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REGULATION AND PUBLIC-PRIVATE PARTNERSHIPS

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REGULATION AND PUBLIC-PRIVATE PARTNERSHIPS

1. INTRODUCTION

As a result of the development of the free-market economy, most countries are engaged in radical changes, not only in their economic functions, but also in the characteristics and the respective roles of the state and the private sector. The traditional concept of an autonomous private sector acting in pursuit of its own immediate goals, notably profit maximisation, and a public sector with discretionary powers and multiple objectives that relate to the pursuit of long term goals in the public interest, has been challenging. This concept apparently no longer reflects the dynamics and interdependencies of economics and social environment. Murray (1975) asserts that the changing situation seems to be evolving toward a mixture of public-private and government-market decision making with a blurring of the lines rather than a distinct bifurcation of responsibilities. Presently, a concept of co-operation between public and private sectors to form an inter-organisational partnership has been widely acceptable and will continue to flourish, especially in the countries where the privatisation process has been actively undertaken.

Growing attention to the importance of the market mechanism, together with the success of privatisation efforts in various countries, have sharply increased interest in a public-private partnership concept. The current issue in public–private partnerships can be dated from the 1960s, in which partnerships were deployed by the federal government in the United States as a tool for stimulating private investment in development of inner-city infrastructures (Fosler, 1986). The public-private partnership can provide a broad umbrella which can shelter and protect the public interest while bringing investment potential and added value from the private sector (Carr, 1998). The economic recession of the 1970s also led the local and state governments to seek more efficient ways to provide public services by contracting out to private firms. Throughout the 1980s, the public-private partnership had been viewed as a derivative of the privatisation movement, which fascinated conservative leaders in western liberal regimes, especially in the UK and US (Linder, 1999 : 36). Public asset sales and outsourcing including divestiture of state-owned-enterprises that occurred under the privatisation programmes became a vehicle for enhancing the provision of public services in the free-market economy (Kettl, 1993). Presently, public-private partnership has been widely accepted in the UK, European Countries, North American, and also increasingly in developing countries.

Experience on public-private partnerships from many countries suggests that where, on normative grounds, regulation may be required to assure that a balance of public and private interests are reached through partnering arrangements (Carson, 1983 ; Saltman and Figueras, 1998). Regulations should be designed and administered to protect collective welfare, ensuring open competition and promoting the advantages of market discipline without strangulating the market with unnecessary or unrealistic controls (Rondinelli, 1991 ; Savas, 2000). It seems logical that as the role of the private sector in providing public services increases with partnering, government regulations would be reduced (Rosenau, 1999). But in reality, partnering can lead to the opposite direction. In several cases, partnerships require effective government regulation, which should be based on a stable and trusted system of enforceable laws concerning property rights, contracts, disputes, and liability. A clear legislative framework specifying theroles of the public and private sectors, their relationships, and the areas for co-operation is essential for building their sustainable partnerships (Wang, 2000).

2. PUBLIC-PRIVATE ORGANISATIONAL RELATIONSHIPS

Although several school of thought have divided society into two sectors, public and private, the actual overlapping functions between a business firm and a government organisation have become increasingly apparent. Scholars from these traditions suggest that public and private organisations can be distinguished according to the presence or absence of market structures, externalities, and ownership transferability (Buchanan and Tullock, 1962 ; Niskanen, 1971 ; Alchian and Demsetz, 1972 ; Clarkson, 1972). More generally, a fundamental basis for distinguishing public and private sectors is concerned with organisational aims and typical functions as executed by each organisation. The adherents of this view are that a public sector focus would stress elements such as equity, fairness, and the rule of law in handling public provisions. Conversely, the private sector would focus on cost-benefit analysis, effectiveness, and efficiency in performing its business. However, this prevailing assumption has been challenged by a more sceptical view of several contemporary scholars. In particular, Murray (1975) asserts that the notion that profits are the sole or main reason for the existence of private business is itself misleading. He argues that all profits are essential requirements for private organisations for existence; but the focus on profits as the single objective distorts or minimises other advantageous business activities such as products, services, employment, including social contribution. Furthermore, while profits are a simple measure, benefits and costs do not always lend themselves to a monetary judgement of effectiveness of the private organisations. On the other hand, such an attempt to argue that profits are never the objective of public sector activities is equally misleading since it is clearly seen that many projects owned by government are notoriously subjected to cost-benefit analysis prior to executing.

