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**Bringing Something Different To The Table:  
Potentials of Public-Private Partnerships  
for Armenia and Other Developing/Transition Countries**

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## 1. Introduction

Among development professionals, three widely held stereotypes are:

1. The private sector is more efficient than the public sector.
2. Public sectors in developing and transition nations tend to be particularly inefficient, as well as corrupt, relative to those in more developed economies.
3. Public sectors in developing and transition nations tend to operate in spheres normally (and better) served by the private sector.

In that they are generally true, these are good stereotypes. Study after study, across all continents, have demonstrated a positive relationship between the degree of privatization and productivity (see Djankov and Murrell (2002) for a comprehensive summary, and Brown, Earle, and Telegdy (2004) for a more recent paper). It is not surprising, therefore, that both International Financial Institutions (IFIs), such as the World Bank and EBRD, and bilateral donor agencies, such as USAID, encourage privatizations, even gauging a nation's progress, in part, by increases in the percent of all production accounted for by the private sector.

These assistance organizations also promote public-private partnerships (PPPs).<sup>1</sup> The word “partnership” suggests that the parties are co-equal or, at least, that their participation is desirable. However, PPPs are often, arguably most often, seen as second best arrangements when governments are reluctant to relinquish all control. In other words, PPPs are devices for reducing the public sector's share in production and are resorted to when governments refuse to exit the stage entirely. So, the public partner in a PPP is there due to history and power, rather than its ability to add value. With luck, a PPP will be temporary, preparatory to the preferred solution of total privatization. In most instances, this view is correct. But we will argue that there are cases in which public sector involvement can lead to better outcomes than full privatization. The heart of this argument is that the two sectors have different qualities and intensities of asset endowments. They have different things to bring to the table and it is out of such differences that potentials any mutually advantageous partnership exists.

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<sup>1</sup> For example, several IFIs and bilateral donors are involved in the PPIAF, the Public-Private Infrastructure Advisory Facility. This organization is “aimed at helping developing countries improve the quality of their infrastructure through private sector involvement.” <http://ppiaf.org/>

Before proceeding, however, a caveat or warning should be added. While there can be significant benefits from PPPs, there are dangers of abuses, particularly in developing/transition countries with weaker institutions. Businesspersons might exploit the access to public officials afforded by the PPP to exert influence. It is a two-way street in that PPPs could also afford bureaucrats additional opportunities for corruption.

The central example for the discussion in this paper is Armenia, one of the nations emerging from the Communist extreme of too much government involvement in the economy. Certainly of primary importance is removal of unreasonable constraints on the private sector while establishing reasonable rules and enforcement systems for government to guard against market failures. Luckily, Armenia has and continues to make considerable strides in this direction. While the necessary and appropriate principal direction of change involves shrinking government's role in the economy, it does not follow that government has no role to play nor that the role should be only as a referee. Indeed during the transition period, government may need to take on some additional tasks to promote the previously near-dormant private sector, which is taking steps to establish itself in the new reality.

And the new reality is not a very friendly one. Despite the progress in macroeconomic performance in recent years, Armenia remains a country with a low per capita income, few natural resources, and depleting human capital stock. Outside of a few Diaspora-led investment projects, very little is happening on the ground, with the lack of progress with replenishment of the existing capital stock and investments into new technologies being a source of serious concern. In addition, despite the EBRD's recent upbeat statements about Armenia's structural reform progress (EBRD, 2005), state capture remains high, rendering the investment climate unfriendly, to say the least. Trust between private and public sectors is very low, leading to a paralyzing situation where private sector agents are likely to play safe and adopt a wait-and-see approach instead of investing in search of profits. Irregularities and subsequent turmoil that followed the 2003 presidential and parliamentary elections did not help generate confidence both in terms of economic policy as well as political risk.

The observed progress on macroeconomic level is not broad-based. A number of private monopolies and export-import ventures (which are connected to the state and form the base of special interest groups, to be dealt with later in the paper) dominate the corporate landscape, leading to sizable economy-wide welfare losses (Holden and

Sahakyan, 2005). This situation creates problems related to distribution, with growth failing to translate into higher social standards, thus slowing down the formation of the middle class and hampering the development of institutions, and, through these, harming the growth prospects in the long run. Armenian workers are still competitive, at least on CIS and East European labor markets, making emigration a less traumatic experience and, therefore, more likely to be chosen than it otherwise could be. Expectations do influence economic outcomes, and observed problems with redistribution and economic fairness only fuel unfavorable expectations about the future. When property and basic human rights are at stake, the agents' incentives to stick around and succeed are greatly diminished. Delaying actions to move out of this standstill could be costly owing to: (1) continuing formation and strengthening of special interests, (2) challenges of dealing with years of below-optimal investment in education and infrastructure development, and (3) continued emigration.

Other, though related, reasons for low investment and business formation rates include all the usual impediments faced in transition economies, as well as uncertainties related to regional instability, isolation from large export markets, and the small size of the domestic economy. An important and, as yet, under-exploited asset is the large Diaspora of ethnic Armenians around the world.<sup>2</sup> Given reasonable chance of positive results and availability of appropriate vehicles for involvement, it seems certain that many Diaspora Armenians would become more involved in Armenia for volunteer activities to advance social and cultural causes, as well as for business ventures and investments to bring about economic growth and development (Gevorkyan and Grigorian, 2003).

In this paper, we assert that:

1. Differences between the endowments and capabilities of the public and private sectors create opportunities for mutually advantageous public private cooperation (PPP), capable of addressing a large portion of problems discussed above.

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<sup>2</sup> Armenia is one of the few nations of the world with a Diaspora of its dominant ethnic group at least twice as large as its own population.

2. PPPs can be used to approach a diverse set of tasks. Such applications may be particularly appropriate for overcoming shortfalls in transition-type environments, where both government and market failures are common.<sup>3</sup>
3. There is a range of structures or organizational arrangements for implementing PPPs. Which organizational arrangement is appropriate depends upon the nature and duration of the task and the types of assets and talents available from the two sectors.

PPPs could be important in mitigating the above-described problems and exploiting opportunities, such as realizing greater involvement by the Diaspora. But there should be careful assessment of the conditions in which they could become advantageous and the forms they could take. As with any partnerships, PPPs must offer advantages for both sides with clearly defined responsibilities.

The paper is structured as follows. In the next section, differences in what the private and public sector can ‘bring to the table’ to contribute to PPPs are outlined along with organizational alternatives for such cooperation. To demonstrate that PPPs are not just second best alternatives for Developing/Transition nations, the example of Ireland is briefly discussed. In the fourth and main section of the paper, the types of tasks for which PPPs could be appropriate are reviewed and specific examples discussed.<sup>4</sup> The latter largely refer to correcting various types of market failures and observed irregularities in the prevailing business climate. In the fifth section problems and opportunities regarding PPPs associated with the existence of special interests are examined. Finally, the results are summarized and conclusions drawn.

## **2. Rationales and Organizational Alternatives for PPPs**

### **2.1. Difference, the Soul of Partnership**

PPPs are partnerships. There are inherent economies in all viable partnerships in that the partners are able to produce more value together than would be the sum of their individual efforts. It is this surplus over their individual efforts that creates the mutual

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<sup>3</sup> See Kuznetsov (2002)’s references to Russia.

<sup>4</sup> These are both ongoing PPPs in Armenia as well as potential opportunities for PPPs.

advantage. Partnerships should not form without potentials for realizing mutual advantage and should be allowed to dissolve if they fail to arise or dissipate. For there to be mutual advantage, as with any form of trade, each party is expected to bring something to the table—assets, talents, rights, powers—not possessed or possessed with different relative intensities by their counterparts. In other words, the potential for partnership arises from differences. In Table 1 some of the differences between what government and the private sector can offer are outlined.

