Power relations and risk allocation in the governance of public private partnerships: a case study from China

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Abstract

This article examines the power relations between the government, the private sector and citizens/users, which underlie the risk allocation process in public private partnerships (PPPs) for infrastructure. It argues that the institutional environment and resource dependency determine power relations, and hence risk allocation. The approach is applied to analyse risk allocation in a PPP toll road in Zhejiang province, China. The analysis reveals the dynamic of power relations among the parties. The findings show how the party with more power (in this case, the local government) was able to shift costs to the weaker parties (in this case, the users and the private sector). The implication of the study is that more effective courts and greater accountability of government to citizens are required to enhance the governance of such PPPs in China.

Key-words: China, public private partnerships, power relations, risk allocation

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Introduction

This article discusses how and why power relations between government, private investors and citizens in public private partnerships (PPPs) distort risk allocation in favour of the stronger party, within the institutional environment of China. In the rhetoric of PPP, the superiority of PPP results from more efficient risk allocation between the government and the private sector, according to which party is best able to manage them (Grimsey and Lewis 2004). However, the worldwide experience of PPP provides many examples of failures in risk allocation (eg. Hodge & Greve 2007), demonstrating that efficient allocation cannot be taken for granted. Much literature suggests that unequal power relations between actors is a critical reason for failure, and has focused on explaining instances of government in western democracies taking on additional costs in PPP projects. Explanations include government having the ultimate responsibility for providing public services, therefore valuing the project more than the private investor does (Besley and Ghatak 2007), while the contract ‘reduces the power of the state by treating it as just another economic agent’ (Froud, 2003:568) and reducing its flexibility in the project and in policy (Edwards and Shaoul 2003). This allows the private investor to ‘hold up’ the government, particularly where government faces high costs and loss of reputation in switching to an alternative contractor or running the service itself (Ball and King 2006, Lonsdale, 2005).

But two aspects have been under-emphasised in this literature. Firstly, the stress has mostly been on power relations between the government and the private sector as contract partners, while ignoring their interactions with citizens and users. Citizens and users as peripheral actors in the contract are not without power in affecting risk allocation outcomes. Secondly, power relations between actors are strongly context specific to the institutional background, which often differs between western and non-western cases (Bovaird, 2004). With most literature deriving from western cases, the context-specific nature of power relations has been neglected.
Aiming to contribute to these under-researched areas, this article firstly presents an analytical framework to enable understanding of power relations between government, the private sector and citizens/users in the risk allocation of PPP. This analytical framework is then applied to the Jin Long Toll Road project in China, to explain how and why the party with more power was able to transfer risks to the weaker party contrary to the contract. In the conclusion, the context-specific institutional environment in China is stressed.

Explaining power relations and risk allocation: an analytical framework

This section presents a framework based on new institutional economics (NIE) to explain the power relations between the government, the private sector and the citizens/users that affect the risk allocation (see figure 1). The article proposes that institutions and resource asymmetry affect the power relations between parties and therefore, the party with more power may seek to transfer risks to the weaker party.

Forces underlying power relations: institutions and resource (inter)dependency

The argument that the party with more power may transfer the risks unexpectedly to the weaker party is based on the behavioural assumption of opportunism. In the rhetoric of PPP, its advantage over the conventional provision mode is that PPP, through involvement of other actors, has better chances of achieving optimum risk allocation between actors with different advantages and strengths (sources). However, in reality, opportunism often better explains the behaviour of parties transferring risks to others. When one party holds more power in the interaction, it has the advantage of being able behave opportunistically to transfer risks to other, weaker parties.

Interaction models between the citizens/users and the contract partners vary between different types of PPP project (for example, in tax paid projects, citizens or users do not interact directly with the contract partners; in user charge projects, users have direct interactions with the contract partners through paying fees). Since the case study involves user charges, this discussion focuses on the context of user charge PPP projects, which involve citizens not only as taxpayers but also as users of the service.
However, risk allocation failure cannot be simply explained by power imbalance, as the term ‘power’ is tautological (March 1988; Williamson 1995) unless the sources of power are demonstrated. This section therefore further argues that power relations are affected by institutions (the rules of the interaction) and the resources the actors hold, as explained by institutional theory and resource dependency theory.