Other literatures also put very strong critiques on the dichotomy of public and private organisations. Critiques to date have demonstrated that, through the use of a simple public-private distinction, many traditionalists have paid insufficient attention to variations in the economic environment. They simply underscore the assertions about the relations between the structural characteristics of public and private organisations and the economic environment surrounding them. A cornerstone of the new economic thought, concerning overlapping disciplines of public and private sectors, is mainly oriented toward the concept of the 'mixed economy' that comprises a vast variety of economic patterns, which are neither totally dominated by state enterprises nor operating under a totally unregulated system of competitive private firms. In the mixed economy system, nothing seems to either purely public or purely private (Friedmann, 1974: 360). Joint private and public venture organisations are found where there are commercial risks involved. In the past, it was because the private sector was unwilling to bear those risks so government was required to step in. In recent years, however, the private sector has stepped in to bear the risks that the public sector does not want to, largely because of the burden of investment. In some cases, policies and relevant regulations have to be endorsed to make private provisions an attractive proposition. Clear evidence of this is seen in several projects that have currently been undertaken by the private sector in the United Kingdom under the new investment scheme called 'the Private Finance Initiative (PFI)' (HM Treasury, 1993).

In short, the environment in the mixed economy system has created greater interdependencies requiring more co-ordination across public and private organisational boundaries. Consequently, the traditional boundary between public and private activities becomes blurred and it is difficult to determine where public organisations end and private ones begin. The traditional dichotomy of public and private organisations is no longer appropriate in handling the substantive issues and the complicated procedural matters. Most of the recent literatures (Tomkins, 1987 ; Gortner, *et.al.*, 1989 ; Farnham and Horton, 1999) point to a blurring of the boundary of public and private organisations rather than to a bifurcation. Of particular interest, highly proliferated in recent years, is co-operation between public enterprises and private firms in common ventures, in which public and private organisations form a strategic partnership to carry out productive activities side by side. In fact, there is a general tendency, where the public enterprises and the private firms do not act like the rivals to hamper each other, but to act as complementary forces to assist and support the society in their efforts and to attain prosperity and welfare through their own initiatives. The mixed economy also emphasises a regulatory framework that the government needs to establish prior to moving into partnership with a private firm.

3. THEORETICAL FRAMEWORK OF PARTNERSHIP

Over the past two decades, a transaction cost economics (TCE) theory has become the most influential ways for integrating the economic implications of organisational behaviour into the strategic analysis of the organisation (Ouchi, 1980 ; Robins, 1987 ; Alvesson and Lindkvist, 1993). Transaction cost economics has gained increasing influence associated with the work of Oliver Williamson (1975, 1979, 1981, and 1985). A number of authors have elaborated Williamson's transaction cost economics framework, using it for the analysis of a wide range of strategic alliances (Hennart, 1991 ; Balakrishnan and Koza, 1993) and as a theory to explain why organisations exist and persist in markets (Ghoshal and Moran, 1996). Theoretical and empirical work in the transaction cost economics have improved an understanding of transactional characteristics that make them economical for organisations to enter into various 'standard' and 'non-standard' contractual relationships such as long-term contracts and interorganisational partnerships (Joskow, 1991).

The purpose of transaction cost economics theory is to identify the sources of transaction costs which provide characteristics or dimensions of a transaction that make exchange problematic or prohibitively expensive (Jones, 1987 : 199). In Williamson's (1975) model, transaction costs arise because a transfer of goods and services takes place in an exchange context where information is imperfect, where parties have made asset-specific investments, or where either party may seek to promote its own interests at the expense of the other by engaging in strategic or opportunistic behaviour. Such factors as a small number of suppliers or buyers or a high level of uncertainty surrounding an exchange process increase the costs of transferring or exchanging goods and services because they make opportunistic behaviour likely and ensuring equity difficult.

