the burden on taxpayers in the delivery of both capital and long-term service contract by the introduction of private capital, private expertise and competitive business practices to the provision of public services. These include education, housing, health care, transportation, social care and many other areas commonly associated with the public sector.” (p. 385). On the other hand, they concede that “A more fundamental (and debatable) argument is that the private sector is better able to provide services at a higher level of efficiency and effectiveness than the public sector which is typically hindered by its bureaucratic, mechanistic and politicized methods of operation.” (ibidem). See also note n.68, Chapter 2.

<sup>11</sup> For the domain of health see David Blumenthal and William Hsiao, “Privatization and its Discontents: The Evolving Chinese Health Care System”, New England Journal of Medicine, September 2005, pp. 1165-1170. According to Jens Leth Hougaard, Lars Peter and Yi Yu, “The Chinese Health Care System. Structure, problems and Challenges”, Department of Economics, Univ. of Copenhagen, Discussion Papers, January 2008, p. 31:

the capacity of privatization, even in its less radical forms, to satisfy fundamental criteria such as efficiency, effectiveness, quality, and equity in domains where the market does not exist, i.e. when lack of competition and asymmetric information make it difficult for actors, at least those at the demand side, to behave rationally as postulated by the market model. Finally, if it is evident that the decision to attribute the provision of any kind of infrastructure is taken by the political authorities, our research has confirmed what we proposed in Chapter 2: the choice of attributing the provision of infrastructures to the market or to the State is more likely to be based upon scientific evidence in the case of private and public goods, whereas for the problematic category of merit goods the choice is more likely to be oriented by ideological, political or opportunistic considerations. This lack of clear scientific evidence explains to a certain extent why countries that have been used for a long time to the provision of all kinds of services and infrastructures by the State have been more reluctant, at least until now, to give access to private money for the provision of merit goods like education, health, and safety nets.

### **Major Factors Conditioning the Implementation of PPPs**

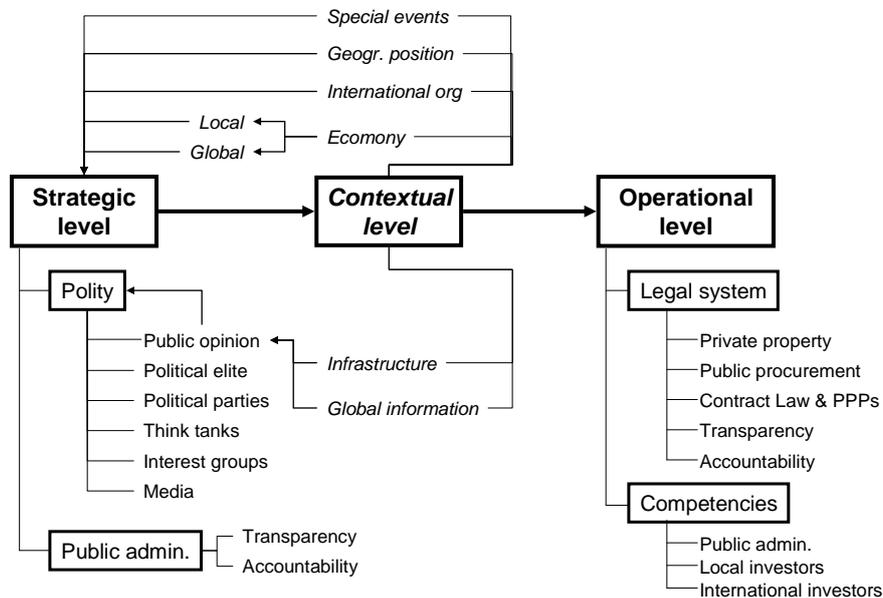
What are the major factors that condition the implementation of PPPs? Before we comment upon them in detail, let us briefly try to present the logic that links all these factors. First of all, it is clear that **history** is the first determinant factor. Russia, Poland and Ukraine have been affected by the collapse of the Soviet Union in 1991, China by the tragedy of the Cultural Revolution that ended in 1976 and led the Communist party to embrace the road of reforms. In spite of the differences between the four countries, and especially the striking differences between the more cautious and incremental path adopted by the Chinese leadership (later comforted in its choice when the Communist party lost power in Russia) and the negative consequences of the shock therapy of the Eltsin years, all four countries started to introduce market mechanisms in their economy. So, historical dramatic events may constitute the first condition that favours PPPs. Bearing this in mind, we will regroup our major findings under three interrelated headings or levels: strategic, contextual, and operational, each of them comprising a set of conditions or factors susceptible to having an impact on PPPs. It must be said that the three levels are not perfectly separated, and this will pose some problems of interpretation. But this is the inevitable consequence of an analytic approach that aims at reducing complexity by dividing reality into more simple and manageable components, whereas they are in fact imbedded into a single reality. The following figure summarizes the conditions having an impact on the adoption and implementation of PPPs.

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“according to the survey of Chinese hospitals Holding Ltd, there are approximately 60 billion US dollars of funds in attention to China’s medical market”.

Figure 1

3 levels of conditions for PPPs' adoption and implementation



The strategic level comprises the major components of the polity (especially the political elite or leadership, political parties, and public opinion), the public administration (especially the administrative elite), and the set of other institutions that have access to the political decision-making process (e.g. think tanks, interest groups). The contextual level comprises the conditions and factors within which the strategy is implemented thanks to the devices of the operational level. The following contextual elements are considered: the state of the economy (domestic and international), the state of infrastructures, the globalization of information, the impact of international organizations and, more generally, of the trends in the global economy, the geographical situation of the four countries concerned, and finally the occurrence of special events. The operational level comprises the more technical factors that have an impact on the adoption and implementation of PPPs, and more generally all sorts of arrangements giving to the private partner the secure institutional and legal environment it needs for accepting the investment risks, to the public authorities the institutional, legal, and expertise necessary for an effective participation in the partnerships, and to the public the necessary instruments for assuring transparency and accountability of the activities placed under the responsibility of the public and private partners. In other words it is a set of “enablers” without which a correct analysis of the contextual level by the political leadership, and an effective implementation of the PPPs objectives run the risk of not producing the expected positive results, or at least may very well be the source of some major difficulties. The operational level comprises first of all the legal system: i.e. the rules governing the economy, private property, public procurement, contract law (and more specifically rules governing PPPs), as well as rules concerning transparency and

accountability; second, the competencies of public authorities and local investors necessary for the mastering of the complexity of PPPs contracts and of the domains in which they are implemented.

We will conclude with an evaluation of the impact of PPPs on efficiency, sustainability, equity and security. Unfortunately, our conclusion on these important aspects will be of a very tentative nature, as the implementation of PPPs in our countries is very recent, and therefore an in-depth evaluation of their impact is not yet possible. Consequently, our discussion will inevitably be based upon the opinion of our respondents, some available empirical evidence in the four countries, and evidence from the experiences of countries with long history in PPPs. But even if we can count on the latter, that we will use with great care<sup>12</sup>, it is clear that the evidence we can provide will be, at best, partial and controversial.

### **The strategic level**

#### **Political will**

The first factor in favour of the introduction of market mechanisms is certainly the political will. This can be based upon an ideological shift operated by the elites (as has been the case in Russia, Poland and Ukraine, although at different paces), or by a pragmatic attitude that prevailed in China after 1978 under the leadership of Deng Xiaoping.<sup>13</sup> In both cases the door was open for PPPs, but Poland and Russia (and later Ukraine) proceeded more clearly in a Western-like strategy that consists in setting up an institutional, legal and regulatory environment first (even if not entirely satisfactory) whereas China (that does not have the same institutional and legal practice) proceeded first by experimentation, and started to establish or amend the legal and institutional arrangements only after a careful evaluation of their adequacy to, and efficiency in the Chinese context.

The importance of political will has been mentioned by a majority of respondents to the standardized questionnaires and mentioned the absence of this factor as being an obstacle to the implementation of PPPs.<sup>14</sup> Some of the people interviewed face-to-face, who considered with favour the implementation of PPPs, complained about the traditional ideological biases and habits inherited from the command economy as factors going against

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<sup>12</sup> As I have pointed in Chapter 2, best Western practices cannot be transposed as they are in in-transition countries, without taking into consideration the characteristics of the local environment that may not be suitable for the transposition of Western practices.

<sup>13</sup> It is perhaps now necessary to recall the famous criterion attributed to Deng Xiaoping: no matter that the cat is black or white, provided it catches the mice: Selected Works of Deng Xiaoping (Volume 1, p. 323), Beijing, People's Publishing House, 1994. We will not discuss here if the changes introduced into China after 1978 are based upon a change in the official ideology or not, as it is not a central point for this research. We deal with these aspects in the first chapter of "Reconciling State, Market, and Civil Society in China in the Reform Era", forthcoming.

<sup>14</sup> We recall the results presented in Chapter 4: 73% of people from the public sector, 90% from the private sector, and 88% from NGOs consider that the lack of political will is a barrier for the implementation of PPPs.

the adoption of PPPs, especially at the local level, where, we may add, some well-entrenched vested interests still operate within the old ideological structure and constitute an obstacle to the adoption of other ways of supplying public services. This may be one of the major obstacles to PPPs at the strategic level. On the contrary, as we had the opportunity to witness in China, some members of the leadership are simply very careful before they make the final decision in favour of PPPs. But, as we have already said, one of the advantages of the Chinese way of managing the public sector and its progressive retreat from a certain number of activities in favour of the private sector is its strategy to experiment on a limited regional (provincial or municipal) base, before extending to the entire nation or, more likely to other regions with similar characteristics the practices that have proven good.<sup>15</sup>

### Peoples' Trust in the State's Will to Introduce PPPs and Public Opinion

The second factor identified by many of our respondents in the four countries is the trust people (and especially those willing to embark upon PPPs) have in the will of the State to set up a reliable and consistent set of public policies making the establishment of PPPs possible. Many respondents in Russia and especially in China have complained that this trust is not yet sufficiently sustained by clear signs given to potential private investors by the political leadership. We will see hereafter that the trust in the political will cannot be satisfied by simple declarations of principles, but must be translated into a complex set of operational means favouring the implementation of PPPs, the fundamental aim being the establishment of a secure environment for private investors.

Strictly linked to the preceding factors is the state of public opinion. In the absence of a survey of public opinion in our four countries it is difficult to evaluate the level of citizens' satisfaction with the existing infrastructure. Opinions expressed by our respondents to the standardized questionnaire (already presented in Chapter 4) give nevertheless a plausible picture: almost 80% are not at all or little satisfied with the present state of infrastructure in their country.<sup>16</sup> And although many consider that improvements have been achieved, the gap between the high percentages of people who are not satisfied and the generally modest level of improvement means that expectations are high. And that the gap could eventually be filled by new initiatives of which PPPs could be a viable choice. Having this perspective in mind, it is clear that citizens with a high degree of confidence in their government will be willing to accept and support the decisions made by the political leadership, provided that it can prove that the day-to-day implementation of public policies favouring PPPs is in fact improving the situation of the different components of society, and this within a relatively stable environment. If this proves to be the case, the choices made for attributing the delivery of public services to the State, the market or PPPs will have a chance of being supported by the

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<sup>15</sup> This is due to the substantial differences amongst the various Chinese regions (3 or 4 according to the authors) which make it difficult to adopt a single model for the entire country. This is presently the case for the establishment of the new health and safety net system, for which China is considering two different systems for the rural and the urban areas.