Douglass North defines institutions as ‘rules and constraints of the game in a society, or more formally, the humanly devised constraints that shape human interaction’ (1990:3). Institutions and institutional arrangements can be regarded as sets of formal and informal rules (Ostrom, 1986; Klijn, 1996, Koppenjan and Klijn 2004). In the context of PPPs, formal institutions refer to the PPP contract, and the laws regulating government procurement (often specifically reformed in recent years to accommodate PPPs), plus the wider commercial law, which regulate and constrain the partners. Informal institutions are those customs, culture or behaviour patterns that guide the interaction between the actors. As institutions regulate actors’ behaviours, they impact on the power relations in PPP. Throughout the interaction, institutions help to achieve power interdependency through constraining both sides or achieve power imbalance by favouring some actors while disfavouring others. As Koppenjan and Klijn argues, rules concern the relations between actors (2004: 79).

At the same time, the theory of resource dependency emphasizes how the resources held by actors affect the power relations between them (Pfeffer 1981, Williamson 1995). Williamson points out that, ‘power accrues to those social actors who provide critical resources for the organization and who cannot be readily replaced in that function’ (ibid:35). Throughout the interaction, actors exchange resources to achieve cooperative outcomes and their self-interest. When each side holds an irreplaceable resource and meets the needs of the other, there is mutual interdependence and equality of power. But if one party is dependent on another’s resource and has fewer resources to exchange, the party is resource dependent and has inferior power status: ‘the dependent party—which varies with the circumstances—is at the mercy of the
other’ (ibid: 35).

In the theory of PPP, the government is supposed to control policy resources, while the private sector holds managerial and financial resources, and institutions (particularly the laws enforcing the contract) restrict opportunistic behaviour. But both parties as contract signers may hold more information resources than the public. Underlying the resource power of any one party is the availability or unavailability to users of alternatives to that resource: the more alternatives are available to users of the resource, the less power does the resource confer on its owner.

The impact of institutions, resources and resulting power relations on risk allocation between the government, the private sector and citizens/users is discussed below, in each of the two stages of a project.

*Contracting stage:*

In this stage, risks are allocated between the signing parties according to the rights and obligations mutually offered and accepted by the signing parties. In PPP theory, risks are allocated between the parties according to the principle of optimum risk allocation. However, in reality, affected by prevailing institutions and resources owned by each side, there may either be equal or unequal power between them, with risks allocated accordingly. For example, Lonsdale (2005) describes UK cases where the government buyer was inferior to the private contractor in commercial resources, and also in contract negotiation, giving power to the private contractor. Similarly for the US, Bloomfield (2006, p.407) reviewing US PPP projects with local governments argues that: ‘The imbalance of expertise between local governments and the private companies with which they do business further undermines local government’s capacity to shift project risks to the contractors’. The result in both cases was that the private contractor was able to shift the costs of risks to the public client, supported by the legally enforced contract, owing to the superior expertise and resource of private sector in contract bargaining. This reflects the PPP
development in western countries with independent judiciaries. But private parties have entered into BOT and other PPP arrangements in countries where the judiciary is less than independent. In such cases other institutions (e.g. policy commitments and guarantees of a powerful government) are relied on to enforce the agreement, as in the joint venture agreement in the case study below.

Meanwhile, citizens/users are peripheral actors in the contract. In the theory of PPP, users’ willingness to pay\(^5\) charges is researched and citizens are informed or consulted about the contract to ensure there is public benefit from the project (Bovaird 2004). However, in reality, lacking resources, particularly information, citizens may have insufficient power to defend their interests in the contract agreement stage. Hodge (2004), in his examination of the Australian City Link PPP project, notes that, ‘in the absence of the information, the political purchase of huge infrastructure projects will continue to leave citizens open to political and commercial trade off. If the price is higher than it need to be, citizens inevitably pay’. The information problem is not confined to upcoming projects, inadequate review of performance in existing projects in the UK is highlighted by Pollock and Price (2008: 177), reviewing the National Audit Office (NAO) reports on the achievement of Value For Money in PPP, finding that out of 622 Private Financial Initiative (PFI) deals that had been signed by October 2007, ‘only ten financial inquiries into central government operational PFIs had been undertaken by the NAO by 2006, and of these only three examined the relationship between risk transfer and risk premiums’. The problem of misleading information on who pays PPP costs in the U.S, is noted by Bloomfield (2006) who provides several examples\(^1\) demonstrating that the information, although released to the public, can disguise costs to taxpayers.

