



Contracting-out public-private partnerships in mega-scale developments: The case of New Songdo City in Korea



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ABSTRACT

In the past few decades, we witnessed an increase in the number of mega-scale urban development projects that are undertaken in the context of public-private partnerships. However, due to the difficulties of public-private cooperation, there has been a growing interest being paid to separating of the roles of the public and private sectors and the contracting-out of the project. In a contracting-out arrangement, urban development is led by the private sector and entails the transfer of development tasks, risks, and responsibilities to the private sector based on a set of public requirements. By empirical case study of New Songdo City in Korea which is claimed to be the world's largest private sector-led development, this paper aims to examine whether the expected benefits of public-private partnerships materialize in practice when a mega-project is undertaken by a contracting-out arrangement. The New Songdo City project demonstrates that in practice, the benefits of a public-private partnerships generally deviate from the theoretical assumptions, other than the development opportunity offered to the private sector. Moreover, the project's challenges are less evident for the public sector but more pronounced for the private sector. Given the magnitude and longevity of the project as well as the strong hierarchical relationship between the Korean government and the business sector, there are great challenges to undertaking mega-scale urban development through a contracting-out public-private partnership.

1. Introduction

Recent decades witnessed a remarkable worldwide increase in the number of mega-scale urban development projects¹ as part of national strategic efforts to secure competitiveness in the globalized economy (Swyngedouw, Moulaert, & Rodriguez, 2002; Weikal, 2008; Orueta & Fainstein, 2008). Although such mega-projects had traditionally been public sector-initiatives financed by the state, fiscal pressure and a wave of neoliberalism that promoted entrepreneurship have increased the public sector's interest in encouraging the private sector's participation and the use of private resources. Therefore, during the past three decades or so, growing attention has been paid to the way public and private sectors collaborate in preparing and managing urban projects in the context of public-private partnerships (Lehrer & Laidley, 2008; Fainstein, 2008; Orueta & Fainstein, 2008; Tasan-Kok, 2009; Heurkens, 2012:90).

The forms of public-private partnerships range broadly from joint ventures to contracting-out arrangements² depending upon the extent to which project risk and control are allocated between the public and private sectors (Angerer & Hammerschmid, 2005; OECD, 2008). Whereas a joint venture involves joint investment and joint decision-making between the public and private sectors, a contracting-out project involves engaging the private sector to render public objectives. In the latter arrangement, urban development is led by the private sector and entails the transfer of development tasks, risks, and responsibilities to private developers based on a pre-defined set of public requirements (Heurkens, 2012:155). Although public-private partnerships have been promoted based on the expectation that added value would be created from public-private cooperation and joint decision-making (Hastings, 1996; Sagalyn, 2007), in practice, such added value has seldom been generated. Therefore, in more recent years, increased interest has been shown in shifting the entrepreneurial activities of property-led

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¹ In this paper, "mega-scale urban development projects" and "mega-projects" are used interchangeably, both to indicate very large projects that involve development sites that cover several hundreds of hectares and development periods that last at least 20 years.

² Joint ventures are commonly referred to as the "alliance model" and the contracting-out arrangement as the "concession model" (Klijn & Teisman, 2003). Although the concession model refers to an arrangement in which the government retains ownership of the project, this paper differentiates the contracting-out arrangement from such a model to include developments led by and land transferred to the private sector.

development to the private sector through developments led by the private sector in which the project is contracted out to achieve public objectives (Klijn & Teisman, 2003; Heurkens, 2012:27).

South Korea (Korea) is of no exception to the recent wave of mega-project boom and its private sector has increasingly participated in urban development. In fact, since the 1960s when rapid industrialization and urbanization began, large-scale urban development or, more specifically, large-scale housing development has been the country's prevalent development scheme. Although the projects were public sector-led, without the necessary capital available, the Korean government resorted to private capital resting upon a close-knit relationship between government and business (Kim, 2013). The New Songdo City project³ currently under construction is an initiative of the Korean city government envisioned to create a business hub of Northeast Asia on a 1500-acre landfill. The project is the first of its kind for Korea, a large-scale mixed-use development for which the government has engaged a foreign developer as well as a domestic construction company to be responsible for its development. Claimed to be the largest private sector-led development in history (Lee & Oh, 2008; Kim C., 2010), the project is at about the halfway stage since its groundbreaking in 2005.

Despite an increased number of mega-projects worldwide, there is a dearth of literature about the real-case benefits and challenges of public-private interactions when undertaking such projects. In fact, little is understood whether contracting-out is a suitable arrangement for mega-projects. Therefore, using New Songdo City as an empirical case, this paper aims to answer the following questions. Do theoretical assumptions about the benefits of public-private partnerships materialize in practice? What challenges in contracting-out arrangements are more pronounced for the public and private sectors? How have such benefits and challenges been affected by the characteristics of Korean government-business relationships? The objective of this paper is not to argue whether a contracting-out arrangement is a better form of public-private partnership than a joint venture, but to examine if, for mega-scale urban development projects, the expected benefits of a public-private partnership can be achieved through a contracting-out arrangement.