<sup>16</sup> For the differences amongst countries and sectors see Chapter 4.

population. This will be true for PPPs, if the government can convince the citizens that in this way the quality and quantity of public services will improve compared to the former provision by state organizations. This will be easier if the population is dissatisfied by the poor performance of existing public services both in terms of quality and quantity, and even more so if the fees for having access to services supplied by the state are increasing. Political marketing becomes a necessity for the government in these circumstances.<sup>17</sup> The analysis of the standardized questionnaires performed by Thomas Zacharewicz in Chapter 4, shows that among our respondents in all our countries there is a high degree of confidence in the capacity of PPPs to realize this objective.<sup>18</sup> Moreover, the majority of people interviewed face-to-face considers that public opinion in their country is either in favour of PPPs or at least is not opposed. This is not surprising if we consider that provision of public service under communist rule has been too often of mediocre quality (in spite of its universal character satisfying the criterion of equitable access), and that after the collapse of these regimes there has been a relatively long period during which these services have considerably deteriorated. Only a few doubts have been expressed about the capacity of PPPs to improve the situation, especially by Chinese and Western respondents.

Nevertheless, some negative opinions have been put forward, that are in tune with some theoretical and empirical findings, concerning the emergence of transaction costs. As Thomas Zacharewicz has already presented in Chapter 4, while analyzing the standardized questionnaires, 57% of respondents don't know, disagree or strongly disagree with the capacity of PPPs to improve the delivery of services in relation to transaction costs. The problem of transaction costs is well known in scientific literature, but not necessarily outside academic and expert circles. That there are many people who do not know what to answer about transaction costs is understandable if we recall the expertise needed to improve the delivery of services in relation to transaction costs. In clear words these people, on the basis of experience and/or knowledge, know that PPPs can increase transaction costs. And these may more than may more than cover the savings in production or delivery costs that private expertise is expected to provide for public services. These and similar questions will be analysed in the last part of this conclusion.

### Stability

Political, social and economic stability is the-factor identified by our respondents that can support and reinforce political will. People we interviewed complained about the lack of this factor during the first half of the nineties in Russia and even later in Poland and Ukraine, but the situation considerably improved in the next decade especially in Poland and Russia,

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<sup>17</sup> Chapman, David, and Cowdell, Theo, New Public Sector Marketing, London, Pitman Publishing (for Financial Times), 1998, Lees-Marshment, Jennifer, The Political Marketing Revolution. Transforming the Government of the UK, Manchester, Manchester Univ. Press, 2004, Bean, Jennifer, and Hussey, Lascelles, Marketing Public Sector Services, London, HB Publications, 1997.

<sup>18</sup> Amongst people who answered our standardized questionnaire: 76% considers that PPPs can improve value for money (measured by the price-quality relation), 77% that they can keep cost, 83% that they can deliver in time, and 80% that they can improve the modernization of infrastructures.

but not so much in Ukraine. It is a well-known concern of the Chinese leadership to maintain political and social stability as a condition favouring economic development.

### Corruption

Another factor mentioned by several respondents, especially in China and Russia that could be an obstacle to PPPs is corruption. Internationally, corruption is considered as a negative behaviour both for private and public cadres as it is not only immoral, but also economically inefficient.<sup>19</sup> It is clear that in Western countries, i.e. in situations corresponding to a mature social, economic and political system, such behaviour is generally condemned without exception. But when we consider it in the framework of our four transition countries, it is more difficult to express a clear-cut judgment. Some authors even consider that in a transition situations, where both culturally and institutionally the country is not yet ready yet to play the game according to Western rules, exchange of favours between elites can contribute to boost the economic system by avoiding bureaucratic deadlocks.<sup>20</sup> Nevertheless all the respondents who mentioned this problem were very much against the corruption practices that they identified in their countries, especially in China and Russia. And this seems also to be the opinion publicly expressed by Professor Hu Angang, University of Tsinghua.<sup>21</sup> The conclusion we can propose is that it is possible that at an initial stage of the transition from command to market economy, there will be an intermediary period (the shorter the better) during which it will be naïve and foolish to try to avoid all forms of collusion between the members of the former public elite and the new emerging elite, or to expect that in the transition process the former elite will not try to barter its public capital for private capital or advantages, as history too often shows to be the practically unavoidable case. But, as the cases of Russia and China very well show, after the process of institutionalization of the market economy has reached a sufficient level of maturity, further tolerate corruption would amount not only to inefficient outcomes, but also to what Hu Angang calls a “black hole, which is an invisible abyss”. If serious and effective measures are not taken to eradicate this “black hole” corruption may not only become a widespread economic harm, but according to the Tsinghua professor corruption has in fact already become “a major enemy of economic development and social stability in China, and has caused prodigious economic costs for the country and its people.”<sup>22</sup> Unfortunately, this is not to say that, as many of our respondents have maintained, that PPPs will diminish corruption.

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<sup>19</sup> We recall that a majority of people who answered our standardized questionnaire considered that corruption is an obstacle to PPPs in their country: 77% in Russia, 80% in Ukraine, 54% in China; if only 45% in Western countries and 23% in Poland consider that corruption is an obstacle to PPPs, this is very likely because they believe that corruption does not exist and/or have a very low impact in their country.

<sup>20</sup> This is the case of Lin Yi-min, Between Politics and Markets, Cambridge, Cambridge Univ. Press, 2002, who nevertheless admits that these behaviours could result in inefficiencies, like over-production, and the artificial (i.e. non economic) survival of inefficient firms.

<sup>21</sup> Hu Angang, Economic and Social Transformation in China, New York, Routledge, 2007, Ch. 11: “Corruption: an enormous black hole: public exposure of the economic cost of corruption”, pp. 217-223. Corruption is also taken very seriously by the Chinese leadership that has taken several measures in order to fight against it, and can count on research conducted by official think tanks and academic institutions like the Centre for research on corruption of the Tsinghua University.

<sup>22</sup> Ibidem, p. 217.

On the contrary, some of our respondents have declared that PPPs will not have any serious impact on corruption, as this phenomenon is rooted in some deep cultural and behavioural traits that cannot be easily eradicated by institutional arrangements alone.<sup>23</sup>

### Efficiency of Public administration

But even with the support of the population, politicians alone cannot do much in any country, unless they can count on an efficient public administration. This is maybe one of the weakest points at the strategic level, as many respondents expressed doubts about the expertise of the national and, even more, the local public administrations to act as a competent partner in PPPs.<sup>24</sup> Now, this is one of the most important weaknesses that explains the difficulties in drafting of the contract and in setting up viable PPPs. If the public partner does not have a level of expertise that is at least equivalent to that of the private partner, the door is open for at least serious difficulties in the management of PPPs, at worst also for some failures. The importance of this factor in Western countries has been already explained by Olivier Breninkmeijer in Chapter 3, and it is not surprising that it has also been put forward by many of our respondents in the four countries. The importance of expertise within government will become even more evident when we deal with the requirements at the operational level. There we will show that expertise by the public authorities is one of the most important factors for mastering the negotiations with the private partners, for writing the contract and for re-negotiating it when necessary, for supervising its execution, and for evaluating whether the objectives set in the contract (both for cost, quality and quantity) are being realized. This makes it necessary to organize a permanent monitoring, realized at regular intervals, to ensure the supervision and the evaluation necessary for detecting in time possible departures from the goals stated in the contract.

### The Four “Prior Decisions” for Opting in Favour of PPPs

In Chapter 2 we introduced the idea of the necessity to go through “four prior decisions” as a preliminary decisional phase before deciding if PPPs are a suitable alternative to provision of public services and infrastructures by the State. It is clear that such decisions are taken in the context of the strategic level we have just described and in the contextual situation we will deal with in the next paragraphs; the success or failure of the decisions will

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<sup>23</sup> In the case of China (but the same is very likely true for Russia and other former Eastern European Communist countries) the introduction of market mechanisms too abruptly (as it was case in Russia after the collapse of the Soviet Union and in to a certain extent also in China during the 90’) resulted in the transfer of public property to the private sector. This occurred in too many cases, via corruption and other methods of a mafia character, especially by people belonging to the political-administrative elite. But as has been born witness to in the public domain, the regrettable effect was the spreading of this type of behaviour to larger segments of the population, where the major, if not the only, goal became the enriching of oneself without any moral restraint, this being of course reinforced by the limited access to consumer goods during the preceding period. For China see: Xiaoying Wang, “The Post-Communist Personality: The Spectre of China’s Capitalist Market”, *The China Journal*, n. 47, January 2002, pp. 1-17.

<sup>24</sup> This is confirmed by the analysis of the standardized questionnaires presented in Chapter 4: the majority of our respondents think that there is a lack of experience (70%) and a lack of knowledge (90%).

depend on the availability of operational factors that support the implementation of PPP. Before we present the contextual and the operational levels, let us go back to the four prior decisions presented in Chapter 2, and examine how our respondents have justified the decision in favour of PPPs. We had considered that the final decision in favour of PPP must be preceded by four decisions related to the superiority of PPP compared to State provision of services in terms of (1) economic efficiency and (2) management performance, (3) the capacity of PPP to provide services more rapidly, and (4) the question of who will pay for them in the end. The last question is more particularly related to the dilemma between efficiency and equity, the other three to efficiency and effectiveness.

In spite of some differences between countries and sectors, the majority of our respondents<sup>25</sup> manifest a high degree of confidence in the superior capacity of the private sector in terms of efficiency, quality, and the capacity to modernize public services. And this opinion also corresponds very likely to the faith in the superior managerial capacity of the private sector. Moreover, the majority think that the development of the intervention of the private sector will improve transparency, accountability and monitoring. Of course we are dealing here with opinions based more upon faith than on empirical evidence. In fact, when asked during the face-to-face interviews to provide empirical evidence sustaining their opinions, the great majority could not refer to real cases of success of PPPs. Of course this finding does not mean that in reality PPPs cannot match these opinions. It simply shows that the majority of our respondents have faith in the beneficial outcomes of more private sector intervention, although this should be confirmed by empirical research, which at the moment of our inquiry was very limited or simply not available. The consequence is that in evaluating the actual chances of success of PPPs in our countries, we will have to go back to empirical evidence available in developed countries, as well as in in-transition countries where research has been already conducted. We will do this in the last part of our conclusion.

