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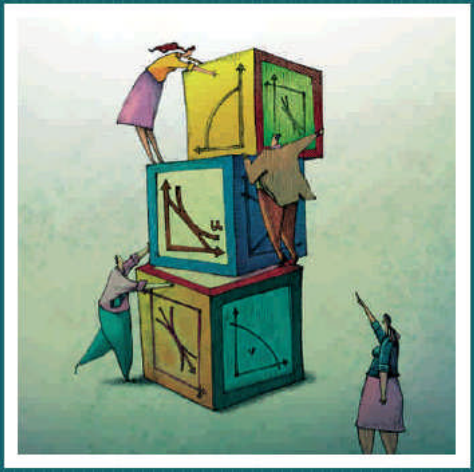

Nº 286 TOWARDS A QUANTITATIVE THEORY OF AUTOMATIC STABILIZERS: THE ROLE OF DEMOGRAPHICS

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Comments on Donahue and Zeckhauser: Collaborative Governance

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1. Introduction

In times of straightened circumstances for governments in most developed countries, it becomes necessary to explore alternative, and perhaps better, means of providing the services that are usually delivered by governments. Since the late 1980t's governments have explored the so-called Public-Private Partnerships (PPPs), which attempt to delegate the provision of some of these services to private firms, in exchange for a remuneration. PPP contracts are meticulous in detailing the outputs, procedures and the measures by which the contract is fulfilled. Frequently, the relationship between government and the private firm, and this can hamper the efficient provision of the services. Moreover, these contracts are often used to disguise increases in public investment, so PPPs have been less successful than their proponents expected, though they can be a valuable instrument if used with care.

In this book, professors Donahue and Zeckhauser (henceforth ZD), from the Kennedy School at Harvard, describe another type of arrangement between the private and the public sectors, which they believe may be more productive in many situations. They propose that some contracts between the private and the public sector work better when they are governed by collaboration, hence the name of the book. This is not a new method, and ZD describe many examples of successful (and sometimes unsuccessful), collaborative agreements, as in the case of charter schools. The contribution of the authors is the description and analysis of these arrangements, its advantages and shortcomings, ending with a checklist of when and how to proceed with collaborative agreements. The book has a conceptual framework that helps to understand the issues that are involved in collaborative arrangements and provides a guide to the practical issues that appear in designing and implementing these special contracts.

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2. The problem

Consider for instance the delivery of health services. One possibility is the public provision of health services by public hospitals, using doctors that are government employees. This is the approach taken by Public Health in England or Canada or by the hospitals belonging to the Veterans Health Administration. Alternatively, the provision can be left to the private sector, as in the case of a private health market. There is also the option of using Private-Public Partnerships (PPPs) to build, operate and maintain hospital infrastructure, while public health workers provide the medical services. The PPP receives an availability fee paid by the government. Alternatively, the hospital and the medical services could be operated by private investors who are paid on a risk-adjusted per-capita basis plus user fees. Under a collaborative agrement to provide health services, a non-profit, chartered hospital is compensated in one of the ways described above, but it is given latitude to experiment with different ways of providing health services. Moreover, it is able to obtain philanthropical resources (which would not normally be given to a PPP arrangement, given its for-profit character). The health services in most countries are delivered by a combination of all or some of these systems.

The book uses a number of real world examples from parks, charter schools, defense, the environment and other sectors to make the point that when carefully designed, collaborative agreements can yield superior results to the alternatives. ZD remark that collaborative arrangements are particularly popular in the US, at all government levels.

There are many reasons for this preference: collaborative arrangements provide more scope for adaptation and innovation, involve volunteer groups and organizations that provide otherwise unavailable resources, and, specially in the US, private participation may add legitimacy to a state-sponsored endeavor. In order to understand the issues involved, it may be best to use the authors'methodology and illustrate them by means of one of their case studies.

2.1. An example: Central Park

The authors present many examples of their proposals, but perhaps the most clear-cut and complete illustration is the case of New York's Central Park. After the financial crisis of the 70's, New York did not have the resources to maintain the extensive network of parks, playgrounds, athletic fields, tennis courts and golf courses that was developed by the powerful Parks Manager, Robert Moses since the mid-20's. After the crisis, the first reaction of the new management was to turn over some amenities to the private sector, such as golf courses, that could be run as concessions. This approach was difficult to extend to amenities that did not generate revenues and were expensive to maintain. The administration came up with the idea of partnerships with private organizations. Responsibility for zoos devolved onto the nonprofit New York Zoological Society, for example, and the idea was afterwards extended to other components of the park system, on an ad hoc basis.

