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## ABSTRACT

In many countries, public agencies or private firms are gradually moving away from being exclusive providers of goods and services that traditionally were assigned to the state or markets, respectively. Instead, state agencies, both at the national and the local level, and private organizations, both for-profit firms and nongovernment organizations (NGOs), increasingly coordinate, collaborate, or partner to finance, produce, or provide public services. This paper attempts to identify the factors that account for the successes or failures of such public-private service delivery arrangements, with a focus on the role of monetary and nonmonetary incentives used in selected case studies in developing Asia. It finds that such arrangements are a viable service delivery mechanism where there is a state or market failure. While governments now increasingly enter into such partnerships, they appear to do so more with for-profit firms than with NGOs. A key lesson is to mobilize potential private sector partners, match the partner's mission with the appropriate type or level of service provision, and then motivate them with the right incentives but also monitor them for performance accordingly.

Keywords: public-private partnerships, NGOs, incentives, public service delivery, Asia

JEL Classification: H39, H49, L31, L33





## I. INTRODUCTION

In many countries, public agencies or private firms are gradually moving away from being exclusive providers of goods and services that traditionally were assigned to the state or markets, respectively. Instead, state agencies and private organizations increasingly coordinate, collaborate, or partner up to finance, produce, or provide public services. Jointly provided public services range from large infrastructure and utilities projects that the public sector normally undertakes for their supposed scale economies and monopoly rents to local public goods and merit goods that confer localized or purely private benefits to target population groups. The state agencies involved include the regular line departments, their bureaus, or attached units. Their private sector partners include for-profit firms, faith-based organizations, nongovernment organizations (NGOs), foundations, professional groups, community-based associations, and other volunteer groups. Different from the usual arms-length procurement of privately produced goods or services, these partnerships assign or delegate to the private partners greater roles and responsibilities over financing, production, or delivery of services. In some instances, a jointly owned and -managed corporation is even established to cement the public-private partnership (PPP). Though limited, the available figures are telling.

In Asia and the Pacific, the World Bank reports for the period 1990–2011 a total of 2,457 joint projects in energy, telecom, transport, and utility alone.<sup>1</sup> While in these particular undertakings the private sector partners are mostly firms (or consortium of firms), in some instances, however, nonprofit, voluntary associations are engaged instead, albeit mostly in the provision of social services such as health, education, livelihood, or employment. While there is no official count of the exact numbers of existing nonprofit, voluntary associations—which include NGOs, foundations, civic groups, and faith-based organizations—some sources indicate their already widening presence. According to the World Association of Non-Governmental Organizations, their roster of members includes 923 in Southeast Asia, 3,524 in South Asia and Central Asia, 724 in West Asia, and 395 in East Asia.<sup>2</sup> The NGOs accredited by the United Nations Office on Drugs and Crime include 618 in South and East Asia, 178 in Central and West Asia, and 168 in the Middle East and Northern Africa.<sup>3</sup> As of November 2011, the Economic and Social Council of the United Nations has granted consultative status to about 3,500 NGOs worldwide.

According to the World Bank (2006), in Bangladesh alone, as of end of 2006, there were already around 2,000 NGOs in operation. Most of these NGOs provide microcredit, health, sanitation, and education services. Together they received on average around \$343 million per year from donors (equivalent to 0.7% of gross domestic product) during the period 1996–2005. The four largest NGOs that extend microfinance services have about 14.2 million borrowers altogether. The largest, the Bangladesh Rural Advancement Committee (BRAC), employs more than 100,000 people in Bangladesh and other countries, and in 2011 had about \$341 million in net assets and \$41 million in net income.<sup>4</sup> In Pakistan, nearly 206 public-private service organizations and 600 NGOs were reported to be engaged in health services provision, advocacy, and research in 2008–2009 (Ejaz, Shaikh, and Rizvi 2011). In the Philippines, there are as of the end of August 2013 already around 10,000 nonstock, nonprofit organizations, including NGOs and private foundations, registered with the Securities and Exchange

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<sup>1</sup> See World Bank Private Participation in Infrastructure (PPI) Project Database (accessed 4 February 2013).

<sup>2</sup> The World Association of Non-Governmental Organizations on its website (accessed 10 February 2013) defines an NGO as any nonstate, nonprofit voluntary organization that is independent from government influence.

<sup>3</sup> See United Nations Office on Drugs and Crime website (accessed 10 February 2013).

<sup>4</sup> See BRAC website (accessed 3 June 2013).

Commission.<sup>5</sup> According to one article (Ronda 2013), the Philippine Department of Social Welfare and Development also engages 421 NGOs and 131 NGOs in implementing its conditional cash transfer program and livelihood program, respectively. Arguably, NGOs and other voluntary associations are likewise ubiquitous, big, or valuable in other developing countries.

One reason for this trend is the recognition of the limitations of pure public or private provision (World Bank 1997, 2004), especially in the light of changing market conditions and institutions. On the one hand, governments now recognize the comparative advantages of private companies in handling large infrastructure projects: management and technical expertise, access to capital and technology, and incessant drive for efficiency (Fiszbein and Lowden 1999). Tapping these advantages also enables the state to spread its financial risks, which becomes even more imperative in the face of worsening budget deficits or macroeconomic imbalances. Where the state fails or falters on its mission, either due to fiscal mismanagement, corruption, natural disaster, internal conflict, or external crisis, non-state providers often step up to extend humanitarian relief or to secure the lives, health, and welfare of children and women, ethnic minorities, and other vulnerable groups. Consequently, these private sector entities acquire specialized knowledge and expertise in certain areas or in dealing with marginalized groups. Where the community's trust is important, NGOs often have this rare advantage that that state agencies can and do tap for an effective service delivery.

Also, democratization has made the state a willing partner with non-state actors for development. Furthermore, decentralization has expanded the number of state actors that can potentially collaborate with private organizations. By embracing globalization, developing countries have likewise opened their borders to foreign donors including international NGOs. These partnerships, especially with NGOs and when they benefit the poor, are also seen to effectively empower the less privileged groups. To the extent that private sector providers are more responsive to the demands of their customers, the partnership can also help public agencies provide superior services to their clients. For these supposed advantages, PPPs are now widely encouraged. However, such partnerships are not always feasible or successful, largely because of the failure of the parties involved to agree on the ends or means of the proposed partnership (Bräutigam and Segarra 2007; Brinkerhoff and Brinkerhoff 2002, 2011; Feiock and Jang 2009; Joshi and Moore 2004; Mcloughlin 2011).

This paper attempts to identify the factors that account for the successes or failures of such partnerships. It focuses on the institutional factors that facilitate or impede such partnerships, and on the role of incentives in the effective joint delivery of the public services. To achieve these objectives, the next section reprises briefly the limitations of pure public and pure private provisions. Then, section III proposes an analytical framework for identifying the critical features, particularly the incentives appropriate for alternative modes of service delivery. This framework is then used in section IV to review of selected case studies. The final section concludes and draws out some policy implications.

In this paper, PPP is broadly defined as collaboration or an agreement between a public agency and a private organization for the provision of a public service. The public service can be a state-provided public good (i.e., nonrivalrous or nonexcludable good) or private good targeted to underprivileged groups. The public sector entity could be a national government agency (ministry, department, or bureau) or a local government unit (state, province, city,

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<sup>5</sup> In addition, NGOs in the Philippines who wish to be accredited as partners in community development are vetted by the Department of Social Welfare and Development.

district, village, etc.). The private sector entity could be a firm, a charity or foundation, an NGO, or a faith-based organization. These are essentially local organizations but possibly with foreign donors, partners, or affiliated organizations. The partnership could be an agency relationship in which the private entity undertakes an activity for the public entity for a fee or remuneration. It could also be a collaboration in which the public and private entities are mutually codependent, i.e., they jointly determine the policy or project design and share in the cost of the public provision. The arrangement could be sealed by a legally binding contract (e.g., a memorandum of agreement) or by a less formal “meeting of the minds” (e.g., a memorandum of understanding). The assumption here is that the parties voluntarily agree to become partners.<sup>6</sup> As such, a for-profit firm may agree to do *pro bono* work for the government, while a nonprofit organization could get paid for its work by the state agency. By and large, however, these private sector providers will engage with the state agencies based on their primary organizational goals: whether to earn profit or to pursue their advocacies. The PPPs considered here are different from arms-length procurement contracts where the private organization’s role is limited to the provision of the contracted inputs, service, or output, and has no substantial say in the financing, production, operation, or delivery of the public project. The PPPs are also different from privatization where the state relinquishes to the private firm all ownership controls over the privatized asset or service. In Singapore, the typical PPP arrangement with a for-profit private firm includes design–build–operate, design–build–finance–operate, and other variants (Government of Singapore 2012). In other countries, joint ventures would be considered a form of PPP. Although existing public–private service delivery arrangements with NGOs in developing Asia are not as neatly classified, they share the distinguishing features of mutual cooperation and risk sharing. Admittedly, the range of possible or actual engagements between state agencies and private sector organizations is larger than is described and analyzed here. Other studies provide more exhaustive or incisive analysis on public partnerships with for-profit firms (e.g., Fiszbein and Lowden 1999; Marin 2009) or with the voluntary sector or NGOs (e.g., Weisbrod 1998; James 1998; Brinkerhoff 2002). This paper draws from these studies in developing a framework, as it were, for comparative partnership analysis in developing Asia.

