

## Statement by **Mr. Siim Kallas**, Vice President of the European Commission

7<sup>th</sup> Global Forum on Reinventing Government  
Vienna, Austria  
June 2007.

The European Commission is the executive arm and the initiator of legislation for the European Union. It also is responsible for the management of the EU budget, more than €110 bn per year. Its activities cover a wide range of programmes and actions, from agricultural subsidies to regional policy, foreign and humanitarian aid, to funding scientific projects and student mobility grants. In Siim Kallas' function as vice president in charge of administration, audit and the fight against fraud, he is the face of the European Commission vis-à-vis the European parliament and the Ministers of member states. When it comes to accountability of how the money has been used and how the systems have function. It won't therefore come as a surprise that he is acutely aware of the need for sound and efficient management and the impact any mishap can have on the trust the public has in the European administration and project as a whole. It takes years to build a good reputation and a single moment to destroy it!

The European Commission is deploying various activities to build trust from its citizens. It is essentially targeting the general public and voters. He has been very active in promoting the concept of transparency as a means of enhancing trust – both through disclosure of the end beneficiaries of EU grants, allowing the public to see how their money is used, and via increased transparency on lobbying. This is important to ensure we know what interests lobbyists really represent, and how much money they have at stake.

The topic of this speech allows him to look at another important aspect of building trust in government: the use of public private partnership – PPP. They have a role in building trust both with the general public but also with the business partners as stakeholders, he will discuss the experience of the European Commission in cooperating with the private sector. In doing so, I want to highlight both the advantages and risks of PPP.

Public administrations have always looked for the best possible ways to implement their policies. There have been waves of nationalization and then privatization. The latest fashion seems to be public-private partnership. In part this is because they are seen as overcoming the limitations both of conventional procurement processes, and of traditional direct provision by the public sector.

Cooperation between Public and Private Sector has many forms. In Europe at least, many important areas of social and economic activity are to a considerable extent either provided, or closely controlled, by the state – education and health care, key elements of transport infrastructure, security provision and to a perhaps decreasing extent utilities etc. Public sector activities account for in excess of 40% of GDP across the EU. Given our notions of social justice and the need to effectively share resources (in particular land) and maintain social cohesion in a densely populated, highly urban continent, this situation is unlikely to change dramatically.

But if the state is to be connected with such a large range of activities, it is vital for reasons of both for economic efficiency and public faith in the governmental process that it does so effectively.

In the past – Nationalization then Privatization – both failed to meet needs of population.

Thus other approaches have been developed, whose essential idea is that there are fields of activity where the skills and role of the public and private sectors are complimentary – and thus that there are advantages in working together to deliver a project. PPP in fact takes various forms and we should not only look at joint undertakings.

Initially, the methods chosen were to promote contracting out and licensing. Procurement is another interaction between public and private, whereby the public sector is a customer whose influence on the market is larger than usual. The Commission has promoted this for many years, making it mandatory for EU Member States by a series of

directives – EU Laws. We have used our procurement rules to drive economic efficiency, by promoting open competition between firms at EU level. The process was also intended to accelerate the development of a single genuinely integrated EU economy. Correctly executed, new ways of smart open procurement ensure that innovative ideas are rapidly adopted across the continent, and that the leading suppliers can develop real expertise and economies of scale.

Correctly implemented public procurement has the potential to increase trust in government – by helping to ensure that tax revenues are not wasted on supporting inefficiencies, or by breaking the unduly cozy relationships which existed between governments and preferred suppliers (sometimes “national champions”).

There have been other forms of PPP cooperation. In 2004 the Commission and 10 member states signed an agreement with PMI to fight counterfeit and smuggling of cigarettes. This was a landmark agreement, whereby law enforcement and a leading manufacturer decided to cooperate in tracking and tracing products and ensuring that sales were only made in legal channels. All but one of the 27 EU member states have joined the agreement in the meantime, and it is a very promising avenue for cooperation between public and business where their interests meet.

More recently institutionalized public-private partnerships – PPP – which take various forms of joint legal entities, are increasingly being used by governments around the world to deliver both public services and economic development and research projects in an innovative way. The objective has been to find a modus operandi which overcomes the limitations both of conventional procurement processes, and of traditional direct provision.

Over the last decade or so, public administrations have also undergone substantial reform and have in their structures, become more similar to private sector enterprises. The development of the PPP approach has probably been supported by the trend to import private management techniques into the public sector. Much more than in the past, this

means that public and private sector partners have a common “language” as regards management techniques, risk identification and sharing, project management, etc. The door is therefore open for joint projects.

For the public sector, PPP, by leveraging private as well as state capital, can allow limited state resources to be spread more widely – and since government can thus deliver more, its public standing is again improved. In innovation focused partnerships PPP will allow the development of marketable products, by benefiting from commercial knowledge that is mostly absent in the public sector. By putting their money in the same basket as leading international companies, the public sector may show to its citizens that the underlying business calculations are sound and the project viable.

To the private partner, PPP offer the attractiveness of political endorsement and prestige for projects and ensuing publicity, longer term stability and the public sector’s support in cross border cooperation. Some financial aspects can also be attractive.

If however we are to realize the potential benefits of partnership, we must also acknowledge the potential difficulties.

