

Werner Heinz

Public Private
Partnerships:
Principles,
Opportunities
and Risks

Lecture given in the course of AER CENTURIO INTERREG III Conference of the
Assembly of European Regions in Ponta Delgada (Azores), 6 May 2005

The „Occasional Papers“ are a collection of articles in languages other than German that have been written for various events such as conventions and conferences. They also contain summaries taken from selected publications of the institute.

The author:

Dr. phil. Werner Heinz, Dipl.-Ing.

German Institute of Urban Affairs, Cologne

© Deutsches Institut für Urbanistik 2006

Distributed by:

Deutsches Institut für Urbanistik
German Institute of Urban Affairs
Straße des 17. Juni 112
D-10623 Berlin
Tel.: +49 (0)30/390 01-0
Fax: +49 (0)30/390 01-100
E-Mail: difu@difu.de
<http://www.difu.de>



I. Introduction and general background

Public private partnerships, that is cooperation between public authorities and private actors, have a relatively long history both in Germany and in other Western industrial nations. The evidence is the proliferation of mixed companies in the field of public utilities, the sector of urban development with a variety of partnership projects, or the Sociétés d'Economie Mixte (SEMs) in France. The latter have been responsible for many different projects in urban and infrastructural development since the 1920s. What is new, however, is the quantitative increase in partnership projects that began as long ago as the 1970s (in the case of the U.S.A. in particular) or in the 1980s (in case of European countries).

This clear increase in partnerships, first of all in urban development and urban regeneration, was the result of a range of conditions and prerequisites found in similar form in the majority of western nation states. They included:

- changing challenges and tasks confronting cities and localities as a consequence of a far-reaching transformation of economic structures, changing market conditions and intensifying competition, and the search for new approaches in order to meet these challenges,
- the increasing replacement of multisectoral planning strategies, corresponding to competition-oriented improvement of cities and their centres and the growing relevance of local marketing strategies and individual, economically significant projects aiming at an increase of the attractiveness of individual cities,
- a change in policy and ideology among central or federal governments in favour of deregulation, liberalization and privatization,
- extensive projects and requirements with regard to planning and infrastructural development following the unification of East and West Germany and the intention of the Federal Government to pursue new approaches by integrating private actors and their financial and planning capacities,
- the far-reaching transformation of local authorities and administration which started in the 1990s and which was determined to a high degree by the private sector and its principles
- finally, and this factor is now to the fore, the growing mismatch between the necessary provision of local services and facilities and decreasing financial means to do so.

II. Some characteristics of Public Private Partnerships

1. The participants, their goals and expectations

The number and composition of public and private participants in partnership projects are not subject to definite rules, they differ from one case to the next. In spite of these differences, however, partnership participants have much in common:

- Participants from the public sector are predominantly representatives of local government (local authorities or enterprises with intermediary functions set up by local authorities). Federal or central governments may also be involved, but usually only as initiators or in a supportive role.
- Private-sector partners are financially powerful actors like property developers and real estate companies, large groups of companies engaged in a broad range of urban-development sectors (particularly in France), institutional investors such as banks and insurance companies, or a wide variety of firms operating in sewage and waste disposal.

In the first instance, the members of public private partnerships pursue one common goal: the implementation, financing and/or management of large-scale projects with high prestige, the provision of specific urban services, or projects intended to strengthen or improve the economic viability and competitiveness of certain urban districts or entire cities.

The expectations of public and private actors concerning cooperation differ according to their specific functions and roles. The public sector, which in the majority of cases is the initiator of PPP projects, expects access to the professional competences and capacities of the private sector, a mobilization of private funds, relief with regard to limited administrative capacities and local budgets and, last but not least, the accelerated and professional realization of projects. Private actors set high hopes in the realization of joint ventures because of the promised access to local powers and authorities, greater influence on planning procedures and planning decisions and, not least of all, well-founded and largely risk-free project implementation.

PPPs not only share the differing expectations of individual partners, they are also associated with different interests, grounded in the different functions of the specific participants: public sector concern for the general interest and private sector hopes for sufficient opportunities to make a profit.

These differing goals and interests imply great conflict potential, which, at least in times of economic growth, remains hidden under a "blanket of consensus". In times of economic decline this conflict potential tends to become manifest: uses and requirements pursued by local authorities, which no longer do not dispose of any incentives, confront the investment interests of private actors who are forced to react on stagnating property markets, in growing competition between locations and a surplus of specific uses.

Public private partnership projects in urban development have therefore often proved to be "good weather-projects". Conditions permitting these projects tend to be hardly problematic; a worsening of these conditions, however, can seriously endanger projects.

2. Areas of activities, projects and spatial preferences

Public private partnerships can occur in a wide spectrum of local activities and services: in the transport sector, in municipal sewage and waste disposal, in urban and regional development, in housing construction and environmental protection, as well as in the operation of cultural, educational or recreational facilities. PPPs may be set up for all

public (local authority) services as long as there are no statutory obstacles to full or partial privatization.