## II. BEYOND THE PUBLIC–PRIVATE DICHOTOMY

What the PPP trends suggest is a need to go beyond the standard economic prescription of pure private provision or pure public provision of goods or services. When markets are competitive,<sup>7</sup> pure private provision will typically work. Consumers can be expected to pay for the goods and services on offer, confident in the knowledge that competition will drive firms to reduce their costs and thereby their prices, while maintaining quality. When markets are not competitive, consumers are forced to pay more than they have to or to accept an inferior product from a monopoly or few sellers. Worse, the parties may forego a trade that is otherwise mutually beneficial.

However, even when markets have many competing sellers and buyers, they will not lead to efficient provision of public goods or goods that lead to an externality. Since once provided public goods are jointly consumed by many, there will be few buyers who would willingly pay the price, which should cover the seller’s marginal costs. Even though each

<sup>6</sup> Alternative government–nonprofit partnerships have been suggested depending on whether the two parties share the same goals or preferred means of achieving those goals, and whether the nonprofit organizations are free to enter into partnership with the state (Brinkerhoff and Brinkerhoff 2002, 2011; Batley 2011).

<sup>7</sup> This means there are many sellers and many buyers, each acting independently, free to choose and with full knowledge of the prices and quality of goods and services on offer. Further, the good or service being traded is *rivalrous* and *excludable* (Stiglitz 2000).

consumer will be willing to pay for such goods, some will also be motivated to free ride on the purchases of others. In the extreme, no one will procure and consequently none will be sold, resulting in losses in consumer and producer welfare.

The market fails as well in the provision of private goods that emit pollution or hazardous wastes, or are a nuisance that adversely affect the health or welfare of those not party to the trade. Since these adverse effects are not internalized in a typical market transaction, the prices of goods that emit externalities are unlikely to reflect their true social marginal costs, thus leading to their overprovision.<sup>8</sup>

Besides these market inefficiencies, pure private provision is also unlikely to result in equitable access to goods and services. Since market access to these goods and services is facilitated by payment of prices or fees, those consumers without the wherewithal will be deprived of them. When these goods are necessary for daily sustenance, like food or services such as immunization, primary health care, or elementary education which are vital to physical well-being, morale, and participation in society, the deprived poor and other marginalized groups will unlikely escape a life of destitution. Worse, the miserable condition of the poor parents is often bequeathed to their children, thus condemning each generation to a vicious cycle of poverty. To some societies, a widespread, persistent poverty is not morally acceptable.

Thus, the alleviation of poverty or reduction in economic inequality and the correction of market failures are the two major economic rationales for state intervention. To accomplish these, the state is empowered to collect taxes and fees, provide subsidies or transfers, finance or produce services, or enable or regulate markets. It can supply *market-supporting* public goods like the systems of property rights, contracts, dispute resolution, and law enforcement to secure ownership rights and facilitate successful private transactions. It can also provide *market-augmenting* public goods like preventive health care, basic education, and roads and bridges that markets usually underprovide due to free riding or they deny to underprivileged groups unable to pay for their use or access. Beyond these goods and services, everything else is assigned to private markets, possibly with state regulation (Besley and Ghatak 2006).

Of course, this simple prescription for public service delivery would not work and the situation could worsen, if there is government failure. The government may fail on its mandate if there is political or bureaucratic corruption, state capture by interest groups, rent seeking or patronage, or apathy or incompetence by government leaders or bureaucrats. These failures arise when governance institutions are weak or dysfunctional; when elections are rigged or not free; when competent leaders are not installed in office and corrupt leaders are not replaced; when media fails to inform or misleads the people; when accountability mechanisms are compromised leading to grave abuse or misuse of public office; or when bureaucrats work only for the perks of office.

However, even with a duly elected, benevolent leader running government, public provision may not necessarily be socially efficient. The government would still need to counter the impulse among citizens to conceal their true preferences for public goods for fear of being taxed accordingly. If these goods are provided free of charge, however, they will be in excessive demand and therefore lead to waste of scarce public resources.

In principle, the information problem may be overcome for local public goods through decentralization. Since these goods have limited service coverage or confer benefits to a limited

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<sup>8</sup> Conversely, if the good exudes beneficial or positive externality, it will be underprovided by private markets.

number of users, it makes sense to assign the responsibility for these goods to the lowest level of government that has jurisdiction over the beneficiary group. Presumably, the local government has better information about the real needs of their constituents and, more importantly, are directly accountable to the latter. The constituents can hold their leaders accountable by exercising *voice options* through public consultations, referenda, or votes. Alternatively, they can opt for *exit options* by migrating to other places with their preferred public services.

**Box 1: How the *Zanjas* of Ilocos Norte, Philippines Avoided the “Tragedy of the Commons”**

In continued existence since the Spanish colonial times, the *zanjas* of Ilocos Norte, Philippines are indigenous communal irrigation systems that allocate water rights to members and appropriate from each a contribution toward the maintenance of the irrigation system. These associations have evolved several devices to avoid free riding among members.

First, members are only given use rights; they do not have full ownership rights over the lands they till, which allows the *zanjera* to reclaim the land of an errant member. Second, a member’s share (*atar*) is both a privilege to till a parcel of land and an obligation to render free labor (proportional to their share) to the association for irrigation maintenance. Third, there is strict monitoring and enforcement through checking of attendance (during workdays and in meetings), announcements of absences, fines and penalties during regular meetings, and open, regular elections of officers. Last, to provide incentives to all members, free food and drinks are served during workdays and meetings, while the officers are given extra lots to till.

Source: Siy (1982).

To a certain extent, government failures can be surmounted by building the technical, human resource, and organizational capacity of state agencies, improving the morale and ethics of bureaucrats, incentivizing good performance, enhancing electoral accountabilities, or increasing transparency to the media and the general population. The feasibility of these corrective measures will depend on various factors, including accountability mechanisms inside and outside the government sector. An opposition party may question the spending priorities of the incumbent party; the judicial branch may rule on the constitutionality of legislated franchises; while an independent central bank can more effectively neutralize the inflationary repercussions of fiscal profligacy. Where accountabilities are weak within the public sector, external pressure may bear on the government depending on the existing social values, culture, social capital, and the militancy of people’s organizations.

However, not all is lost where government failures thrive. It has been observed that voluntary associations or community-level mutual help associations form to provide for collective goods. For example, communities in many developing countries have been observed to solve their allocation problems concerning common water resources (Ostrom and Gardner 1993). In many countries, faith-based organizations have been running local schools and health clinics catering to the needs of poor families. In remote areas where private providers are not present, households organize themselves to provide, among others, small, short-term credits to their members on a rotation basis. Moreover, where the government is physically present but otherwise negligent in its duties, there is often an NGO supplying critical public services to the underprivileged. Even in rich, gated subdivisions, homeowners form their own associations to maintain roads and parks, and to hire security services.

The relative success of these community-level associations derives from their ability to solve their collective action problems, particularly the strong desire among members to free ride on the efforts or contributions of others (see Box 1). In a typical public sector setting, free riding among citizens is avoided or minimized through the state's exercise of coercive powers: collection of taxes or fees in most cases, but also forfeiture of property or liberty in exceptional circumstances. In a typical neighborhood association, however, such coercive powers are not present and external enforcers are rarely summoned; instead, the members count on each other to enforce agreements or to impose penalties on errant members. Communities have evolved various institutional arrangements for self-enforcing agreements. Trust, social networks, cultural norms and practices concerning fairness, reciprocity, and charity are just some of these "man-made constraints on human behavior" (Munshi 2006) that helped facilitate and sustain cooperation, especially in traditional societies.<sup>9</sup> Where such norms and practices are critical for effective delivery of services, NGOs, because of their close and long relationships with marginalized groups, are often better positioned than other private providers or even state agencies.

Increasingly, many governments in developing countries have engaged these voluntary associations, NGOs, and civic and faith-based organizations. Cognizant of their technical, financial, or managerial limitations, state agencies have engaged businesses as well in the provision of public services. While it seems now that governments in developing countries are more open to work with non-state providers, these collaborations vary widely in terms of type, feature, and success rate, which warrants further analysis.

### III. INCENTIVES IN PUBLIC–PRIVATE SERVICE DELIVERY ARRANGEMENTS

This section<sup>10</sup> discusses the role of incentives, both monetary and nonmonetary, used in various types of PPPs for providing public services. The focus is on the critical factors that determine the choice of a private sector partner—that is, whether a for-profit firm or nonprofit, voluntary organization (or simply NGO)—and of the incentives with which to motivate it to promote social objectives. Hence, the main concern is the design of the service delivery mechanism rather than simply the optimal level of public service provision.

