

Privatisation and Public–Private Partnerships

Module Introduction and Overview

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1 Introduction to the Module

This module aims to introduce you to the main forms of cooperation between the state and the private sector in the provision of public goods and services. It does so both by examining the theoretical bases of public–private partnerships, and by an analysis of a number of recent case studies of PPP in action.

The Study Guide is focused primarily around the following two questions.

- What are the role and the duties of a state – which goods and services should be guaranteed to the population when employing financial resources raised through taxation?
- Which provisions should be made directly by the state, or instead outsourced to the private sector operating on its behalf?

2 Module Author

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He was economic advisor for CONSIP, the Italian Procurement Agency, from 2003 until 2008, for the Japanese Embassy in Rome as well as for public and private institutions in The Netherlands, on procurements design.

Dr Dimitri's academic interests and professional experience are in procurement, auctions and market design, game and decision theory, contracts, the economics of innovation, health care and pharmaceutical economics. He published several papers in international journals and contributed, as editor and author, to various books. In particular, jointly with Gustavo Piga and Giancarlo Spagnolo, he edited the *Handbook of Procurement*, Cambridge University Press (2006).

3 Study Resources

This study guide is your central learning resource as it structures your learning unit by unit. Each unit should be studied within a week. It is designed in the expectation that studying the unit and the associated core readings will require 15 to 20 hours during the week, but this will vary according to your background knowledge and experience of studying.

There is no one key text that covers the scope of this module, but you will have access to a substantial number of module readings.

Module readings

The module readings provide a selection of academic articles and extracts from books and journals, which you are expected to read as part of your study of this module. You will note from reading them that the topics covered in these articles often vary widely from the study guide. The module readings are often more technical or adopt a more in-depth approach. This should not put you off, as many were written with an academic audience in mind. These articles were selected so that the central arguments and concepts could be understood and appreciated at a level appropriate to this module.

4 Module Overview

The module consists of eight 'units' of work, each with set readings, questions and exercises. You also have the opportunity to discuss aspects of the module with your fellow students through the Discussion Forum.

Unit 1 Defining Public–private Relationships

- 1.1 Introduction
- 1.2 The Role of the State
- 1.3 Public Procurement
- 1.4 Public–Private Partnerships
- 1.5 Privatisation
- 1.6 Conclusion

Unit 2 The Size and Institutional Framework of Public Procurement

- 2.1 Introduction: How Important Are Regulations for Effective PP?
- 2.2 Outsourcing Trends in the Public Sector
- 2.3 Public Procurement and Supranational Institutions
- 2.4 Defence Procurement
- 2.5 Public Procurement of Innovation
- 2.6 Case Studies
- 2.7 Conclusion

Unit 3 Designing Public Procurement

- 3.1 Introduction
- 3.2 Public Procurement and Economic Policy
- 3.3 Best Value for Money in Procurement
- 3.4 Centralised vs Decentralised Procurement
- 3.5 Tendering Formats
- 3.6 Risk Sharing and Incentives in Public Procurement
- 3.7 Obligational and Adversarial Contracting
- 3.8 Contracts and Quality Enforcement
- 3.9 SMEs and Public Procurement
- 3.10 Green and Sustainable Procurement
- 3.11 Case Studies
- 3.12 Conclusion

Unit 4 Concessions of Public Assets

- 4.1 Introduction
- 4.2 The Rationale for Public Concessions
- 4.3 Types of Concessions
- 4.4 Infrastructure Concessions
- 4.5 Forest, Land and Mining Concessions
- 4.5 Conclusion

Unit 5 Public–Private Partnerships (PPP): Principles

- 5.1 Introduction
- 5.2 The Variety of PPPs
- 5.3 The Economics of PPPs
- 5.4 Conclusion

Unit 6 PPP Case Studies

- 6.1 Introduction
- 6.2 The London Underground
- 6.3 Urban Water Provision in Developing Countries
- 6.4 Infrastructural Projects in Indonesia and Vietnam
- 6.5 Conclusion

Unit 7 Privatising Public Assets

- 7.1 Introduction
- 7.2 Why Privatisate?
- 7.3 Which Public Assets to Privatisate?
- 7.4 How to Privatisate?
- 7.5 Privatisation and Regulation
- 7.6 Conclusion

Unit 8 Privatisation Case Studies

- 8.1 Introduction
- 8.2 The Privatisation of the British Rail System
- 8.3 Privatisation of Sydney Airport
- 8.4 Partial Privatisation in China and Singapore
- 8.5 Telecom Privatisation in Croatia
- 8.6 Conclusion

This module focuses on the relationship between the public and the private sectors of the economy. Its perspective will take as given the range of activities in which a state is involved, and we will focus our attention on how provision of the relevant goods, services and infrastructures is made.