Effective governance arrangements are key – and the process of establishing and working them is of itself very important in building understanding and trust between public and private partners.

The structure must be as simple as possible and bureaucracy limited. Industrial experience can be important in this regard, though it is also important that the industry partners understand the different and often extensive needs of the public sector in terms of accountability.

More generally, the principles of competition, openness and transparency should be reflected in the governance structure – this is particularly important in PPPs in the research field.

## **Finance and access to information**

In terms of transparency, there are occasions where PPP deny access to information – particularly financial – which was previously in the public domain, on the grounds that it is now “commercially confidential”. While effective competition is certainly vital, and may justify some limits on disclosure, PPPs must be designed to ensure the maximum possible public scrutiny. Otherwise the charge that PPP is simply an ideological fashion, or dodgy “off balance sheet” finance is impossible to rebut.

Clarity is also needed about the financial objective of a PPP. Since governments can almost invariably borrow more cheaply than private companies, it is obviously inefficient to use a PPP simply to raise capital. Thus private capital involvement is justified essentially by the need to share risk and allow the private partner to obtain a fair return for its participation. But in early PPPs, the private sector was concerned that it was taking on long term and unquantified liabilities, and so priced the risk high. When the situation became clearer, the debt was refinanced at much lower cost, creating a windfall gain to the private partner – and a loss of credibility in the PPP process. Thus it is important that PPPs are designed with mechanisms to properly distribute any such benefits between all parties to the PPP.

Of course, there is a tendency to seek to use PPPs as a means of funding projects the public sector cannot or will not fund on its own. You may be familiar with the GALILEO project to build the EU’s own global positioning system to complement GPS. Given the large start up costs, the big risks and the expected benefits to the EU economy, it was decided to pass the financing, launch and operation of the Galileo system to a consortium of leading EU aerospace companies. These were to pay for the system out of various fees paid by users. Members of the operating consortium were not however able to agree on how to make this arrangement work (it may have been flawed since most users will use the free basic service). Thus launch of the satellites has been delayed. Finally, to ensure the project continues, EU ministers have been forced to renationalize the financing and launch phase.

## **Flexibility and Review**

Business partners should not be scared off by the rigidities brought into the project by the public participation. The agreed rules must include clear mechanisms for monitoring implementation, with flexibility to take appropriate action where its objectives are not being met, in terms of staffing, financing or any other adjustment. Flexibility for future review is also needed to ensure that the terms of reference can be adapted with reasonable ease to future developments.

## **The Commission experience of PPP**

Our direct experience with PPP in the Commission is so far limited and focuses on delivering projects of pan-European interest rather than direct service delivery to the public.

In our efforts to increase the competitiveness of the European economy, the area of greatest current action in the Commission is the research field. Here PPPs are seen as important in bridging the gap between publicly funded academic research and the delivery and exploitation of innovation in industry. We hope also that they will form part of the strategy to increase the overall EU investment in R&D, which is a key part of the competitiveness strategy.

The new PPP type instrument we are using to deliver this is called “Joint Technology Initiatives”, JTI, which are part funded by the Commission and involve both government and private sector parties. Their objectives are:

- ensuring coherent implementation of European research efforts in the strategic technological fields for the future; and

- accelerating the generation of new knowledge, innovation and the uptake of research into strategic technologies. Of course, the expectation is that this should lead to enhanced productivity and strengthened industrial competitiveness;
- pooling user requirements to guide investment in research and development towards operational and marketable solutions.

The six areas where the Commission has presented or intends to present proposals for JTIs are innovative medicines, embedded computing systems, “Clean Sky” (aeronautics and air transport), nanoelectronics, fuel cells and hydrogen and GMES (Global Monitoring for Environment and Security).

It is vital for the success of the JTI model that the JTIs do not have a restrictive effect on competition. They are designed to enhance downstream competitiveness in key technologies by addressing market failure arising from the high costs and risks associated with long-term, pre-competitive, multidisciplinary research, and should not become a vehicle for the creation of national “champions:” and old fashioned dirigiste industrial policy.

#### Conclusion

PPPs can be used to build trust in Government by ensuring improved service delivery and by forcing governments to identify and be transparent about their real policy goals. Successful delivery with the private sector should improve the image of parts of the public sector as wasteful and old fashioned. It allows Public to be on the cutting edge of new development. They can bring new money and innovative ideas, ensure the closeness to the market and immediate commercialization of ideas, and help develop a common understanding between public and private sector of the different opportunities and constraints each faces.

To make PPP work imposes real discipline on the participants to define clearly at the outset what they are seeking to achieve. There has to be a real assessment of on going costs –and matching funding – for the life of the project. No longer can a prestige project

be created for short term political impact, with little thought given to how (or even if) it will be funded once initial development is over. Or without clear identification of likely developments in the medium term – and contingency plans for when things go wrong.

But the creation of successful PPPs is not straightforward: great care must be taken to ensure that the arrangements include transparency, appropriate risk and opportunity sharing and flexibility. And while the great benefit PPP is indeed in the creation of partnership, that partnership should not be such as to exclude other parties, innovation or competition and a PPP should not be a new name for an old fashioned industrial policy.