

# Public-Private Partnership: Fashion or Trend?

*The business model of public-private partnership (PPP) is the key to fast socio-economic growth*

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**The recent two or three years have seen an increased interest in public-private partnership in Belarus and elsewhere. PPP is discussed in newspapers, at scientific conferences, roundtable sessions, and seminars. International experts come to Belarus to share best practices. In 2011, the Academy of Public Administration offered a master's course in the discipline "Management of investment projects in public-private partnership". The curriculum of the fourth-year students now features the discipline "Mechanisms of public-private partnership".**

## Back Story

The first important step towards public-private partnership in Belarus was made by a traditional State of the Nation Address delivered by the Belarusian President on 20 April 2010. The address emphasized the importance of new forms of interaction between business and the government. The President was more specific about the idea of PPP in his next State of the Nation Address a year later: "One of our most important tasks today is to come up with efficient mechanisms of public-private partnership and the adequate legal framework. This will create a foundation for a new format of relations between the government and business. This new format will be based on agreements on joint projects that are of paramount importance for the public."

The State of the Nation Address was followed by Directive No. 4 "Concerning promotion of entrepreneurial initiative and stimulation of business activity in the Republic of Belarus" that was signed on 31 December 2010. Article 8 of the Directive deals with the formation of the legal framework to encourage public-private partnership in Belarus.

A concept of the draft law "Concerning public-private partnership projects in the Republic of Belarus" was elaborated. In August 2011 the draft law "Concerning public-private partnership projects in the Republic of Belarus" was developed. It passed international examination and was to be enforced in 2012. But it was not. It was not even on the agenda of the parliament for 2013. More than that, there is some doubt as to whether the PPP

law is needed. Skeptics insist that investment projects related to infrastructure development could rely on the Investment Code that has a provision on concessions. Others say that it would suffice to develop the law "On concessions".

Most of technologically advanced countries have effective laws on public-private partnership, including the EU (2003), Germany (2003), Poland (2005), the Republic of Korea (1997), Ukraine (2010), and Moldova (2009). The Russian Federation has not drafted a single law on PPP yet, but regional governments are authorized to pass such laws and have been taking advantage of this opportunity for the last ten years. The federal law is to be enforced in Russia in 2013.

In fact, Belarus is not even in the list of countries promoting public-private partnership. It cannot be found in any rankings and country profiles made by international organizations.

Several years ago Deloitte & Touche compiled a rating of countries promoting the business model of public-private partnership. Of all the former USSR republics, Russia was the only one in the list and it stood at the very bottom of the ranking. Belarus was not there (Pic. 1).

So, what is public-private partnership all about? Is it just a tribute to fashion or a modern economic trend? Why do the majority of

technologically advanced market economies and economies in transition use this model across various economic sectors? Why is this business model so popular? What is going on in the world? Why is this model gaining ground globally?

### Through Globalization to Geo-Economics

The world is getting increasingly globalized. The ultimate goal of globalization is the establishment of the single global network economy - geo-economics.

This economy will run as a single system on the global scale. Accordingly, it will comprise not national states or national economies but the so-called "outer parts of national economies". In fact, these parts of national economies function according to geo-economic market and competition rules.

Thus, part of national economies is transformed into an exter-

nal economy. This process goes through transnational corporations (TNCs), regional groups, special economic and border zones, bilateral free trade agreements, and cluster-network regionalization. Then these sectors get separated from national economies and get inter-connected with each other as components of geo-economics.

These parts and the associated infrastructure form a new entity - geo-economics. It is almost impossible for the majority of countries to get integrated into it. The paradigm of the world economic development when a country could "catch-up" by borrowing the liberal model of development has changed already. Examples are South Korea and other countries of Southeast Asia.