Little information was provided by our respondents on the question of “who will pay in the end”, whereas they spent more time explaining the lack of public money, which, combined with the urgency of either upgrading the existing services or building new ones, appears to be the main argument in favour of PPPs. This opinion is further reinforced by the scant confidence our respondents have in the expertise of the public authorities (especially at the local level) and the inefficiencies of the bureaucracy. To this some respondents added the resistance of vested interests at all levels, and the difficulties in managing the relations between the central and local authorities. These final difficulties are also considered by some people, especially in Russia, as some of the major obstacles encountered when defining a governmental development strategy in which to insert the contribution of PPPs. Although we know that the same problems also exist in China, nobody mentioned the management of centre-periphery relationships as one of the major obstacles to the definition of Chinese development strategy.

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<sup>25</sup> This is true for both the face-to-face interviews and for the answers to the standardized questionnaires (for the latter see note 21 above and Chapter 4).

### The Main Reason in Favour of PPPs

Therefore, the main reason in favour of PPPs seems to be the urgency in providing or upgrading infrastructure and services, and in this respect the dominant opinion is that only the private sector can provide the huge amount of investment needed. If the availability of domestic private money is limited, the only way out is to favour foreign private investment. And this is valid also for countries like China and Poland, where the government and some domestic private investors begin to be able to invest considerable amounts of money, not only in their countries but also abroad. Nevertheless, the problem is that, according to a majority of respondents, the task is so big that private money coming from abroad is necessary at least as a complement to public investment. And this favours PPPs where the public and the private sectors share the financial investment and risks. One of the major consequences of this situation, however, is that it poses a strategic dilemma for the governments concerned, to the point that they have imposed some limits on foreign investments in domains they have qualified as strategic. These concern mainly the defence industry, natural resources, and mass media.<sup>26</sup>

### Public Institutions for Sustaining the Implementation of PPPs

Finally, some respondents complained about the lack of a centralized unit in charge of defining a consistent policy on PPPs, and also being able to provide expertise to local government. This poses again the problem of the necessity of improving the expertise of public authorities at all levels, for the efficient management of the complexities of PPPs.<sup>27</sup> On the contrary, the existence of an Investment Fund is considered as a positive institutional and financial instrument favouring the implementation of PPPs, as in the case for Russia. Moreover, several Russian respondents considered as a positive evolution the increasing number of local initiatives to establish PPPs, even if some expressed the fear that this will further complicate the relationships between local and central authorities.

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<sup>26</sup> According to the website of the official Chinese Xinhua Agency (accessed 2006-12-18 21:00): in December 2006 the State Assets Supervision and Administration Commission (SASAC) published a list of seven sectors critical to the national economy and in which public ownership is considered essential: armaments, electrical power and distribution, oil and chemicals, telecommunications, coal, aviation, shipping. The situation is more complicated in Russia, at least as far as formal rules are concerned, where a new law was approved by the Parliament on April 2, approved by the Federation Council on 16 April and 29 April signed by the President of Russia on 29 April. The law recognizes 42 strategic activities in the nuclear, space and aviation industries, in the areas of production and trafficking of arms, military and special technology in the field of subsurface geological study, exploration and mining in areas of federal significance. Strategic status was also attributed to television and radio broadcasting in the territory, where the population was of half or more than half the size of the Federation entity, as well as the issue of periodical publications, products which are issued in separate circulation numbering at least 1 million copies each, such as "Rossiyskaya Gazeta."

<sup>27</sup> We will come back to this important point when examining the conditions of the operational level.

## The Contextual Level

The decisions taken about the possibility of introducing PPPs will be conditioned by a series of factors we have regrouped under the heading of “contextual conditions”, and first of all the state and trends of the economy.

### The State and the Development of the National Economy

Here we will take into consideration the national economy, whereas the global economy will be dealt with in conjunction with the role of international organizations. Many respondents consider that stagnating economy, economic slowdowns, an immature banking system, problematic financial markets are all factors that render the implementation of PPPs difficult if not impossible. The major characteristics of the domestic economy favourable to the development of PPPs have been identified by a majority of respondents in the four countries: a robust economic development in a stable environment driving to a growing consumer market, an ongoing process of industrialization and urbanization (this being particularly important in China), the support of a robust banking system willing to lend money to private investors (and not only to big conglomerates but also to small and medium size investors).<sup>28</sup>

All these conditions mentioned so far sound rather positive *per se*. But there are some other conditions, that are clearly negative, that will, because of their negative character, favour the choice of PPPs: these are the persistence of public deficits and the consequent increase of public debt, that is most of the time considered in the neo-liberal theory of public finance as to be avoided at all costs (and often without regard to the nature - current consumption or investment - of the expenses that led to public debt). If, moreover, the prevailing opinion is that taxes should not be increased because they will discourage domestic demand and investments, this situation will be considered as proof of the lack of public money we referred to above, and therefore this will reinforce the option in favour of PPPs.

### The Globalization of Information and the State of Domestic Infrastructure

Second, as we have already said when examining the role of public opinion, the actual state of public services and infrastructure will influence the attitudes of both political leaders and the citizens. Even if our research has not been designed to deal with public opinion specifically, it is nevertheless necessary to introduce it in this conclusion, as it is a direct

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<sup>28</sup> This is generally recognized in the literature as being an important element because at the local levels some small or medium size services can be better organized and managed by relatively small PPPs. Moreover, large international multinationals may not be the best partners, especially in view of satisfying the criterion on equity. See for example for water supply the UNDP Human development report 2006; Emanuele Lobina and David Hall, “Problems with private water concessions: a review of experience”, PSIRU, Business School, University of Greenwich June 2003, available at [www.psiru.org](http://www.psiru.org); Emanuele Lobina and David Hall, “Water privatisation and restructuring in Latin America”, September 2007, PSIRU, Business School, University of Greenwich, available at [www.psiru.org](http://www.psiru.org).

result of the globalization of communication. This certainly has an impact on the way the population of in-transition countries evaluate their living condition compared to what they know about the more developed countries. It is a plausible hypothesis that on this evaluation they address demands to their elites for the improvement of their living conditions, of which infrastructures and public services are a fundamental component.

The importance of the globalization of information for our research has been widely recognized because information technology revolution has considerably reduced the distance between nations and people. Contrary to the first globalization of the XIX century (where capital and labour mobility was not less important than now) the present globalization has this distinctive feature: it places practically all the people, even those living in the most remote places of the developing and transition countries, in a position to read, hear and see what is going on in the most developed part of the world: the high standard of living, the facilities in transportation (public and private) and in housing, with all the modern facilities such as current cold and hot water, central heating, sanitary in-house equipment, modern kitchen, domestic apparels; nice clothing, plenty of food and beverages, decent (if not generous) safety nets, and even luxury products. It is not surprising that these people are wanting all these material goods and services, and the sooner the better. It is only thanks to the ability of their national government if they can accept to limit to a reasonable level the desire to satisfy all these needs. But even though, the pressure on the national and local governments cannot be ignored by the leadership. Finally, we may add that this factor, linked to the globalization of information, is reinforcing the need for services improvement of infrastructure available in transition countries, because, as we mentioned before, the latter are generally of a mediocre quality and quantity.<sup>29</sup> And in the framework of this vast domain of unsatisfied needs, the state of the domestic infrastructure, as it is perceived and evaluated by both the population and the political elite, constitutes the third factor of the contextual level.

### The Impact of the Global Economy and International Organizations

The impact of two interrelated factors, the global economy and international organizations, constitutes two additional conditions that favour the implementation of PPPs. As we already mentioned in Chapter 2, since the beginning of the 80' a vast movement of trade liberalization (the origins of which can be traced back to the immediate period after the second world war) occurred at the international level, based upon the revival of liberalism (later labelled neo-liberalism) of which the most operational consequences have been the "Washington consensus" and the "New Public Management". Based upon neo-classical economy and public choice theory this movement has favoured a total liberalization of the world economy (including liberalization and deregulation of financial markets), as well as the privatization or semi-privatization of large sectors of the national economies (including both hard and soft infrastructures). This trend has been powerfully supported not only by the most advanced nations (led by the US and later by the European Union) but also, and may be more

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<sup>29</sup> On the difference between the XIX century and the present globalization see Daniel Cohen, La mondialisation et ses ennemis Paris, Hachette, 2004, especially pp. 41-126.

significantly, by global international organizations dominated by these countries, such as the World Bank, the International Monetary Fund, the World Trade Organization and the OECD. Neo-liberalism has thus become the admitted (and imposed) orthodoxy for organizing the global economy and for boosting economic and social development in both developing and transition countries. It is in this context that the latter have been forced to implement structural reforms based upon neo-liberal orthodoxy in exchange of loans from the IMF and other organization, international and national. This meant basically two set of measure: (1) opening their national economy to the world, and (2) privatizing large segments of their economy, including both hard and soft infrastructures. This of course has reduced the choice of these countries as to what would be the better strategy for boosting their development. As the negative consequences of these events are well documented, it is only necessary in the context of this research to direct the reader to the scientific literature that has criticized the neo-liberal movement both on its theoretical flaws and its material consequences, for both developed and transition countries.<sup>30</sup>

The consequences of this movement can be seen on our four countries. During the first phase of its transition to market economy Russia has followed almost literally the advice, prescriptions and guidance of neo-liberal experts, with the consequences we know. But the fact of not being totally imbedded into the global economy (Russia is not a member of the WTO) has facilitated the transition to the leadership style and the economic development initiated under the administration of President Putin. This has in part reversed some of the neo-liberal trends of the Eltsin era, and has given more autonomy to the developmental strategy of Russia.

Poland has also experienced a shock-therapy implemented from January 1<sup>st</sup>, 1990. Prepared by a commission led by the economist and then Prime Minister Leszek Balcerowicz (and with the support of some world famous economists, such as Jeffrey Sachs), the Polish shock-therapy was as well of clear neo-liberalist inspiration, and was approved by the IMF and the World Bank. Its effects are still today controversial; it is generally admitted

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<sup>30</sup> For transition countries the most recent references are: Chang, Ha-Joon, Bad Samaritans. The Myth of Free Trade and the Secret History of Capitalism, New York, Bloomsbury, 2008, and Ocampo, José Antonio and Stiglitz, Joseph (eds.), Capital Market Liberalization and Development, Oxford, Oxford Univ. Press, 2008. Although this book deals mainly with capital market liberalization, several contributions deal more generally with neo-liberal orthodoxy. See also: Stiglitz, Joseph E, Globalization and its Discontent, New York, W.W. Norton, 2002, Stiglitz, Joseph E, The Roaring Nineties. Why We are Paying the Price for the Greediest Decade in History, London, Penguin Books, 2003, Stiglitz, Joseph E., Making Globalization Work. The Next Steps to Global Justice, London, Penguin, 2006, Stiglitz, Joseph E. and Charlton, Andrew, Fair Trade for All. How Trade Can Promote Development, Oxford, Oxford Univ. Press, 2005, Chang, Ha-Joon (ed.), Institutional Change and Economic Development, Tokyo, United National University Press, 200. For developed countries see Suleiman, Ezra, Dismantling Democratic States, Princeton, Princeton Univ. Press, 2003. May we add that some scholars, who have been making research on the New Public Management during the last 20 years or so, are now taking stock of the flaws of this movement and are returning to Max Weber for the purpose on (re)constructing a New Weberian Bureaucracy: Geert Bouckaert, "La réforme de la gestion publique change-t-elle les systèmes administratifs?", Revue française d'administration publique, N. 105-106, 2003, pp. 39-54, and Laurence E. Lynn, Jr, "What is a Neo-Weberian State? Reflections on a Concept and its Implementations", Draft, 24 January 2008 (I am grateful to Frédéric Varone - University of Geneva - who has given me a copy of this paper).

that in the short term the “Balcerowicz plan” provoked both a sharp rise of inflation and unemployment, and a dramatic fall of the economic growth.<sup>31</sup> However, for the long term, it is generally considered that the shock-therapy has been beneficial to the Polish economy.