The main success was Central Park, which developed a more systematic approach to partnerships with the private sector. The new Central Park administrator managed to convince a group of New York society philanthropists to create the non-profit Central Park Conservancy. The Park administrator set up a visitor's center in Central Park, manned by Conservancy volunteers, which rapidly began to provide additional benefits for park visitors, such as concerts and art exhibits. Already by 1983 the Conservancy was sufficiently well recognized that it was able to raise US$ 23 million for a trust fund.

By the 1990's, the Conservancy was able to start rebuilding some of the decaying structures of Central Park. It remained a private organization, even though it provided paid workers to help manage the park, as complements to city workers. In 1998 the city government formalized the relationship by transferring the stewardship of Central Park to the Conservancy. The contract was open-ended, in the sense of not specifying in detail the duties of the Conservancy. It set out the responsibilities of each party in the management and upkeep of the Park in general terms. For example, the Conservancy was to provide services for the Central Park to the "reasonable satisfaction of the Commissioner"(page 164). As ZD remark, the critical element that made the contract a collaborative arrangement and not a standard contract is that it did not specify the precise way in which the Conservancy was supposed to satisfy the Commissioner.

Since there was no other realistic option, the award of the contract was not competitive. This gave rise to a legitimacy issue, with some groups denouncing the arrangement as a sellout of the Park to a philanthropist elite. However, there were contractual clauses intended to preserve the legitimacy of the arrangement in public opinion. In particular, the wording of the contract was careful in defining what constituted a conflict of interest, in particular in the case of competitive bidding for contracts and in any financial dealings with members of the Conservancy or their relatives.

Despite the misgivings of some groups in New York, the results of this collaborative arrangement have been dramatic. Central Park now receives more than 25 million visitors a year. Park security is so improved that nighttime use is again possible, after many years in which it was a danger zone. The Conservancy raises ample funds for the care of the Park. There have been some issues of preference discretion, because the landscape choices of the members of the Conservancy are at odds with the more active uses preferred by local residents. This means that there are fewer fields for sports such as frisbee, soccer or ball throwing and more flower gardens than residents want. All in all, ZD proclaims that Central Park is the epitome of successful collaboration.

3. The argument for collaboration

In the Central Park example we find the main ingredients of collaboration: an alliance between the private and public sector that is not defined by a rigid contract. It is loose in the sense that there is no pre-specification of the methods by which the objectives of the collaboration will be reached. Moreover, the relationship between the parties is flexible, can evolve over time and is not adversarial. The authors also present cases (in some of which one of the authors was involved) in which collaboration takes place with for-profit companies.

One of the attractions of collaborative agreements –as in the case of Central Park– is the possibility of acquiring additional resources without creating future obligations for the government. There still remains the difficult problem of how to share or control the additional resources, and of the legitimacy of the relationship. The authors note that these conflicts may lead to the failure of the collaborative agreement.

Why and when does this type of alliance work? Ever since economists became aware of the problems caused by asymmetric information, the profession has focused on opportunism and on the informational rents that plague any relationship based on a contract that is not easily enforceable, such as those required by collaborative agreements. ZD do not deny the existence of the problems of loose contracts, but argue that they must be weighed against the potential benefits of the relationship. The authors admit that in many situations a collaborative approach will not work and traditional contractual approaches, with detailed service provisions, will be more successful.

One of the characteristic features of collaborative governance is that it does not specify how the desired end will be achieved. This means that the private party can use its imagination, and modify failed or unsuccessful strategies without renegotiating the contract and incurring the associated costs. These renegotiation costs include not only legal costs but also the deterioration of the relationship, and also the loss of legitimacy. This flexibility often leads to more creative and efficient service delivery. On the other hand, the public sector must consider the risk of payoff discretion, that is, that the private party takes advantage of the relationship to increase its fraction of the total value created by the relationship. Only then can it decide if these rents are excessive and may potentially lead to a loss of the legitimacy of the agreement.

Payoff discretion is a problem in a collaborative agreement both with a for-profit or a nonprofit institution (we have all heard government agencies' complaints about the results of agreements with universities). They are more of a problem with for-profits, because they are "engineered to be more avid for financial payoffs" (page 57) and to take advantage of opportunities. As is well known, payoff discretion is more problematic when the public partner knows less, because the informational rents are higher.

The second issue that the public party must consider is the risk of preference discretion. This is a special danger in the case of collaborations with non-profits. These preference problems can range from assigning benefits to a preferred group (ethnic, age-related), or to providing public benefits that are mostly appreciated by favored groups –as in the case of the flower beds in Central Park. These may even be a problem of conflicting values that can lead to a loss of legitimacy, as when a private organization prefers to exclude from the benefits of the project those who do not share its moral values.