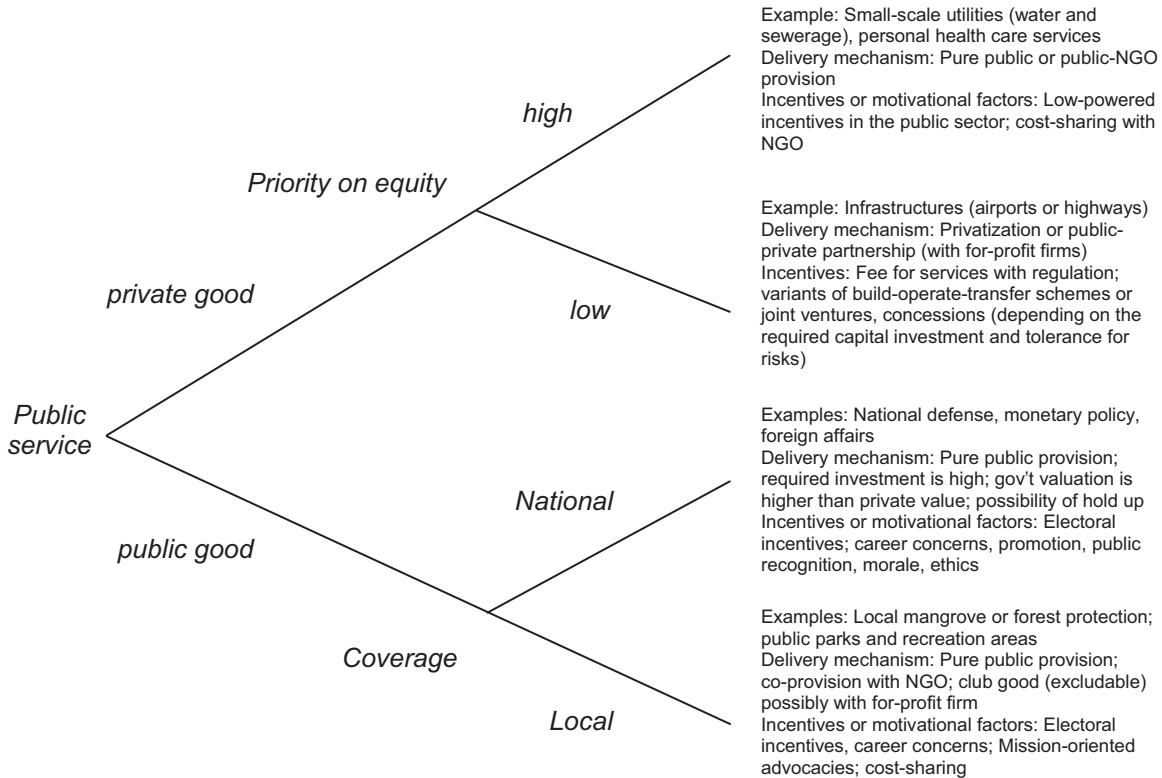
To aid the discussion, we introduce using Figure 1 the five Ms (adapted from Besley and Ghatak 2007) to guide the selection of an appropriate service delivery mechanism. An implicit assumption of Figure 1 is that the state is able to *mobilize* the potential private sector partner. Mobilization encompasses laying the requisite legal and administrative framework for PPPs and an institutional-organizational willingness of the state agency, including local governments, to engage a private sector partner. In the case of PPPs for an infrastructure or a utilities project, mobilization involves passing the necessary build–operate–transfer (BOT) or joint venture laws, building the capacity of state agencies to solicit and evaluate bids, and strengthening regulatory capacity to monitor performance (ADB 2008). In PPPs involving NGOs, mobilization may include registration and accreditation facilities so that they may legitimately receive or use government funds or other resources. While NGOs and other volunteer organizations are known to thrive in difficult situations, there is merit in the policies of some developing countries to adopt

<sup>9</sup> While institutions may help foster local cooperation at some point, they may not be efficient at some later time or in some other context. In his analysis of community-level rotating savings and credit associations in Bangladesh, Munshi (2006), for example, also found them to restrict competition.

<sup>10</sup> This section draws heavily from Bennet and Iossa (2004); Besley and Ghatak (2001, 2006, 2007); Dixit (2002); Francois and Vlassopoulos (2008); Grossman and Hart (1986); Hart, Shleifer, and Vishny (1997); Shleifer (1998); and Williamson (1975, 1985).

a legal-administrative framework to facilitate or encourage NGO operations. While NGO presence is sometimes misconstrued as a signal of government failures, their performance in an open environment, much like that of firms in a free market, is a signal of their own preferences and organizational capacities, which a state agency can use in selecting potential NGO partners. Conversely, in an overly restrictive environment where, for example, only government-sponsored or accredited NGOs operate, the success or failure of the partner NGO may be due more to the government than its partners, which then undermines the need for a partnership.

**Figure 1: Service Delivery Arrangements and Incentive Schemes**



NGO = nongovernment organization.

Source: Author.

The next three Ms are *mission*, *match*, and *motivate*. Basically, *mission* pertains to understanding the typical organizational goals and the relative strengths and weaknesses of the for-profit firms and nonprofit organizations. Given their organizational goals, the next step then is to *match* them to the type of public service, which typically involves the provision of a public good, private good, or both to a target population. To ensure that the private sector partner delivers, it is also necessary to *motivate* them with pecuniary or nonpecuniary incentives or with both. Often, an ideal incentive scheme would have a stick that goes with the carrot since the threat of a loss (e.g., of reputation or credibility) sometimes is more compelling than the promise of a gain (e.g., fees or grants).

This in turn would oblige the state agency to *monitor* its partner's performance to make it accountable for its behavior or decisions. Since both sides cannot anticipate all possible contingencies that might arise, conflicts about failures to achieve the shared goals or to implement assigned tasks are inevitable. A monitoring scheme then should also facilitate the resolution of such conflicts.

#### **A. Mission: Comparative Advantages of Private Sector Partners**

Partnerships with private sector organizations are sought presumably for their advantages, which these organizations have developed or acquired in pursuit of their own organizational goals. It is convenient to classify possible private sector partners into two broad types, depending on their main objective. On the one hand, there are the for-profit firms that sell products or services to earn profit or net revenues for their owners. Their main comparative advantage is their superior technical or managerial expertise, better access to financial resources, or greater flexibility in responding to changing market conditions. These comparative advantages follow from the fact that the firm's entrepreneur (or the firm owner) is the *residual claimant* (i.e., the party entitled to the firm's net income or residual assets). For the same reason, for-profit firms are less keen to voluntarily pursue social objectives like catering to the poor or reducing harmful externalities.<sup>11</sup>

These firms are also sensitive to governance factors, especially regulatory policies and procedures, as these affect their costs of doing business and the rate of return on their investments. The quality of the business environment—as indicated by licensing procedures, property and contracts law, independence of the judiciary, and restrictions on foreign investments—is critical to economic growth in general and to firm performance in particular. In a typical PPP for infrastructure or utilities, the agreement will specify how the firm will recoup its investments, how much it will earn in the process, and the safeguards to protect its claims. Many attempts at PPPs have failed due to weak governance institutions—ambiguous property laws, weak enforcement of contracts, or slow arbitration procedures (ADB 2008; Economist Intelligence Unit 2011).

On the other hand, there are the voluntary, nonprofit associations whose main preference is to undertake certain activities or to reach out to certain groups in line with their advocacies. Included under this category are civic organizations, corporate foundations, faith-based organizations, and NGOs. Unlike profit-oriented firms, these so-called mission-oriented organizations finance their operations mostly through donations and voluntary labor. Precisely because of their advocacies, their main advantage is their closer relationship with the poor or other marginalized groups, or presence in hard-to-reach areas.

Their main disadvantage is sustainability since they primarily rely on donors and volunteers. Their limited resource base makes them relatively vulnerable to economic stagnation or crisis.<sup>12</sup> Even when resources are tight, however, NGOs can easily shift focus from service delivery to advocacy, which is their core competency. Time and again, NGOs have demonstrated their effectiveness in waging information dissemination and education campaigns directed to the poor and physically disadvantaged, mothers and elderly, farmers and fisherfolk,

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<sup>11</sup> Some firms do so but on a short-term or temporary basis as part of their corporate social responsibility.

<sup>12</sup> It is possible though their sources are countercyclical: volunteer labor is more abundant in times of economic crisis when the labor market is tight; donor funds are more abundant in times of economic growth. However, the high turnover of volunteer labor in the NGO sector may lead to disruption in their services.



ethnic minorities, and other marginalized groups. They have also espoused crosscutting issues such as climate change, reproductive health, environment and biodiversity, and human rights.

It is said that since NGOs are not paid or elected by their service clients, they are then less accountable than for-profit firms or state actors (directing the state agencies). They are also more directly accountable to their donors, who might be more inclined to monitor how funds are used than monitor their impact. To be sure, however, donors increasingly demand more concrete evidence of welfare effects, and more NGOs now subject their programs and projects to rigorous impact evaluations. Until such or similar evaluation schemes are universally adopted, however, the weak accountability of NGOs will remain a disadvantage.

Admittedly, this classification of private sector partners is simple. There are firms that likewise provide voluntary, free services as part of their corporate social responsibility. There are also NGOs that charge fees for their services. Some enter into contracts with firms or state agencies for which they earn revenues (or profit). However, classifying the potential private sector partner according to its primary objective (profit or mission) seems to explain better its choice of activities or clients, as manifested in its observed comparative advantages.