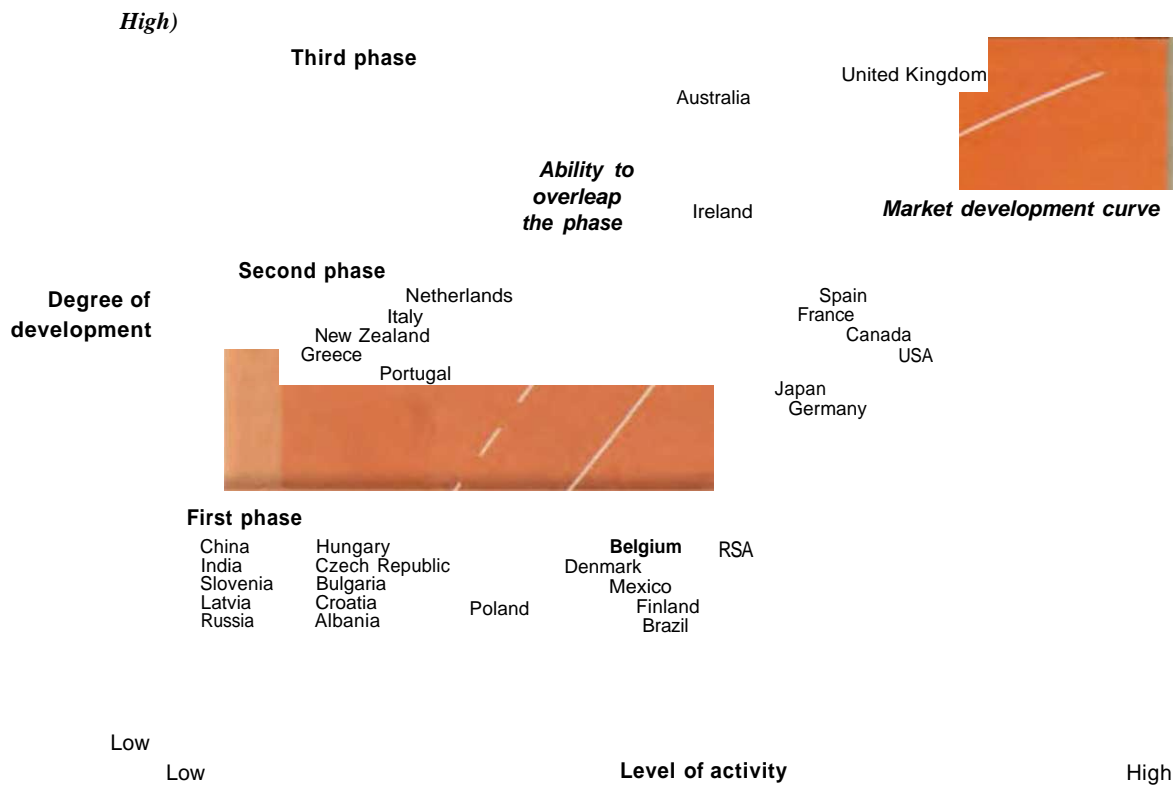
In the age of globalization national economies need to be open. Without it this phenomenon cannot exist in principle. In turn, the openness of a system implies its adjustment to the external environment.

However, without a new modernization strategy this openness turns the countries wishing to make part of geo-economics into the instruments exploited by globalization leaders to address their issues.

Today we see how the unified network of the market economy is being formed in different sectors of the world economy - mechanical engineering, power engineering, production of vehicles and aircrafts, oil and gas sector, and so on. This is no longer a theory. This is happening now.

Geo-economics is an end product of globalization. Its global players-actors are taking shape today. In traditional industries global players have already matured, though their configuration changes periodically. It does not seem possible to advance with traditional products and technologies using the "catching-up growth" model. The traditional markets have already been divided by the global players.

Picture 1. "Maturity (development) curve" of the PPP market



Source: Deloitte & Touche USA LLP.

Today it is these actors that define the world economic development. It is they who are forming geo-economics.

The studies conducted by the University of Zurich show that a small group of companies has a significant impact on the world economy. From Orbis 2007, a database listing 37 million companies and investors worldwide, the Zurich team pulled out 43,063 transnational corporations and the share ownerships linking them. Then they constructed a model to depict shareholding networks between companies as well as their operating revenues, to map the structure of economic power.

The work revealed a core of 1,318 companies with interlocking ownerships. Each of the 1,318 had ties to two or more other companies, and on average they were connected to 20 companies.

What is more, although they represented 20% of global operating revenues, the 1,318 appeared to collectively own through their shares the majority of the world's large blue chip and manufacturing firms representing a further 60% of global revenues.

The findings of the study were rather predictable. This is the underlying trend. What is more, in order to preserve their leadership, these regions invest heavily into research and development. As can be seen in Picture 3, European countries, the United States and Southeast Asia account for 87.8% (!) of the world's (\$1,276 billion) expenses on R&D.