## **2.2. Alternative PPP Organizational Structures**

Organizations can employ a spectrum of structures to facilitate cooperation. Each has its own strengths and weaknesses. The choice of a specific structure depends upon the nature and duration of the task envisioned and the assets and capacities available from each sector. For expositional convenience, we divide organizational choices into four types:

- Non-Invasive Cooperation (NIC)
- Management Contracts (MC)
- Concessions (CONC)
- Joint Ownership-based Cooperation (JOC)

**Non-Invasive Cooperation** is defined as cooperative endeavors in which none of the cooperating organizations, in any meaningful way, assumes authority over all or part of other cooperators. It is cooperation in the sense that the partners exchange information and coordinate some aspects of their actions to realize mutual gains, but they do this at arms length, with no party usurping direct control over another. For example, the Government of Armenia (GOA) and a private firm might coordinate their shipments to take advantage of volume discounts in transport. In a disaster, GOA and a non-governmental organization (NGO), such as CARE, might agree on regions in which each has primary responsibility for providing assistance, thereby avoiding duplication, and maintain contact about their stocks of relief supplies to be able to cover temporary shortages each might have.

The primary strengths of NICs are flexibility and speed. They are flexible as they can be used in a very wide array of situations. Essentially, whenever the primary objective of cooperation is not to rectify an internal problem of one partner and/or if the

‘defective’ partner can entirely vacate an area in favor of another partner<sup>5</sup>, an NIC can be employed.

NICs can be established quickly, relative to other arrangements, for two reasons. First, because each organization treats its partners as independent “black boxes,” NICs are relatively simple. There is no need to assess the relative internal strengths of the partners and design mechanisms for effecting cross-organization managerial and facility linkages to take advantage of these differences. Second, as the autonomy and managements of each organization is not threatened, there is less potential for political or bureaucratic resistance, i.e., turf battles. For the same reasons, it is relatively easy to set limits to, and conditions for, ending NICs.

The primary weakness of NICs is that they do not take advantage of opportunities for cross-organization mechanisms, which could improve the internal performance of the partners. When such potentials exist, an NIC may be a quick fix, but not an optimal one. Even in such circumstances, an NIC may be useful as an interim arrangement.

A **Management Contract** is a device for transferring ownership-like responsibilities without actually transferring ownership rights. An MC is simply an agreement in which an organization hires an external management team for part of its operations. MCs are appropriate when an organization wishes to obtain external managerial expertise, but not outside investment. For example, these are common throughout formerly socialist countries, for operating upscale, state-owned hotels. MCs may also be used for essentially non-commercial units, such as national parks and prisons. MCs normally define:

- Areas over which the management team has authority;
- Operational parameters, such as service frequencies or minimum production amounts, quality standards, employment minimums, pricing, etc.;<sup>6</sup>
- Compensation;<sup>7</sup>

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<sup>5</sup> For example, if GOA were unable to provide medical services to an isolated part of the country, perhaps due to an emergency elsewhere, it might agree to cede those functions entirely to an interested NGO.

<sup>6</sup> Particularly if the MC is viewed by the organization as a transition phase, the management team may be obligated to perform tasks, such as training.

<sup>7</sup> Since an important goal of MCs typically is not only to obtain more skilled but also a better motivated and entrepreneurial management, compensation normally is tied closely to performance. Compensation

- Length of the contract and renewal options.<sup>8</sup>

Since investments are not sought, it is relatively easy to attract potential management teams. Also, because the organization holds all of the equity and through its rights to review performance and cancel the contract, it is clearly in ultimate control.

It should be pointed out, however, that designing an MC can be a lengthy and difficult process. The primary difficulty of MCs is the complexity of ensuring consistency between management team incentives and organization goals.<sup>9</sup> This is particularly true as underlying economic conditions change and because management team incentives are likely to transform as the end of the contract term nears. Another problematic area, in this regard, are incentives related to additional tasks, such as training, intended to have the management team create its own replacements. If the management contract is lucrative, incentives for delaying or even sabotaging these tasks are evident.

That said, ‘complexity’ is not meant to imply ‘impossibility.’ Indeed, if potential incentive problems are recognized at the outset, corrective compensatory mechanisms can be developed. For example, the management team could receive a bonus related both to how expeditiously it is able to train a replacement team and the unit’s profitability. The bonus would be designed to compensate, wholly or partially, the management team for the present value of the earnings it would have realized had it delayed its training program. Similarly, the management team might be given a bonus based on growth and improvements effected toward the end of the contract term to allow it to capitalize on improvements which, otherwise, would have primarily benefited the management team’s successor. In the absence of such bonuses, a management team

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systems should align, as closely as possible, the goals of the institution and the self-interest of the management team.

<sup>8</sup> It is important to have contract lengths sufficiently long to allow a management team to become well-established, make and recover from inevitable mistakes, and reap significant rewards from improvements it effects. On the other hand, overly lengthy contract periods may weaken incentives from competitive threats from other management teams wishing to take over when the contract is again open for bids.

<sup>9</sup> This is identical to issues about alignment of incentives of corporate managements with those of the owners, but with the added complications that stock cannot be issued to the managers also to make them owners and the owner (i.e., the State) may have non-economic as well as economic goals for the unit.



nearing the end of a contract period would have incentives to maximize current earnings by deferring maintenance and improvements.<sup>10</sup>

In some instances, management team performance can be guaranteed, in part, by the broader impact unsatisfactory performance would have on that firm's reputation. In reality, an MC is a form of franchise agreement, with the management team being the franchiser. If unsatisfactory performance in one locality would impact negatively on earnings in other locations, through the negative effects on firm reputation, then the management team would have added incentives to ensure high performance. Examples of this include MCs held by worldwide hotel operators.

The only difference between MCs and **Concessions** is that with the latter, the firm providing the management team is also expected to make capital (i.e., investment) commitments. Particularly if the capital investment is significant, relative to the existing capital, the concession may be referred to as a BOT, for **Build Operate Transfer**. If the terms of the management contract stipulate that no capital commitments are required, then that contract is an MC, but if the management company must also make investments, it is a CONC. For this reason, discussion of CONCs will be abbreviated.

The requirement for investment would most likely limit CONCs to commercially viable enterprises. However, CONCs can and frequently are used to between governments and NGOs to advance social or cultural causes. As an example, for over 10 years, the state-owned Arabkir Medical Center for Children in Yerevan has allowed a joint venture between a Swiss and an Armenian NGO, VAD/DAA, to occupy two large buildings in return for providing schooling, psycho-social counseling, lodging, and other services for the hospital's patients and their families. The NGO has made hundreds of thousands of dollars of investments on these facilities. While it is doubtful if anyone directly involved refers to the arrangement as a concession, in fact it is.

The opportunities and problems associated with CONCs are identical to those for MCs, with the exception of the impact of the concessionaire's investments. One impact is that, as investments are expected for CONCs, all things equal, it would be

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<sup>10</sup> A condition for renewing the contract could be forfeiture of bonuses designed to avoid non-optimal behavior toward the end of contract periods.

harder than for MCs, to attract firms. Compensation schemes would have to compensate appropriately, including mechanisms to avoid perverse behaviors toward the end of the contract period. In addition, a (desirable) potential concessionaire might recognize opportunities for effecting revenue generating improvements through investments which would be absent with total reliance on commitments from the State. Potential concessionaires should also recognize that investments would be leveraged by the value of the State assets and the fact that the State's ownership may dissuade potential rent-seeking by government bureaucrats.<sup>11</sup>

Public and private sector entities may cooperate by virtue of common ownership of assets, hence the name **Joint Ownership-based Cooperation**. A typical example of JOC could be joint public-private ownership of utility companies, which although secures private sector involvement to attract new technology and private funds, may not be fully privately-owned due mainly to social functions performed by utilities. Even though JOC requires joint ownership, this does not, in itself, indicate the nature of the cooperation. If the functions of the JOC are sufficiently separable (e.g., different stages of a production process) one sector may operate one part and the other another part and actual cooperation be NIC. On the other hand, an entity in one sector or the other may assume overall management, resulting in MC or CONC structure. Finally, in some cases, ownership might effectively be a portfolio holding, with no actual involvement, much less cooperation.

The primary practical importance of a JOC is liquidity. Particularly if the stock is listed on a recognized exchange and shares are in reasonably small denominations, it is relatively easy to effect changes in ownership compositions.

The PPP types and relative strengths and weaknesses are outlined in Table 2.