Moreover, contrary to the Russian case, Poland and Ukraine have been attracted by the European Union that, as we have already mentioned, has posed some clear condition for accession. These include the implementation of the features of liberal democracy and market economy, and the introduction in their institutional order of the so-called “acquis communautaire” of which many policies are of a clear neo-liberal character. Moreover, as Olivier Brennkmeijer has developed in Chapter 3, the EU has taken many initiatives and adopted many regulations in favour of PPPs. There are therefore more prospects for developing PPPs in Poland and Ukraine (especially when it has complied with all the EU requirements for membership). The case of China is at the same time different and similar. Different because China has on its own initiative considered at the end of the 1970s that by opening its economy to the world, it would put some additional pressure on Chinese enterprises (both SOEs, private and semi-private) thus forcing them to improve their efficiency. The idea of introducing competition is perfectly in line with liberal economic theory, but the decision is taken independently of external pressure. The similarity becomes apparent after China’s accession to WTO, as now it has to comply with the rule of WTO. Russia will be in a similar situation when it will access to WTO. Nevertheless we know from experience that countries that face difficulties in their economy because of the opening of their national market, can take measures to protect the domestic sectors, be it in accordance of WTO regulations or even in contradiction with them.

### Geographical Situation

The geographical situation is another set of factors that can condition the decisions countries may take in favour of PPPs. Although this is not apparent in all our four countries,<sup>32</sup> the case of Ukraine is a good example in this context. As Tatiana Chernyavskaya and Oleg Gurynenko explain in Chapter 7 quoting an assessment by the Economist Intelligence Unit, the situation of Ukraine as a potential gateway between central Europe and other members of the Commonwealth of Independent States (CSI) may be a factor leading its government to develop the transportation infrastructure that is presently underdeveloped. But as the country lacks of the capital needed for this endeavour, the option in favour PPPs (and very likely with foreign investment) becomes a plausible one.

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<sup>31</sup> We should remember that it is difficult to determine with precision its influence on these phenomena, since the simple transformation from a planned to a market economy inevitably implies an economic crisis. Nevertheless it is interesting to note that contrary to the Russian and Polish examples, the Chinese case shows that it is possible to move towards a market economy without a major economic crisis, provided that the transition is incremental and governed by a strong political leadership.

<sup>32</sup> This is true if we take into account only the geographical situation, and not the other factors linked to the territory, like the natural resources, like forest, agriculture, water, gold, coal, natural gas, petrol, etc. It is clear that in case domestic capital and expertise for developing economic activities in these sectors were not available, the use of PPPs could be a choice the government could seriously consider.

## Special Events

At the beginning of this concluding chapter we have already mentioned the dramatic events that led to the introduction of market mechanism in our four countries, namely the collapse of the Soviet Union and the Chinese Cultural Revolution. These have been events we may qualify as a dramatic “big bang” without which the changes introduced in these countries would have been very difficult to implement, as Gorbachev’s reforms have shown, or as in China before 1978, in spite of opinions expressed in favour of reforms within the Chinese leadership before the Cultural Revolution.

In the following paragraphs we will refer instead to less dramatic events that may occur after the “big bang”, but that can (in conjunction with other factors) favour PPPs. During our research we came across two important events that can be placed under this category: the Olympic Games attributed to Beijing for 2008, and the European Football Championship attributed to Poland and Ukraine for 2012. Given the increasing interest and enthusiasm of the population of practically all the countries for events like these, it is expected, on one hand, that a huge amount of people will attend these events and on the other hand, that athletes and their federations require modern sport infrastructure. Therefore stadium must be upgraded or built anew, roads, railways, airports, hotels and other facilities must be built or upgraded. There are nevertheless some differences in the capacity of these countries to take advantage of these events for the development of PPPs. For China the Olympic Games of 2008 have represented a good opportunity for developing sport infrastructure: it seems that the construction of the sport facilities has been realized through PPP for at least 30% of the constructions. As for the European Football Championship, there is an important difference between Poland and Ukraine. Whereas in Poland the institutional arrangements set up for favouring the implementation of PPPs (see Chapter 5) seems to be on the right way for providing at least part of the infrastructure by PPPs, In Ukraine some difficulties have arisen recently to the point that some people fear that Ukraine may not be able to organize its part of the event.<sup>33</sup>

## The Operational Level

It is not surprising that the operational level as it is presented by our respondents is quite similar to the one described by Olivier Brenninkmeijer in Chapter 3 for Western countries. This is probably due to the fact that institutional arrangements like PPPs, that are very closely linked to the logic of market economy, need everywhere the same technical conditions to produce the expected results, i.e. reduction of cost for a given output (or value

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<sup>33</sup> We recall here the information already given in note 14 of Chapter 1: The President of the Ukrainian Football Federation, Grigori Sourkis, has recently declared that for the moment no Ukrainian airport satisfies the requirements of the European Football Union (UEFA) and he expressed fears that Ukraine could lose the organization of this event. As reported by the Geneva newspaper Le Temps, Geneva, April 23, 2008.

for money), improvement of quality, technical and managerial innovation, timely delivery of the service or infrastructure agreed upon in the contract, as well as all the related conditions that will make these outputs possible, such as competition (at least for the market, if not in the market), transparency, accountability, evaluation of performance (or performance management) and monitoring. It is therefore not surprising that the majority of our respondents have mentioned many of, if not all these technical conditions, that should make the implementation of PPPs a success. The general and combined role of these conditions is to create a secure institutional, legal, and political environment favourable to the development of private activities, of which PPPs are a special case. Some of our respondents also mentioned conditions that should protect the public, and more particularly people belonging to vulnerable groups, who may not be in a position to have access to the service provided by PPPs, if access would be conditional upon the payment of a fee these people could not afford to pay.

Differences in the opinions expressed by respondents in our four countries are not very important, especially if we remind that our respondents have not been chosen by a random sampling procedure.<sup>34</sup> Small differences cannot therefore be considered as significant, and we will therefore take in consideration much more the similarities than the differences.<sup>35</sup> Now, it just happens that many of these conditions have in common a very important characteristic: they are closely linked to the concept of the rule of law. Here of course one could conclude that this is the proof of the validity of the convergence thesis. Our research brings an additional argument to this thesis, if we take into consideration Poland, Ukraine and Russia (who are clearly moving towards the Western legal system based upon the rule of law (even if Russia is moving more slowly according to some Western critics), but not so much if we take China. For this country, the thesis is still true if we take this demonstration in a very general sense, by referring more to the objective (security) than to the actual means for realizing security (Western legal systems), but not necessarily if we refer to the means. If we explore this path, we could formulate the hypothesis that there may be alternative legal systems, different to the Western ones, which can also satisfy the objective of security. In fact, research is going on in several academic institutions to determine whether there exist non-liberal variants of the rule of law. Randall Peerenboom adds another dimension which is essential for in transition countries, i.e. transition is more an historical process than a state as it is defined by Western standards. From this perspective we could say that China is more in transition than for example Poland. But in transition towards what? Peerenboom suggests that if the Chinese transition is certainly leading the country towards a more prosperous society, with an enlargement of human rights, and a better balance between efficiency and equity, we must not forget that “different normative systems and social-

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<sup>34</sup> Let us note that considerable differences appeared in the answers to the standardized questionnaire between Western countries and all the four transition countries: only 8% of Western respondents consider that the legal framework is not sufficiently developed in their countries, whereas the percentage is more than 60% for Poland and Russia.

<sup>35</sup> However it should be noted that contrary to the thesis of the convergence we have already mentioned in the first chapter, this does not mean that every country will use the same technical device for realizing the general objective of creating a secure environment for private activities.

political philosophies will lead to different thick conceptions of rule of law<sup>36</sup> and that “when laws are at odds with the dominant values they are rarely implemented.”<sup>37</sup>

Bearing this in mind, what are the main technical conditions mentioned by our respondents? Let us mention them without entering into technical consideration that are in any case outside the scope of our research, and for whom there exist already a vast and serious literature. Moreover, they have been described with a sufficient level of precision in Chapter 3 Olivier Brenninkmeijer.

### Law and Regulations

First of all there should be rules protecting private property, fair compensation in case of nationalization, possibility of repatriation of profits for foreign investors. Second there should be a fair, clear and transparent tendering procedure, assuring competition, and a competent and fair evaluation of the proposals. Moreover there should be measures for avoiding corruption, and this may necessitate the creation of an independent institution either for managing the tendering procedure or at least for supervising it. In any case it is suggested that this task should be performed by a body composed of several persons representing the major stakeholders. And the need for procedures for arbitration and mediation has also been considered by many as a necessity in case problems may occur. Technical competence is in any case a must for managing these different aspects and phases of the adoption and implementation of PPPs: the people representing the public authorities should be capable of mastering all the technical and legal aspects implied in the evaluation of the tendering procedure.

In this context, the most negative aspects at the operational level put forwards by our respondents in the four transition countries concern lack of a sufficiently developed administrative and legal framework, the lack of supervision, the lack of competition (related

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<sup>36</sup> Peerenboom gives the following definition of thick and thin conceptions of rule of law: “Briefly put, a thin theory stresses the formal or instrumental aspects of law – those features that any legal system allegedly must possess to function effectively as a system of laws, regardless of whether the legal system is part of a democratic or non-democratic society, capitalist or socialist, liberal or theocratic. Although proponents of thin interpretations of rule of law define it in slightly different ways, there is considerable common ground (...) In contrast to thin versions, thick or substantive conceptions begin with the basic elements of a thin conception, but then incorporate elements of political morality, such as a particular economic arrangements (free-market capitalism, central planning, etc.), forms of government (democratic, single party socialism, etc.), or conceptions of human rights (liberal, communitarian, collectivist, ‘Asian values’, etc.)”: Randall Peerenboom, China Modernizes, Threat to the West or Model for the Rest?, Oxford, Oxford University Press, 2007, pp 306-307. Then referring to the case of China, Peerenboom goes on to say that there is relative little controversy over the merits or elements of a thin rule of law; on the contrary, “there are competing thick conceptions of rule of law, and considerable disagreement over particular aspects of particular thick conceptions in China, Asia, and elsewhere.”, ibidem, p. 307.

