



## **JRI news release**

### **The Promising Market for the Outsourcing of Public Works — A Focus on the Living and Environment Infrastructure Sector**

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### **Summary**

Of the many structural reforms proposed by the Koizumi Administration, one that has been given a particularly high level of priority is the reform of public works. This report describes the new approach to the commissioning of public works to the private sector (outsourcing), incorporating the principles of the PFI (private finance initiative) system, as a means of reform, and examines its content, the scale of the market, its benefits in terms of reducing the burden on government finance, etc.

## **1. The Ongoing Trend of Harnessing the Capabilities of the Private Sector**

(i) Devised in Great Britain, the PFI is a system of entrusting public works in their entirety — the construction, operation, maintenance and management of facilities, the related fund procurement, etc. — to private business.

(ii) In 1999, a Law Relating to the Promotion of PFIs was enacted in Japan. As of September 2001, some 260 PFI projects are either in progress or under consideration in this country.

(iii) A high proportion of the work involved in living and environment infrastructure projects, such as waste processing or water and sewerage, lies in their operation, and this sector of public works is highly promising as a target for cost reductions through the use of PFIs.

(iv) The PFI relating to the Nishi-iburi Wide Area Waste Disposal Project, centering on the city of Muroran in Hokkaido, yielded considerable benefits, including a 30% reduction in life cycle costs.

(v) As set out in the *honebuto* ["strong bones"] policy, Japan should set out to harness the capabilities of the private sector not only for the construction of new facilities, but also for the management, maintenance, and operation of existing facilities.

## **2. What is Outsourcing?**

(i) The practice of commissioning the management and maintenance of facilities to private business is already widespread in Japan. However, the private sector does not have enough room to be more efficient by their own creative, and the system remains inefficient.

(ii) "Outsourcing" is a system that seeks to stimulate the creativity of the private sector, to reduce costs and to enhance efficiency, through the commissioning of projects to private business, and is characterized by:

- the introduction of performance-based ordering
- performance-based commission
- systems for the observance of performance
- an expansion of the scope of public works entrusted to private business, and
- contracts running for several fiscal years

(iii) At Moriya in Ibaraki Prefecture, the adoption of some of the ideas of outsourcing achieved a 9% cut in the management and maintenance costs of the local waste processing facility.

(iv) At the national level, in the field of water and sewerage, efforts are being made to promote the introduction of outsourcing.

### **3. The Benefits of the Introduction of Outsourcing**

(i) An estimate of the scale of the outsourcing market based on the example of wastewater treatment, for which a full range of data are available, suggests that an expansion of the range of work on be outsourced could yield up to 250% market growth from the viewpoint of the private sector. This could lead to the creation of new markets based on domestic demand.

(ii) Meanwhile, the attendant reduction of the number of public officials and of the costs relating to public works have the potential to cut overall management and maintenance costs by around 20%.

(iii) Moreover, outsourcing is likely to promote the accumulation of management know-how by private business. Major foreign companies (e.g. the Vivendi Group of France) have used the know-how they have accumulated through outsourcing

work in the context of PFIs promoting outsourcing will make a foundation for the introduction of the PFI system.

#### **4. Issues Surrounding the Introduction of Outsourcing**

(i) As there are no systemic obstacles, it should be possible to introduce outsourcing under the present system.

(ii) However, steps must also be taken to reduce the burden on local governments, including measures to help local governments make smooth progress with the arrangements for the introduction of outsourcing, systems to provide support on the technical side, and the creation of standard contracts.

(iii) There must also be a change of outlook among local governments, which should entrust actual work to the private sector in order to be able to focus on their own work, such as PR to local residents and policy proposal.

(iv) In future, because many facilities in Japan are of a smaller scale than their counterparts overseas, collective outsourcing of multiple facilities will be necessary. For this reason, it will also be necessary to create systems of collective ordering with some local governments.