In a market relationship, the transaction takes place between the two parties and is mediated by a price mechanism in which the existence of a competitive market reassures both parties that the terms of exchange are equitable. The transactions cost approach explicitly regards equity as one of the fundamental element in determining the nature of organisational activities. Ouchi (1980 : 130) argues that it is this demand for equity, which brings on transaction costs. A transactions cost is any activity, which is engaged in to satisfy each party to an exchange that the value given and received is in accord with parties' expectations. By doing so, each side may require an extensive and complete contract which will describe exactly what is being bought and sold. In the face of opportunism, this contract has to be laden with safeguards that are designed to protect each party from the opportunistic behaviour of the other. Such safeguards are costly and include costs associated with negotiating, drafting, and monitoring contracts (Chiles and McMackin, 1996 : 88). All of them are regarded here as transaction costs.

The market failure framework argues that markets fail when the costs of completing transactions become unbearable (Ouchi, 1980 : 134). To minimise the transaction costs, it is necessary to create a perception of equity among all parties to the transaction through a co-operative behaviour or a form of partnership instead of pursuing it through a costly contractual safeguard. From the perspectives of Mayo (1945) and Barnard (1968), the fundamental problem of co-operation stems from the fact that organisations have only partially overlapping goals. They often pursue incongruent objectives and their efforts are uncoordinated. Market transactions are efficient if the parties can tolerate relatively high levels of opportunism or goal incongruence. The partnering organisations can create an atmosphere of co-operation much more easily than a market can if they assume some commonality of purpose and learn that long-term relationships will reward good performance and punish poor performance. In order to mediate transactions efficiently, organisations must develop some goal congruence between parties to reduce their opportunistic tendencies and thus the need to monitor their performance (Ouchi, 1980 : 135).

The transaction cost economics (TCE) theory is useful in analysing which transactional situations a partnership is best suited (Kogut, 1988). Partnerships may be used to bypass market inefficiencies in which there are high uncertainties over specifying and monitoring performance, in addition to a high degree of asset specificity. It is uncertainty over performance, which plays a fundamental role in encouraging a partnership over a contractual safeguard. The critical dimension of a partnership is its resolution of high levels of uncertainty over the behaviour of the contracting parties. A partnership creates a superior monitoring mechanism and alignment of incentives to reveal information, share technologies, and guarantee performance (Kogut, 1988 : 321). Instrumental in achieving this alignment are the rules of sharing costs and/or profits and the mutual investment in dedicated assets such as the assets that are specialised to purchases or sales from a specific organisation. High asset specificity increases transaction costs because the quantity and quality of information exchanged between actors increase. High levels of investment in specific assets can limit economies of scale and scope and thereby lead to loss of production efficiency. High asset specificity can also lead to a dependent situation that can be exploited by powerful partners. Partnership relationships, based on trust, can, in principle, provide a solution to the problems associated with asset specificity. The development of trust can be seen as a rational and self-interested method of maximising the total value of interorganisational activities because of mutual dependency. McDonald (1999) argues that partnerships allow the necessary investment in specific assets that leads to reductions in operations costs and quality advantages while avoiding the high transaction costs that are connected to the complex control and monitoring systems.

Equity control and parties' sharing in the profits or losses attained through the partnership's performance serve to align the interest of the parent firms, reducing the opportunism that may arise in contractual agreement (Stuckey, 1983 ; Hennart, 1988). A partnership is normally considered more difficult than a contractual agreement to establish, terminate, and fundamentally change (Harrigan, 1988). Nevertheless, Balakrishnan and Koza (1993 : 103-104) indicate that transactions governed by a partnership will be efficient due to the following reasons:

First, a partnership, unlike an acquisition, avoids a terminal sale and transfer of ownership rights and allows the partners to cancel the relationship at a relatively low cost. It can be structured as a mechanism that allows piece-meal transactions. The possibility of repeated contracting and termination of the relationship under a partnership can lead to information revealing and mitigate the unfavourable selection problem.