Post-contract stage:

In this post-contract stage, the final risk allocation emerges. Theoretically, one of the

\(^{5}\) ‘Willingness to pay’ estimates have often turned out to be over-optimistic, suggesting they are poorly researched—sometimes because both parties to the contract are keen to progress the project (Kanowski 2011:16)
functions of a contract is to provide constraints against possible opportunistic
dbehaviours by the other party and ensure that both parties have equal stakes in the
relationship through posting ‘hostages’ in the contract articles (Williamson, 1985;
Lonsdale 2005). In reality, due to bounded rationality and the power imbalance in the
contract signing, the contract may not be well enough designed to maintain the power
balance between the two parties, enabling one party to shift risks to the other(s).

As in the contracting stage, whether the legal environment is strong or weak affects
the power balance and brings in the roles of other resources (and ‘hostages’ such as
guarantees) in creating assurance for the agreement to go ahead.

In this post-contract stage, the power held by the citizens/users is less affected by
information asymmetry, as the project’s costs and benefits are now revealed, and
more by the institutions regulating and responding to citizens/users. With the risk
distribution now revealed in the quality of service actually provided by the facility
and the charges levied, citizens/users can take retaliatory action. They can exercise
consumer choice (paying or refusing to pay fees) if there is an alternative facility e.g.
a free road, or use institutions (by complaining through official and unofficial
channels) to try to resist costs imposed on them by the contract partners.

The analytic framework outlined above is now applied to the Jinlong toll road case
study.

**The case study: Jinlong PPP/BOT toll road project in Zhejiang, China**

PPPs were transplanted into China in the 1980s, with ‘Build Operate Transfer’ (BOT)
---where a private company builds, operates and then transfers the asset to the public
sector after 20 to 30 years--- as one of the PPP models most commonly used. It
attracted the attention of China’s government because of its promise to create public
infrastructure without the need for government borrowing to finance it.

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6 ‘Hostages’ in resource theory are mechanisms which impose costs on a party seeking to use power to pass costs
onto the other party in a contract. They take many forms such as revenue sharing, joint ownership, guarantees
and penalties.
This case—the Jinlong toll road project in Zhejiang province—was initiated in the mid 1990s, a boom era for private investment in infrastructure, particularly the road sector, supported by government policy.

In 1996, invited by Jinhua city, Zhejiang, a private investor from Hong Kong, the Kwangying Company (KY), decided to invest in road projects in Lanxi urban area. After approval from the Zhejiang provincial government, the public participant, Transportation Service Company, a state-owned company under the control of the Lanxi local government, signed the contract with KY. The ‘special purpose vehicle’ company, Jinlong Road Construction Company (JRCC), was duly set up in 1997, with responsibility for the construction and operation of the Jin Long Toll Road (JLTR) project for 20 years, and to transfer it back to government when the contract expired.

The total investment for the project was about 110 million RMB($17million) to build a 17 km-long road, in which the private side invested 77 million RMB ($12million), including a bank loan of 25 million RMB, and the public sector 33 million RMB($5million).

Since the private partner had 70% of the investment share and the financial return mainly relied on the toll incomes, it was allocated the majority of the demand risk and financial risk. In this way the JLTR contract indicated that the demand risk and the financial risk were shared between the public sector and the private sector according to their respective investment shares (Articles 5 and 17 of the contract).

In order to reward the private investor for taking on this risk, ‘Cooperative Joint Venture’ (CJV) was used as the cooperation model for the JRCC company, because of its attractiveness for the private investor in loading its profits on the ‘front end’ of the project, through prioritized division of revenues and government guarantees of profit levels. The agreement between Jinhua city government and KY company stipulated that the revenues of the JRCC (from toll income advertisement boards and land development along the road) would as a priority be used to repay the private sector for
its investment, after deducting management and other costs. The toll charge was set at the maximum level permitted by Zhejiang provincial government to ensure that the project would be profitable: double the standard toll, with the top-up element belonging to the joint venture companyiv.