Therefore, recognizing the new paradigms of the global economic system and its laws, each national economy begins to rebuild its structure. For that, they need substantial financial resources in order to make their infrastructure attractive for foreign big business, and above all, for branches of the nodes of the evolving geo-economy.

Secondly, it is necessary to form new players-actors using new business models and managerial solutions. This, above all, concerns the scientific and innovation component. It is only in the innovative environment that it is possible to create new actors who could play in the "field" of the emerging sixth technological paradigm.

## Competition and Development

Since the second half of the 1950s mixed economies began to open up and companies started going transnational. Thus, the process of globalization was launched. It reached its pinnacle in the 1980s. Governments that came to power in the UK, the United States, and Germany at that time started revising their regulation models, taking advantage of globalization, creating the necessary conditions for their companies operating in the world economy, encouraging transnational companies to invest in their assets. Back in 1981 Professor at Harvard University Theodore Levitt stated in his article "Globalization of Markets" that "companies must learn to operate as if the world were one large market— ignoring superficial regional and national differences".

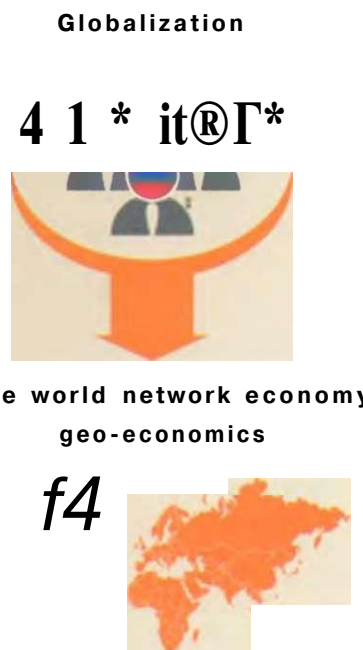
In the second half of the 20<sup>th</sup> century globalization spread across the entire world, which was once seen as a complex of national economies interconnected by a system of

international division of labor and economic and political relations. National economies intertwined through transnationalization and regionalization.

Revision of the government regulation model of the 20<sup>th</sup> century prompted transformation of the General Agreement on Tariffs and Trade (GATT) into the World Trade Organization (WTO, 1995) which spearheads this process. Thus, a part of state regulation functions were "handed over" to the supranational organization.

Economic globalization implies, first of all, openness of national economies. Without it this phenomenon cannot exist in principle. In turn, the openness of a system implies its adjustment to the external environment. However, as it has already been noted, without new development methods countries eager to make part of geo-economy will turn into the instruments used by globalization leaders to address their issues. For instance, WTO accession requires openness. We have taken the course towards the WTO, but at the very beginning of this road we have already faced

Picture 2. Globalization - Geo-Economics



problems integrating our economy with the economy of Russia that is a WTO member. The economy has turned out to be unprepared for it.

In other words, the national economy should be competitive, with its structure meeting every trend and process going on in the global economic system. Without structural changes, a country will not be able to secure economic growth or maintain the adequate level of economic development and the current living standards. This is imperative for any economy integrated into the global economy and partaking in global processes. It is nothing new anymore. It is the main condition for being an actor of these global processes.

The second condition is modernization of economic mechanisms, first of all, the model of government regulation which was developing in the market-economy countries through the 20<sup>th</sup> century, the age of industrialization. A new age means a new model. Under these conditions, public-private partnership is becoming an important instrument of government regulation of economy.

With the arrival of John Major who succeeded Margaret Thatcher as the UK Premier, the PPP model got a priority attention in the United Kingdom.

This business model was then adopted and widely used by Canada, Australia, France, the European Union and the United States.

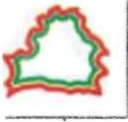
Of course, each country applies this model in most promising economic sectors. But still, these areas can be structured. A PPP business model may be used by infrastructure facilities, including highways and rail roads, schools, military installations and educational establishments, urban water treatment and sewage systems, utilities services, waste treatment services, hospitals and even prisons. In the late 1990s the author of the article studied the PPP model applied in various areas in the U.S., including a prison in Philadelphia. This model is also widely used in government regulation when certain services that require less expenditure are provided by private-sector companies.