<sup>37</sup> Ibidem, p. 288. Peerenboom continues to say : « China’s socialist rule of law, Singapore’s soft-authoritarian or communitarian rule of law, Islamic rule of law, and liberal democratic rule of law will produce different outcomes in particular cases because the laws and practices reflect different values. (...) laws must reflect social norms and conditions. Liberal laws are not always appropriate. When laws are radically at odds with the deeply held views of the dominant majority, they are rarely implemented. This creates a gap between law on the books and the actual practice that undermines respect for the legal system and rule of law, and fuels resentful nationalism in Asia and other developing countries over the neo-imperialistic imposition of contested values”.

to the complexity of the procedure and/or to the lack of supervision), the confusion of roles between central and local authorities (especially in Russia and China), frequent changes in government (that is of course at the conjunction between politics and administration, and has been put forward in Poland, and is certainly also an important factor in Ukraine after the “Orange revolution”), the impossibility for local government to issue bonds (in China).<sup>38</sup>

To solve these problems from a technical point of view, the experience accumulated in Western countries could be useful, if it is carefully examined in light of the local conditions of the strategic and contextual levels. The solution of the problems mentioned above is linked to the definition of the formal rules of the game, the other rules are related to the strategic level and can only be determined by constitutional rules (that should pose some general and fundamental principles) those related to the contextual level being largely outside the reach of formal legislation. The generally accepted Western rule of legislative technique is that the rules of the game should be defined with the necessary clarity and precision. Lack of clarity and complexity has been mentioned by many of our respondents. Maybe even more important is the lack of legal instruments subordinate to laws that can bring more precision and legal security to the process, as it has been put forward by Russian respondents. On the contrary, some Polish people have complained about the excessive rigid legal apparatus that makes the process too long and complicated.

In any case there will remain at least the following dilemma, the solution of which could be rather difficult as it points inevitably towards a trade-off. This dilemma concerns the level of precision of the legal rules governing the procedures. If the legislation is composed of general principles and rules, this could lead to dysfunctions and eventually to sub-optimal outcomes, or even to corruption. If the rule is too precise, this could make the process too long and complicated and this could discourage potential private partners. The choice is not an easy one. If corruption practices have been numerous in the past, a more strict legislation would be advisable. Here we can see the importance of the adequacy of formal instruments to the cultural values and habits that prevails in all the countries. Countries like Poland, with a high degree of convergence with the Western way of managing the public sector and the relationship between State and economy, may very well adopt the formal framework of the West. Other countries may be advised to look for functional equivalents better adapted to their culture, without forgetting that the goal is to sustain economic development so that it can improve the attainment of four interdependent values: the economic use of resources for producing goods and services (economic efficiency) in ways that safeguard resources for future generations (sustainability), while assuring a fair distribution of the wealth thus created (equity), and a secure national and international environment without which the other values could not be realized. And this is what we are going to examine in the last part of this conclusion: to what extent can PPPs

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<sup>38</sup> Although Chinese local governments are not allowed to issue bonds, they find alternative ways, like borrowing from banks, to raise the fund for development. In China, Local Government Debt has become a big problem and risk in China's financial reform. The amount of local government debts is extraordinarily huge.

allow transition country to realize all or at least one of the four values without simultaneously hampering the others?

### **The Contribution of PPPs to Efficiency, Sustainability, Equity and Security**

In the preceding paragraphs of this conclusion we have seen that it has been quite easy to identify with precision the varied and many strategic, contextual, and operational conditions favourable to the adoption and implementation of PPPs in our four transition countries. Moreover, these findings are confirmed by what we know in Western countries, especially with regard to the contextual and operational conditions (as discussed in Chapter 3). On the contrary, determining to what extent PPPs in these countries can improve, and in fact have improved efficiency, sustainability, equity and security has been a more difficult task. The main reason is that, as we have noted more than once, experience with PPPs in these countries is rather recent, and therefore empirical evidence is at best scarce and/or balanced, at worse inexistent. Moreover, many of our respondents admitted a low level of knowledge about PPPs in general, i.e. both for their country and abroad.

Consequently, we are left with the opinions of our respondents and with the available empirical evidence from Western and other transition countries. When discussing the four prior decisions in favour or against PPPs, we have already mentioned that the great majority of our respondents have been unable to sustain their faith in the superiority of private provision of services and infrastructures by referring to empirical evidence; and this is true not only as regards economic efficiency (or value for money) but also as regards equity, sustainable development, and security. Of course this does not mean that PPPs cannot in fact realize one or several of these four values, there being empirical evidence (see Chapter 3) that in some cases PPPs have indeed delivered satisfactory results in both Western and transition countries. But, as at the same time there is empirical evidence to the contrary, the only conclusion we can draw from our interviews in these countries is that our respondents' opinions are based upon a theoretical (or even an ideological) bias in favour of PPPs. Moreover, as we have already mentioned, this bias is sustained by the too often poor performance (both in quality and quantity) of public services and infrastructures provided by the State in the framework of the former command economy. Of course, this poor performance has often been counterbalanced by equitable access, and this may have played against PPPs, at least until information about the better performance of public infrastructure and services in the West became widely available in transition countries. As we have already noted, quasi universal access to information in transition countries about the quality of services in the West very likely explains today the desire of people in these countries to have access to services of better quality and quantity based on the Western model, even if quality in the West is in some cases counterbalanced by inequitable access, one of the most striking

cases being medical care. But here again, we are dealing with opinions more than with considerations sustained by empirical evidence.

As for the empirical evidence available for Western and transition countries, we will refer the reader to what we have already said in Chapters 2 and 3 and in the first part of this conclusion. We will simply add some considerations developed in the chapters on our four countries and in the last OECD book on PPPs<sup>39</sup> and we will summarize the main recommendations we can address to the policy-makers of these countries, not forgetting, however, that the suitability of these recommendations should be evaluated in the framework of the domestic conditions prevailing both at the centre and at the periphery. As these conditions are based on the fundamental values and habits prevailing in these countries, deciding in favour of PPPs will therefore necessitate some political arbitration. It would therefore be pretentious on our part to consider our recommendations as having a prescriptive or normative “scientific” character, as this task will of course be performed by the political leadership of the countries concerned.

#### Opinions About the Impact of PPPs in the Four Countries

Overall, we can say that the majority of our respondents expressed a favourable opinion on the capacity of PPPs to perform better than the State for the provision of infrastructure and services practically on each criterion: economic efficiency, sustainability of economic development, equity and security. This is also true for the more detailed and practical dimensions of PPPs like transparency, accountability, monitoring, and limitation of corruption. But, as we have already mentioned, only a very few of them could sustain their opinion by providing empirical evidence based upon positive experiences gained in the West or in their own country. Of course some doubts and even negative opinions have also been put forwards, more often by NGOs and University people having empirical knowledge of both success and failures of PPPs, but also by public officials of our transition countries<sup>40</sup>. The doubts or negative opinions of the latter may be explained by their ideological attachment to the former planned economy, by the persistence of vested interests (as some members of the old nomenklatura still hold today official positions both at the central and local levels) or by a genuine concern about the negative impact PPPs may have upon equitable access to public services in some domains like health and education.

We can conclude that in our four countries there is an overall favourable actors’ environment where the ideas of implementing PPPs as a viable alternative for providing infrastructure and social services may gain the support of a majority of stakeholders. Nevertheless, and in spite of the overall positive picture, it is worth noting that even if the

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<sup>39</sup> OECD, *Public-Private Partnerships. In Pursuit of Risk Sharing and value for Money*, Paris, 2008.

<sup>40</sup> We remind the reader that we also sent a standardized questionnaire to Western people representing the public and the private sectors, as well as University and NGOs representatives, and that doubts and negative opinions have been more numerous amongst Western countries than in transition countries (see Chapter 4). We have explained this difference by the better knowledge Western people have acquired about PPPs.

doubts and negative opinions have been generally put forward by a minority of respondents, they correspond to important practical difficulties and/or the intrinsic theoretical weaknesses of PPPs dealt with in the scientific literature. Moreover, the last publication by the OECD, that became available at the time we were writing the conclusion to our report, very clearly constitute a powerful caveat to all those who may be tempted to implement PPPs in a variety of domains mainly on ideological grounds, without taking the time, and effort, to consider the difficulties and limits of this way of providing public services and infrastructures.<sup>41</sup> Moreover, OECD warns that “PPP’s should not be seen as a mechanism that will largely replace public procurement in the future.”<sup>42</sup> This report, that concludes several years of research, international meetings and seminars organised by OECD with members and non-members, is a valuable complement to our research findings; we will try to take advantage of its conclusions and combine it with empirical and theoretical evidence available elsewhere in the scientific literature.<sup>43</sup>

### Evidence from Empirical Research

Let us note first of all that the 2008 OECD report concedes that the move of Governments to rely increasingly on the market for the provision of public services “has been made both for ideological reasons and in the pursuit of value for money (...) Public-private partnerships are part of this trend.”<sup>44</sup> The aim of OECD is “to provide governments with a toolkit of issues to be explored and resolved from a public governance perspective before engaging in a PPP project.”<sup>45</sup> It further concedes that “the mere participation of the private sector in the delivery of the service is not sufficient to ensure improvement in service delivery and efficiency.”<sup>46</sup> But OECD remains a strong defender and believer in the superiority of the private sector, as this sentence is preceded by the assertion that the “private sector participation in PPPs frequently contributes to higher levels of efficiency”<sup>47</sup> and in the

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<sup>41</sup> OECD, Public-Private Partnerships, op. cit.. The Foreword informs us that: “This book discusses important issues for countries that use PPPs or are considering their use. It also discusses the extent to which countries are now using public-private partnerships in service delivery. Issues include affordability and value for money, how PPPs are accounted for and treated in national budgets, and the institutional framework for a PPP process. The book also highlights ten good practices, summarising what countries should consider before entering into long-term contracts such as public-private partnerships.”

<sup>42</sup> Ibidem, p. 28, and OECD also remind us that “for a number of years in the United Kingdom, private finance initiative deals (PFI) have made up a mere 10-15% of the total annual public investment expenditure, thus a small proportion in the country probably best known for its relatively extensive use of public-private partnerships.”

<sup>43</sup> Let us remark that OECD defines PPP in a more restrictive way by considering only private investors on the side of the private partners, thus excluding NGOs (ibidem pp. 12 and 132). Also OECD considers that PPPs are different from concessions (although it admits some important overlappings): see pages 12, 18-24, 95 (Box 4.2.) and 132. We remind that reader that David Hall includes concessions in the vast category of PPPs along with out-sourcing, the British Private Finance Initiative, Lease, and BOT (David Hall, « PPPs: a critique of the Green Paper », available on the website of the Public Services International Research Unit (PSIRU), Univ. of Greenwich, London, 2006.