Second, the partnership, unlike a lease, introduces for each parent-limited formal and informal property rights and obligations by way of shared ownership. When the partnership is formed, the parents have a responsibility pertaining to a legal trust to each other. In incorporated partnerships, the members of the governing board or the executive committee whom are usually drawn from both the parent organisations, collectively decide the policies of the partnerships. They may also have limited rights to formally or informally audit and verify the claims and actions of the parents by monitoring the use of the assets of their respective parent organisations as well as those of the partner. These features of a partnership, unavailable in a pure contract such as a leasing agreement, help to reduce the incentives for opportunistic behaviour in the partnerships.

Third, the partnership affords opportunities for learning and gathering new information about the value of the partner’s assets. Some partnerships explicitly stipulate a dissolution date and many others end in purchase by one of the parents. In such cases, monitoring and auditing the partner’s asset use facilitate the learning process and eventually, the pricing of those assets.

Organisations enter into a partnership for a wide variety of strategic motives, using diverse organisational forms and legal structures. Some partnership structures are inherently more likely than others to be associated with high opportunity to cheat, high behavioural uncertainty, and poor stability, longevity, and performance (Parkhe, 1993). The incentive to cheat in co-operative ventures occurs because each partner finds it ‘advantageous to maximise his own gains at the expense of the venture’ (Hennart, 1991 : 186). In partnership, co-operation is maintained as each organisation comparesthe immediate gain from cheating with the possible sacrifice of future gains that may result from violating an agreement (Telser, 1980).

The partnership, however, is not a costless mechanism for combining culture and set of values between distinct organisations such as public and private organisations. Because of the absence of ‘unity of command’, costly disputes over sharing the gains from the partnership are still a possibility thus resulting in increase of the administrative costs of managing and controlling the partnership (Balakrishnan and Koza, 1993 : 104).

4. PUBLIC-PRIVATE PARTNERSHIPS IN THE MARKET ECONOMY IN TRANSITION

A public-private partnership is a concept, in which government and private sector assume co-responsibility and co-ownership for the delivery of public services. It includes interaction between government and business in which the focus in achieving convergent objectives is on synergy. The objectives of public-private partnership have both social and commercial characteristics and the respective identities and responsibilities of the parties involved remain intact (Kouwenhoven, 1993: 120). The term ‘public-private partnership’ has been used for nearly two decades to describe any joint activities that the public sector (e.g. federal, state, local government agencies, and State-Owned-Enterprises) interacts with the private sector (e.g. families, employees, philanthropy, media, civic groups, and service providers). In practice, there are various joint partnership activities, ranging from a municipal outsourcing contract for refuse collection to a public-private strategic taskforce to develop national strategies for economic growth. The public-private partnership approach represents a departure from the traditional procurement of assets where the public sector pays for the construction or development of an asset and then makes separate arrangements for the on-going maintenance and operation of this asset (INTOSAI, 2000). It is also different to traditional outsourcing, which simply involves some portions of public services contracted out to the private firms. Instead the public-private partnership approach involves the provision of services to the public sector by the private sector, which also takes responsibility for the construction, development and financing of any assets needed to provide the required services. Also, the services provided may extend beyond those support services which traditionally the private sector has provided to the public sector, such as building maintenance, to services whose delivery in the past has been the responsibility of the public sector itself, such as the provision of utilities. Thus public-private partnership contracts typically involve public sector clients specifying services which they wish to purchase and, through competition, selecting private sector suppliers to provide them. Alternatively, they can involve the award of a concession to a private sector supplier who then charges the general public for the use they make of the services provided.