The JRCC constructed the road in 1997 and 1998, and began charging tolls from the end of 1998. However, the expected toll income-- which was the main income of the JRCC and KYv-- did not achieve planned levels. The financial data from the JRCC showed a clear decline in traffic volume and toll income, particularly from the early 2000s. By 2006 toll income had only reached one fifth of the planned level. The low toll income strained the management of the JLTR. Traffic demand was a key issue to the JRCC, because not only did repayment of the bank loan and profit depend on toll income, but also the JRCC had to assume the responsibility of paying a salary to toll staff but did not have the right to hire or fire the staff, since they were public servants (shiye danwei) on secondment to the project. After deducting the management fees, the remaining income could not even repay the bank loan, so making a net profit was out of the question.

The decline of the toll income was caused by increasing availability of alternative roads and the determination of drivers to avoid the toll.

The availability of alternative roads resulted from expansion of Jinhua city, with construction of more non-toll roads. In particular, the Binhong road in the urban area was expanded extended to Bailongqiao in 2004, connecting with another new developed urban area Wucheng, which diverted the main traffic volume from the main toll point of this project—the Bailongqiao toll booth.

The fieldwork in the JLTR project showed that the decline in the toll collection was directly due to the openness of the highway around the city and the enlargement of the city area. Although traffic volume rose every year, the highway distracted a large part of the traffic away from the toll road. Also, with the development of the road network,
more and more non-toll roads became alternatives. In other words, urban expansion and transportation improvements provided various choices for the road network which had a negative impact on the toll income of the JLTR project.

But the main cause was the determination of drivers to avoid the numerous toll booths and excessively high tolls, which were a feature not only of Jinhua city and Zhejiang province, but of China more widely at this time. “China is building more toll roads with its rocketing number of expressways, but legions of drivers are trying almost anything to avoid them. … Toll rates are close to average levels of industrial countries. In a society where earnings are still far below developed world averages, this means that the real cost of tolls in China is very high. The current process of setting tolls does not aim to maximize revenue. … More flexibility in setting tolls and creating a climate of toll acceptance will help to increase low traffic levels” (Ojiro 2003:22).

The second cause, which is also the major one, is vehicles fleeing from use of the toll road. As explained above, the frequency of toll booths in Jinhua and even the whole of Zhejiang province added a huge burden on drivers. The strategy of the users was to avoid the toll.

In 2004, the JRCC complained to Lanxi local government that the Longma cement factory near the toll booth had constructed an exit from the factory to the road to avoid driving through the toll booth. This was not an uncommon phenomenon in Zhejiang. Many drivers tried to avoid the tolls by driving through village roads around the toll road. In 2006, an informal brochure named: ‘The handbook of how to avoid toll booths in Zhejiang province’ written by several anonymous users was circulated around websites, and obtained huge attention. In an informal way, this handbook introduced in detail the methods of how to circumvent the toll booths around Zhejiang province.

The resulting increased traffic through villages even produced the phenomenon of an ‘informal toll’ in some villages: village residents built roads to avoid the nearby formal tolls, and set up toll booths and collected cheaper tolls from the fleeing drivers
(Chen Xiadong 2004:85). In sum, the fleeing of the vehicles from the excessively high tolls was an expression of public opposition.

But the decline of the toll income was not the only problem facing JRCC and its main shareholder KY. The other sources of income from the government guarantees and the contract articles did not materialize. The policy and contract for this project under CJV policy had provided attractive guarantees: according to the local policy at that time, the private sector was guaranteed an 18% profit on its investment, tax exemptions, and the right to manage the toll booths and operate businesses advertise hoardings along the road. However, these promises were not fulfilled by the local government. With the toll revenue declining, as the traffic volume decreased, the government did not fill the financial gap to reach the guaranteed 18% profit rate; the agreed share from tax exemption was not refunded to the private sector; the private sector had to pay for the operational costs of the toll booth management but had not the right to hire or fire the toll staff. As for the right of business people to operate advertising hoardings along the toll road, the government even auctioned that right to other companies without permission of the private partner. When added to the declining toll income, all these unfulfilled promises meant that the CJV company (JRCC) and its main shareholder (private investor KY) lost a main source of income and faced serious losses.