## **B. Match: Type of Public Service**

In general, public service provision involves the delivery of *public goods*, *private goods*, or both to a target population. The characteristics of the public service will determine the type of private sector provider that will be naturally drawn to co-provision with the state agency. Since a for-profit firm needs to charge a price to recover at least its cost, it will supply those goods that can only be consumed by those who pay and can be excluded from those who do not pay. Hence, they are more likely to co-provide private goods, for which exclusion is intrinsic. In the extreme, the provision of a private good can be privatized, possibly with regulation to protect consumers who are unaware of product quality and other features that can adversely affect their welfare.<sup>13</sup>

In pursuit of equity objectives, the state retains responsibility for the provision of private goods such as basic health care or education services, which for-profit firms are unlikely to provide to the poor and other marginalized groups at prices below cost. Hence, the government has to produce and provide such services directly, grant financial assistance to the poor, or both.

The subsidized provision of a public good is also required if a for-profit firm were to efficiently provide it. Alternatively, the firm may be given the legal right or allowed to adopt a technology to exclude non-paying consumers.<sup>14</sup> The size of the subsidy or the extent of the legal right depends on how much the state values the loss in consumer surplus relative to the gains (possibly rents) that accrue to the private provider. In some PPPs for infrastructure or utilities, the private concessionaire is explicitly made to target “mission” areas (e.g., water provision in slums or electrification in remote villages) to protect or promote the welfare of some underprivileged consumers. In exchange, the firm may be allowed to cross-subsidize or price discriminate to recoup investments or operating losses in these low-paying areas.

<sup>13</sup> Thus, regulation is imposed when the product is produced with increasing returns to scale (as in utility services), or is an experience good like drugs whose true quality is revealed only after it has been consumed.

<sup>14</sup> The legal right to exclusive ownership such as a patent is normally awarded to promote inventions, which are privately costly but socially beneficial. These products of research and development activities are essentially public goods.

In contrast, mission-oriented private providers attach greater priority to the welfare of the poor and are less concerned about revenues (or profit) than their income-oriented counterparts. Hence, it is not uncommon for NGOs to provide a mix of public goods and private goods for free (or below cost) to raise the welfare of their target beneficiaries. While these organizations make them ideal partners to deliver services to marginalized groups, they may not have the same technical or managerial expertise or access to financial capital as business firms to scale up or sustain their operations. Besides, the state agency and private voluntary organization may not agree on the best approach to help the poor.

Private partners are suited for *local public goods* that have limited service coverage (i.e., those that have a small set of beneficiaries). They are not suited for delivering *pure public goods* such as national defense, monetary policy, or law enforcement that benefit a large and widely dispersed population.<sup>15</sup> There are several reasons private firms are not ideal for such a purpose. One reason is strategic: if a contracted private firm is successful enough to enforce law all over the country, it must also be strong enough to hold the state (and the courts) up in case of conflict. Another reason is that charging user fees is not feasible for these goods. Hence, the private firm has to collect taxes, but since taxes are generally inefficient, the firm may not internalize the resulting deadweight losses as well as the state agencies do. Hence, a partnership between a state agency and private organization may be limited to the provision of market-augmenting public goods, while the state may remain the sole provider of market-supporting public goods.

### C. Motivate: Incentives

The potency of the pecuniary and nonpecuniary incentives will depend on the types of public service and private sector partner. As mentioned earlier, for-profit firms will be naturally drawn toward the delivery of private goods, for which they can charge fees (directly to the service users or from the state agency) in order to recoup their investments. In general, the prescribed incentive scheme is to tie service payments to performance. In these so-called high-powered incentive schemes, the firm will be motivated to expend efforts toward the desired outcome of the partnership. In the extreme, the firm could be made the *residual claimant*. There is, however, an important caveat to this prescribed rule.

If social objectives such as targeting the poor or the quality of the private good are more important than the quantity supplied to the target population, then making the private firm the residual claimant will not serve the purpose. This is because the private entrepreneur will skimp on costs at the expense of quality or concentrate more on paying clients and neglect non-paying clients. While the terms of the contract should be structured so that the “residual claims should be given to the party whose investment is more important to the success of the project” (Grossman and Hart 1986), this has to be conditioned by how the state agency defines the success of the project (i.e., relative weight between social objectives and mere quantity provisioning). If the public service provided is essentially a public good, then the party who values it more should be given the “ownership” of the project, irrespective of its investments (Besley and Ghatak 2001).

Thus, in typical PPPs for large infrastructure projects, the private contractor may be allowed to build, operate, or lease the project over a period of time, during which it collects fees, depending on the state’s capacity to raise its share of the required capital and tolerance for

<sup>15</sup> However, some big NGOs are able to offer public services that exhibit economies of scale, albeit excludable. For example, in Bangladesh, BRAC operates a number of schools.

risks.<sup>16</sup> The partnership can make allowances for social objectives as part of the private firm's corporate social responsibility or by building it directly into the firm's allowable rate of return on its investments.

In small-scale infrastructure projects or when the social objectives are more important, the state agency can partner up with nonprofit firms. Since these firms are normally mission-oriented, monetary incentives are less needed. They will participate in public projects that are aligned with their advocacies, such as catering to the needs of marginalized groups (the poor, women and children, ethnic minorities, senior citizens, or people with disabilities) or certain causes (e.g., environmental protection, human rights, preservation of indigenous or endangered flora or fauna). Unlike for-profit firms, NGOs usually do not require payments for their inputs or services. And when they do, presumably they accept fees only to defray part of their costs and not to earn profits.

Government–NGO partnerships could also work in the provision of public goods, especially local public goods. In the provision of these goods, there is no residual claimant, and therefore less attractive to for-profit private firms. These services are usually provided free of charge or for a minimal fee. Moreover, whatever revenues are generated usually become part of the state agency's general fund (or go to the state treasury), which may or may not be earmarked for the delivery of the contracted service. Since local public goods have only limited service coverage (or beneficiaries) they can be targeted to specific groups. If these goods are targeted to the poor or other marginalized groups, then NGO delivery will be apposite.

Where the quality more than the cost of public service is important, a nonprofit partner has its advantages. Since the nonprofit provider will not get the cost savings as additional wage or bonus, it will not skimp on spending. It may get its “perks” by spending the entire budget. Since it does not fully control how the budget will be spent, however, the “perks” that it can appropriate will be less than those that it may want. Consequently, the extra resources will be used to raise the average quality of the service provided by the nonprofit firm. The average quality in this case may be even higher than under a state partnership with a for-profit firm (under conditions of imperfect observability of the firm's actions) (Glaeser and Shleifer 2001).

However, the alignment of objectives does not guarantee a successful partnership. Potential conflicts in government–NGO collaborations could arise if they attach different weights on the social objectives of the project or in their preferred ways for undertaking the project. For example, while a local government unit (LGU) may be content to engage an NGO merely to build an irrigation facility for poor farmers in a remote village, the NGO may want as well to build into the project design the access and allocation rights once the irrigation facility is built. A more difficult situation arises when the NGO insists additionally on a comprehensive intervention involving tenancy reforms or asset redistribution and farmers' education.

Since a state agency typically has to account for its use of public funds, it may not be able to transfer such resources to an NGO unless the latter is officially registered (or have a corporate personality). So instead of formal contracts (or an agency relationship), the government and NGO may simply collaborate, where each party coordinates its activities or share in the costs, without any explicit penalties that will be imposed on the reneging party or payment of damages on the aggrieved party. The main factor that binds the two sides in this case is their mutual acknowledgment of the synergistic or complementary nature of their

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<sup>16</sup> The state presumably weighs these financial costs against the possible social costs of temporarily “privatizing” the ownership or operation of the infrastructure project.

activities. However, not all gainful partnerships are like coordination games where cooperation is mutually self-enforcing.

The importance of mission orientation in the delivery of public goods by either the NGO or a bureaucrat or elected politicians cannot be underestimated. Monetary incentives in the public sector can advance greater productivity among government employees, but only up to a certain extent. Where the agency's output is not easily defined or multidimensional or requires the inputs of several employees, tying wages or bonuses to outputs may be difficult. If the agency serves several principals (with dissimilar objectives), then fees (compensation or rewards) tied to particular outputs will induce employees toward them, possibly at the expense of other outputs. In these situations, low-powered incentives (e.g., fixed wages) or nonmonetary motivational factors are more useful. Extra effort may still be motivated through career concerns, promotions, social recognition, or ethics training.

For politicians to whom monetary incentives are less important, they can be induced to build a reputation for hard work and probity if the election process is effective in winnowing the "good" from the "bad" performers. The same result may also be obtained through other accountability mechanisms like an independent media or social audits (possibly undertaken by voluntary associations or NGOs), or through mandated public consultations.

#### **D. Monitor: Accounting for Performance**

Ultimately, the PPP will be judged for its impact on public welfare. Each partner should and will be held accountable, and the crucial questions are *for what?* and *to whom?* (Demirag and Khadaroo 2009; Bovis 2010). Due to uncertainties and information asymmetries, these questions, however, are not easily answered.

The link between a party's inputs and the resulting PPP outputs are not always verifiable for several reasons. First, the input itself may not be perfectly observed. The contractor's effort, diligence, work ethics, or dedication matters a lot to the success of a project, but each cannot be easily monitored. Second, the output itself may not be clearly defined or could be multidimensional. In the delivery of social welfare services, for example, the objective could be psychosocial well-being and physical security of the battered women, or in agricultural interventions it could be the income and empowerment of the farmer beneficiaries. The situation is aggravated when there are many principals, each trying to sway a common agent to pursue different goals. The mothers and infants, the working adults, and the ethnic minorities living together in one community often demand disparate health services, which may be different still from those promoted by local officials or monitored by the central health ministry. Fourth, there could be intervening external factors that could weaken or strengthen in a complex way the link between the parties' inputs and the observed joint output. An unanticipated typhoon or a labor strike may foil the best attempt of the government and its private contractor to agree on how to finance the extra construction costs resulting from the delay or damages.