**Box 1. Not Just Poor Man's Strategy—the Example of Ireland**

If PPPs were solely devices to nudge governments out of arenas better served by the private sector, they would be rare or non-existent in developed, capitalistic economies. The Republic of Ireland, one of the most progressive economies in the

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<sup>11</sup> As noted earlier, it should be recognized that State involvement may create opportunities for rent-seeking by bureaucrats.

world, offers an example of the value and flexibility of PPPs. With a view toward “combining the best of the public and private sectors with an emphasis on value for money”<sup>12</sup> the Government of Ireland established the Central PPP Policy Unit in its Ministry of Finance. It currently has 53 projects underway or in planning. The estimated total value of these projects is between €5 and €8 billion. These include projects between the private sector and:

<u>Government Agency</u>	<u>Number of projects</u>
National Roads Authority	10
Courts Service	1
Department of Education and Science	4
Department of Health and Children	1
Arts, Sport, and Tourism	1
Office of Public Works	1
Irish Prison Service/Department of Justice	
Equality and Law Reform	2
Department of Transport/Railway	
Procurement Agency	3
Department of Environment, Heritage, and Local Government	30

The projects range from development and/or operations of roads, ports, and rails to housing, prisons, and even gardens. Arrangements vary from simple management contracts to long term concessions with significant investment requirements.

### **3. Potential Applications for PPPs in Armenia**

Having established the topology of possible types of public-private cooperation, we would like to point out that PPPs may be employed to tackle two different types of tasks: (1) those which would otherwise be performed strictly within and by the private sector, having public sector entities assist in their implementation, or (2) those performed

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<sup>12</sup> See “Welcome to the Irish Government Public Private Partnership (PPP) Website” at <http://www.ppp.gov.ie/>

within and by the public sector, having private sector entities assist in improving their efficiency.<sup>13</sup> Employing this division (between measures to improve performance of what would normally be either private or public sector functions), below we discuss some specific problem areas for which PPPs potentially could be used to advantage. Examples are presented of existing PPPs in Armenia or potential opportunities for them. The listing and the examples are not exhaustive. Indeed, they are intended primarily to convey a sense of the range of possible applications, by also discussing concrete measures to address the underlying problems.

### **3.1. Improving Public Sector Performance**

#### **A. Improving Efficiency of Core Functions**

There are some functions, such as customs, prisons, preservation of significant historic and natural sites, social security, mass transit, and defense, which are almost universally accepted as public sector responsibilities. While government certainly cannot abrogate its obligation to ensure these are carried out, in some cases PPPs can be employed to enhance performance, often with lower costs or higher net revenues to government. As has been done in various jurisdictions throughout the world, the private sector can be employed to operate all or parts of customs services, prisons, parks, social services, and public utilities.<sup>14</sup> It is difficult to imagine private militaries, but there is scope for PPPs for support services, such as logistics. Somewhat more common are cases of PPPs in provision of municipal services. For a brief summary of international experience of private participation in provision of a wide range of municipal services (i.e., water and sewer in Mexico, drinking water in Turkey, and solid waste facility in Hong Kong SAR) see Bennett, Grohmann, and Gentry (1999). The three examples discussed below - which include: (1) preserving and developing historical sites, (2) maintaining country's scientific potential, and (3) improving environmental protection -

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<sup>13</sup> Obviously, there are instances where tasks in one sector involve contacts (or client-type relationships) with entities in the other sector. An example of this could be private sector mechanics (occasionally) fixing government-owned vehicles. These are not included in our definition of PPPs. However, a public-private partnership to supply vehicle repair services would be a PPP.

<sup>14</sup> We do not imply here that privatization is a panacea against all evils all the time. Without appropriate safeguards, costly abuses can result in any environment. For example, after privatization of electricity in California, companies such as Enron and El Paseo were able to artificially create shortages and raise prices.

are less common but just as illustrative of the potential of the PPP in helping the state to improve the efficiency of its core functions.

### **Preservation and Use of Historical Sites – A Case for Tourism Concessions**

There is a long history of using the concessions model with regard to archaeological and other tourist sites in the world. Egypt, Turkey, Greece, Mexico and several other nations have granted concessions to universities, foundations, and even private individuals to excavate and renovate sites. In many economies, private companies are granted concessions to operate restaurants, lodgings, conduct tours, and other functions in national parks (see, e.g., World Wildlife Fund 2000). Perhaps the most ambitious and successful use of concessions in tourism was the 20 year concession granted by the government of the Former Yugoslavia to develop tourism on the Montenegrin island Sveti Marko (Beilock and Nicolíć 2000). Similar approaches might be used in Armenia to lower the burdensome overhead of the country's historic and natural treasures and even turn them into revenue generators. The potential of tourism for Armenia is significant. Preliminary estimates for 2005 are for 300,000 tourists, contributing over \$150 million to the economy (Armenia Information). This represents considerable growth over previous years and prospects for continued growth are good.

The importance of Armenia's heritage is reflected by the fact that this tiny country has five sites on the World Heritage List,<sup>15</sup> in addition to over 1,000 archaeological sites, almost all of which are owned by the Armenian Church or the government. While there have been considerable efforts, particularly by the Church, to preserve and even restore some sites, for the large majority of sites there is no work and, more often than not, no protection. Both to preserve and increase knowledge about Armenia's history as well as to make sites more accessible and attractive for tourists, the government and the Church might consider a partnership for the purpose of granting one or more concessions.<sup>16</sup>

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<sup>15</sup> Haghpat, Sanahin, Geghard, Echmiatsin, and the Zvartnots archaeological site.

<sup>16</sup> Relative to Egypt, Greece, or even Mexico, Armenia is remotely located and, while in the aggregate its historic sites are significant, each site tends to be fairly small. For these reasons, to attract qualified (world-class) tourism industry operators, the government would be well advised to have only a few concessions (possibly only one), with each covering several sites. There are advantages for the state and the Church in having one or very few concessions. Dealing with fewer parties lowers complexity in negotiating and

In brief, responsibilities for concessionaires could include: (1) excavation, (2) preservation, including security, (3) restoration, (4) tours and other tourist services, (5) encouragement of independent tourist businesses (e.g., hotels and tour guides), and (6) advertising. Compensation for these could be in some or all of the following forms:

1. A [large] share of fees collected from tourists visiting the sites, controlled by the concessionaire, to provide incentives for enhancement of controlled sites.
2. A [small] percentage of all tourism-related revenues, such as landing fees and hotel taxes, to encourage generic advertising.<sup>17</sup>
3. Percentages of revenues collected by hotels and other services promoted by the concessionaire, to encourage development of other tourism providers.
4. Rights to show artifacts on tours in other countries (with the government and/or the Church retaining the ownership) and to publish research results, to encourage in-depth investigation of archeological sites.

The ideal concessionaire in this case would be a partnership between a university or research foundation and an international tour operator.

- **Sustaining the Scientific and Research Potential – the Case of CRO**

Armenia's image as the silicon valley of the former Soviet Union proved to be hard to sustain after its independence. Because virtually all research was publicly funded (and consumed outside of Armenia), drastic reductions in government revenues and disappearance of subsidies directly translated into less research by universities and institutes. Initial frustration of the scientific community with frequently unpaid wages and ever-declining appropriations failing to keep research centers afloat too often led to attempts to find employment opportunities outside of Armenia. Job offers were

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monitoring the agreements. Having one party overseeing several (perhaps all) sites promotes consistency. In addition, the more broadly defined the concession and its revenue sources, the more the concessionaire has incentives to do generic, rather than just site-specific advertising.

<sup>17</sup> This is important to give the concessionaire a stake in promoting tourism in Armenia in general. See section 3.2.B for a discussion on generic advertising.

forthcoming for the brightest Armenian scientists and engineers in Russia and Eastern Europe. Research in Armenia, as a result, has been in a state of disarray.