Where partnerships are actually established (in what fields and in which spatial areas) and for what purpose depends, as international experience has shown, on one crucial factor: whether the private partner can earn a profit from a satisfactory return on his investment or because of sufficient public subsidies. This is obvious, especially in town planning and urban development. Public private partnerships can mostly be found in specific locations. On the macro-level they are frequently limited to a few attractive large cities and centres of economic growth; on the micro-level, they tend to be city centres or areas which are attractive from an urban development point of view and/or already privileged areas. As a rule, private developers show an interest in economic crisis regions or areas with low commercial demand only when the public sector offers attractive incentives, particularly of the financial or planning-regulation type, and when, despite the problems they face, the areas concerned, appear to possess the potential for economic and commercial growth.

As regards the project priorities of public private partnerships, first of all construction, urban development, and infrastructural improvements play the prime role in the majority of cases. As a rule, these are complex and quite often spectacular projects which are expected to improve the image of an urban area or the city concerned. Many these projects have not been undertaken in reaction to actual demand; they have been the outcome of a supply-oriented growth strategy, fuelled by government subsidies and private borrowing opportunities.

In the meantime, because of radically changed conditions, partnerships for such large-scale development-projects have become the exception. Cooperation between local authorities and private actors first shifted to other areas of urban development (unspectacular projects and approaches in property development); beginning in the mid 1990s, private actors showed increasing interest in the profitable facilities of urban transport, sewage and waste management infrastructure; and nowadays, apart from these activities, "practical" activities (like renovation, operation and management) in a wide range of public facilities are to the fore.

3. Types of cooperation

There is no binding rule on what form public-private partnerships must take. Indeed, this approach characteristically comes in many shapes and forms. Whatever differences there are, however, three types of cooperation may be distinguished, varying in function and according to the degree of institutionalization involved.

a.) Informal mode of cooperation among local business and public leaders (so-called "handshake partnerships")

In the majority of cases, partnerships of this type are not in charge of specific projects and services. They tend to operate as initiators and coordinators in the context of comprehensive planning and development strategies. Participants are for the most part influential representatives of industry and commerce or their associations, as

well as top-ranking civil servants or local politicians. This type of cooperation may be based on statute or simply on personal relations between participants.

b.) Cooperation based on agreements and contracts

This is the most common form in all countries under survey. The subject matter of these contracts is the roles and responsibilities of partners, their specific tasks and duties, their input as regards personnel, funding and equipment, as well as the distribution of potential risks. The content of contracts is determined by the concrete project, its goals and procedure, but it also depends on the negotiating competences and skills of the partners.

Contract-based PPP quite often follows specific models developed for the provision of specific services or the implementation and financing of public sector activities' by private actors. These model contracts are quite frequently applied with regard to public utilities, waste management and transportation, and range from so-called "operating" and "management models" to "facility management" and "leasing". Subject of the "leasing model" are infrastructural facilities or buildings which are built and financed by a private partner before leasing them to a local authority.

c.) The merger of public and private interests into joint cooperations

This mode of partnership is quite rarely employed, except in France. More than 1000 Societes d'Economie Mixte (SEMs) operate in a variety of fields: in property and urban development, in housing and commercial projects and in the provision and management of public facilities.

In Germany mixed-economy companies are especially prominent in the public utilities sector. A number of mixed-economy development cooperations have also been set up in urban development since the late 1980s: first in West German cities, then in East German centres. Last but not least, public private partnerships of the mixed-economy corporation type have been established on the regional level, too. Their main objectives are regional economic development and the formulation of development concepts targeting the regional level. A good example is the "Emscher-Lippe Agency", which pursues the structural improvement of the northern Ruhr-area and which was set up in 1990.

III. Results and Opportunities for Partners

With regard to the realization of their aims, public private partnerships tend to be most successful when concerned with the image-enhancing restructuring and revitalization of frequently centrally located urban areas. In such cases, partnerships contribute to the facilitation of complex urban renewal projects and to the acceleration of the procedures necessary for implementation. In many countries – from the U.S. to Sweden – this has led to the construction of many commercial and shopping centres, office and convention buildings, tourist facilities, and luxurious residential developments, all of which generally figure as symbols of urban revitalization and an improved quality of city life.

For public sector participants, the outcome of public private partnership projects is quite often ambivalent, because of the negative side-effects of some of the advantages associated with such projects.

The main advantage for the public sector is considered to be that public authorities and public servants gain access to private-sector know-how and principles, and hence access to economic thinking and entrepreneurial logic, to private management and marketing strategies, and to information on different markets and the rules that govern them.

It has proved a substantial advantage, too, that cooperation with private partners has generally shortened project procedures: because private sector know-how and public sector powers are combined, because private actors operate under profit-driven time constraints, and because the public partners and public functions involved are separated from local government line administration.