<sup>44</sup> Ibidem, p. 3

<sup>45</sup> Ibidem, p. 12

<sup>46</sup> Ibidem, p. 18

<sup>47</sup> The link between the two sentences is given in ibidem: “the discussion below will show that, although private sector participation in PPPs frequently contributes to higher levels of efficiency, the mere participation of the private sector in the delivery of the service is not sufficient to ensure improvement in service delivery and

belief of the superiority of the management skills of the private sector.<sup>48</sup> Moreover, the whole treatment of the conditions under which PPPs will yield the expected results (i.e. basically value for money, that OECD considers as the primary objective of PPP) very clearly places the burden for the viability of PPPs on market or quasi market mechanisms, namely competition for the market during the bidding phase, and contestability after the contract has been signed.

This permanent, and, we must recognize, consistent faith of the OECD in market mechanisms, even when markets very clearly do not exist, presents a remarkable similarity with the position of the International Monetary Fund mentioned by Joseph Stiglitz and associates in their last book about capital market liberalization: even if IMF experts recognize that capital market liberalization has not led to growth and efficiency, they persist in considering that it “should”, and qualify as “anomalous” the empirical findings that prove that liberalization does not bring the benefits promised. And Stiglitz and associates concludes that “the basic problem is that their ‘theory’ (i.e. orthodox neoclassical theory) is predicated on perfect capital markets (...). Yet it has long been recognized that such assumptions are also entirely unrealistic.”<sup>49</sup>

Moreover little is said in the 2008 OECD report about the impact of PPPs on equity<sup>50</sup> and security<sup>51</sup>, and nothing about the impact of PPPs on sustainable development, nor on the

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efficiency.” And the decision between PPP and Government procurement will be taken as follows: “the distinguishing feature that determines whether a project is defined as traditional public procurement or as a public-private partnership should be whether or not a sufficient amount of risk has been transferred.”, *ibidem*.

<sup>48</sup> *ibidem*, p.133. Box 1, point 2.

<sup>49</sup> José Antonio Ocampo, Shari Spiegel, and Joseph E. Stiglitz, “Capital Market Liberalization and Development”, in Ocampo, José Antonio and Stiglitz, Joseph (eds.), *Capital Market Liberalization and Development*, Oxford, Oxford Univ. Press, 2008, pp. 3-4. Moreover, they inform us that: “Theoretical and empirical research over the past quarter century have helped explain why the market economy often does not function as well as free market advocates had hoped.”

<sup>50</sup> Equity is mentioned only twice in the text of the book (pp. 61 and 67) and once in footnote 12 of page 47. True, these are very important aspects, but one could have expected a more profound treatment of such an important dimension as equity.

On page 61: “Nevertheless, efficiency is not necessarily the only reason for using a public-private partnership. Even if the service is not a general interest good but a private good (meaning it has no externality), a PPP can be preferred to both traditional procurement and full-blown privatisation. This preference occurs when effectiveness, in addition to efficiency, is also an aim of government policy. Effectiveness becomes important with issues such as equity where poverty levels prevent the poor or financially less well-off from making an effective demand for a service even when their need is large (e.g. electricity supply to poor and remote areas in developing countries, or the provision of expensive medical procedures in any country).”

On page 67: “If renegotiations fail, or if the private operator fails, the PPP contract is in danger of terminal failure. Failed renegotiation that results in the termination of the contract can often be ascribed to tensions that occur in the contractual relationship. Examining these tensions for least developed countries, Estache (Estache, A., “PPI Partnerships vs. PPI Divorces in LDCs”, *Review of Industrial Organization*, 29, pp. 3-26.2006, p.18) found that, although PPPs resulted in higher levels of efficiency, quality and access rates, their fiscal and distributional (as in social equity) costs were higher than expected. This combination of efficiency, quality, access and costs leads to tension between a government and its private partners and, according to Estache (*ibidem*), explains the higher degree of partnership divorces.”

In note 12 of page 47 (dealing with the role and nature of risk by taking into consideration three types of efficiency): “Note that allocative efficiency is only one of the grounds on which a decide to deliver goods on the basis of their distributional effects, e.g. free education or health care to all, including the less well-off who would not otherwise be able to afford it. As is the case with allocative efficiency, once the decision to deliver

place PPPs may take within the national development strategies. It is true that transaction costs are mentioned at least five times, but without dealing satisfactorily, in our opinion, with the problems of their identification and measurement of their size; in view of the fact that efficiency (value for money) is for the OECD the primary objective of PPP design and transaction cost may be quite large, their calculation should become of paramount importance for deciding whether PPPs are better than traditional procurement.<sup>52</sup> Without a proper and precise methodology for calculating transaction costs, OECD is forced to place great faith in the virtues of market (and more often of quasi market) mechanisms to reduce these costs.<sup>53</sup>

The methodological problems with transaction costs will become even more important when linked to the fact that the market for PPPs is generally very limited both on the supply

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the goods has been taken, the next decision is about the mode of delivery, i.e. deliver the goods through traditional procurement or a public-private partnership. If a PPP is selected, the distributional element might impact on the decision whether the private partner will receive a fee from the government, thereby obviating the need to charge a user charge on the relatively less well-off consumers of the goods, or whether to allow the private partner to charge a user charge, but with the government then subsidising the relatively less well-off.”

<sup>51</sup> Security is mentioned only once on p. 128 (OECD, *Public-Private Partnerships*, op. cit.) by reference to the United Kingdom case: “... the legal framework must confer on the public authorities the right to take over service operations under extreme cases or in the case of default. In extreme cases, the United Kingdom government retains the right to take over services when □ there is a serious risk to public health and safety; there is a serious risk to the environment; □ the government is required to exercise its statutory responsibilities; there are national security implications.”

<sup>52</sup> *Ibidem*, pages 64, 78, 79, 110, and 130.

Page 64: “The complexity of negotiating a public-private partnership may generate substantial transaction time and costs that could cancel out the purported benefits of a PPP and that might be much higher than in other forms of delivery. For instance, in a review of 42 United Kingdom projects in health, education and civil engineering, Ahadzi and Bowles (“Public-private Partnerships and Contract Negotiations: An Empirical Study”, *Construction Management and Economics*, 22, November 2004, pp. 967-978) noted that there were excessive time overruns in the pre-contract stages which in turn resulted in large advisory cost overruns. (...) In addition to pre-contract time overruns, there were also substantial precontract cost overruns which ranged between 25-200% and were due to the continued retention of advisors by the government and the private parties during negotiations.”

Page 78: “When putting together project designs and contract details in the case of only one buyer and only a few projects, there is not much scope to exploit economies of scale if the scale depends on the number of projects. The relative transaction cost per contract will be increased; and the higher the transaction cost, the fewer bidders there will be.

Page 79: “At lower levels of government, there is the possibility of deeper markets – in particular, for instance, if there is a large group of local authorities that all use public-private partnerships. This group of local authorities constitutes a larger group of buyers, thereby approximating more closely a true competitive market ideal. The larger group of buyers also gives sellers the opportunity to participate in more bids. If contracts for projects and the procedures are standardised from the buyers’ side, the positive effects can be improved even further. Sellers know that if they fail in their bid for one contract, they can merely bid on the next. If the service and the design of the assets with which the seller must deliver the service have a significant level of homogeneity, economies of scale might exist in contractual design and bidding, with the scale to be found in the number of contracts. Transaction costs will be reduced, which in turn might cause the number of sellers that bid for a contract to increase. This increase in the level of competition may increase the potential for value for money. (However, care should be taken that the same group of companies does not dominate bidding, which again raises the danger of oligopolistic behaviour.)”

Page 110: “The main task of the PPP unit is not to advocate PPP projects, but to ensure that transaction costs are as low as possible and that value for money is the main criterion.”

Page 130: “Where possible, contracts can be standardised to improve clarity and to reduce transaction costs.”

<sup>53</sup> See the quotation on page 79 in note 51 above.

and the demand side.<sup>54</sup> Let us remind the reader that for OECD “competition remains the main driver of value for money”.<sup>55</sup> But OECD is forced to concede that most of the time there is only a limited number of bidders that, moreover, may start exhibiting oligopolistic behaviour, and that, on the buying side, the market for a particular service may be dominated by a monopsonist (the government). In order to escape from this uncomfortable situation in such a setting, OECD proposes to use the Public Sector Comparator (PSC): “whether or not the price established in such a setting will ensure value for money cannot be determined *a priori*, which explains why the existence of a thin market may require the use of a Public Sector Comparator (PSC). The public sector comparator does not replace or simulate the effect of competition in a thin market; competition remains the main driver of value for money. However, the PSC, in effect, is used to establish whether or not the oligopolistic structure of the market does not undermine the pursuit of value for money.”<sup>56</sup>

It is therefore clear that OECD considers PSC as a second best, and formulates the hope that “in time, a large number of awarded contracts may yield the details necessary to compile a database that in turn can be used to compile benchmarks of best practice. Thus, with higher levels of competition, the need to have a public sector comparator may be reduced, but only if reliable best practice benchmarks have been created on the basis of past data. Therefore, in countries that are currently still setting up PPP frameworks and in which the number of PPP contracts has not been extensive, such a database and the resulting benchmarks do not exist. In the absence of benchmarks, the PSC may again be a valuable tool to ascertain value for money, at least until such time as the government has collected enough information with which to compile reliable benchmarks.”<sup>57</sup> And this may be an interesting alternative for our transition countries.

Unfortunately, OECD recognizes that the implementation of PSC presents such a great number of major difficulties and limits that one can at least express some doubts about the effectiveness of this device to help governments to measure with the necessary precision the comparative value for money of PPP and traditional public procurement.<sup>58</sup> We remind the reader that value for money is, according to OECD, the primary objective of PPPs.<sup>59</sup> Now, in

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<sup>54</sup> In these circumstances one can hardly speak of a “real” market. There is even a rather funny sentence on page 78: “PSCs are also useful instruments for governments to use in markets that may lack competition.” (underlined by us).

<sup>55</sup> *Ibidem*, p. 79.

<sup>56</sup> *Ibidem*, pp. 78-79

<sup>57</sup> *Ibidem*, p. 79.

<sup>58</sup> *Ibidem*, pp. 78-88. The next paragraph is sufficient to explain our doubts: “When using a public sector comparator, a government should not just mechanically compare the PSC and the public-private partnership, but should take note of the “dangers of putting disproportionate emphasis on a single figure comparison” (...). In essence, the PSC is used to generate a net present value (NPV) of what traditional procurement would cost. This NPV must then be compared to the NPV of either a reference PPP or the actual PPP bids (or both). Because a PPP and a PSC both involve assumptions about the future and projections that include risk assessments, one danger of using a public sector comparator is that of spurious precision (...). In such a case, the NPV calculations in the PSC and the PPP proposal might be very close. A slight change in assumptions or in the assessment of risk may change the NPV calculations and cause the preference for a PPP to shift in its favour or against it.” (*ibidem*, p. 75)

<sup>59</sup> *Ibidem*, p. 133, Box .1. point 2.

the absence of a robust methodology for evaluating the difference in efficiency between the provision of services by PPP or the traditional method, political and ideological considerations may be the decisive criteria for deciding, especially if the difference is rather small.