There have, however, been some scattered attempts to stop and even reverse this trend. One case where a PPP has been successful in preserving and furthering Armenia's scientific potential is the partnership between Armenia-based, state-owned Cosmic Ray Observatory (CRO) on one side, and the Armenian Engineers and Scientists of America (AESAs) and Bay Area Friends of Armenia (BAFA) on the other side. The primary role of the AESAs and BAFA has been to provide funds (or coordinate giving from other organizations and private individuals) to cover overhead expenses and facilities' maintenance at the CRO.<sup>18</sup> They have also assisted the CRO scientists in establishing contacts with other researchers and centers. Owing partly to this cooperation, in 2002 the CRO was named as one of the top five solar and cosmic ray research centers in the world, uniting approximately 80 scientists, technicians, and support staff. Although this is not the only example of PPP in the areas of research and development, cooperation between CRO, AESAs, and BAFA is a good example of how far a well-concerted effort could go in helping the state to improve the country's research capabilities. In 2003, from more than 800 projects submitted from 136 countries, CRO won the World Summit on Information Society Award in the e-science category. To continue expanding cooperation with international space organizations, CRO signed agreements with the European Space Agency (ESA) in 2004 and the UN/NASA/ESA in 2005. This involves the CRO in the preparation for the International Heliophysics Year in 2007. Specifically, CRO will design and produce a global network of space weather monitors, which will then be managed from the Aragats Space Environmental Center in Armenia.

- **Improving Environmental Protection – the Armenia Tree Project**

The Armenia Tree Project (ATP) was founded in 1993 under the umbrella of the Armenian Assembly of America to support the Armenian government's reforestation program (prompted by severe deforestation during the energy crisis in early 1990s). By then it became evident that even though the government made the issue of reforestation (and environmental protection in general) a priority, given the lack of public resources (as a result of almost 65 percent decline in GDP between 1989-1993), the government could not devote sufficient resources to address the issue. Yet despite these circumstances, early

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<sup>18</sup> The primary source of funding for CRO's research and training are foreign funded projects.

efforts by the ATP to work with the government failed to produce desired results. It soon became clear that sustainability of any environmental protection efforts would require greater state and community involvement than originally envisioned.

ATP has increasingly worked with local governments and individuals to develop its programs. Local government agencies assist the ATP in determining appropriate sites for tree planting, including hospitals, schools, orphanages, senior centers, and other public areas. Although ATP does not rely on local law enforcement to ensure protection of its project sites, it does encourage cooperation by offering incentives for the survival of trees: high survival rates can lead to the delivery of more trees, as well as increased amounts of tools and training provided by the ATP. Since then, through close cooperation with the government and local groups, the ATP has planted over 300,000 trees, employing hundreds to help replant the country's damaged forests and national parks; developed two nurseries; and established a fruit drying and distribution center.<sup>19</sup>

The success of the ATP projects demonstrate the significant contributions that can be made by PPPs in this area. As pointed out by Bell (2000), "by harnessing self-interest, and using informal incentives and discipline to enforce adherence to its rules and regulations, ATP is working - albeit on a small scale - where Armenian forestry laws are failing." As the project continues to gain legitimacy, community involvement can lead to greater public support for environmental laws and protection, thereby assisting the government in implementing at least one of its core functions.

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<sup>19</sup> In addition to these activities, the ATP developed a coppicing program in 2001. It worked to coppice public areas including the Genocide Memorial Park, the Botanic Institute of the Armenian Academy of Sciences, and the Martuni area of Lake Sevan National Park.



## **B. Affecting Law- and (Executive) Decision-Making Process**

PPPs can advance the economic, cultural, or social causes of private groups involved in the process. The latter may range from religious organizations to those focused on health or social issues to labor unions and business associations. These groups then can, in practice, help government to understand the needs of their memberships (however wide). They could also communicate rationales behind government policies to their memberships. It is for these reasons that governments have incentives to encourage formation of, and support for, these organizations.<sup>20</sup> Without it, advocacy is adversarial. An example of this is streamlining customs procedures. Creating and strengthening of groups such as the Association of Armenian Freight Forwarders can simplify the government's task in determining which services are needed from customs, and assessing user acceptance/rating of its performance.

Examples of dialog between the state and the private sector that led to procedural and legislative changes include the activities of “Astghik” Disabled Children’s Parent Union, which lobbied the government to make the design of public construction projects in Armenia more disabled-friendly, and the “Antenna” NGO, which successfully promoted changes in the Law on TV and Radio through an advocacy campaign.

The potential for PPPs in this area, however, is much greater and could include measures leading to across-the-board improvements in efficiency of law- and decision-making in Armenia. We will discuss three of them, which we believe have the highest potential in terms of their impact on shaping legal base and streamlining executive decision-making to induce growth and reduce poverty. These examples are Diaspora Agency, Anti-corruption Agency, and Public Policy think tank. Some design elements for each of these (in essence CONC-type) arrangements are discussed below.

- **Institutionalizing Diaspora’s Involvement – Design of the Diaspora Agency**

The potential role which Diaspora can play in Armenia’s domestic affairs as a source of physical and human capital as well as new mentality is hard to underestimate (Gevorkyan and Grigorian, 2003). With a steady flow of emigration from Armenia in

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<sup>20</sup> One of the side-effects of this relationship is the formation of special interest groups that aim at redistributing public resources to serve their own objectives. Issues related to special interests and ways to deal with them will be discussed in Chapter 4.

recent years, the term Diaspora is beginning to symbolize more than it did a decade ago, leaving more at stake for the government to react upon. The relationship between Armenia and the Diaspora has, however, so far been shallow and concentrated, far from being broad-based and systemic to maximize the benefits of Diaspora's involvement in Armenia.

A PPP could be designed to institutionalize a Diaspora-Armenia link with the aim of capitalizing on the full potential of the Diaspora. To be effective, the proposed Diaspora Agency will have to have a status of a Ministry, have wide executive powers and legislative rights. To benefit from partnership with the private sector (in this case Diaspora private and public groups and individuals), the Agency will have to have joint Diaspora and local (state-appointed) management. Its performance should be measured against the scale and the scope of Diaspora-led projects initiated with direct involvement of the Agency.<sup>21</sup> With a dynamic and goal-oriented management, the Agency will be able to identify and address main barriers to Diaspora involvement in Armenia and lay ground for more productive cooperation. The recent abolition of the ban on the Dual Citizenship in Armenia gives additional incentive to form the Agency as it allow for more active engagement of the Diaspora in Armenia. A successful example of a Diaspora agency is Israel's Ministry of Diaspora Affairs.

- **Weeding out Corruption – Design of Anti-Corruption Agency**

Despite widespread recognition that reduced corruption in Armenia will lead to sizable economic benefits, previous attempts to address the issue failed to generate any tangible results. The recently created committee was criticized by international observers and poorly received by the civil society. Apart from issues of political will and degree of tolerance, this outcome has to do with the lack of a designated agency to fight corruption. The basic design of an efficient Anti-corruption Agency in Armenia will have to satisfy a number of conditions. First of all, it will need a high degree of independence from political influence, particularly from sources prone to corruption. Second, to fully benefit from the experience and perspective of the private sector, in addition to reputable civil servants who enjoy wide public support, the top management will have to include private

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<sup>21</sup> The range of issues/projects that the Agency could facilitate may include designing volunteer and professional exchange programs, establishing Diaspora-funded investment and venture capital funds, and in the long-run also launching a sovereign "Diaspora" bond program (see Gevorkyan and Grigorian (2003) for a detailed discussion of these objectives).

sector Diaspora and local Armenian professionals experienced in law enforcement and judiciary. Third, the Agency will have to have its own security apparatus (an anti-corruption police force) to help isolate it from any type of unwanted external pressures. Fourth, while investigating large scale corruption deals, the Agency will have to have prerogative over local law enforcement bodies. (See Box 2 for a detailed account of Hong Kong's and Singapore's anti-corruption agencies.) Finally, the Agency could work in close cooperation with the office of Ombudsman, which Armenia introduced as a part of its Council of Europe membership requirements.

## **Box 2. Weeding Out Corruption – How Did Hong Kong and Singapore Do It?**

Any place where corruption thrives has much to learn from Hong Kong and Singapore. Once amongst the world's most corrupt places, they became two of its cleaner business centers. The main reason these two have succeeded where so many others have failed are that their fight of corruption began at the top and, just as critical, was removed from the hands of the police.

For years though, Hong Kong was a place where the great majority of the police took bribes while its British colonial governors appeared not to mind. By 1973, however, the level of corruption people would tolerate had been exceeded. The turning point in the corruption fight came in June 1973, when an internal investigation revealed that a senior police officer, Peter Godber, had managed to skim off \$550,000, or about six times his total net salary during his 20 years of police service. Outraged by the ability of Godber to escape to London and avoid arrest by Hong Kong police, people took to the streets. The implications were obvious. If Godber had been allowed to escape, the administration must be rotten right up to the top.