A public-private partnership has become a locus of the policy concepts of the 1980s as a consequence of the shift toward privatisation and quasi-privatisation among most developed countries in Europe and North America and the developing countries in the Latin America, Asia, and Africa. The public-private partnership approach has been fairly well engaged by various government task forces and private sector organisations together with several non-profit groups in those countries. The relative merit of the idea of public-private partnership is oriented mainly around a mutual benefit toward greater co-operation and effective sharing of resources among government, business, non-profit groups, including individual citizens in solving social and economic problems, addressing community needs, or streamlining public provisions.

Public-private partnerships do not simply mean the introduction of market mechanisms or of privatising public services as some have proposed but rather that the public and the private sectors have common goals and that partnerships can take advantage of the separate strengths of each to achieve their mutual objectives (ADB, 1999). It is argued that in partnerships, the private sector needs to consider its social responsibility while the public sector needs to create the appropriate legal and regulatory structures as well as a democratic and participatory process in decision making (ADB, 1999: 3).

Public agencies and private organisations can seek mutual advantages in developing a strategic partnership, which is characterised by trust, openness, fairness, and mutual respect. For the public agency, the main rewards from partnering with the private sector are improvement of programme performance, cost efficiencies, better service provisions, and appropriate allocation of risks and responsibilities. Whereas the private sector expects to have a better investment potential, to make a reasonable profit, and to have more opportunities to expand its business interests (OCSE, 1997). Both sectors view positive or negative results as a reflection of their joint efforts and share the responsibility accordingly. However, Schermerhorn (1975), Williamson (1975), and Proven (1984) suggest that the formation of partnering relationships between the two distinct organisations often lead to some negative outcomes such as increasing complexity, loss of decision-making autonomy, and information asymmetry. Rosenau (1999) also states that public-private partnerships have substantial problems. Evidence from his study suggested that in various policy sectors, public-private partnerships have not resolved problems with regard to equity, access, participation, and democracy. In fact, public-private partnerships may achieve cost reductions at the price of democracy and equity (Rosenau, 1999 : 27).

Many countries are facing a push for privatisation, partly from their own experience of the fiscal difficulty of sustaining public services (Batley, 1996). Privatisation has been accompanied by an advance to move public sector activities to the private sector and through contracting out and commercialisation of government activities (Hughes, 1993 : 2). Traditionally, the philosophy and objectives of the public sector do not derive from a profit motive, but from the delivery of government services. This means the public sector cannot always react to the market in a strictly commercial sense because of its statutory requirement to deliver some services that may be resource-intensive (Scollay, 1993 : 1). The public sector can seek to deliver those services in the most cost-effective way, but this is not always possible. The public sector has an obligation to act in the public interest in the delivery of public goods which may not sit comfortably with the imperatives of least cost and competitive advantage that are the benchmarks of private sector practice (Singleton, 1994). In the mixed economy system, where the opportunities for public-private partnership arise, different sorts of public services can be provided through different public-private combinations. Both public and private sectors are coming to realise that they can have common stakes in responding to their partnership arrangements.

Public-private partnership can be seen as an appropriate institutional mean of dealing with particular sources of market failure (Ouchi, 1980 ; Kogut, 1988). It is most likely to occur where there is a strong possibility that opportunities for private investors will be generated by government involvement. Public-private partnership involves a variety of techniques and activities to promote more involvement of the private sector in providing traditional public services (EPA, 1999 : 1). It enables each party to do what it does best and can result in a ‘win-win’ solution for public provisions. The public sector’s contribution aims to undertake necessary investments which private organisations are unable to perform due to their large scale, high risk, or difficulty of charging to consumers. It also intends to facilitate private actions through financing or the use of the coercive powers of the state. In the same manner, it is required an equal position on the governmental side that there will be public gains from the private investment (Batley, 1996 : 736).