Public-private partnership is not only about cooperation between the

public and private sectors as it is often interpreted, but a business contract between the government and a private party to implement projects in infrastructure development, public services, and innovative development. It should be noted that Belarus' draft law "Concerning public-private partnership projects in the Republic of Belarus" narrows down the use of *Jhe* model to the infrastructure sector. Innovative development which is based on public-private partnership across the globe has been dropped behind. Moreover, the draft law "Concerning public-private partnership projects in the Republic of Belarus" puts the main emphasis on investment projects. The question arises in this respect: cannot we do without this law and be guided by the Investment Code only? The bill does not contain such notions as trust management and leasing as one of PPP forms. Everything that is related to public administration is withdrawn from the bill. The same is true about the importance of PPP for the innovation area.

PPP projects aim to channel private capital into the development

Picture 3. The world's expenditure on R&D by region, 2009 (billion U.S. dollars, by purchasing power parity)



of infrastructure, higher quality of services, including public administration services, and building an innovation-driven economy. Public-private partnership is meant to redistribute responsibilities and risks connected with the development of clusters which usually fall within the scope of the state.

It is worth saying that to manage such a business model one needs to carefully divide spheres of influence of the state and the business. As a rule, in PPP projects the public sector is in charge of setting parameters and standards for infrastructure facilities and the services sector.

Private business is, in turn, responsible for the development, construction, and financing of the project. It is in charge of project management in compliance with the

established standards and parameters and assumes the responsibility to observe these requirements when providing services. In return, the private sector gets paid by the state or the consumer. The size of payments depends on the results of work. By the way, this model needs clear-cut standards and parameters. Otherwise, public-private partnership lacking norms and standards will instigate corruption and abuse.

For example, in Russia this model was compromised in the municipal services sector. Managing companies received money from the state and tenants. However, there were no effective norms and laws. As a result, the industry was enmeshed in corruption. This happened not because of the defective PPP model, but because of the lack of the adequate legal framework and standards which regulate the business. By the way, the draft law "Concerning public-private partnership projects in the Republic of Belarus" envisages only transparent tender procedures. The state is the only controlling body. In fact, the real mechanism of public-private partnership needs to be controlled by the people who will use public and municipal services. It is essential to establish multilateral ties between the state, the civil society and business in order to engage the general public in the administration of public affairs. Therefore, if the bill is passed it will be necessary to amend the legal framework related to public organizations.

Why do we need public-private partnership in Belarus? What does it give to the state, government, citizens, and business? Using this business model the government gets an opportunity to save a lot of financial resources and accelerate social and economic development. The business model will help raise the quality of the necessary expensive infrastructure (roads, depots, airports, terminals, schools, water treatment and sewage facilities, bridges, waste processing facilities, etc.), take advantage of the funds and managerial solutions of private business, and share risks with them. In such a way private business gets access to the industries previously dominated by the state, i.e. private companies are given new invest-

ment opportunities and a chance to communicate with the government directly. Consumers will enjoy an optimal price/quality ratio, accelerated development of the infrastructure and higher quality of public services.

The business model will play a big role in the innovation sector. It is especially important for us because the social and economic development program for 2011-2015 envisages radical modernization of all sectors of the economy, establishment of new science-intensive and high-tech production facilities.

Moreover, if we are going to join the WTO we must fulfill the accession requirement which says that at the precompetitive stage the state can finance up to 75% of scientific research. At the competitive stage the share of state financing cannot exceed 25%. The innovation sector needs private investments. Therefore, the innovation industry should be reformed in line with the requirement. This is what Russia has been doing since the early 2000s.

The majority of countries apply this business model. Among them are the United States, Germany, France, Austria, Australia, the Netherlands, China, India, Israel, Canada, etc.

Therefore, public-private partnership is not a tribute to fashion. Nowadays it is a major trend in the majority of countries, which is connected with globalization and geo-economics. Public-private partnership is how the main instrument of state regulation of the national economy.

If we are slow in passing the bill "Concerning public-private partnership projects in the Republic of Belarus" and the bill "Concerning state support to technological innovations" in the innovative and technological sector, we will lose competitiveness needed to raise foreign investments and develop the innovation-driven economy. It is competitiveness that should ensure geo-economic breakthrough together with Russia and Kazakhstan, with whom we are partners in the EurAsEC. This integration is based on the cluster and network regionalization in the innovation sector built to the public-private partnership model. •

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just cooperation between  
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