This was all that Murray MacLehose, the new governor, needed to snap into action. Four months after Godber's disappearance, MacLehose formed the Independent Commission Against Corruption (ICAC), took it out of the hands of the police, and had it report directly to him. The new organization had tremendous power of search and seizure (some of which are now subject to court orders), and anyone disclosing that investigation by the ICAC was underway was liable to prosecution under the anti-corruption statutes of the day. In 1975, Godber was apprehended in Britain, returned to Hong Kong and jailed. Eventually the ICAC would arrest 260 other Hong Kong policemen, and a long, sordid chapter in local history came to a much-deserved end.

Singapore's story is similar, if less dramatic. Its anti-corruption agency, the Corrupt Practices Investigation Board (CPIB), operates apart from the police and is based in the Prime Minister's office. Founded but dormant under British colonial rule, it only started gaining power as an effective anti-corruption tool in the 1960s and 1970s. A crucial difference between CPIB and ICAC is that the former did not communicate with the public, while the latter had a community relations department and depended heavily on public cooperation to pursue investigation.

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Source: Segal (1999).

### **C. Improving Management Of Inherently Private, But Government-Owned Assets**

At the time of Armenia's independence, in 1991, the GOA owned virtually all productive assets. Since that time, GOA has privatized most, but not all, assets which, in developed market economies, would normally be in the private sector. PPPs may be appropriate for managing remaining assets. This is particularly true because there is an inherent conflict of interest when a government operates a private firm because, at the same time, that government is charged with regulating that firm and being impartial between that firm and competing private sector firms.

- **Improving Management - the Case of Armenian Railway**

Fifty or so years ago, private ownership of railroads was the exception, at least outside of North America. Today, it is the norm. Recognizing the advantages of private sector management, on every continent, governments have either privatized railways entirely or granted long term concessions to private operators (e.g., see Kopicki and Thompson, 1997). Thus far, Armenia has attempted to improve the efficiency of its railway by moving it from a soft-budget agency to a state-owned enterprise with clear profit incentives. While this certainly has been a step forward, it falls far short of that which could potentially be achieved through contracting for a truly private operator.

Virtually all Armenia's rail freight is for cargoes moving between the vicinity of Yerevan and Georgia's Black Sea Ports. At the current time, the Armenian and Georgian national railways individually handle the portions of these movements which occur on their systems. The potentials for coordination problems and conflicting incentives are obvious and are reflected by often lengthy delays at the interchange between the two railways at Ayrum/Sadakhlo, see Beilock (1998).

An interesting possibility might be a concession to operate trains between Georgia's Black Sea ports and Yerevan.<sup>22</sup> The grantors of the concession would be the two national railways and the concessionaire would be a private operator. The Customs Services of the two countries and the Georgian port authorities may also be involved, since streamlining their work would significantly improve service. The range of

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<sup>22</sup> It should be underscored that what is described here would not be a privatization of the railway nor even operational control over tracks, rights of way, and most or all equipment.

possibilities for such a concession is quite wide. At one end of the spectrum, the concessionaire might be, in effect, a transport broker with special privileges to and obligations from the railroads, customs, and the ports. Under such a scenario, the concessionaire would lease all locomotives, rail cars, and the rights-of-way. At the other end of the spectrum, the concessionaire would own and operate the trains, including the locomotives, as well as their repair facilities. In this case, only the rights-of-way would be leased from the national railroads. In between, the concessionaire would own, operate, and/or maintain some types of equipment if and as they are able to do so more cost effectively than the national railroads.

It should be stressed that this is not a pipe dream. Mexico has granted concessions for U.S. railroads to operate into their country. Also, several pairs of nations in Africa have or are in the process of forming transnational concessions. Among these are Cote d'Ivoire and Burkina Faso, Senegal and Mali, Benin and Niger, and Malawi and Mozambique (Thompson, 2000). Further concessions in progress are Ghana, Kenya, Uganda, Tanzania, and Ethiopia (Bullock, 2005). For transnational concessions, and as would most likely have to be the case for Armenia and Georgia, they are brokered by an International (Financial) Organization, such as the World Bank.

### **3.2. Improving Private Sector Performance**

Certainly, government's primary function for enhancing private sector performance is as referee, enforcing reasonable rules of the game. But government may take a more active role to mitigate market failures and ensure provision of services and facilities necessary for an efficient and internationally competitive private sector. An interesting example of this is Fundacion Chile: A three-way partnership of the Chilean government with private enterprise and the academic community.

#### **A. Reducing the Knowledge and Information Gaps**

In developing and transition economies, private sector performance is typically compromised by insufficient availability or quality of business support services, such as accounting, legal and information technology-related services, credit and financial advice. Therefore, businesspersons will most likely benefit from training in areas like management, financial planning, and marketing. It is common for government to become involved in meeting these needs, frequently in cooperation with the private sector. As

this is primarily work of a remedial nature and rarely is inherently profitable, private sector partners assisting the government in addressing these shortcomings may be non-profit NGOs.

In addition, private sector performance can be impaired due to insufficient information and/or information asymmetries. For example, farmers in rural villages may make poor production decisions and/or be disadvantaged when selling their produce to intermediaries due to lack of timely market information. In such circumstances, government may provide such information, either directly or by contracting with a private firm.

- **Reducing the Knowledge Gap - Development Associates**

Lack or inadequacy of private sector skills necessary to run modern businesses have driven many governments in developing and transition countries to seek international assistance to educate the private sector about complexities of modern business environment. As a result, various international organizations and donor agencies have set programs to promote business development in developing countries. Experience of these agencies, however, shows that the quality of assistance is higher the closer the incentives of those aid agencies and their clients. Unfortunately, these agencies are poorly prepared for designing approaches to exploit constantly changing business opportunities in developing countries, therefore prompting a never-ending search for a better assistance strategy.<sup>23</sup>

An alternative approach is being proposed to overcome these problems. The heart of the program (outlined in detail in Beilock and Grigorian, 2003) is a cadre of experienced businesspersons recruited from developed countries (called Development Associates or DAs) to seek out and exploit opportunities for increasing business activity within developing countries. DAs – recruited in case of Armenia among highly skilled Diaspora business professionals - would work directly with businesses in Armenia which are wholly or predominantly locally owned. Selected based on their skills and the needs

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<sup>23</sup> Programs to promote business development and incorporate should incorporate, as much as possible, decentralized, self-interested decision making. Only this can provide the capacity to identify business opportunities, the intensity of effort to fully exploit them, and the flexibility to adapt to changing conditions. These are functions at which government and government-like bureaucracies, including aid agencies, are poor.

of the local company, the DAs would be assisting companies in one or more activities, such as product design, marketing, financial reporting, and others. In addition to facilitating a transfer of skills, the DAs would be able bring in financing in the form of equity investments or loans to be made available to DAs through government controlled foreign assistance money, making this an example of public-private cooperation.<sup>24</sup>

The most unique feature of the proposed approach is to raise the intensity and improve incentive structure behind the developmental assistance. For the time and efforts spent with local companies, (in addition to their fixed salary) the DAs' would receive performance-based compensation through the following possible mechanisms: (1) ownership of the "above-normal" returns to equity investments made available through donor funding, (2) full ownership of returns to equity investments by DAs using their own personal monies, and (3) revenue sharing agreements between DAs and companies they assist.

## **B. Correcting Inefficiencies Related To Collective Action Problems**

Collective Action problems are due to externalities which take place when an agent is not charged fully for the (costly) outcomes of his/her actions, or he/she enjoys the benefits from actions of others without having to pay for those benefits. Externalities are also said to be present when the agent does not receive full benefits from his/her own action, after bearing the full cost of it. A classic example of collective action problem (or free-riding) is generic advertising. It is in the interest of the Areni Wine Company to advertise the virtues of its own wine, as well as those of Armenia in general (i.e., generic advertising). Clearly, to the extent the former persuades customers of Areni Wine's virtues, the firm benefits. Likewise, information about the desirability of Armenian wines generally should enhance the desirability of Areni Wine. Other Armenian wine producers, however, would also share these benefits. Areni would bear the full cost of generic advertising, but reap only a portion of the benefits. As such, Areni Wine would be less likely to invest in generic than own-firm advertising and, indeed, would prefer not to facilitate free-riding from its efforts, but to be a free-rider benefiting from the efforts of other firms. With firms sharing Areni's perspective, there will be less generic advertising than optimal, that is, necessary to maximize total industry returns.