Both preference and payoff discretion are intimately related to the issue of legitimacy in public opinion. Loss of legitimacy can spell the failure of the collaboration. In the US, the participation of the private sector by itself can lend legitimacy to a government sponsored project, but in other countries, private participation may act to its detriment. Even in the US, legitimacy depends on the extent to which the private party appropriates the payoffs from the project, or on the degree of divergence between the preferences of the private party and those of the public. On the other hand, the need for legitimacy can be a useful tool not only by limiting the appropriation of benefits by either party, but also by aligning the interests of the two parties if they want the collaborative arrangement to continue.

One way of seeing if the arrangement is feasible is by observing if the interests of the parties have some degree of alignment. If they are opposed, collaboration is impossible, but when interests are partially aligned, there is scope for these arrangements, and the problem for the government agency lies in assessing whether the potential benefits can compensate for a given degree of misalignment.

4. Appraisal

Collaborative agreements between the private and public sectors have an ancient history, which the authors mention perhaps too briefly. Consider, for example the use of privateers – such as Francis Drake– in Elizabethan England to achieve the foreign policy aims of both weakening the Spanish empire and generating resources for the government. Most of the Spanish Conquest of America was achieved under collaborative agreements with the private sector. including Colombus'trips. The Thurn and Taxis family held the postal monopoly for a large part of Europe from the XVI century until the XIXth century. ZD mention the East India Company, which was given monopoly rights to trade in the Indian Ocean. It eventually ruled India for almost 130 years (recall also the Dutch East India Company in Indonesia and Java) and acted in favor of English interests in the subcontinent until it lost legitimacy in the mid-nineteenth century. It is easy to find other examples of collaboration in the past. Only since bureaucracies grew more extensive and capable did they become able to provide public services by themselves, with such success that we believe that it is a natural arrangement.

ZD propose that collaborative agreements should be embraced as one policy option for the delivery of public services in modern times, providing criteria to select appropriate projects and to avoid the pitfalls of such a complex relationship. The authors provide examples of collaboration across many sectors, identifying the problems and noting when they are successful. They also provide a framework to understand the issues that can lead to the failure of collaboration. In doing this they use our modern understanding of the risk of opportunism associated to flexible contracts, as well as two ideas that appear to be new in economics: preference discretion and the legitimacy of an arrangement in public opinion. These two concepts are important and may explain the convoluted forms (for an economist) that collaborative arrangements often take.

However, the generalized use of collaborative agreements –even in those cases where it is in principle legitimate and economically sensible– seems difficult because it requires finding two matching partners for this complex relationship. Take the example of charter schools. They require finding energetic, dedicated and creative promoters of the school project and it is hard to believe that these individuals are abundant. This is probably the main reason that modern societies have embraced the bureaucratic and rigid, but more consistent, approach to providing educational services. Otherwise , it would be hard to ensure full coverage. The moral seems to be that one should embrace collaborative agreements if a suitable and aligned partner can be found, otherwise it is better and less risky to opt for one of the traditional approaches to the provision of these services.

Another issue, relevant in countries with civil law which do not have the judicial concept of equity, is that the lack of a clear-cut contract specifying detailed commitments can lead to extreme forms of opportunism (under civil law, the rules of a contract represent an obstacle course for firms that will attempt to increase their payoff at the expense of the other party). For the same reason, legitimacy becomes a worry and therefore these arrangements do not have the advantages they may hold in common law countries, where a judge can adjudicate on the basis of equity. This may be one of the reasons for the conspicuous relative lack of philanthropical institutions in these countries, unless linked to religious institutions.

ZD's book is a useful description of a neglected type of relationship between the public and private sectors, explaining when it works and the reasons for its failure, as well as a guide to anyone attempting to establish collaborative agreements. If the reader is an economist, she will be slightly put off by the lack of mention of asymmetric information and contract theory problems in the first few pages, specially considering that one of the authors (Zeckhauser) was an important contributor to the literature. However, further along the book has clear explanations of all these issues.

The book is written in an effort to reach middle-brow readers, so the analytical sections (no formulas) are interspersed with many examples, which lengthen the book and make it more verbose and repetitive than it should be, at least for economists. In some places, there are evident clashes of writing styles, even within the same page.[1] Despite these quibbles, ZD have written a valuable book, that looks at contractual arrangements that economists have omitted from their analysis, and which show promise for our times.

[1]For example, in page 9 we find: "The form and the complexity of interactions with the private sector have also changed." followed a few lines later by "...suppliers who make a buck meeting the specs of government.".

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