While the project was struggling with financial problems, the central government issued a circular to deal with unreasonable toll collection and clearing and combining toll booths since 2001. This policy changed the direction of this project. Zhejiang started clearing the toll booths in the whole province from 2001. Regulation on the administration of toll roads, which was published in 2004, declared that there would be no new toll booths set up in the future, and the government would not continue the approach of ‘four things done by local government itself’ projects any more. The policy change meant the end of the era of toll road encouragement to be replaced with a non-toll road system. The immediate result of the new policy was a further decline
in toll income. Private investors who could now not attain their projected profitability were left with BOT projects which had not even run half their contracted 20 year life.

According to the regulation on the administration of toll roads, Lanxi toll booths were planned to be removed in 2007. However, in 2009 this plan was still under negotiation, the tolls were still operating, how to compensate the private investor KY and how to deal with the toll booth employees remained to be resolved (KY executive director, interview with first author).

**Analysis of the case study: risk allocation, resources and power relations**

We now apply the analytical framework, with its concepts of power relations and their underlying institutional and resource factors, to understand how power relations between the local government, the private sector and the users affected risk allocation in the Jinlong toll road project in the contracting and post-contract stages.

**Contracting stage:**

In the contract, the private partner as the main investor carried the bulk of financial risk; but the CJV arrangements, under which the special purpose vehicle company (JRCC) had been set up, in theory took much of this risk back to government. However, underlying this risk managing arrangement was the strategy of shifting costs to the users through high toll charges which the provincial government allowed in order to attract private sector investment for toll roads So JRCC was able to double the charge to users at its toll booths in order for the investor to recoup its capital as soon as possible.

The above allocation of risks in the contract resulted from the power relations between the actors. First, resource dependency of the private investor on local government is observable. The local government of Jinhua city was eager to attract financial resources from private investors to build the local road system, and prepared
to guarantee returns and priority share of revenue, while at the same time laying down increased tolls so that it would not have to pay out against the guarantees. But the private investor was about to commit capital on the strength only of the local government’s promise of returns and priority share of revenue, rather than a contract enforceable under law. In doing so it was relying on the power of the government to enforce the high toll charges. This willingness emerged from the context of zealous political promotion of private investment in China in the 1980s and 1990s, and the eagerness of private investors (usually foreign, as in this case) to get a share of the growing Chinese market.

After the 1994 tax sharing reform, the bulk of taxes were collected directly by the central government while expenditure responsibilities were left at local level, local governments faced a dilemma: infrastructure investment using public finance had became unaffordable; but rapid economic development required improved infrastructure (Ma 1997; Wong 2000). Under this pressure, seeking private investment for infrastructure became popular in many provinces, with guaranteed rate of return and double toll charges seen as the cheapest way to attract private capital. For private investors, the local guarantees were also attractive options for investment in China. As the interviewee from KY said in his letter of complaint, ‘In the early 1990s, Jinhua local government encountered huge difficulties in financing and developing the road system of Jinhua. In this situation, the local government issued attractive and preferential policies for tax exemptions, land concessions, and so on. Private companies became involved in the road development of Jinhua, with these policy encouragements’ (KY executive director, interview with first author).

Second, the users’ weak resource in the contracting stage is observable in the shifting of the cost of the risks to users through increasing the toll charge. As China’s National Audit Office noted in 2008 in its investigation of results of toll road operations in eighteen provinces, including Zhejiang:

‘On the one hand, the private investor obtained profits from the high toll charge and
long-term charge period; on the other hand the local government obtained tax income from the private enterprise profits. This behavior from both sides added to the burden on the public... the local government wants to develop the road system quickly but does not want to take responsibility and therefore shifted the responsibility to society [the public]' (NAO of China 2008: section 2).

For the users and citizens in this case, information resource asymmetry was the factor that weakened their power in the relationship. The users were blocked from obtaining information or engaging in the decision-making process regarding the toll charge standard. Interviews with a local official from the bureau of transportation, Jinhua city, and with the private investor reveal that the double toll charge policy was set up according to the policy negotiation between the local communication department and the price bureau, based on the consideration of expected traffic volume and the expected period of time for the private sector’s return7. The interviewees also admitted that there was no formal means by which users could obtain information or be consulted. In addition the Zhejiang provincial government permitted the highway companies to charge a ‘vehicle fee’ (Checi fei) to vehicles on the highways. From 2003 to 2005, the income from this charge reached 1.955 billion RMB (around $300 million). But throughout the policy decision-making process, the users did not participate in setting tolls or charges (NAO China 2008: section 2).