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<sup>24</sup> DAs will also be encouraged to invest their own personal funds to establish a stronger bond between the local companies and themselves.



Another manifestation of collective action problems is when there is common resource use. A problem with common resource use arises when a fisherman catches a large number of fish from Lake Sevan - he receives all benefits from use or sale of his catch, while sharing the costs associated with reduction in the fishery's potential with all those using the lake. If he were to consider the total costs of his actions, he would catch less than what he does now, guaranteeing at least a constant or even increasing stock of fish. When there are several fishermen pursuing their individual benefits, the common resource – the stock of fish – faces the risk of extinction, which carries heavy costs for the society as a whole.

- **Addressing Collective Action Problems - Wine and Fish**

The assignment of property and/or management rights is key to the solution of common resource problems. In some cases, the government can resolve the problem internally, by establishing special-purpose agencies to manage a common resource. National parks are one such example. It often is more beneficial, however, to involve the private sector by creating associations that take responsibility for certain activities related to the management of common resources in a way that benefits all users.

In the case of advertising Armenian wines, an industry association might be formed to take advantage of a mutually beneficial publicity campaigns. Such an association might work in partnership with the government's export promotion agency in their attempts to increase international sales of Armenian wines. The government could undertake this activity itself, but it is more likely that a consortium of private producers would know better the demands of their customers, and, therefore, be more successful at designing advertising campaigns and, more generally, internalizing other industry-related externalities.<sup>25</sup>

For the Lake Sevan cooperative of fisherman might serve well to establish limits on quantities of fish caught. Fishermen might be best qualified to police each other's behavior, since they are in close contact with each other and can easily monitor the behavior of their peers. In principle, the development of individual private fish farms is

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<sup>25</sup> Still, the government might have a useful role in discouraging free-riding through its taxing authority (e.g., taxing all exported wines to cover expenses related to generic advertising) or by requiring all suppliers to be members of the consortium.

another way to internalize the externality of over-consuming the public resource (i.e., the stock of fish in the Lake). By siphoning a small quantity of the natural resource for private (re)production, fishermen effectively eliminate the potential social costs of their profit-seeking behavior: within the limits of their own individual farms they will be the only ones to bear the full cost of over-exploiting their private stock of fish.<sup>26</sup>

In sum, there is potential for public-private cooperation. The assignment of property and management rights is critical in all of the cases, and the creation or involvement of user groups and associations (created as MCs or CONCs) often is the best option to ensure (public) efficiency.

### **C. Reducing Problems Related To Small Size And Thinness of Markets**

Perhaps as a consequence of thin domestic markets and difficulties accessing the external ones, the overwhelming majority of Armenian firms are very small. In some instances where the fixed costs of accessing foreign markets (e.g., expenses related to marketing abroad, export/import licenses, etc.) are high, size could be an important deterrent on small and medium size firms' from selling goods outside of Armenia. In these cases, PPPs could be successfully used to facilitate formation of larger scale units, either as independent businesses or to carry out sets of functions that benefit from having pronounced economies of size. Examples of this include agricultural cooperatives for purchasing inputs and/or processing and marketing products. Particularly in the case of emerging industries, such as tourism, PPPs could be of advantage for licensing firms to ensure that the number of firms does not overshoot the extent of the market. Such entities could also be employed to ensure standards, provide generic advertising, and act as an agent to facilitate matches between customers and vendors.

- **Addressing Small Size and Thinness of Markets – The Case of Tourism**

Relative to the size of its GDP, the potential for Armenia's tourist industry is significant. However, the thinness of the current market creates barriers for suppliers, particularly smaller providers unable to spread the fixed costs of aggressive marketing campaigns over a large number of clients. With the celebration of the 1700<sup>th</sup> anniversary

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<sup>26</sup> To the extent that there are economies of scale to production of fish, establishing cooperatives of fishermen might be a more optimal option to follow than individual fish farms.

of adoption of Christianity, 2001 was a banner and unusual year for Armenian tourism, with approximately 120,000 international tourists visiting the country. A more typical number in recent years has been 40,000-50,000 international tourists per year, which is only equal to the number of entrants in one morning at Disney World's Magic Kingdom.

For the Hotel Armenia and a few of the other flagship hotels of Yerevan, the small total numbers are certainly a problem. But a large percentage of all international tourists use these hotels for at least part of their visit so each of these hotels is assured at least some flow of clients. Consider, by contrast, the magnitude of the problem for a Bed and Breakfast or other small operator in more remote locations, such as Meghri or Kapan. For such businesses, the markets may be impossibly thin, with months or even a year passing before a tourist happens upon their establishment. With little ability to market their services widely, formation rates for these firms will be low and failure rates high. It is a classic chicken and egg problem: without a reasonably reliable stream of tourist, small tourism providers will not develop throughout the country and without these, the tourists will not come. A central tourism concessionaire which is, in part, charged with promoting the development of small tourism providers could break this deadlock.

Such a concessionaire was described above under the section on Improving Efficiency of Core Functions. In that discussion, the primary focus was on a concessionaire to manage and develop archaeological sites. However, the concession could also include authority to oversee other types of tourist sites or, at least, have responsibility for generic marketing of those attractions. That concessionaire would have a large number of international tourists as clients. Given incentives to promote other tourism operators (perhaps through percentages of their revenues and/or shares of tourism-related taxes), the concessionaire would be motivated to direct sufficient numbers of tourists to tourist operators it endorses to ensure their viability. For a more detailed discussion of this approach, see Beilock and Nickolic (2002).

#### **D. Ensuring Quality And Adherence To Standards**

Of increasing importance for the private sector is information and assurances about quality. Are the cattle from that vendor disease free? What kind of services can I expect from that hotel in Sisian, Yerevan restaurant, or hospital in Gyumri? And if I do not get what was promised, what recourses do I have? Establishing and enforcing standards, has been a function of government since at least Hammurabi. This can take

several forms. At one end of the spectrum, government itself may dictate standards and carry out all certification and enforcement activities. This is most common when there are significant safety risks associated with substandard service performance or material quality. At the other end of the spectrum, government may sanction, sometimes even tacitly, the development and enforcement of standards by a formal or informal industry association (examples may include private sector professional groups providing licensing in their respective areas of expertise). Usually the solution involves a PPP of some sort, with the private and public sectors sharing responsibilities for creating and monitoring standards.

The potential for PPPs in this area cannot be overstated. Across virtually the entire spectrum of goods and services in Armenia reliable information about quality, much less mechanisms to maintain standards, are essentially non-existent. As such, many goods and services are sold as reputation goods, with quality judged by the word or experience of individuals buyers trust (Satterthwaite, 1979). Moreover, information asymmetries regarding quality tend to erode attained quality standards and reduce overall levels of market activity (Akerlof, 1980). For these reasons, establishment and monitoring of quality standards can potentially benefit all parties - consumers, producers, and government. As discerning quality becomes more difficult the more remote the buyer is from the seller, increased information and certainty about quality would be expected to impact strongly and positively on exports.

- **Ensuring Quality and Adherence To Standards - From Tourism to Food and Medicine**

The tourism concessionaire discussed in the previous subsection, would be in an ideal position and have incentives to establish and monitor quality standards. As the officially sanctioned overseer of Armenian tourism, the concessionaire would likely be trusted more than an unknown vendor from a distant town. Moreover, the concessionaire's rating system could be applied across a wide range of outlets, offering the added benefit of affording clients both absolute and relative assessments of alternative offerings. The concessionaire would need to monitor quality in outlets it recommends and it would be little effort to translate this into a rating system, with that investment offset by greater ease when communicating with clients. Finally, the concessionaire could sell its service of giving ratings to other vendors. Another alternative for instituting and maintaining such a rating service would be an industry association. Examples of

industry associations controlling quality and licensing their members as a result of the “quality checks” include a wide range of specialized medical and dental associations in the US, with their respective National Board Exams and certification procedures.

