Parag Khanna

THE RISE OF HYBRID GOVERNANCE

Parastatals occupy a vital middle ground between public agencies and private-sector organizations. They're powerful, opaque, and proliferating around the world.

PARAG KHANNA is director of the Hybrid Reality Institute, senior research fellow at the New America Foundation, and visiting fellow of LSE IDEAS. His most recent book is *Hybrid Reality: Thriving in the Emerging Human-Technology Civilization* (coauthored with Ayesha Khanna). Soenke Ziesche, a researcher at the Hybrid Reality Institute, contributed to this article.

The age of hybrid governance is already upon us. China today is a hybrid of 19th-century communist ideology and 21st-century capitalist practice, yet it stands on the cusp of becoming the world's largest economy. Asian state capitalism is actually a centuries-old European practice dating back at least to the government of Victorian Britain, which gradually brought the British East India Company under its direct supervision and control over the course of the 19th century, absorbing all of its colonies and wealth. Could China's state-owned companies and banks today—with their expansive operations and lending across the developing world—be the East India Company of the 21st century? As much as this article is about the future of governance, there are always important echoes from the past.

More and more entities occupy the middle ground between state-owned and fully privatized, especially in emerging markets. What was taboo under the "Washington Consensus" is today the norm, particularly sizable government stakes in leading industries, whether in the form of ownership, management, subsidies, or other forms of preferential treatment. More fundamental than this shift in the regulatory environment is an evolution in the very nature of the players. The many variations that occur when public not only meets private but blends with it are what we can call "hybrid governance": government-sponsored entities with multi-stakeholder management, publicly financed corporations that compete in the international marketplace, federally chartered bodies with substantial private investment, and other

combinations. In other words, public-sector skeletons with private-sector DNA. Many of the most prominent state-owned enterprises, sovereign wealth funds (SWFs), and special economic zones (SEZs) exemplify elements of this increasingly visible public-private fusion that goes beyond the traditional division of labor between public- and private-sector roles toward a more active, if blurry, cogovernance among them.

The return of parastatals

Today we are witnessing a massive proliferation in the number of new parastatal entities around the world.[1] Parastatals are wholly or partially publicly owned but often privately managed; they include wealth funds, extractive companies, utilities, administrative and judicial centers, export-processing zones, and urban-development authorities that run—with little or no democratic scrutiny—some of the most important pools of money and sites of growth. It is precisely in authoritarian-capitalist China and the petro monarchies of the Middle East that one finds the greatest number of parastatal entities. Power diffusion continues even in the shadow of strength.

Over the past two centuries, parastatals have come and gone in waves. In the post-Depression West, a wave of nationalizations created parastatals that became an institutionalized form of unemployment insurance, providing jobs in excess of productive needs. Operating in closed domestic markets with little shareholder scrutiny, many became bastions of mediocrity and corruption. In the 1980s, Margaret Thatcher's Britain led a global movement away from purely state-run enterprises and privatized widely to curb subsidies, reduce inefficiencies, and improve services.

Recent decades have witnessed a gradual revival of parastatals that foreshadowed their present surge. They gained access to international capital markets and have leveraged investment to expand operations. By floating shares on exchanges, contracting with auditing firms, establishing independent boards of directors, restricting subsidies from the government, and improving recruiting standards and managerial incentives, parastatals have been able to make themselves competitive with the private sector even if most are still less efficient.

Rather than disappearing, therefore, parastatals appear to have expanded their scope and mutated their forms. South Africa and India each have dozens of parastatal vehicles spanning functional fields such as the postal service, energy, railways, telecoms, health care, alcohol, gambling, and education. Britain's BBC; Australia's ABC; the United States' Fannie Mae, Freddie Mac, and Overseas Private Investment Corporation; Brazil's Petrobras; Russia's Gazprom; Qatar's Al Jazeera; and China's China Mobile are all publicly financed but independently operating entities. Today there are very few, if any, areas of governance that have not been placed in the custody of parastatal entities that undertake commercial activities on the government's behalf.