Walsh (1995) argues that the public sector needs to act to provide merit goods because individuals can not reach the best judges of what are in their own or in the public interest. However, the high proliferation of the neo-liberal idea and the adoption of the market-based economy have been rapidly routing to an argument that the governments do not necessarily have to assume the entire responsibility for the provision of a service. On the contrary, governments could, in principle, usually achieve their objectives without getting involved in the direct production or delivery of services. Several authors (Kolderie, 1986 ; Wunsch, 1991 ; Ostrom *et. al*., 1993) distinguish between the responsibility for 'provision', which might be governments' concern and 'production' which might be done by private actors. According to this argument, public services can be provided through different combinations of the many direct- and indirect- provider roles. One way of restricting governments' responsibility is by separating the elements of direct provision, particularly in the case of monopoly. The World Bank (1994a) describes this as the 'unbundling' of services in which the processes of production and delivery of services are separately considered only some elements may require public intervention. For example, the electric power industry can be 'vertically unbundled' by separating generation (which can easily be competitive) from distribution (which is more likely to be monopolistic).

Under the concept of 'services-unbundling', various kinds of joint arrangements can be established where state agencies and private firms act in a mutual endeavour and working in parallel rather than dividing roles hierarchically. Of particular important is that it is unlikely that a pure provision arrangement, in which government or the private sector takes full responsibility for all direct and indirect aspects of a service from its ownership, planning, financing, and installation to its management and delivery, will normally exist. In practice, private organisations supplying services will almost always be subject to some level of governmental control or support, even if only on paper. Similarly, pure public provision without any private involvement is also difficult to justify on the technical grounds of the characteristics of goods and services (Batley, 1996 : 732-733).

5. REGULATION AND PUBLIC-PRIVATE PARTNERSHIPS

In the absence of meaningful participation, the private sector feels alienated from government decisions and is more likely to work to reverse or undermine them, government similarly gives less recognition to the existent of the private sector (Niue, 2000). However, under the market-oriented system of service provisions, government alone cannot effectively operate using a hierarchical command system of management, effectiveness depends more on negotiation, persuasion, participatory decision-making, and co-ordination among public agencies and private firms (Rondinelli, 1991 ; Balakrishnan and Koza, 1993). In recent years governments in various countries have been seeking a variety of ways in which public and private sectors can work together to provide better qualities of public provisions. Attention has been paid to the use of private sector business skills and capital in pursuing public services toward a series of partnerships between public enterprises and private firms.

Under a presumption of market incentives, public-private partnership seems to be more appropriate than hierarchical command relationships or adversarial regulatory processes. Nevertheless, successful implementation of public-private partnership considerably depends on the development of sound legal procedures, agreements, and contracts that clearly define the relationship between government agencies and private firms. Without thoughtful and professional legal frameworks and contracts, disputes are likely to occur and projects can and will be delayed and terminated (IP3, 2000b). These legal frameworks function to reduce opportunistic tendencies (Kuttner, 1997) and to align the interest of the partners (Stuckey, 1983 ; Hennart, 1988). Gulati (1993) argues that opportunistic behaviour and the fear of opportunistic behaviour between the partners reflect a negative departure from the full range of co-operative relationships maintained by the organisations. According to Williamson (1975 and 1985), opportunistic behaviour is influenced positively by the benefits from such behaviour, and is negatively related to safeguards such as regulations and controls, agreements, and monitoring.

Even if public-private partnership appears to reduce costs, it cannot be defined as a success if it results in lower quality of public services; the need for more government oversight; or the need for expensive monitoring (Sparer, 1999). In general, the development of regulatory structures is constrained by the capacity of governments to enforce regulatory rules and to monitor contracts (Cook, 1999: 551). Over regulations and contractual safeguards also restrain economic growth and hinder private sector's ability to remain competitive in the market (Lundqvist, 1988). Nevertheless, regulation and contractual safeguards in public-private partnerships are not withering away, and they may even be increasing in some policy sectors along with the trend toward partnering (Supiot, 1996 ; Sparer, 1996 and 1998 ; Saltman and Figueras, 1998). According to government's view point, a well-defined regulatory framework is essential if the private partners ideologically and financially oppose seeing themselves as having additional responsibilities to the public interests (Hassan, 1996 ; Colton, *et.al*. 1997).