PPPs could be used to develop public-private agencies or industry associations to establish and monitor quality standards across a wide range of goods and services. Possibilities for this include services to rate and monitor: (1) restaurants, (2) food quality at retail outlets,<sup>27</sup> (3) physicians and/or hospitals, (4) retail petrol vendors, and (5) jewelry and other high priced handicrafts (both for export and also for local markets, such as the Vernisage). One organization that is doing this is Made in Armenia Direct (MIAD) ([www.madeinarmeniadirect.com](http://www.madeinarmeniadirect.com)). In addition to the primary purpose of distributing artisan works globally, MIAD works with other PPPs in funding projects. Proceeds from sales help support two projects previously mentioned: Cosmic Ray Observatory, and the Armenia Tree Project.

#### **4. Special Interests: From Barriers to Development to Engines of Growth**

At the most general level, any party, whether an individual or an organization, with a unique set of goals and the will to act toward the furtherance of those goals may be defined as a special interest (SI). If the goals of a special interest are consistent with a desired action, the special interest can be a ready champion and partner. On the other hand, a special interest with conflicting wants will be a detractor and may create barriers. In almost any setting and for any desired action, the responses of special interests have to be taken into account. Accounting for special interests in PPPs is the topic of this chapter. In well-established political and economic settings, special interests often are easily identified and their reactions may be constrained and regularized by custom and law.<sup>28</sup> In developing and transition countries, identifying special interests can be problematic and there may be few constraints on, and potentially high social costs of, their actions. For these reasons, addressing issues related to special interests are particularly important.

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<sup>27</sup> Such a service could be of particular value with regard to foods highly susceptible to spoiling or contamination, such as meats and dairy products.

<sup>28</sup> Examples include procedures for filing complaints and comments about planned construction, laws guarding against conflicts of interest, etc.

#### 4.1. Strategies For Dealing With Special Interests

Special interests may be dealt with through any of four basic strategies, as well as mixed strategies:

1. **Suppress/Destroy** – this is appropriate when a special interest can do appreciable harm and is vulnerable to repressive measures. This strategy is most frequently employed when a special interest is viewed as being morally objectionable and/or when it is believed that the costs of not suppressing would be exacerbated by (the encouragement of) similar activities.
2. **Ignore** – this is appropriate when a special interest has little power to influence the situation and/or when the costs of effecting any other strategies exceed potential gains.
3. **Buy Off** – this is appropriate when the net gains to both the special interest and the party that pays the special interest to alter its behavior are positive. This suggests both that the negative effects of the special interest's actions are recognized by the other party and that there are significant costs for the special interests in carrying out these actions.
4. **Make Part of the System** – this is appropriate when the special interest's goals are consistent with or complementary to those of the other party. Moreover, in some circumstances it may be possible to develop reward systems which make consistent/complementary behaviors more attractive.

With this framework in mind, in this Chapter we will explore how PPPs could be used to address a wide array of special interests. Before that, we briefly discuss the multiple types of special interests which may be found in individual organizations.

## **4.2. Basic Definitions**

### **A. Core Functions**

In the political/economic context, a special interest is usually portrayed as an entity having a single, well-defined objective or set of objectives. We will refer to these as core functions. Examples include, a firm seeking to increase its profits, a regulatory agency seeking to assure adequate supply to all at reasonable prices, an NGO working to improve health, and a business association endeavoring to maintain standards among its members.

An entity may have one set of core functions, acting on its own, and a different, though usually related, set of core functions when acting as a member of a larger special interest. For example, a freight forwarder might work for expansion of its fortunes by seeking entirely new business, wooing business from its competitors, and currying favor with the authorities. That same freight forwarder may, as part of an industry association, work toward more transparent and equitable laws and procedures which would assist all freight forwarders and, indeed, hamper its own individual efforts at securing special advantages. Why would the freight forwarder's behavior within the association be so different, in some ways conflicting, with its behavior as an individual firm? It is not that the underlying goal of the freight forwarder to maximize its own net worth magically transforms. Rather, when advantage can be wrested from others through any means, legitimate or otherwise, that freight forwarder has incentives to do so.

Such environments, however, bear risks from official punishments for illegitimate acts as well as from competitors taking similar measures to acquire the freight forwarder's customers. Risk normally imply costs. This is both because of risk-averseness and expenses associated with carrying out and concealing illegitimate actions and protecting itself from those of others. As the costs become larger, illegitimate actions become harder to conceal and, importantly, the entities have more to lose from illegitimate actions of others and become more tempting targets for such actions. This is exactly the mechanism which leads successful crime organizations to become legitimate businesses. The trick, of course, is to develop opportunities in which the advantages from such cooperative ventures are recognizably real.

### **B. Territoriality and Shirking, Corruption and Criminality**

In theory, entities (public or private) single-mindedly work to advance their core functions, without significant efforts toward other goals. Reality is more complicated. While organizations do, in general, devote their main efforts toward their core functions, they may also seek to maintain and enhance their prestige and control of resources beyond that necessary for, or consistent with, maximizing core functions. We call this territoriality. This tendency is evident across virtually all areas of human endeavor and in some cases territoriality could take a great deal of efforts from entities in addition to those directed towards the core function. Those performing these divergent behaviors may be viewed as special interests. From the standpoint of their organizations and those served by those organizations, such behaviors are parasitic. At one end of the spectrum is shirking, while at the other end are corruption and criminality. In between these two extremes, there are different types of special interests whose rent seeking takes a combination of effort minimization and bribe maximization. The legal limit is somewhere in the middle – those crossing that limit are against the law. But no matter where on this scale the special interests are located, they can sap gains from organizations, and to the extent that they require "to be fed" by public resources, they may result in funds being channeled away from publicly desirable (i.e., first best) outcomes.

To the extent, however, that a PPP can alter incentives systems to reduce shirking and/or corruption, there is potential for mutual gain, the basis for any partnership. Note that this spectrum of special interests is almost as wide as the menu of choices to deal with them discussed in section 4.1 above. In the case of shirking, to the extent that special interest's goals are consistent with, or complementary to, those of the organization, it can be made a part of the system. In some circumstances it is possible to develop reward systems which make consistent/complementary behaviors more attractive. For example, it may be possible to turn (threat-based) petty bribery into a performance-based payment system. Changing the 'game' for customs officers from delay and extortion to expediting for a premium (via special express lanes) is such an example. Also, installing incentive payment schemes for transit workers to cut down on shirking and poor attitudes toward customers is another example of how to make special interests a part of the system.

The other extreme of the special interest spectrum, severe corruption and criminality (the "bad guys") will need to be handled differently. The logic behind this is simple: any above-zero level of tolerance towards the "bad guys" will encourage similar behavior and increase the costs of handling them in the future. Suppressing or destroying



them would be the proposed course of action in this case. But what would make a program against the “bad guys” a success? Section 3.1.B and Box 2 above provide a useful point of departure for designing a PPP capable of tackling these issues. In a nutshell, however, for a public-private cooperation against corrupt special interests to be effective, the programs will have to:

1. enjoy unlimited support from and ownership of country’s top leadership,
2. be unexpected, swift, and decisive, with the agency in charge of the program given wide executive powers (at least in the beginning),
3. have an active public relations campaign running alongside the main search-and-seizure actions, to provide the general population with up-to-date information and solicit feedback and evidence on possible corruption cases.

The above (necessary) conditions, however, would have to be accompanied by other transparency-enhancing measures and institutions (such as, annual income tax declarations by senior officials, well functioning unified property registry, laws preventing active ownership of private sector assets by members of the parliament and key cabinet members, etc.) to guarantee success of the program.

## **5. Summary and Conclusions**

The paper first explored the underlying conditions needed for potentially advantageous Public Private Cooperation (PPP). Next, the advantages and disadvantages of alternative structures for PPPs are examined. The paper divides the PPPs between those that would enable the public sector to improve its efficiency, and those that will assist the private sector’s quest for growth. Building upon this framework, existing and potential PPPs for Armenia—to include partnerships with business associations, NGOs, and the Diaspora—are discussed. Consideration is given to the influence of special interests on PPPs as well as roles for PPPs in containing the impact of special interests. In discussing this topic the paper offers a menu of choices to deal with special interests, and conditions under which those choices would be appropriate.