There are very sensible reasons that parastatals have assumed such prominence in governance today. First and foremost, legacy institutions are broken. Frustration has grown around the inability of traditional ministries to manage investment, infrastructure, manpower, and other fundamental concerns. Today it is such ministries that serve as "unemployment insurance" the way parastatals did in the post-Depression era. By contrast, today's parastatals are now accorded the higher-profile tasks such as strategically spending currency reserves (as SWFs do) and raising private coinvestment for mega-infrastructure projects. To secure the capacity to meet these responsibilities, governments now place their top talent at parastatals and recruit internationally, further elevating their

[1] Such bodies are variously referred to as government-owned corporations, state-owned companies, state enterprises, publicly owned corporations, government business enterprises, or quasi-governmental nongovernmental organizations (QUANGOs).



THE SPEED OF PROGRESS
The Delhi Mumbai Industrial Corridor, an autonomous parastatal and one of the world's biggest infrastructure projects, aims to bring high-speed rail links to the region.

status as the key locus of effective governance. In short, parastatals are the entities everyone wants to do business with because in places where politics is an opaque void or a byzantine labyrinth, they "get things done."

Second, the new parastatals are a response to the speed and demands of globalization, which requires faster-paced bodies that are more responsive and more technocratic to harness capital flows while asserting national political control. Emerging markets in particular need to correct for the market failure by which private capital prefers the stability of developed markets. State-owned enterprises, national oil companies, SWFs, and urban-redevelopment projects are the most visible and well-endowed examples of parastatals seeking to master the demands of globalization.

China's State Grid Corporation and Japan Post Holdings rank among the top ten largest companies in the world and can rely on public financing to keep them afloat despite massive inefficiencies. (Chinese state-owned enterprises, or SOEs, still represent an estimated 65 percent of the economy, while Kazakhstan's joint-stock Samruk Kazyna accounts for more than half of GDP through its more than 100 constituent companies.) The parastatals CNPC, Gazprom, and Petrobras are also among the largest companies in the world today, competing with Exxon, Shell, and BP for contracts worldwide. Such giants not only have public support but also support the public: Saudi Aramco generates approximately 90 percent of government revenue, while Gazprom's tax payments generate 10 percent of Russia's GDP. Statoil and Petrobras, by listing on international exchanges, have gradually raised sufficient capital to become world leaders in deep-water exploration. These examples demonstrate how, unlike the SOEs of the past, today's parastatals don't fear international linkages, are happy to encourage diverse minority ownership, and embrace competing aggressively internationally.

Like national oil companies, SWFs have also existed for decades (for example, the Kuwait Investment Authority was founded in 1953) but recently acquired far greater prominence as some of them climbed toward $1 trillion in assets under management. Arab and Chinese SWFs' nimble acquisition of large shares of prominent Western banks and advanced technologies, as well as their increasingly diversified allocation toward other emerging markets, makes them financially oriented and diplomatically important players. Indeed, the lack of clarity over whether they are purely financial or also strategically motivated has raised concerns and barriers, even in countries seriously in need of foreign direct investment. Collectively, these types of parastatals have been crucial for rising

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powers to capture the commanding heights of international finance. Their recruitment of top investment-banking and private-equity talent and riskier international investments are a major departure from decades of more conservative asset management by central banks.

Parastatals have also been crucial for quickly achieving the level of international regulatory harmonization that international investors demand. This is the niche filled by SEZs, special administrative zones, and free zones. In 1980, Shenzhen became China's first SEZ, quickly leveraging foreign investment to rise up the value chain in manufacturing and now in services and technology. Also in the 1980s, the United Arab Emirates launched Jebel Ali Free Zone Authority, which catapulted the emirate into the top tier of global logistics and trans-shipment hubs. The side-stepping or suspension of national laws in the interest of harmonizing to international standards remains a key driver of the establishment of SEZs from Mozambique to Vietnam. But the Gulf petro states remain the most prolific creators of new parastatals. The Dubai International Financial Center, for example, has now had domestic commercial disputes referred to its independent courts due to its higher standards of professionalism and efficiency. Parastatals can thus be productive bridgeheads of global rules into local arenas, bending the latter ever more toward the former.