In spite of these remarks, our analysis of the 2008 OECD report should not be considered as a total rejection of the OECD approach to PPPs, but it simply stresses the differences between this report and our research, especially in regard to transition countries: the goal of the OECD report is clearly to find means for building viable PPPs and to determine in what environment and sectors this is possible.<sup>60</sup> Our goal is to determine under what conditions PPPs can improve in transition countries at least one of the following values without damaging the others, i.e. economic efficiency, sustainable development, equity and security.

Having said that, it is a pity that the OECD exclusively focuses its attention and efforts in seeking means for discovering if, when, and how PPPs bring more value for money than the traditional public provision, and moreover does not even mention either the possibility of improving State provision of public services (be it through traditional public procurement or SOEs) or the possibility of using Public-Private Partnership as an alternative to PPPs.<sup>61</sup>

With these limitations in mind, we consider that the 2008 OECD report is a remarkable document that will be certainly not only fuel the debate on PPPs and traditional procurement, but also constitute a very useful guideline for governments and private investors, if it will be remembered that many aspects of the methodology of PPPs design and implementation must be further tested and improved, and that, as the OECD report concedes, the questions whether there should be public or private provision of services that are traditionally provided by the public sector “involve economic and political choices that depend on the relative efficiency of public services in a given country, on the potential availability of capital, and on the social consensus about acceptable ways of delivering certain services. The public and social acceptability of such partnerships is often a key factor.”<sup>62</sup>

Moreover, and more interesting for us, the OECD report confirms many of the conclusions of our research and puts forward an idea that complements very well our “four prior decisions approach” (to be discussed hereafter), by introducing the concept of

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<sup>60</sup> We remind the reader that the OECD book is meant for any country using or envisaging using PPPs, and, in spite of some caveat about some sectors like health and education, the report gives the impression that PPPs may produce good results in a great variety of sectors including health and education. In Chapter 2 (note 68) we have drawn the attention of the reader that some proponents of PPPs envisage their implementation in a great variety of sectors, including schools, hospitals, water, energy, and social services.

<sup>61</sup> See for example Emanuele Lobina and David Hall, “Public-Private Partnerships as a catalyst for capacity building and institutional development: Lessons from Stockholm Vatten’s experience in the Baltic region”, PSIRU, Business School, University of Greenwich, Old Royal Naval College, London, 15<sup>th</sup> August 2006

<sup>62</sup> OECD, Public-Private Partnerships, *ibidem*, pp. 11-12.

affordability, that constitute together with value for money the two “benchmarks for PPP viability. In principle, affordability is about whether or not a project falls within the intertemporal budget constraint of the government. If it does not, then the project is unaffordable.”<sup>63</sup>

Apart from the central place that market mechanisms take within the OECD approach and their consequences we have commented above, there are some remarkable similarities with our own approach (presented in Chapter 2) and our own findings (Chapters 3 to 8) especially at the operational level (see Figure 1 and comments above). In order to best appreciate these similarities, we will briefly comment upon the OECD approach on the basis of Figure 2, we have especially constructed for this purpose. Understandably, is not possible, nor necessary, to present in detail the OECD approach in this conclusion, but we will briefly comment upon some of its features that are controversial or that add something new and valuable to our own approach.

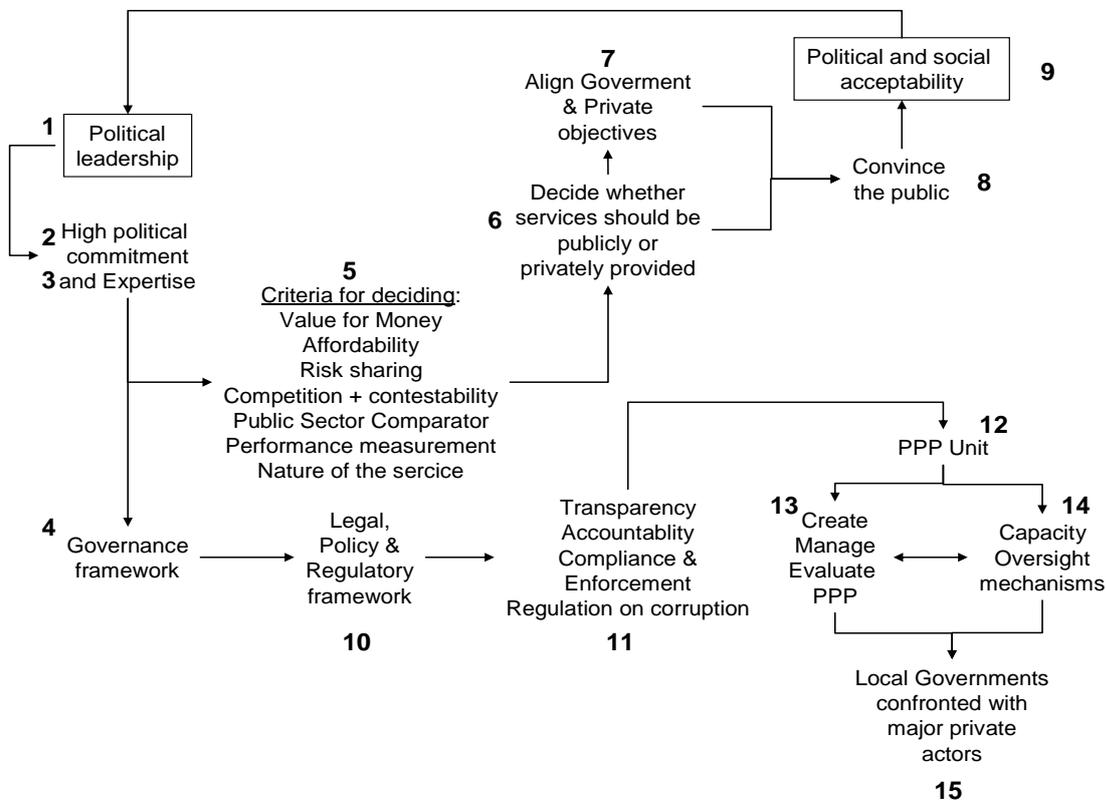
First of all, there should be a strong political leadership (point 1 in Figure 2) showing a high political commitment (2) in favour of finding the best way of providing public services and infrastructures. This political will must be complemented by a high degree of expertise (3), necessary for establishing a suitable governance framework (4). For deciding between traditional procurement and PPP it is necessary to take into consideration a certain number of criteria (5), and first of all the two benchmarks for PPP viability, i.e. value for money (or efficiency) and affordability. Value for money is further linked to the concepts of competition and risk transfer. Given the “market approach” of the OECD, it is not surprising, as we have already noted, that competition is considered as a necessary condition both during the bidding phase and after the contract is signed (here competition is designated by the concept of contestability).

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<sup>63</sup> OECD, Public-Private Partnerships, ibidem, p.133.

Figure 2

A simplified presentation of the 2008 OECD approach to PPPs<sup>64</sup>



For risk sharing OECD “argues that sufficient transfer of risk to the private partner is necessary to ensure efficiency and value for money.<sup>65</sup> For the transfer of risk to be the most effective, risk must also be transferred to the party best able to carry it. By defining risk as the probability that the actual outcome (i.e. sales, costs and profits) will deviate from the expected outcome (...) the book argues that efficiency depends on a sufficient transfer of endogenous risk to the private partner. The book also refines the principle that risk should be transferred to the party best able to carry it, by clarifying that ‘best able to carry it’ means the party who can carry the risk at least cost, be it the government or the private partner.”<sup>66</sup>

As said before, affordability is about whether or not a project falls within the intertemporal budget constraint of the government. If it does not, then the project is unaffordable. The great advantage of this concept is that it definitely discredits the fallacious belief of some governments that “if a project is off the government books, it becomes more

<sup>64</sup> Our interpretation of the approach presented in OECD, *Public-Private Partnerships*, op. cit.

<sup>65</sup> The reason for this given by the OECD report this that “risk is an important part of the incentive mechanism for the private partner to be as efficient as possible”, *ibidem*, p.133.

<sup>66</sup> *ibidem*, p.13. The difference between exogenous and endogenous risks is explained in this way: “Unlike exogenous risk, endogenous risk represents the case where the private partner can do something to ensure that the actual outcome approximates the expected outcome. », *ibidem*, p. 14. note 2.

affordable”.<sup>67</sup> This concept is an excellent complement to our “four prior decisions approach” presented in Chapter 2. The four prior decisions concerned the necessity to evaluate first the urgency of providing or of upgrading a service, taking into consideration the strength of the demand from the population; second, the efficiency of PPP compared to State provision; third, and related to the second decision, whether the private sector is able to provide a more effective and efficient managerial capacity; and fourth who will in the end pay for the service. In relation to this fourth decision our discussion commenced by putting forward a truism, i.e. that money must come from somewhere, meaning by this that no cheap a solution can come out of a poor or inexistent service. It must be built or refurbished and someone has to pay for it. We went on to say that if private companies are the only investor in a PPP, money will have to come from consumers, and as this will have to cover production costs (including profits) this may pose some problems for equitable access. If on the contrary, the money comes from the government (either for PPPs totally or partially funded by public money)<sup>68</sup> this may pose problems of high taxation (that may be supported by companies and/or tax-payers), increasing public debt, reduced efficiency and quality of the service provided. But this discussion did not make it clear that even if a positive answer could be given to the four questions, there could still be a major problem: the service could not be affordable because neither a single actor nor a combination of actors could sustain its cost.

The concept of affordability further completes and clarifies this discussion, at least inasmuch as it concerns the financial capacity of the government. Moreover, the OECD report warns against the use of PPP as a means to escape from the obligation of introducing expenses into the annual budget. With very good reasons OECD considers that this solution is not acceptable as it does not comply with the idea that expenses for the project should fall within the intertemporal budget constraint of the government. Finally, the concept of affordability is quite useful for another reason: we remember that the main reasons given by our respondents in favour of PPPs was the urgency of providing or upgrading services and infrastructures in the absence of sufficient governmental financial means. Little attention was given to the “who will pay in the end” questions, nor to the related questions of fiscal policy. Now the concept of affordability shows that this motivation is not valid on all occasions: it is valid only if the expenses of PPPs fall into the intertemporal budget constraints of the government.

These considerations put an additional burden on the political leadership: i.e. it has to explain to the citizens that the desirability of better services and infrastructures is closely linked to the financial capacity of the State, and this in turn depends on the country’s economic development. So we are driven back to one of the ideas presented in Chapter 2: in case of insufficient financial means for rapidly providing new or upgraded infrastructures (i.e., in the language of OECD, in case of lack of affordability), the government should instead set up the public policies aimed at boosting economic development instead of

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<sup>67</sup> *Ibidem*, p. 36. OECD further notes that “affordability is not only related to PPPs, but to government expenditures items in general.”