Key findings of the paper can be summarized as follows:

1. As with any partnership, mutual advantage is gained from having partners offering different types and relative amounts of assets and talents. They can be particularly advantageous when the strengths of partners can offset weaknesses of other partners. Such complementarities and resulting potentials for mutual advantage are present in any society. Potential for PPPs is particularly good in Armenia due to:
  - a. A broad range of general transition- and Armenia-specific problems that limit government's ability to act as a push factor for growth,
  - b. At best a slow development of public and private capacities and yet still significant gaps and weaknesses in the domestic private sector, and
  - c. Large potential for increased cooperation with the Diaspora, NGO community, and foreign stakeholders (e.g., companies and governments).
  
2. PPPs can be of advantage to help the public sector improve the efficiency of:
  - a. Its core functions
  - b. Law-making and (executive) decision-making
  - c. Inherently private, but government-owned assets
  
3. PPPs can be of advantage to help the private sector to:
  - a. Reduce knowledge and information gaps
  - b. Minimize collective action problems
  - c. Reduce the negative effects of thin markets
  - d. Ensure quality and adherence to standards
  
4. Special interests can be positive engines for change (insofar as they can encourage PPPs and generate benefits outweighing the costs of their transformation) or obstructionist/parasitic. Through the broader viewpoint and range of talents afforded with PPPs, the positive impacts of special interest can be enhanced and negative effects controlled.

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**TABLE 1: COMPARISON OF PUBLIC AND PRIVATE CAPACITIES AND ASSETS**

<b>ITEM</b>	<b>PUBLIC/PRIVATE COMPARISON</b>	<b>COMMENTS ON ARMENIA</b>
<b>Human Talent</b>	Throughout the world and across virtually all areas, the pool of talents in the private sector tends to be richer than that in government. It should not be inferred from this, however, that non-government individuals always have superior talents or are always preferable to those working in government. While the pool of talent is larger in the private sector, there are some highly trained, experienced individuals working in government.	For Armenia, this is likely to be particularly true because of low salaries for government employees and potentials for drawing on overseas private sector talent (especially Diaspora) as well as from domestic sources.
<b>Incentives and Intensities</b>	A government employee is charged with enforcing the policies of his/her agency. While those policies may advance the fortunes of the agency, ideally they should do so only to the extent that the agency's fortune is coincident with those of the public. In part to ensure independence and objectivity and in part because of budgetary and other difficulties designing appropriate incentive structures, typically official compensations to government employees only weakly reflect their attained performance. On the other hand, those in the private sector expect compensation to be strongly related to effort and they endeavor to maximize returns to themselves, either directly or through their firm or organization. <sup>1</sup> As a result, the intensity of effort from private sector workers is generally higher than for their government counterparts. Again, it should be stressed that there are always exceptions to this rule. Moreover and importantly, there are situations in which the broader, more objective viewpoint of government workers is preferable and others in which focus and intensity are the most desirable qualities.	Budgetary constraints on GOA have resulted in extremely low wages for government employees, with few, if any performance-based incentives. Indeed, these wages have, in part, precipitated a serious corruption problem, with some government employees dividing their efforts between their work in behalf of the public and using their positions to extort the public. For this reason, PPPs using private sector workers may be particularly advantageous.
<b>Financial Assets</b>	Given sufficient incentives, the private sector has access to almost limitless financial assets.	This can be particularly advantageous from the standpoint of a government, such as Armenia's, intent upon limiting its debt burden.

**TABLE 1: COMPARISON OF PUBLIC AND PRIVATE CAPACITIES AND ASSETS**

<b>Physical Assets</b>	<p>The private sector, of course, possesses a wide range of physical assets. Of particular importance, in this regard are assets, such as sophisticated machinery, unavailable to the government, at least without incurring debt.</p> <p>In all nations, the government possesses significant physical assets for which there are only imperfect private sector substitutes, for example public lands of historic importance or with unusual natural features.</p>	<p>In transition economies, such as Armenia, the government also possesses assets such as factories, hotels, railroads, farms, and other productive assets.</p>
<b>Knowledge</b>	<p>The private sector may also possess knowledge unavailable to the government. This does not only include technical knowledge, such the formulation for a better fuel mixture, but management skills and market information.</p> <p>Governments also can possess unique information. All governments collect and compile data, such as customs records. Invariably, some of this information is withheld from the public.</p>	<p>The disruptions and isolation of recent years, combined with GOA's austere budget make likely that there are many areas where it could gain from knowledge acquired through PPPs.</p>
<b>Guarantees, Assurances &amp; Enforcement</b>	<p>Where information is not readily available and risks are or are perceived as significant, the ability to provide convincing guarantees or assurances can be important. Included in this are defining and certifying attainment of quality standards. Based upon its reputation and/or financial strength, a private entity may be in a position to provide assurances or guarantees impossible for a government.</p> <p>On the other hand, government may be uniquely able to monitor some types of activities, such as border crossings, and to enforce standards or conditions.</p>	<p>These points are relevant for Armenia. For example, an international tour operator may be better able to convey the quality of Armenian tourist facilities worldwide than could GOA. On the other hand, GOA could enforce structures, such as agricultural marketing orders, better than the private sector.</p>
<b>Rights</b>	<p>Certainly, legal systems grant and enforce rights for the private sector. However, these rights usually can be enjoyed by government units. In addition, governments have additional rights, such as eminent domain, and the ability to dictate additional ones. For example, a government could assert a right to regulate an industry.</p>	<p>For Armenia, the ability of GOA to assert rights could be of use to facilitate reduce uncertainties, problems associated with thin/small markets, externalities, and free-rider problems.</p>

**NOTES:** The private sector includes non-for-profit NGOs. Such organizations, as well as their employees, may derive part or all of their compensation in the form of psychic or other rewards related to the advancement of social or cultural causes.

**TABLE 2: PPP ORGANIZATIONAL ALTERNATIVES**

Type	Description	Example	Relative	
			Strengths	Weaknesses
Non-Invasive Cooperation (NIC)	Cooperation in which none of the cooperating organizations assumes authority over all or part of other cooperators.	<ul style="list-style-type: none"> <li>Government agency and NGO divide territories to effect emergency relief.</li> <li>Public and private entities align shipment schedules to take advantage of volume discounts.</li> </ul>	<ul style="list-style-type: none"> <li>Easily established and ended</li> <li>Avoid ‘turf’ battles as do not alter internal managements of organizations.</li> </ul>	<ul style="list-style-type: none"> <li>May not take full advantage of comparative advantages of the cooperators.</li> </ul>
Management Contract (MC)	The hiring of external management (in this case from the other, normally private, sector).	<ul style="list-style-type: none"> <li>Government hiring private sector managers to run a state-owned utility.</li> <li>Government contracting with a private sector firm to run a generic advertising campaign, such as to promote tourism.</li> </ul>	<ul style="list-style-type: none"> <li>As no investments sought, relatively easy to attract bidders.</li> <li>Contractor retains clear control.</li> <li>Contractual arrangements can cover a wide range of considerations.</li> </ul>	<ul style="list-style-type: none"> <li>With no investment, it may be difficult to ensure that manager incentives correspond with those of the owners. This is particularly true toward the end of the contract period and if the owner also has non-economic objectives, such as cross-subsidies to disadvantaged groups.</li> </ul>
Concessions (CONC)	Identical to MC, but concessionaire required to make investments	<ul style="list-style-type: none"> <li>Government hiring a private sector firm to manage a State-owned hotel, with that firm obligated to make investments.</li> </ul>	<ul style="list-style-type: none"> <li>With investments, management has incentives to act more like owners.</li> <li>Contractual arrangements can cover a wide range of considerations.</li> </ul>	<ul style="list-style-type: none"> <li>As investments are sought, attracting bidders may be more difficult than for MC.</li> <li>End of contract period incentive problems similar to MC.</li> </ul>
Joint Stock Companies	Private and public sector entities holding stock in one corporation	<ul style="list-style-type: none"> <li>Government maintaining partial ownership in effectively privatized firms.</li> <li>Government and private sector entities sharing costs and splitting ownership to develop a new road or airport facility.</li> </ul>	<ul style="list-style-type: none"> <li>Liquidity, ease of altering ownership structure, particularly if stock listed on a recognized exchange.</li> </ul>	<ul style="list-style-type: none"> <li>Being a JOC does not, in itself, convey the management structure.</li> </ul>