Turning to another public-sector goal in partnership projects, the mobilisation of private finance, it is not easy to judge either the extent to which this is achieved, or the financial consequences of such projects. In large-scale urban development projects, for example, it is claimed that the acceleration and improved co-ordination of projects and procedures cuts costs; at the same time it is pointed out that these projects almost always involve substantial preliminary municipal investment (in buying and developing property or in providing infrastructural facilities or inexpensive land).

Besides, private-sector commitment from which local authorities benefit may presuppose a number of subsidies by other authorities, ranging from low-interest loans and tax relief to attractive write-off allowances. Thus, in many cases the easing of the burden on local-government budgets expected of partnership projects is first of all the result of direct or indirect financial support from other authorities and only to a limited degree the result of injected private capital.

For private actors, co-operation with the public sector generally brings access to local public powers and competencies and a significant influence on local government decision-making. The private sector also benefits particularly from the provision of inexpensive land and the cost cutting acceleration of planning procedures and project implementation.

Another positive outcome for private participants in partnership projects is access to financial subsidies provided by other public authorities: state governments, the Federal Government, and the European Union, and to a wide range of tax advantages in function of the project and model concerned.

The key advantage for private partners in public private projects, however, lies in the safeguards on which they could almost always rely. Comprehensive preliminary public investment and clear-cut planning decisions safeguard investments; public guarantees permit and back extensive borrowing; long-term contracts ensure long-term returns, and, finally, certain "basic safeguards" are often agreed with public partners, especially on risky projects, to hedge against unpredictable cyclical developments and potential risks.

IV. Potential risks and dangers for the public sector, and some recommendations on how to avoid them

As experience with projects from different cities and different countries show, public partners may be confronted by a series of potential problems and dangers. These include, in particular:

- a reduction in control and influence for democratically legitimised representatives at the local level, as a result of the special situation frequently obtaining in public private cooperation (exemption from the normal administrative process, reduction of the public domain to a very few protagonists relevant to urban planning and development policy, etc.);
- a waiver of long-term, strategic perspectives in favour of comparatively short-term commercial calculations, as a result of the increased influence of profit-oriented thinking on local authority planning, planning aims, and priorities;
- a reduction in local competencies and manoeuvrability resulting from the transfer of local authority and responsibility to private partners;
- an unequal distribution of risk between partners, often imposing unforeseen procedural difficulties and financial deficits on the public sector.

Whether or not these dangers actually occur depends on a number of factors, not least of all on objectives and interests, and the quality of information and qualifications public protagonists contribute to cooperative undertakings with private business.

Public actors are therefore well advised to observe a number of "rules of conduct" in order to avoid such pitfalls:

- First, co-operation with the private sector should not be idealised because of the term partnership. It must be looked upon as a business relationship between fundamentally different entities in order to perform a given task or provide a given service.
- Second, the form of co-operation, the procedural steps, and arrangements concerning responsibilities should not be determined by abstract models but by the concrete factors of the given location and the main aspects of the undertaking envisaged.
- The public partner should set clear and unambiguous objectives, in order to prevent the primary aspects of the project and the activities involved from being dominated by the profit-oriented conceptions of the private partner.
- Public-private co-operation is mostly based on complicated negotiations. Public-sector negotiators therefore have to improve their strategic and technical proficiency as well as their negotiating strategies and tactics if they wish to act as equal partners and to be accepted as such.
- As far as the costs of co-operative projects are concerned, public actors should distinguish between short-term liquidity and long-term profitability. Costing should therefore take account not only of short-term advantages from the postponement of financial burdens, but also of the total costs accruing to the public purse.

- Public-private partnership projects require democratic control. The insulation of proceedings against democratically legitimised bodies and the broader public, that is often considered necessary in the interests of confidentiality and efficiency, conflicts with the statutes of local authorities and can prove to be dysfunctional in the long run.
- In order to ensure that agreements are honoured, the public partner should see to its long-term capability to exercise influence and impose sanctions.
- Last but not least, increasing public-private co-operation should not downgrade quality and competence in established local authorities. On the contrary, what is needed is to improve local government strategic and technical proficiency in order to meet today's demands and challenges.

V. Outlook for the future

Since the early 1990s, the conditions that had favoured a strong increase in public private partnerships and facilitated many of their projects have obviously changed in many European countries.

I have already pointed out that these changes have caused obvious changes in PPPs, too: especially a shift in activities to public sector functions and services that prove interesting and profitable for the private sector now.

There is far-reaching agreement that public private partnerships will continue to play a key role in the future, too; presumably they will even gain in importance. Less clear is the direction PPPs will take and the functions they will perform. This will depend on the future development of factors decisive for the growing importance of partnerships: economic conditions and prerequisites, local authority scope for action and finances, and the way local authorities define themselves. Together with the relevant political actors and their main priorities, all these factors and their development will determine whether PPPs become the rule, an exception or a transitional stage towards the progressive privatization of public sector responsibilities.