With insufficient information, unconsulted and excluded from formal or informal decision making, the citizens/users had no power to resist the transfer of risks from the contract partners in the contracting stage. The evidence from this case echoes the criticism in the literature that PPP is too often a government - private partnership rather than a public - private partnership (Hayllar, 2010).

Post-contract stage:

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7Article 63of the ‘Highway law of P.R.C’ stipulates that the toll standard of toll roads is made through the following procedures: the unit responsible for the toll charge proposes and submits the price plans to the bureaus of transportation at the levels of the province, autonomous region or municipality directly under the Central Government for examination and approval, with negotiation from the price bureaus at the same level.
The post-contract stage shows that the demand risk and consequent financial risk eventuated in costs mainly borne by the private investor, contrary to the intention of the contract.

This resulted mainly from the decreasing toll income of the JLTR, which was the major source of the project’s finance. This undermined the financial viability of the company JRCC, since it had to bear the loss, did not control key costs (toll staff), and the local government did not resolve the problem of toll avoidance or fulfill its financial promises.

Table 1 below is an incomplete calculation of the losses suffered by the project company JRCC

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<tr>
<th>Table 1: Financial losses of JRCC (2001-2005) (^8) (RMB millions)</th>
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<tr>
<td>Loss from additional interest on unrepaid bank loan</td>
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<td>Loss in toll income</td>
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<td>Loss from unfulfilled promise of roadside advertising revenues</td>
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<td>Loss from the unfulfilled promise of tax exemptions</td>
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<tr>
<td>Unpaid amount from the government to keep the promise of ensuring the annual return at an annual interest rate of 18% (data until 2003)</td>
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<tr>
<td>Total (incomplete) of losses</td>
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Source: the authors’ calculation based on the data provided by JRCC interviewees

The underlying power relations among the actors explain the losses suffered by the project company JRCC, contrary to the intention of the contract. At first the users had only limited power to resist the high tolls imposed on them, since they had no institutional means e.g. political representation or legal recourse, and limited market power (ie. choice to use the toll road or not). So initially they paid the costs shifted from the government and the private investor onto them in the form of higher tolls.

\(^8\) This is incomplete owing to lack of data. It is expected that the actual loss is greater than this amount.
Only when convenient alternative roads became available through the rapid growth of Jinhua city, did the users acquire real choice. Market power is more easily used than institutional power, which usually requires collective action and bureaucracy. Market power—through users exercising choice-- is individual and direct. Users were thus enabled to “vote with their feet” against the excessive tolls, thereby inflicting the revenue losses on JRCC.

These losses revealed the dominance of local government in its relation with the private investor. Although unable to control the users, the local government was able to resist the private investor’s demands to honour the promise of a guaranteed rate of profit. Perhaps local government never had intended to honour the guarantee, as suggested by its reneging on promises re tax exemptions and advertising revenues from roadside hoardings.

The local government’s dominance of the private investor resulted from weaknesses in the contract and in the justice system. A legally enforceable contract plays an important role in ensuring power balance in any collaborative project. However, in this case the contract failed to constrain the power of the government. The contract was a loose one in which mutual obligations were only outlined and the government’s promises (including the double toll charge, tax exemption, and roadside land use) were not listed in the contract: they were only to be found in the ‘red title documents’vi (administrative orders and government policy documents) which are not legally binding and are easily changed.

In this case, the loose contract implied that the local government and the private sector had formed an agreement which was heavily ‘relational’ in nature (guanxi contract) based on the trust they had established informallyvii. However, this ‘relational contract’ was based on unequal power between the government and the investor. On the one hand, state dominance seemed convenient to the private investors because of government’s apparent ability to guarantee high rates of profit. On the other hand the absence of contractual constraints on state power turned out to be at the
cost of the private investor.

As well as contract weakness, the formal justice system was regarded by the private investor as unable to defend their interests. When the government failed to keep its promises, the reaction of the private investor was only to seek further policy guarantees through letters of complaint rather than appealing to the courts. The interviewee from KY expressed why he preferred to use informal means:

‘It is more difficult for the rich man than the poor to appeal against government behavior. Strong complaints from poor people may cause trouble for the government, because the poor have nothing to lose, and the media may become involved. However, the rich man or big company cannot do that, as most of the company’s resources are controlled by the government. Just one policy will decide the fate of your company.’