As you will see as the module progresses, the questions cited in the module content section about the role and the duties of the state are fundamental ones with no easy answers, as to how many and which functions the state government should assume. Classical texts, beginning with Adam Smith, conceived the presence of a state in few fundamental activities, such as:

- protection of individual liberties
- safety and security

- definition and enforcement of property rights.

An often-cited view concerning an essential, distinguishing, feature of a modern state is the monopoly of violence (Weber, 1919). That is, no other subject within its defined geographical boundaries is allowed to use violence for achieving any given goals, or to enforce actions etc. without state authorisation. According to this view, a key role of the state is protection and security of the citizenry – its defence from external and internal offence. However, in countries where institutions are weak, as in the so-called *fragile states*, unauthorised violence can hit citizens without the state being able to cope with it.

While legitimated violence and security may be strong qualifying elements, modern states have taken on many other functions, such as supporting economic and social development, education, health care and well-being and, in general, providing a wide range of *public goods*.

A number of functions and activities performed by the state for direct provision of public goods – such as security, health care, rule of law and administration – require procurement of goods, services and works from suppliers, which are usually private companies. Because of its importance, procurement is a highly regulated activity by states, and in Unit 2 of this module it will be discussed from an institutional point of view.

The legal set-up will be discussed in Unit 3, which will present an analysis of how public entities can conduct effective procurement to deliver best value for money. Appropriate procurement design has become more important over the years, with public finances becoming tighter and available resources more limited. Successful purchasing procedures depend on a number of elements, the most important of which are discussed in that unit. For this reason, the prevailing perspective in Unit 3 will be economic.

Because of the increased prevalence of private firms in the provision of public services, in Unit 4 you will study concession contracts. The main feature of these is that they are most commonly used when the public good is deemed too expensive to be run exclusively by the state – which will, however, maintain some control over its provision. An apt example of this is the construction of motorways for the provision of transportation services, when the physical infrastructure belongs to the state. However, sometimes the state may decide not to operate the road directly, instead allowing a business company to do so on its behalf. Such a relationship is denoted a concession contract, where the public sector delegates to private companies the task of maintaining and managing an infrastructure for efficient public service.

However, when public finance is tight and the asset is not available, then we call this relationship a public–private partnership. Continuing with the previous example, if the state wishes to construct a new motorway, but does not have the resources, it may decide to ask one or more company to provide the needed financial means in exchange for the right to operate the road, over a sufficiently long period of time that the revenues accruing to the company from the motorway tolls would more than compensate for the initial investment in building it. Therefore, because the private sector is active from the

very beginning in providing financial resources and building the infrastructure, Public–Private Partnerships (PPP) represent a deeper involvement than concessions of the private sector in the provision of public goods.

Units 5 and 6 will cover the advantages and limitations of Public–Private Partnerships. This is a multi-faceted type of relationship, mainly used in large-scale infrastructure projects, and often justified on two fronts – cost and efficiency, where it is claimed that private enterprise is more efficient than the state in creating and managing such projects.

Finally, the state can privatise public assets and/or enterprises, as has happened in many countries with natural monopolies related to utilities such as energy provision, railway transportation, telephone communication, postal services. When this takes place, the provision and pricing of such public goods (electricity and gas provision, for example) becomes regulated by an independent authority, to allow companies a reasonable profit margin, at the same time preventing their monopolistic position to be exploited at the expense of the customers.

In Units 7 and 8, then, we shall discuss the strongest form of private sector involvement in the provision of public goods, when the state completely divests ownership of public assets to private buyers.

5 Learning Outcomes

When you have completed your study of this module, you will be able to:

- outline how state functions have evolved over time
- discuss how the public sector typically relates to the private sector for the provision of public goods
- explain and assess the main features of alternative public–private relationships
- quantify the size of PP markets across the world and explain the source of PP regulations
- assess the merits and limitations of alternative procurement legislations and procedures
- identify the goals of the procuring administration
- select the main dimensions for effective procurement design
- describe concession contracts and their rationale, and assess different types
- identify some of the merits and limitations of a PPP contract
- explain the differences underlying alternative PPP models in different sectors
- identify the main economic principles behind PPP case studies
- explain the main reasons underlying privatisation of public assets
- detail the regulatory challenges behind privatisation
- assess the importance of regulatory institutions when privatising natural monopolies.