The possibility of a holdup arises in a partnership where the parties make initial investments toward the production and provision of the public service and in the face of uncertainties that could foil the desired outcome of the partnership. In a typical infrastructure project, for example, the firm will have to mobilize its own team to draw up a detailed engineering plan, hire construction workers, and rent heavy equipment. The firm, however, is unlikely to make these initial investments without a down payment from the government or an assurance of recouping these initial costs. Conversely, without the firm's commitment to use the initial government outlay as planned, the state agency is unlikely to make the down payment.

The risks are compounded when unanticipated factors arise that could prevent the parties from fulfilling their part of the agreement or lead to a less-than-desired output. The resolution of the eventual conflict rests on how evidence that connect each party's inputs to the resulting output can be verified by a third party (usually the courts).

The huge transaction costs involved in specifying *ex ante* the parties' respective roles and responsibilities and their shares in the net output under each possible contingency will compel the parties to leave gaps in the contract (or agreement). To avoid protracted bargaining when conflict arises in the future, it is then necessary to specify at the outset the procedures for resolving disputes.

Notwithstanding these informational problems, specifying to whom the parties should be accountable raises its own problems. If the overriding concern is public welfare, then the pertinent performance indicators should include impacts on, for example, health status, empowerment, economic or social participation, literacy, etc. However, these indicators are not easily measured, and teasing out the PPP's contribution in them is confounded by various extraneous factors. Other proxies of welfare impact such as client satisfaction, net approval, utilization rates, feedback, and the like have also been used. Though these indicators are relatively easier to generate, they are highly subjective and sensitive to survey errors. Instead of these performance indicators that favor *downward accountability* (i.e., accountability to service clients), indicators of PPP outputs, processes, or inputs tend to favor *upward accountability* (i.e., accountability to the contracting state agency). Of course, this latter set of indicators are even further removed from the real welfare impact. Also, these indicators are more susceptible to regulatory capture. The possibility of using a combination of the two sets of indicators arises under decentralization when an LGU engages the private sector. They can also be used in large PPP contracts where the state agency involves an NGO in the monitoring of the private firm's performance. Where an NGO itself is the service delivery partner, the same need for a monitoring and evaluation mechanism arises for it cannot be taken for granted that mission-oriented organizations will always be efficient or effective in the use of project resources.

#### IV. REVIEW OF EXISTING CASE STUDIES

Following the framework introduced in the previous section, this section reviews how the five Ms of institutional design are accounted for in selected case studies of PPPs in health, microfinance, and water and sanitation services in some developing Asian countries. These case studies are limited, highly selective, and mostly about partnerships with NGOs; thus, they are not representative of the range or trends in PPP arrangements or outcomes. They were also originally written for other purposes. However, they are chosen here because they contain details that in the light of this paper's framework help identify the critical factors behind their successes or failures.

As an overview, the first two cases—that of NGOs in Nepal and Myanmar—highlight the challenges of mobilizing PPP in conflict areas. The next three cases—that of NGOs in India and Cambodia—illustrate contractual features that matched, motivated, and monitored a mission-oriented organization. The last two cases, from the Philippines, show that a tripartite arrangement involving a government agency, for-profit services providers, and NGOs can work when the assigned roles and incentives are aligned with each partner's objectives.

### **A. Mobilizing Nongovernment Organizations in Politically Unstable Areas: Microfinance in Nepal and Health Services in Myanmar**

The two case studies<sup>17</sup> presented here underscore the importance of *mobilization*—in particular, setting up an enabling environment and the government's openness to work with NGOs. The first case is about NGOs extending microcredit in Nepal and the other is about NGOs providing health and other humanitarian relief services in Myanmar.

As early as the 1990s, the then Government of Nepal already recognized the need of rural households for credit. However, it then dominated the microfinance sector by regulating the entry of private organizations into the sector. To widen private sector participation in providing microfinance services, the government established two banks in 1992 patterned after the Grameen Bank model. In addition, the country's central bank issued a directive requiring a bank to set aside 3% of its total loans for poor, marginalized borrowers. Seventeen commercial banks complied with this directive. Since 1998, the government has issued permits to 43 NGOs to provide microfinance services. Despite these policy directives, Nepal has had only limited success in widening the access of the poor to microcredit facilities and in promoting small-scale business enterprises.

Relative to the government banks, the NGOs appeared to have a cost advantage in extending microfinance services. Since they used volunteer workers, they were able to operate at lower costs. In contrast, government banks relied on salaried employees. This required them to operate at sufficient scale to reduce their average costs (per borrower), which was difficult to achieve in low-density rural areas. The then Maoist insurgency in the country aggravated the problem. State-owned regional banks, and private microfinance institutions and private banks were unable to penetrate conflict areas. In contrast, NGOs were less preyed by Maoist rebels, which should have made them then viable, alternative conduits of microcredits.

Another instance in which an NGO was effective in penetrating conflict areas but whose continuation was also threatened by political instability is the case of Health Unlimited in Myanmar. Since the mid-1990s, Health Unlimited has been working with the health department of Kachin Independence Organization (KIO), the local insurgent minority authority in Special Region 2 in Kachin State, Myanmar. Initially providing humanitarian relief for refugees, the NGO has created and strengthened a basic health care system in the region in collaboration with KIO health department. In 2006, Health Unlimited initiated a 4-year integrated health program with several components, including maternal and child health, expanded program of immunization (EPI), tuberculosis and malaria control, community health education, construction of health facilities, supply of essential health equipment, and advocacy.

Through its work, Health Unlimited was able to earn the trust of the local community that proved essential in monitoring EPI implementation and in solving other problems. In 2007, the organization was able to provide monthly EPI services to about 160 villages and immunization to 2,063 infants (or about a 83% coverage rate). By facilitating a dialogue, Health Unlimited was able to secure the cooperation of the KIO health department and the Government of Myanmar for child immunization. As an offshoot, the Government of Myanmar agreed to provide vaccines and cold chain equipment, and to train the staff of the KIO health department for free. Unfortunately, this initial cooperation was put on shaky ground because of the political uncertainty surrounding the then upcoming 2010 election in the country. More pointedly, the following contributory factors were cited as threats to the continued progress of the project:

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<sup>17</sup> The primary sources here are Antuono et al. (2006) and Development Finance International (2009).

fragmented health administration system, low/inadequate pay to health staff, restrictions imposed by the military regime on the health staff's discharge of their duties, and lack of budget.

The experiences of Nepal and Myanmar offer a lesson in engaging private sector providers (NGOs) for their comparative advantage, which is their presence in hard-to-reach areas. Unfortunately, the strict NGO certification requirements imposed in Nepal and then then political instabilities in Myanmar foiled initial headways made in capitalizing on these advantages.

## **B. Contracting Nongovernment Organizations for Health Services in India and Cambodia**

The following three cases<sup>18</sup> illustrate some contractual features that engaged a mission-oriented private organization to provide local health services in India and Cambodia. Established as a public charitable trust in 1986 by a public-spirited doctor, the Karuna Trust initially concentrated on the control of leprosy among ethnic populations in the poor areas of Chamrajnagar District in Karnataka, India. Karuna Trust's immersion in the tribal areas convinced it to expand its delivery of health services to include tuberculosis control and to support local government-run primary health centers (PHCs).

Recognizing that it can do more to provide better health services because of its available staff, and proximity and close relationship with the service clients, Karuna Trust wanted to manage some of the government's PHCs. An opportunity presented itself under the World Bank's India Population Project IX (IPP IX), which then awarded grants to NGOs to run PHCs on an experimental basis. In 1996, the Department of Health and Family Welfare (DHFV) of the State Government of Karnataka approved Karuna Trust's proposal to manage the PHCs in Honnur and Thithimathi. Instead of in Honnur, Karuna Trust, however, eventually established a PHC in Gumballi. While the government then planned for a PHC in Gumballi, the continued delay forced the community to travel a distance to the nearest government hospital. Since Karuna Trust at that time had already been operating its own clinic for several years, its collaboration with the DHFV was therefore opportune.

For its part, the DHFV saw some benefits in the partnership with Karuna Trust. For one, it enabled the government to address its problem of managing and assigning health staff to faraway PHCs. The staffing difficulty was partly due to the then restrictions in government recruitment practice (apparently, only once in 5 or 6 years). In contrast, Karuna Trust had greater flexibility in hiring doctors. For its part, the then director recognized that there was no need to run parallel services with the public sector, especially when it became increasingly difficult to raise funds from private individuals and donors. Despite its own budget constraints, Karuna Trust opted for cost sharing with the government to keep its independence and not compromise on issues of "equity, integrity and quality" (Nair, 2008).