(KY executive director, interview with the first author).

The statement above suggests that the private investor could stand to lose more were he to prosecute the local government in the courts, given the power of government over companies. This highlights the dilemma facing private investors: they are attracted by the guarantees offered by a powerful government, but legal enforcement is difficult and costly; rather they are trapped in an informal, internal resolution process within the public bureaucracy, which may yield them nothing.

**Summary and conclusion**

This article has investigated how and why power relations between government, private investors, users and citizens in PPP projects distort risk allocation in favour of the stronger party. As a result risks may not be allocated to the party best able to manage them, as in PPP theory. An analytic framework was set up in which relative power of parties is founded in resources they command in the institutional environment. This was then applied to a case study of the Jinlong tollroad project in Zhejiang province, China.
The findings demonstrate how the changing relative power of the parties enabled shifting of risks and costs on to weaker parties. In the contractual stage, the private investor was attracted by local government’s guarantees of a minimum rate of profit, tax exemptions and advertising rights along the roadside, secured by a doubling of the standard toll to users. Trusting in the power of local government to enforce the increased tolls and keep its promises, it entered into a cooperative joint-venture agreement with the local government transportation agency to construct and operate the toll road over a twenty year period. At first, road users paid the increased tolls; but when alternative roads became available through expansion of the city, they used their new-found power of choice to avoid the tolls. The project then accumulated losses, and the local government reneged on its minimum profit guarantees and other promises. The private investor did not pursue the case through the courts, preferring to continue making representations to the local government. In this way, road users---institutionally excluded from road toll decision making---initially had costs passed to them by the contracting parties; but subsequently acquiring power of choice of roads to use, passed costs back to the toll road operator; local government---using its power---ensured these costs remained with the toll operator.

The finding that the party with more power was able to shift risks to others is not a surprise, as evidence for this can be found in existing studies. Many of these studies are of PPPs in western democracies, and observe that government tends to be locked in by the contract with the private investor and by their accountability to the public for delivering public services. But the Chinese case discussed here tells the opposite story: that the government locked the private investor in. The government’s superior power relative to the private investor was reflected in a weak contract and relatively weak courts. Although legal reform has been undertaken in China law the courts are still expected to be secondary to Party-state control. (Lubman, 1999; Peerenboom, 2001; Zhang Qianfan 2010; Luo Jun 2011). State dominance has a double-edged effect on PPP projects. On the one hand, it can ensure success through government support, i.e. guarantee letters and/or support policies. It has been shown that in many
successful PPP projects in China, guarantees and support policies from the governments have been regarded as essential and sought by the private sector before signing the contract (Wang and Tiong 2000, 70; Bellier and Zhou 2003; Shen, Wang and Qiang 2005). On the other hand, state dominance and the weak court system pressure the contract towards legal informality reducing the enforceability of contract terms. While the ‘relational contract’ with government is attractive to private investors for its flexibility (Jing, 2008; Rui Mu et al, 2010) it can be easily overturned by government if it becomes costly for government, as in the Jinlong toll road case. This puts operation of toll roads in China on an unstable base than in India for example (Postigo 2008).

Secondly, this case demonstrates the weakness of citizens/users relative to the government. This differs from many cases in western democracies as discussed in this article, in which the government was constrained by its public services responsibility and public accountability. In China, as a legacy of the institutional environment, the government still possesses superior status in relations with citizens/users, although this power is gradually being challenged by the emerging civil society. There has been a great gulf between the state and society (Lubman, 1999). A by-product of long-term state monopoly is that there are only very limited channels for public participation in policy. Moreover, when the government forms a working relationship with business, the lack of public participation easily results in the sacrifice of local public interests. On the other hand, state control over the public is gradually being challenged by the development of a civil society. In the last three decades the ruling party-led reform has, on the one hand, protected the vested interests of the powerful through improving the economy, while on the other hand, it has cultivated the middle class, from which is emerging the increased strength of civil society (Hook, 1994; Goodman and Hooper, 1994; Gries and Rosen, 2004). As Liu has argued, there is a contradiction between a monolithic political regime and the pluralization of society (Liu Xiaobo, 2006). This pluralism is featured in the expansion of channels for public voice, particularly the internet, despite state controls.
On the evidence of this case study, practical means to improve risk allocation in China’s institutional context are those which help to reduce unequal power between government, the private investor and citizens: greater involvement of citizens in the planning of local infrastructure might have stopped in the early stages what turned out to be a non-viable project. To secure public interest and prevent collusion between government and private investor, the approach for citizens’ voice throughout the project process is required. In the long term, further development of civil society is the way to enhance the power of the citizens and accountability of public private partnerships for infrastructure in China. Furthermore, the more effective courts could have prevented local government from over-riding its contract with the private investor.
Figure 1: The analytical framework: power relations between government, private sector and citizens behind risk allocation