The financial and other resources of private and state enterprises are always limited. Projects developed as public-private partnerships are mostly based on risk sharing and a security package of interrelated contracts between the two parties (IP3, 2000b). Consequently, many developing and emerging market economies require effective models on how best to design and establish frameworks for contract compliance and performance monitoring for public-private partnerships (IP3, 2000a). The private sector needs a great deal of certainty and protection against unforeseeable changes as the economic and financial costs of poorly designed, drafted, and negotiated agreements are tremendous and can jeopardise entire public-private partnership programmes (IP3, 2000b). The establishment of a transparent and sound regulatory framework is a necessary precursor to private sector participation in public-private partnership. On the contrary, governments need regulation to ensure that essential partnerships operate efficiently and optimise the resources available to them in line with broader policy objectives ranging from a social policy to a policy for environmental protection (The World Bank, 1994b : 57-59).

Public-private partnership also involves sharing or transferring a measure of responsibility and control for operations. It may cause shifts in accountability arrangements, creating new accountability hierarchies and reporting requirements for public sector managers (Rodal and Mulder, 1997). While governments have been largely preoccupied with political accountability through the electoral process, public-private partnerships open new channels of accountability. In arrangements where government still retains ultimate or partly accountability, government partners must ensure the respective accountability of their partners through the use of sound formal agreements. There are also new accountability demands on the private participants to a partnership, as they are required to disclose information about partnership-related activities including expenditures to their partners and the public. Problems that arise as a result of shifts in accountability arrangements can be avoided if appropriate accountability arrangements are put in place toward a well-defined regulatory framework.

Regulation is a key element to maintain competitive market discipline on public service provisions in developing countries. Experience in these countries confirms the importance of putting a sound regulatory framework in place before implementing the public-private partnership programmes. While many governments in developing countries have already signed their first demonstration public-private partnership contracts, most have not yet designed the legal and regulatory framework for monitoring the performance of private contractors and for ensuring contractual compliance (IP3, 2000a). Regulatory systems should be established as soon as possible to define clear rules for financial performance, provide practical experience to the staff responsible for their implementation, and provide assurance to the private sector that the regulatory system includes protection from expropriation, arbitration of commercial disputes, and respect for contract agreements. In turn, it will increase benefits to the government by achieving better and more informed decision-making, improved performance, and raising efficiency and accountability (The World Bank, 1994b : 57-58). Meanwhile, private investors must be convinced that the government as a partner will protect private investments and will not use regulation as a direct or indirect mechanism for 'administration expropriation'. Investor security is significantly important. Developing countries with limited histories of private participation, investors with doubts about the safety of investments will either require very high returns, or not invest. The only way for these countries to be successful in attracting private capital is to establish a regulatory regime that reduces this risk.

The greatest deterrent to private participation in a public-private partnership is the regulatory environment and attitude (Savas, 2000). Private investors will be kept away and will seek a more hospitable place to invest if regulation is unlimited in scope, unclear in operation, and inclined toward micro-management. The regulatory regime must be limited, transparent, fair, and consistent, and government must always keep its promises. Private investors are cautious not only of expropriation but also of many small regulatory actions that together constitute incremental expropriation, taking away the private partner of legitimate recovery of costs and of profit proportional to the risks undertaken.

Regulation has to satisfy the demands of both public and private sectors, which can at times be conflicting. Public agencies externalise net social benefits as a result of organisational activities, whilst private firms demand adequate returns on their stake. Some essential characteristics of regulatory framework required for public-private partnership formation include a balance between establishing a system of regulations that ensures accountability of partners and avoiding over regulation that stifles innovations; protection of the legitimate interests of all stakeholders in fostering partnerships; and elimination of unintended consequence of blocking partner participation (ADB, 2000).