Besides matching the mission-oriented Karuna Trust with the delivery of a local public service within its area of competence, the arrangement secured the motivations of the partners as well. Under the terms of the contract, Karuna Trust for an initial period of 5 years was entrusted with the care, operation, and management of the new PHC in Gumballi and its subcenters, including a new building established for the purpose. The contract further stipulated that Karuna Trust will perform tasks consistent with national and state program mandates. It

<sup>18</sup> The primary source here is Nair (2008); Bloom et al. (2006); Bhushan, Keller, and Schwartz (2002); and Development Finance International (2009).

was also responsible for appointing its own staff subject to the approval of the DHFW. For its part, the state government committed to providing 50% of the management costs, while the IPP IX provided new pieces of furniture. In addition, the local *zilla panchayat* (district-level local government) provided a grant-in-aid to cover 90% of the operating budget, while Karuna Trust shouldered the remaining 10%. The grant was reduced proportional to the amount of the drugs supplied to the PHCs by the local governments.

Since the initial partnership was successful, Karuna Trust was entrusted to manage two more PHCs in June 2003. By 2007, it was already administering 23 PHCs, 2 primary health units, and 2 clinics across Karnataka. The success of this arrangement between Karuna Trust and the DHFW was the fount of ensuing public–NGO partnerships in the state.<sup>19</sup> Clearly, in this case, there was a mutual codependence in both the partners' objectives and a mutual agreement in the means to achieve them. Since the partnership's objectives were aligned with Karuna Trust's own advocacy, which was promoting the welfare of the marginalized groups (tribal population), it was willing to bring in additional resources to improve both the PHC's physical setup and services. Arguably, the same gesture increased its credibility with the government, which together with the fact the local officials can easily observe or verify Karuna Trust's activities, rendered monitoring it less necessary.

In sum, three critical factors made the DHFW–Karuna Trust partnership possible and successful. First, there is willingness on the part of the state government, especially the DHFW, to work with NGOs. This willingness enabled Karuna Trust and DHFW to explore an arrangement that was then possible only under a foreign-funded project (IPP IX) despite the already existing enabling legal framework. Second, the Karuna Trust director reportedly used his credibility and influence of his membership in various state- and national-level commissions and committees to advocate for increased PPPs. The trust between the two partners enabled them to get over initial criticisms among district health workers who claimed that while Karuna Trust staff members were able to staff the PHCs, the quality of their services was not on par with the organic health personnel. Other than this, there were no reported serious contractual disputes between the parties.

Similar in some aspects to the first case study, the second case study is about government collaboration with NGOs to deliver facility-based basic health services in Cambodia. Like Karuna Trust, these NGOs in Cambodia espoused pro-poor advocacies. In contrast to the DHFW–Karuna Trust arrangement in India, the government–NGO service delivery arrangements in Cambodia used sophisticated incentive schemes, presumably because the government essentially determined the ends and means of the partnerships and the NGOs performed largely an agency role. As discussed in the previous section and as will be shown here, monitoring the performance of the agent (NGO), who may not share the objectives or methods of the principal (government), becomes critical to the success of the joint enterprise.

When the Government of Cambodia in 1999 first tried on an experimental basis to contract out the management of government health services to NGOs, the country was facing a severe service delivery capacity. To get around this constraint, the Ministry of Health tendered a bid to provide a minimum package of health services (including preventive, promotional, and simple curative health care services) in selected districts. To see whether such an arrangement

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<sup>19</sup> The new scheme permits NGOs and other charitable institutions as well as private medical colleges to fully administer or coadminister PHCs. The new contract stipulated a 75%–25% cost sharing between the state and the private sector partner. Apparently, the high cost share of the NGO is adopted to discourage politicians from establishing their own NGOs and then have them “win” lucrative PHC management contracts.



will work and under what conditions, the government specified the performance measures and the incentives to be used. The performance measures included service delivery coverage indicators such as antenatal care, facility delivery, child immunization, receipt of vitamin A capsule, knowledge of family planning, and contraceptive prevalence rates. Also included were indicators for outcome and health facility management such as 24-hour service at the health center, staffing, maternal delivery services, and collection and transparency of user fees.

Since the government unilaterally specified these performance and outcome indicators, there was no assurance of buy-in from among the winning bidders. To motivate the NGO partners, the government tendered two types of management contracts. Under the first type of contract, the NGO partner was engaged only to provide administrative assistance to the government health staff stationed in the concerned health facilities. In exchange, the government provided for the NGOs' operating budgets in the same manner as ordinary districts. These NGO contractors were granted an additional budget supplement amounting to \$0.25 per patient (out of the loan funds from multilateral institutions). In this setup, the contractors had full management control over the allocations and disbursement of their budgets, but had to follow the existing government system for the procurement of drugs, equipment, and supplies using public funds. Under the second type of contract, the NGO partners had the same tasks and responsibilities as those under the first type of contracts. In addition, though, the NGOs under second type of contract had the prerogative to directly employ their own staff.<sup>20</sup>

To tease out the effects of the two types of contracts on the predetermined set of health performance and outcome indicators, the contracts were randomly introduced in 8 of 12 selected districts in the country, with the remaining four districts as controls (i.e., where the government continued to administer the local health services). Of the eight districts originally targeted for treatment, only five were successfully contracted out: three contracting-in districts (i.e., first type of contract) and two contracting-out districts (i.e., second type of contract). These management contracts were awarded in 1998, before the start of the 4-year (1999–2003) Contracting of Health Service Pilot Project, which covered about 1.26 million people, around 11% of Cambodia's population.

Notwithstanding the small number of districts involved in the pilot project, the targeted service outcomes in the treatment districts were found to be better than those in the control areas, which indicate that NGOs had indeed some comparative advantage over the government in the delivery of basic health services to some population groups. More interestingly, however, the NGOs that had greater managerial autonomy achieved greater improvements in terms of health center management than those in the contracting-in districts. This result suggests that a mission-oriented private sector partner if given the leeway will even find a better way to deliver the same results. On the demand side, the intervention also led to reductions in private health expenditures. These results indicate that there is room for experimenting with various incentive schemes even if private sector partners are already appropriately matched with the type of public service to be delivered.

Compared with Karuna Trust in India, these NGO partners in Cambodia appeared to have received greater financial support for delivering basically the same services. What differentiates the contracts between Karuna Trust and DHFW in Karnataka, on the one hand, and the NGOs and the Government of Cambodia, on the other, is the stricter contractual

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<sup>20</sup> The then existing government health staff could either join the contractor's organization (with the latter's concurrence) and take a leave of absence from government services or be transferred to another government in another district.

obligations of the NGOs in the latter case. This is understandable since the NGO partners in Cambodia had to follow stricter protocols and deliver certain results under an experimental setup. These strictures included hiring existing health staff presumably at civil service rates, which could be higher than if the NGO partners were to hire on their own terms. In the case of Karuna Trust, however, the NGO is known to hire doctors and health staff at lower than government rates. Given the hiring restrictions, the NGOs in Cambodia had to shoulder higher costs, which, in light of this study's framework, partly account for the generous monetary support they received from the government.

Another attempt in Cambodia to use performance contracts to improve health service delivery was undertaken by the Reproductive and Child Health Alliance (RACHA), a local NGO. Established in 1996, RACHA received an award from the United States Agency for International Development in 2003 to undertake a 5-year Maternal and Child Health Program. RACHA has worked with the Ministry of Health of Cambodia due to its extensive community-level links. It trains and provides support to village-level health workers (midwives, health promotion volunteers, and traditional birth attendants) and other influential village members (shopkeepers, nuns, female elders).

In 2000, RACHA introduced community development performance contracts in target villages to improve a number of health indicators, including the number of pregnant women who received iron pills, who could identify the danger signs of pregnancy, and whose baby was delivered by a midwife. Other maternal and child health indicators monitored are the number of infants who received full immunizations, and women of reproductive age who had tetanus injections, and who know the recommended birth spacing interval, and the signs and treatment practices for children with diarrhea. To meet its health targets, RACHA brokered the agreement between provincial health departments and health centers on the one side and the villages on the other. Under these agreements, the health centers committed to providing a package of health services to the communities. For their part, the communities promised to extend additional resources to the health centers. Besides monitoring with the provincial health departments the implementation of the agreed health plans every 6 months, RACHA also gave incentives, in the form of wells, to villages. Depending on their performance in achieving the health targets, each participating village may earn 1–3 wells; the poor performers will not get any award. RACHA was able to roll out the incentive scheme in 2,329 villages in 259 communes, altogether with an estimated catchment population of about 2.3 million people. Reportedly, partial assessments showed that some of the contracts had achieved significant progress toward some of the health targets. Moreover, it is claimed that the villages have grown accustomed to health planning as a consequence, even without the incentives (provision of village wells).

What the case studies illustrate is that NGOs can be motivated formally through contracts to take advantage of their local knowledge and relationship with the poor. Karnataka Trust in India and RACHA in Cambodia both employed their local expertise to improve the community's use and support of local health facilities. It is not clear from the available reports, however, how these particular government–NGO partnerships in the two countries were sustained after donor support winded up. Presumably, government assistance was extended or expanded given that the partnerships were successful in improving health access.

### C. **Public–Private–Nongovernment Organization Partnerships in Water Service Delivery to the Urban Poor and Child Immunization in the Philippines**<sup>21</sup>

The two final case studies show how sustainability is built into the delivery of water services and child immunization services in the Philippines. Interestingly, these cases also demonstrate that financial sustainability can be achieved without sacrificing equity. Moreover, these cases also illustrate that PPPs can be extended to include a government agency, a for-profit firm, and an NGO.