Because the vast majority of foreign investment in emerging and frontier markets remains in capital cities, urban redevelopment has become another key arena of parastatal activity. One of the great examples of city-region success comes from the once deeply troubled separatist Basque region of Spain. At the height of political tension with Madrid in the early 1990s, Basque authorities created an umbrella parastatal called Metropoli-30, which convened leading industrial and political figures to launch a total overhaul of the province's shipping, rail, urban-infrastructure, and cultural strategies. The result is visible not only in the gleaming Guggenheim Museum in Bilbao but also in an overall standard of living that is considered the best in all of Spain. This example proves that fiscal autonomy can matter much more than political sovereignty.

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Where urbanization, infrastructure, and advanced technology come together in so-called smart cities, a diverse range of parastatals have emerged. For example, Songdo International Business District in South Korea is chartered by the municipality of Incheon, but the largest shareholder in the futuristic real estate is an American commercial developer. By contrast, the Skolkovo district of Russia is entirely government owned. All smart cities seek to partner with corporate investors and academic institutions to build an effective ecosystem. Indeed, without technology partners such as IBM and Cisco, such instant cities would just be high-end housing projects. Whether or not these city projects are owned privately or by the government, they must be jointly managed in order to succeed. It is no wonder then that mayors are increasingly referred to as the "CEO of the city."

Perhaps the world's most ambitious infrastructure project at the moment is the Delhi Mumbai Industrial Corridor (DMIC), which aims to build an entire new artery of cities, railways, airports, expressways, power projects, and innovation clusters on a 1,400 kilometer stretch across seven states, firmly linking India's two most important cities.

Given low investor interest in India today, creating an autonomous parastatal unit such as DMIC—whose main offices occupy a hotel suite rather than a government building—was an essential prerequisite to bring the largest investors, such as the government of Japan and India's major conglomerates, on board.

Is hybrid governance better governance?

It should come as no surprise that parastatals have emerged to unite whatever political will exists in the public sector with whatever resources can be corralled from the private sector. The post–Cold War period has witnessed dozens of ineffective and populist democracies, from Argentina to Greece to Thailand, as well as postcommunist states and postcolonial states still struggling with ossified public sectors.

There is no doubt that the current wave of parastatals has dramatically improved the efficiency of governance and thus represents to some extent the triumph of technocracy over democracy. The question thus becomes what impact will they have on accountability. Indeed, to a large extent each parastatal has a unique bureaucratic structure and legal mandate that makes its authority specific yet opaque and its management structure clear but detached from democratic oversight. Even if parastatals do not reflect a deliberated "will of the people," at their best they can be stewards of Rousseau's "general will," improving hard and soft infrastructure and building companies that mobilize and empower struggling societies. On the other hand, at times they can also crowd out a genuinely inclusive private sector in favor of corporate monuments manipulated by "bureau-garchs" for personal gain.

Alongside the other form of hybrid governance in vogue today—public-private partnerships—parastatals give rise to a schizophrenia about the relationship between public and private. It is only half in jest, therefore, that futurist Peter Schwartz likes to call Singapore "the best run company in the world." Indeed, up to 60 percent of Singapore's GDP is linked to companies owned wholly or partially by Temasek and associated holding companies. Ultimately, the measure of their utility and desirability will be performance. Parastatals should be studied more closely to determine which most successfully blend public mandates and capital with private investment and management to bring about the most successful outcomes for nations and citizens.

Parastatals have clearly become the tool of choice for governments to modernize governance and manage globalization. Despite the lack of public scrutiny, they have proven to be effective vehicles for harnessing scarce financial and managerial resources. Furthermore, as international competition for investment intensifies, increasing numbers of states are likely to take the path of parastatals to promote their attractiveness to the outside world. Governance has never ceased to be a competitive arena. Exporting parastatal models—whether Singapore's land-management authority, Rotterdam's port, or Songdo's smart city—is a new economic and commercial field. Parastatals are spreading faster than any other institutional form because they have been necessary and successful in the absence of alternatives—and are competitive today, even against more democratic options.■

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