- **Institutional interdependence**: (formal institutions, i.e. rule of law, contract articles; and informal institutions, i.e. culture, behavior patterns, informal interaction rules)
- **Resource interdependence**: (policy resource; financial resource, information resource, etc.)

**Power relations between actors**
- Govt
- Contract signers
- Privat
- Citizens
- Peripheral actors

**Contractual risk allocation between actors**

**Power relations between etactors**
- Govt
- Contract partner
- Privat
- Users
- Citizens

**Post-contractual risk allocation between actors**

Contract signing stage

Post-contractual stage
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Notes

\(^i\) For example, in the Plymouth correctional facility project in the U.S, the taxpayers were obligated to fund these lease payments over the thirty-year financing period, the publicity generated by the project created the misleading impression that taxpayers were not paying for the project under the “off budget” claim that the project was not obligated to public funds. Furthermore, the local officials disseminated the project publicity, claiming huge cost savings, but it was revealed through independent analysis that a further $43 million in project costs were omitted from the calculation.

\(^ii\) Article 5: the JLTR joint venture company is a Limited Liability Company. Both contract partners share the responsibility, the profits, and risks and the deficit of the JLTR joint venture company according to each side’s investment share.

Article 17: the income of the JLTR company is from the toll income of the Magongtan toll booth and Zhuge toll booth after the toll charge level is increased; other operational income (after deducting the costs of operating toll booths and other operational activities). The profit share principle: the private investor [KY] has priority to receive the income of the JLTR before the public sector side.

\(^iii\) The Cooperative Joint Venture is the most common model of company for implementing PPP highway projects in China. From 1990 to 2000, there were more than 80 CJV road projects between Hong Kong developers and provincial or municipal authorities, which mobilized 75 billion Renminbi (Chinese currency; hereafter RMB) from private sources (Bellier and Zhou 2003). A CJV is a BOT contract with profits loaded to the ‘front end’. It is preferred mainly because it enables the investors to recoup their investment more quickly than other structures, since the parties can negotiate how and when the profits are ultimately divided. Furthermore, a CJV with a government agency might give the private partner more confidence that government will comply with the preferential treatment clauses in the contract (e.g. guarantees, tax incentives, foreign exchange loss protection) as well as the profit-sharing arrangements.

\(^iv\) Excessively high tolls were not confined to the Jinlong toll road. In 2004 an internal
Investigation report by the Ministry of Communication in Zhejiang acknowledged that there was a problem of too many and excessively high tolls. It noted that two thirds of bridges and tunnels and almost half of all roads in Zhejiang of second class and above are toll roads. Regarding excessive toll charges, the report notes that in 1996, Zhejiang published standard toll charges for different vehicles. However, at the same time, the provincial government allowed a higher charge if the toll road project was a large-scale project. Therefore, in practice, 100% of the tollbooths charged at the higher level (Research Unit of Ministry of Communication of Zhejiang 2004).

We were not able to establish what profits if any KY had made from supply contracts to JRCC during the construction phase.

Red title documents (Hongtou wenjian) refer to the policy documents issued by the authorities, with the titles of the issuing authority in red. The existence of numerous red title documents reflects the dominance of the government in society.

The term “contract” is used when referring to the agreement between Jinhua City and KY Company since this is the term used by the interviewees. But strictly speaking this seems to be an agreement relying upon the honour of the parties, not necessarily enforceable by courts, since the intention to create legal relations does not appear to be present (the lack of consolidation of the government’ undertaking into a single document), and it is likely that the JRCC was not a legal person (the basic CJV model company was often not a legal person; only if a limited liability company was formed did the CJV acquire legal person status).