In 1997, the Government of the Philippines privatized the operation of the Metropolitan Waterworks and Sewerage System (MWSS) to meet the increasing demand for water and sewerage services of a rapidly expanding population in Metro Manila.<sup>22</sup> The service area—covering Metro Manila, the province of Rizal, and parts of Cavite province—was divided into the East Zone and the West Zone. Two firms won in separate competitive bids and were each awarded a 25-year concession agreement. Manila Water was awarded the East Zone and Maynilad Water Services was awarded the West Zone. Each company was a consortium of some of the most successful private corporations engaged in many industries in the country and some equally competent foreign firms. The MWSS oversaw the implementation of the contracts and regulated the operations of the two concessionaires.

Since essentially water and sewage services are private goods, the winning concessionaires were allowed to charge user fees to recover their investments and operating costs and to earn some profit. In particular, they were allowed to petition for rate adjustments based on inflation, extraordinary circumstances, and rebasing. They were also granted a 6-year tax holiday, preferential tariffs of 3% on imported capital equipment, and tax credits on locally produced capital equipment until the end of 1997. In addition, they were exempted from paying local government and franchise taxes, and the value-added tax on the supply and distribution of water.

In turn, the concessionaires were mandated to supply water for 24 hours every day to all connections not later than June 2000, and to keep a satisfactory water quality for drinking and other purposes. In addition, the private firms were required to maintain minimum equity investments (amounting to 20% in the first 5 years) and post-performance bonds, and pay other fees to the government. For the initial years of operation, the concessionaires were permitted to collect water and sewer charges based on their bid prices.

Apparently, given the incentives under the agreement, the concessionaires proved up to the task. Reportedly, Metro Manila following the privatization had achieved the lowest water rates in the whole of the Philippines and in the Association of Southeast Asian Nations (ASEAN) region. Despite initial financial difficulties, the two concessionaires then appeared poised to recover their losses.<sup>23</sup> Both were able to reduce their so-called non-revenue water from leaks,

<sup>21</sup> The primary sources are Inocencio and David (2001); Marin (2009); Franceys and Weitz (2003); and Development Finance International (2009). These cases are used here only to illustrate how a tripartite arrangement could work at least for some specific objectives, notwithstanding the other possible failures of the private sector firm in other service delivery aspects.

<sup>22</sup> While the operation of a water utility is privatized, the franchise, however, belongs to the government. Beyond the concession period, the water utility company will cease its service provision unless awarded a contract again by the government. Effectively, the privatization of water services is like a build–finance–operate scheme.

<sup>23</sup> Although later events show that Maynilad Water Services, partly due to its failure to fulfill some of the terms of its contract with the government, had to sell its concession contract to another firm.

illegal taps, metering errors, and nonpayment of service connections. Reputedly, most of the non-revenue water was lost in the poor, slum areas in Metro Manila.

To address this particular problem and at the same time continue to cater to the needs of the depressed communities, Maynilad shifted from its initial strategy of providing a standpipe to serve a group of households to another strategy of providing individual household connections. From Maynilad's perspective, the "Water for Community" program made sense since it facilitated the payment for water consumption. To entice more households to get their own water connections, Maynilad waived its land title requirement that many of the urban dwellers failed to satisfy. To make the cost of connection affordable, Maynilad further allowed households to pay for their water connections on a staggered basis over 6–12 months and the partial payments to be added to their regular monthly bills.

In the rollout of the "Water for Community" program, Maynilad saw the need to engage several NGOs to serve as social intermediaries between it and the relevant communities. These NGOs first undertook information and education campaigns. A foreign NGO (Medicins San Frontieres) was tapped to help improve the sanitary conditions in the slum areas by encouraging community participation. In Malabon City, a local NGO (Lingkuran sa Ikauunlad na Ganap ng Pamilya Foundation or LINGaP) was also engaged to assist in the sanitation and health education drives in the urban poor communities.

All parties contributed resources to the undertaking. The local NGO provided transport and materials, while the community (through its homeowners' association) provided free labor as well as storage and security for the materials, tools, and equipment used. Maynilad provided the individual water connections, while the City Government of Malabon contributed a total of P600,000 to procure materials for the drainage system and other logistics support.

The partnership that carried out Maynilad's "Water for Community" Program proved successful. More households benefited through their increased water consumption. Feedback from the focus group discussions reveals that many of the newly connected households claimed to have been empowered and become a "legitimate part of society" (Franceys and Weitz 2003). For Maynilad, the project made business sense as its revenues increased with the water consumption and was considered good corporate social responsibility.

What this last case study reveals again is the potential gains that can be realized from alternative service mechanisms and the suitability of incentive schemes to the types of service delivery partner engaged in the process. The provision of the water and sewer services in a metropolitan area is rightly assigned to a private firm, which has greater access to the required financial investments and technical resources, with the right to charge user fees that most households will be willing to pay for the water connection and for the actual water they consume. The needs of the poor households, as shown in this case, need not be sacrificed. They can be connected to the water system with the help of NGOs and local governments, who presumably are both motivated to support the poor households. By engaging the latter in a very particular activity (water connection), Maynilad has shown that privatization of a water utility still has room for other service delivery mechanisms.

Another case where user fees are used to ensure sustainability is that of the Well Baby Bakuna Program of the Philippine NGO Council on Population, Health and Welfare. (PNGOC). In support of the Philippine Department of Health's Expanded Program for Immunization (EPI), which aims to ensure that all babies get their EPI vaccines within 12 months from birth, the PNGOC developed its Well Baby Bakuna Program in July 2007. The novel feature of this

program is that it was targeted at families in the C and D income classes (“middle classes”) who had expressed preference for the quality but not always the ability to pay the full price charged in private health clinics. Reportedly, these families preferred private practitioners for, among others, the “type of vaccines available (monovalent versus multivalent vaccines); the better quality of private health facilities; the sometimes difficult attitudes of certain public health deliverers; shortages in vaccine stocks at public facilities; and the limited range of vaccines at public facilities” (Development Finance International 2009). The key challenge then was to lower the price barrier to accessing these vaccine services.

The PNGOC overcame this challenge using a two-pronged strategy. Working on the supply side of the market, the PNGOC entered into a partnership with the Philippine Pediatric Society (PPS) to identify and engage PPS members and PPS-recognized hospitals to provide quality vaccines affordable to C and D families.<sup>24</sup> In particular, the PNGOC advocated a tiered pricing scheme to encourage the target families to use vaccine services and at the same time ensure reasonable profits to private providers.

Working on the demand side, the PNGOC conducted patient screening through community mapping and surveys, house visits, hospital coordination, and community-level meetings, especially with mothers. The main purpose was to “market” the program to the target families by increasing their awareness and improve their understanding about the value of full immunization of their children. The other purpose was to use the information collected in the community-level advocacy to segment the market by directing the class E families (poorest) to public health facilities for free services and the class A and B families (richest) to other, nonparticipating private pediatricians who charge full price.

Apparently, this two-pronged strategy was successful in that by December 2007 around 19 private hospitals and clinics were participating in the Well Baby Bakuna Project. Located in some of the country’s areas with low immunization rates and underserved populations, these facilities were in Metro Manila and the provinces of Batangas, Cavite, Laguna, and Zambales.

One lesson that can be drawn from these two Philippine case studies is that the government need not partner up exclusively with a for-profit firm or an NGO. Some public services are large and complex enough to accommodate the respective missions and motivations of both types of private sector entities. By targeting the poor, slum dwellers, Maynilad found a willing NGO partner in the areas. By helping segment the market, the PNGOC found willing private health providers to cater to middle-class families.

## V. CONCLUSIONS AND POLICY IMPLICATIONS

Though not exhaustive, the case studies reviewed here suggest that public–private service delivery mechanisms can help overcome the limitations of pure state or pure private provision of public services. For one, the state agency can still steer the objectives of the partnerships toward the provision of market-augmenting public goods that private markets would normally underprovide, especially for the poor. By engaging a private sector partner, the state agency can also tap the private sector’s financial, organizational, managerial, or technical resources it normally does not possess. Where the state fails to secure the welfare of the marginalized groups or cater to the needs of people in conflict areas or geographically isolated places, there is usually an NGO taking the cudgel and which the government can engage. In extreme

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<sup>24</sup> In this undertaking, the PNGOC and PPS were supported by GlaxoSmithKline, a pharmaceutical company.

circumstances where the government has lost the confidence of the people, it can tap volunteer, nonprofit organizations to help win back the trust of the people. The realization of the potential gains from such partnerships, however, will depend on how well the state can mobilize and match the private sector partner's mission with the right public service, and motivate and monitor it to achieve the desired service delivery outcome. Notwithstanding the limited number of cases reviewed here, some lessons can already be drawn on how to make such hybrid service delivery arrangements improve service delivery and welfare, at least on the margin.

### A. Key Policy Messages

First, public–private partnerships, as defined here, are viable service delivery arrangements so long as there are market failures and government failures. The idea though is not to supplant pure public provision or private provision when they work; but since neither is likely to work all the time and in all places, hybrid service delivery mechanisms should be tried or adopted to serve the public interest, especially in promoting the welfare of the poor and other marginalized groups.