The methodologies of this study include a comprehensive review of documents covering project agreements and contracts, progress reports, master plan and implementation plan documents as well as academic papers, books, newspaper articles and magazines. Personal interviews were also conducted on May 4, 2015, which included one person from the public agency, the Incheon Free Economic Zone Authority (IFEZA) and two executive-level employees at the private developer's office⁴ responsible for obtaining public approvals and securing financing. The following section outlines the benefits and challenges of different forms of public-private partnerships, namely, joint ventures and contracting-out arrangements. The section also briefly addresses the emergence of public-private partnerships in Korean urban development projects. The section that follows discusses the New Songdo City project, focusing on its contractual arrangement between public and private sectors, their respective responsibilities, and development progress. Then, the paper examines whether a gap exists between theoretical assumptions and actual practices for the benefits and challenges of contracting-out public-private partnerships. It highlights the distinct characteristics of mega-projects and relationships between Korean governments and businesses. The paper concludes with lessons from its empirical findings.

³ New Songdo City as discussed here refers to the Songdo International Business District that is being developed by Gale International and POSCO E & C and is differentiated from the Songdo area as a whole.

⁴ This refers to Gale International Korea LLC (GIK) which is an entity created by New Songdo International Development (NSIC) to assume the responsibility of the actual execution of the project. NSIC, as the owner of the project, has the final approval of design, schedule, costs and revenue.

2. Public-private partnerships in urban development

2.1. Mega-projects and public-private partnerships

In many places around the world today, we encounter mega-projects of multi-billion dollars that have been undertaken as a strategic choice to enhance urban competitiveness in the globalized world (Chen, 2007:9). While these mega-projects are becoming increasingly large in scale and more complex, entailing a mix of uses with different risks and cashflows, governments are faced with limited fiscal resources and market experience. Therefore, in recent decades, global attention has been paid to public-private partnerships as options for undertaking urban projects. For the public sector, pooling the private resources of capital and market experience is expected to reduce government spending and provide better solutions for projects. For the private sector, partnering with the public sector is expected to bring new development opportunities and reduce project uncertainties from governmental support in development and construction approvals as well as in legislations and policies (Han & Wang, 2003; van Ham & Koppenjan, 2002).

As a large number of societies have promoted public-private partnerships, they have emphasized the potential benefits to be gained by public-private cooperation (Sagalyn, 2007). Urban studies and practices have been devoted to joint venture-type public-private partnerships in which the government and private actors jointly invest and collaborate through all phases of development. The very attraction of such arrangement is that, theoretically, they add value from the synergy between two different sectors, producing new insights and solutions. Transformative process is assumed to occur during the negotiation process which modifies each party's view on how to resolve development issues (Hastings, 1996). In addition, sharing the risks and responsibilities between the public and private sectors makes each party more readily react to changes that occur during the development, including from the market, political and social environments (Edelenbos & Teisman, 2008; Gordon, 1997; Sagalyn, 2007). However, scholars who hold a negative position on joint venture-type partnerships argue that their success is rare and that their transaction costs are too high (Angerer & Hammerschmid, 2005; Ball, Le Ny, & Maginn, 2003; Klijn & Teisman, 2003).

Evidencing the many difficulties of public-private cooperation, we witness a growing interest being paid to separating of the roles of the public and private sectors and the contracting-out of the project (Heurkens & Hobma, 2014; Klijn & Teisman, 2003). Although the extent and degree of transfer may differ across societies, such projects generally involve “transferring risks, revenues and responsibilities for the plan, land and real estate development to private developers based on a pre-defined set of public requirements” (Heurkens & Hobma, 2014). Conceptually, a contracting-out arrangement enables both public and private sectors to benefit from the partnership more efficiently and effectively. From the public side, the public sector can achieve its public objectives without the fiscal burden. From the private side, the private sector can more easily mobilize its market creativity without the bureaucracy of the public sector involvement (van Ham & Koppenjan, 2002).

Despite the benefits of separating public-private roles, such an arrangement also has a set of distinct challenges. A key concern for the public sector in a contracting-out arrangement is its loss of control over the project (Heurkens, 2012:157). Once the landownership is transferred, the private sector might choose to pursue its own interests, which may run contrary to those of the public sector who no longer assume a strong control over development activities. For example, the private sector may concentrate on short-term profit gain than long-term investment or walk away from the project before fulfilling its contractual obligations (van Ham & Koppenjan, 2002). Therefore, a key challenge for the public sector in a contracting-out arrangement is to contractually tie and effectively monitor the activities of the developer,

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