Regulation also appears to be crucial for the success of public-private partnership in the utility sector. It provides clear rules and a framework where investments and business opportunities can be more appropriately gauged. Utility industries include gas, electricity, water, telecommunications, and transport. They are natural monopolies, primarily because of their infrastructure requirements (The World Bank, 1994b : 57). The traditional electric power industrial structure is one of vertical integration, which combines generation, transmission and distribution (Lee, 1994 : 135). Many developing counties such as Thailand, have privatised and proceeded with vertical unbundling, separating generation from transmission and distribution under a mixed system of public and private ownership (World Bank, 1994a ; Cook, 1999). According to an unbundling structure, to achieve economic co-ordination between distributors (public ownership) and generators (private ownership) will depend heavily upon contract-based transactions and regulation. The long-term contract could spread risks and help guard against opportunistic behaviour (e.g. exploitation) from any one of transaction parties (Williamson, 1975). Regulation for utility industries is required to protect consumers and encourage efficiency while preserving the monopoly’s economies of scale. A well-defined regulatory framework could provide sufficient incentives for private sector to invest in generation and for public sector to protect the safety of energy supply and ensure that issues relating to environmental protection are given priority (Cook, 1999).

6. CONCLUSIONS AND DIRECTIONS FOR FUTURE RESEARCH

The fundamental difference between the roles of the public sector and the private sector is that governments respond to national interests and concerns, while private corporations are driven by the imperatives of profit maximisation. A major rationale and catalyst for increased private sector participation in public service provisions has been provided by the poor performance and mismanagement that characterises most publicly-owned and operated utilities (Shambaugh, 1999). In the mixed economy system, conventional boundaries between public and private sectors become blur and the new interaction patterns have provided numerous opportunities for the private sector to perform public services under governmental binding contracts and regulation. An interest in the potential of public and private partnerships has been flourishing, partly because the national governments cannot contribute to expand its financial responsibilities for meeting social needs. Presently, there has been widely acceptable that the private sector is best suited to address new problems or typical needs while the government alone seems incapable of dealing with broader complex agendas in association with the inherent and sophisticated problems.

Partnership creates the strengths of both the public and private sectors in pursuing public service delivery. However, the public sector in developing countries still maintains an obligation to act in public interest in the delivery of public goods, whilst private firms also expect more governmental binding agreements and regulations to protect administration expropriation and to secure long-run maximisation of profits. As a result, public-private partnerships are still subject to extensive and complicated bodies of legal doctrine and to legal enforcement mechanisms. As stated by the World Bank (1994b), adequate regulation requires a general legal and commercial framework that provides essential preconditions for private ownership and investment in public provisions. Most developing countries still need to have the regulatory and surveillance machinery in place to ensure effectiveness, fairness, and openness of their public-private partnership schemes.

Although a concept of public-private partnerships is becoming increasingly common in many areas, a well-defined regulation for partnership is more an idea than a reality at present. What most public and private organisations have found instead is that implementation of regulatory framework in their partnerships has apparently created a number of prevailing issues that are in need of clarification. Threads for future research include whether control mechanisms and accountability as defined in the regulation are intrinsically related to the performance of partnering organisations. More thought also needs to be given to identify the extent of the regulation in term of particular governance mechanisms that can lessen the problem of transaction costs associated with the partnership performance. Another area for subsequent research is to examine how both public and private partners are accountable for their partnership activities. More empirical studies are needed of how the regulation is related to the level of accountability inherent in partnering to fulfil policy functions and particularly how such accountability varies under different institutional environments or different regulatory regimes, such as a single regulator (the British model) and a regulatory commission as in the United States) (World Bank, 1994b).

Given the needs for effective public-private partnerships, future research might address on the issue of incentive mechanisms for partnerships. Focusing on this variable may spur development of a more sophisticated framework of the regulation. One such avenue of this concern includes further study on whether there are differences in criteria weighting and/or the methods used for examining incentive mechanisms where competition is not feasible, including a study on the extent to which alternative regulation exists for replicating benefits and economic incentives when dealing with a competitive market structure in natural monopolistic industries. These extensions of the research directions can provide more insight into the relationship between regulation and public-private partnerships.

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