<sup>68</sup> This is because we cannot exclude intermediate situations where the government subsidizes a service (that could be provided either by a SOE or by a private company) in order to reduce its selling price.

embarking itself and the country on the dangerous road of persistent public deficits and public debt. In these circumstances, only this strategy can favour the development of a robust economy in which the governmental fiscal policy can obtain the financial means necessary for co-financing PPPs and/or for providing sufficient guaranties to the potential private partners. As we have already said, the other guaranties are to be assured by the establishment of a robust legal system. This discussion about affordability also shows that it would be foolish to expect that potential private partners would be willing to support alone the financial risk. In the domain of economic development and the development of public services there is clearly no free lunch.<sup>69</sup>

Two other factors are considered by OECD as criteria for evaluating PPPs: performance measurements and the so-called Public Sector Comparator, two criteria closely linked together, that cover a number of sub-criteria to be used for evaluating, both *ex-ante* and *ex-post*, the superiority of PPP compared to the traditional State procurement.<sup>70</sup>

In the process of deciding, on the basis of the above-mentioned criteria, whether services should be publicly or privately provided (6), the Government should also find the means of aligning public and private objectives (7) and this will enable it to convince the public that it has made a “good” decision (8); if it succeeds in doing so, then it will have obtained political and social acceptability (9), and will be able to count on public support during the implementation phase, provided of course, may we add, that it delivers satisfactory results.

Going back now to point 4 (Governance framework) the OECD 2008 report further specifies that a sound political, legal, and regulatory framework should be established (10) based upon the principles (11) of transparency, accountability, compliance and enforcement, and capable of limiting (and possibly eradicating) corruption. In order to better implement the governance framework for PPPs it is further strongly suggested to set up a PPPs Unit (12) whose role is on one side to help the government to create, manage, evaluate PPPs (13) and on the other side to increase the overall capacity of the Government, and more particularly

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<sup>69</sup> The strategy to be followed in this case is discussed by specialists of economic development for transition countries. See for example: Stiglitz, Joseph E., Making Globalization Work. The Next Steps to Global Justice, London, Penguin, 2006; Stiglitz, Joseph E. and Charlton, Andrew, Fair Trade for All. How Trade Can Promote Development, Oxford, Oxford Univ. Press, 2005; Sen, Amartya, Development as Freedom, Oxford, Oxford Univ. Press, 1999; Chang, Ha-Joon (ed.), Rethinking Development Economics, London, Anthem Press, 2003; Chang, Ha-Joon, Globalization, Economic Development and the Role of the State, New York, Zed Books, 2003; Chang, Ha-Joon, Kicking Away the Ladder. Development Strategy in Historical Perspective, London, Anthem Press, 2003; Chang, Ha-Joon, and Grabel, Ilene, Reclaiming Development. An Alternative Economic Policy Manual, New York, Zed Books, 2004; Chang, Ha-Joon (ed.), Institutional Change and Economic Development, Tokyo, United National University Press, 2007; Chang, Ha-Joon, Bad Samaritans. The Myth of Free Trade and the Secret History of Capitalism, New York, Bloomsbury, 2008; Braga de Macedo, Jorge, and Chino, Tadao, Sustainable Recovery in Asia, Mobilizing Resources for development, Paris, OECD, 2000; World Bank, World Development Report 2006: Equity and Development, New York The World Bank, 2005.

<sup>70</sup> In the framework of the criteria for deciding (5 in Figure 2) OECD also proposes to consider the nature of the service. But, as we have already said above in note 57, the report gives the impression that PPPs may produce good results in a great variety of sectors including health and education.

its oversight mechanisms (14). The latter are more especially needed to help the local governments that are confronted with major private actors (15).

Combining the results of our research and the conclusions of the OECD 2008 report, we may conclude by formulating some general recommendations and caveats. But first of all let us concede that it is impossible to provide a fully rational methodology for making decisions about the provision of infrastructures and services in transition countries that simultaneously improve efficiency, sustainability, equity and security, or that just improve one of these values without damaging the others. As Nobel Prize winner Herbert Simon has demonstrated years ago, only limited rational decisions are possible in situations of incomplete information.<sup>71</sup> Decisions are in fact a bet on the future. As it would be foolish not to take advantage of the information and robust methodologies available at the time of decision (provided of course that their cost does not exceed the expected benefits) it would equally be foolish (and perhaps also immoral) to pretend that we possess the methodology for making totally rational decisions. The case of infrastructure and services in transition countries (but the same is true for any country) is a good case in point. In our opinion the major determinant of decisions for arriving at outcomes satisfying (even if not optimising) the four values, is the vision and will of the leadership of the countries concerned. All the four values are necessary for the sound development of a society: efficiency in order not to waste precious resources (both natural and human), sustainability so as not to damage the living conditions of future generations (and again, both for the human and the natural environment), security for assuring the peaceful and secure environment necessary for the development of all societal activities, and finally equity is necessary not only to avoid injustice (which is necessarily based upon moral norms that not everybody may share) but also to assure the national cohesion without which the peaceful development of society would most likely be in danger. Any type of infrastructure and service (be it a PPP or any other form of organization), if not well conceived and managed, may very well contribute to damaging one value while contributing to improving the other. A well-known case in point is an infrastructure contributing to economic efficiency but damaging the environment. It is up to the political authorities to set up infrastructures (either through PPPs or the traditional method) so that the four values are safeguarded at least in the long term. On the basis of scientific evidence (drawn from both the natural and the social sciences) this is certainly possible today even in a situation of incomplete information. Only policies based upon blind ideology can favour solutions that damage efficiency, sustainability, security and equity. It is up to the political leadership of these countries to develop public services and infrastructures in such a way as to realize the four values to a reasonable level. And this will need much more than technical expertise. What is needed is a political philosophy of man and society based upon the respect of the four values.

In this (may we say: more reasonable) perspective, our research provides a checklist of conditions that the leadership of transition countries may consider when deciding how to

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<sup>71</sup> Herbert Simon, Administrative Behavior. A Study of Decision-Making Processes in Administrative Organization, New York, The Free Press, 1997, fourth edition (first edition 1945).

provide services, knowing that both traditional procurement and PPPs may satisfy or not the four values. The main hypothesis put forward by our research that PPPs can provide citizens with costly infrastructure and public services that they might not otherwise have been able to afford, *under certain conditions* has been largely confirmed. These conditions have been presented in the chapters analysing the situation in our four countries, and have been summarized above in our comments of Figure 1 and complemented by available evidence from Western countries (Chapter 3). Without entering into too much detail:

1. At the contextual level:

conditions favouring the development of market economy (or at least some market mechanisms); these may be largely independent from the will of the political leadership of the countries concerned, but as noted hereafter in point 2.1 the leadership may take advantage of these contextual conditions.

2. At the strategic level:

- 2.1. A strong political leadership at the top of the political system able to take advantage of favourable contextual conditions
- 2.2. A strong political will at the top favourable to market economy (or at least to market mechanisms), able to maintain a stable social and political environment in which the economy can develop at a steady pace
- 2.3. High expertise at the political and administrative level
- 2.4. High political capacity to interpret the needs of the people
- 2.5. A strong leadership willing to associate people (civil society) to the design, implementation and evaluation (*ex ante* and *ex post*) of PPPs
- 2.6. High capacity of the political leadership to assure compliance and enforcement of policies, laws and regulations, especially at the local level (in general and with regard to PPPs)
- 2.7. High capacity of political leadership and their administration for evaluating the contribution of PPPs to economic efficiency, sustainability, security and equity
- 2.8. High expertise in the private sector (if private money is not available for PPPs, foreign private money may be used; nevertheless care should be taken to develop in the meantime the capacity and expertise of domestic private actors)
- 2.9. A robust financial system (and for this it is also necessary to develop expertise) both in the public and private sectors, given the inter-dependence between private and public finance)

3. At the operational level:

- 3.1. Develop the legal system in order to achieve legal security, capable of sustaining the development of the economy, especially property and contract law. If necessary, establish special laws and regulations for PPPs (including a fair, transparent and clear bidding procedure)
- 3.2. Develop a culture of “rule of law”, even if it does not necessarily correspond to the “rule of law” of liberal democracies
- 3.3. As a consequence introduce formal means to assure accountability and transparency in both the public and private sectors and limit or eradicate corruption
- 3.4. Set up a PPP Unit, eventually also an Investment Fund
- 3.5. Set up training programmes for politicians and civil servants in all the methodologies related to the mastering of PPPs; these should cover all the range of expertise needed (as mentioned or suggested in this research report) and not only expertise based upon economic and managerial theories and models
- 3.6. Take decisions about the way of providing infrastructure and services on the basis of empirical evidence as far as possible
- 3.7. Take decisions that improve infrastructure and services in such a as to obtain a reasonable balance between efficiency, sustainability, equitable access, and security.

Finally, we would like to remind the reader that PPPs should be placed within the development strategy of transition countries. This has been recognized by the scientific literature<sup>72</sup> and by many of our respondents that favoured the creation of a PPP unit able to help the political leadership in creating, managing and evaluating PPPs.<sup>73</sup> Evaluation is essential of course, especially periodical monitoring, that will make it possible to eventually correct mistakes. It should nevertheless be noted that mistakes in the setting up of heavy infrastructures may be difficult to correct in the short run and may entail important costs. Hence the importance of *ex ante* evaluation, bearing in mind the difficulties we have discussed above. Moreover, the possibility to experiment before taking decisions for the entire country should not be neglected. This is maybe one of the greatest advantages of the strategy of the Chinese leadership that experiments locally different alternative means before deciding which one is the best for the entire country. Of course this is facilitated by the vast territory and the huge size of its population. But are the European Union and the USA such small entities? But this may be the beginning of another research suggested years ago by

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<sup>72</sup> See for example the references given in note 29 of this conclusion, and in notes 17, 25, 53, and 61 of Chapter 2.

<sup>73</sup> This has also been confirmed by the OECD 2008 report that proposes the creation of a PPP unit, even if it does not consider PPPs within an overall strategy of economic development.

Randall Peerenboom and other academics and practitioners who try to discover and propose alternative modes of managing our societies.<sup>74</sup>

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<sup>74</sup> This is the case of Randall Peerenboom who has served as an experts witness on PRC legal issues and a consultant to the Ford Foundation and the Asian Development bank on legal reforms and rule of law in China; he is presently Professor of Law at UCLA Law School: China Modernizes. Threat to the West or Model for the Rest?, Oxford, Oxford Univ. Press, 2007, and "A Government of Laws. Democracy, Rule of Law, and Administrative Law Reform in China", in Suisheng, Zhao (ed.), Debating Political Reform in China. Rule of Law vs. Democratization, Armonk, New York, M.E. Sharpe, 2006, pp. 58-78. For a more general, more critical and theoretical approach: Mangabeira Unger, Roberto, Politics. The Central Texts, London, Verso, 1997 (edited and introduced by Zhiyuan Cui)