Second, the enabling legal and institutional framework for engaging private sector organizations, including NGOs, as public services providers needs to be established. In many countries, the requisite laws, guidelines, and procedures for PPPs with for-profit firms have already been established. In addition, however, the state's institutional capacity has to develop as well. As borne by the experience in other countries, the PPPs for infrastructure projects failed to proceed because of the government's weak organizational and technical capacity to conduct competitive bids, draw up the necessary contracts, and regulate or monitor performance (ADB 2008; Fiszbein and Lowden 1999; Economist Intelligence Unit 2011).

A similar environment is needed to widen the opportunities for engaging NGOs, especially with respect to those aspects concerning their receipt, use, and accountability for government funds and other resources. In the case of Nepal, the then existing legal framework was not suitable for engaging the NGOs in the extension of microcredit facilities. In the case of India, the legal environment allowed for NGO partnership, but the implementing facility was not yet ready for the transfer of PHC management to an NGO. Even where the legal and institutional framework is less than ideal, it is sometimes possible for PPPs to improve public service delivery *on the margin*. As shown in the case of RACHA, NGOs are still able to extend health and other humanitarian services to people caught in difficult situations. Furthermore, the case study has shown that an NGO can broker a small-scale, limited cooperation between conflicting factions to provide critical pro-poor services.

#### **On the main factors that contributed to the success (or failure) of the partnership of the Philippine National Dairy Authority and Heifer International – Philippines (NGO)**

“Strong commitment by leaders and staff of both organizations to make this project work. Regular communications among national, regional, local partners and organized groups, especially if there are problems to solve. Openness of both organizations (NDA and Heifer) to learn from each other. Honest discussion of problems and the focus on finding concrete, realistic and mutually agreed solutions. Complementation of expertise: Heifer on social capital and values formation; NDA on dairy development – technology, dairy management, processing, and marketing.”

*Hercules C. Paradiang*  
Country Director  
Heifer International – Philippines

The state should not automatically assume it fails on its tasks when and wherever an NGO is present. Voluntary associations may emerge to serve idiosyncratic needs of a group or community. The state may not anticipate, be capable of, or obliged to fulfill all such needs. Where those needs are within the purview of the government, the case studies on Cambodia, India, and the Philippines show that NGOs can be tapped to serve hard-to-reach areas, urban poor communities, or isolated population groups.

Third, while incentives are important and nonmonetary incentives are no less effective than financial compensation or rewards, another key aspect is to match the right incentive for the right partner and the right task. In this aspect, an important consideration is a clear understanding and acceptance of the private sector's mission and their comparative advantages (see Box 2). Much like the elected officials and the bureaucrats in state agencies, entrepreneurs in for-profit firms or managers in nonprofit organizations have their own objectives. Their objectives will determine their preferred activities and their competencies. It should be noted as well that NGOs or voluntary associations may be ideologically driven, which means that they could be attaching greater weight to certain social objectives or a preference for certain activities than is suitable for the partnership to work. Respect for the partner's mission is also important. For most NGOs, their advocacy is more important than the funds or support that they will receive from the government. As in the case of the Karuna Trust, many NGOs would rather contribute their own resources and keep their independence than be co-opted by the government. In this case, an open dialogue should help thresh out the differences.

While it is commonly assumed that people working in NGOs are mission-oriented, it is not always the case. As argued by Besley and Ghatak (2006, 2007), NGOs may unwittingly attract incompetent or crooked workers in developing countries where formal sector work is scarce. These NGO workers may just be skimming rents from donors. Hence, it would be prudent for the NGOs and the government to weed out these volunteer workers by making NGOs more accountable. While government accreditation can help, this should not be taken too far as it can be misconstrued or misused as a ploy to control NGOs critical of the government.<sup>25</sup>

On the part of the state agency, it should also be transparent and committed to partnering up with non-state actors. The state agency should be clear about its objectives and relate to the prospective partners what it can and cannot do given the existing laws, procedures, and institutions in government. If the output is multidimensional, it would help if it could rank the dimensions in terms of priority. Better still, if it unpacks the dimensions, it can then contract these out to different partners. For example, it can tap different private partners to provide the same education services to different groups of schoolchildren.

However, for large, complex undertakings, a tripartite agreement may be suitable. In the case of major infrastructure projects such as for the construction of superhighways, dams, or irrigation systems, a private firm may be engaged to execute the financing, engineering, and operation aspects, while an NGO may be tapped for social mobilization. The NGO can better communicate the social benefits of the project to the affected communities, and the concerns and apprehensions of these people to the project proponents. By mediating between the community and the project proponents, the project may proceed without delay and with minimal adverse effects on the livelihood or environment of the concerned communities.

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<sup>25</sup> In the Philippines, the requirement that local governments accredit the NGOs that are invited to become members of local consultative bodies have disenfranchised some legitimate NGOs and entrenched the NGOs established or supported by politicians.

### **Box 2: Mismatch in Mission and Motivations? The Case of Public–Private Partnerships and Nongovernment Organizations in the Philippines**

In 2010, the then newly elected President Benigno Simeon C. Aquino vowed that his administration would follow Daang Matuwid (literally, “straight path”), presumably to set it apart from the previous administration widely perceived to be corrupt. This policy was soon set in place, including in government deals with the private sector. In the same year, the Public–Private Partnership (PPP) Center was established and tasked to bid out of 45 infrastructure projects. Since then, however, it has been able to award only three projects. In August 2013, the much-delayed public bidding for the P60 billion Light Rail Transit-1 Cavite Extension project failed when “the lone bidder failed to meet all the requirements and the other three pre-qualified bidders withdrew despite their sizable outlays in preparing their bids.” Reportedly, under the terms of the contract, the winner would have assumed too much risks and costs, since the government did not want it “to make too much money.” Perhaps realizing that a for-profit firm has to make some money at least, the PPP Center is considering revising the contract’s provisions to have the government instead absorb the estimated P2 billion real property taxes and even to extend a subsidy to firms during the bidding process.

While the government seems overly cautious in its PPP projects with for-profit firms, it seems rather less prudent when it hands over pork barrel funds to nongovernment organizations (NGOs). Up until July 2013, members of the two houses of Congress could expect annual pork barrel allocations called Priority Development Assistance Fund (PDAF): on average about P200 million each for the 24 senators and P70 million each for the nearly 290 congresspersons. These legislators justify their PDAF allocations on the basis of their supposed better knowledge of the needs of their constituents, especially the poor and other marginalized groups. For the same reason, it seemed sensible to them to channel these funds to and undertake projects with NGOs. Recent controversies, however, have revealed that not all NGOs are mission-oriented after all. According to a special audit report of the Commission on Audit, the total PDAF from 2007 to 2009 was about P12 billion. Of this amount, about P6.2 billion that were allocated to 12 senators and 10 congresspersons went to 82 NGOs, and 10 of these NGOs received P2.2 billion. All 10 NGOs are linked to Janet Lim Napoles, who is now being held in prison for alleged plunder, implicating several legislators. Apparently, the PDAFs went to dubious NGOs with dubious projects, but eventually most of it was kicked back to concerned legislators. Reportedly, this practice continued in 2010–2011 under President Aquino’s term.

These incidents illustrate that motivations (incentives) can work only when matched with a clear understanding of the private partner’s mission.

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Finally, mutually acceptable monitoring and accountability mechanisms should be set up. This would require prespecifying whenever feasible the performance indicators and the corresponding carrots and sticks to enforce compliance. Where gaps in the contract or agreement are inevitable, the procedures for resolving possible conflicts should be specified. If the expected outputs are clear to all, especially the service users or beneficiaries, then an unhealthy connivance between the state agency and the private sector partner to cover up a subpar performance can be avoided.

It should also be noted that in practice the state agencies do not necessarily follow all or the sequence of steps mentioned. What is attempted here is simply to list down the steps and order them based on a review of the literature and existing case studies, and to show that departures from these steps help explain some of the observed PPP failures. The larger question of course is what would make the state agencies, including local government units, be more methodical and consistent in their selection and engagement of private sector providers in the delivery of public services. Therein lies the importance of governance institutions that will



motivate (or constrain) the contracting state agency itself. Where the state agency itself is weakly accountable for its action, engaging a private sector partner will not necessarily help it fulfill its mandate. Worse, PPPs may become just another vehicle for more corruption or rent seeking.

Admittedly, the limited case studies reviewed cannot be substituted for dedicated inquiries that control for extraneous factors such as conflict situations and focus more on the principal factors that determine the suitability of PPP arrangements according to a partner's mission, match with public services, and motivation for a successful outcome. In addition, local conditions, such as those that affect the willingness of local governments to work with NGOs, to improve the range, quality, and coverage of local public services should be given greater focus. To draw out more generalizable lessons, these are just some of the issues that may be pursued in greater detail in future studies.

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## **Public–Private Service Delivery Arrangements and Incentive Schemes in Developing Asia**

Increasingly, state agencies—both national and local levels—and private organizations, both for-profit firms and nongovernment organizations, increasingly coordinate, collaborate, or partner to finance, produce, or provide public services. This paper attempts to identify the factors that account for the successes or failures of such public–private service delivery arrangements, with focus on the role of monetary and nonmonetary incentives used in selected case studies in developing Asian countries. A key lesson is to mobilize potential private sector partners, match the partner’s mission with the appropriate type or level of service provision, and then motivate them with the right incentives but also monitor them for performance accordingly.

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