Public Private Partnership as a Last Resort for Traditional Public Procurement

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Summary: This paper discusses recent changes in the way public services are delivered. A marked increase in the cooperation between the public and private sector in the realisation of complex projects, mostly concerning development of infrastructure, is the main characteristic of present-day developing economies. The creation of new, innovative agreements is driven by the limitation of public funds and an ever-growing demand for an increase in the quality of public services. Looking upon the western economies experience, alternatives to the traditional public sector procurement are identified in the public/private partnership. The public/private partnership can be seen as one component in the rearrangement of the public sector with a management culture that focuses on the citizen or customer. Also included in this are accountability for results, investigation of a wide variety of alternative service delivery mechanisms, and competition between public and private bodies for contracts to deliver services consistent with cost recovery and the achievement of value for money. The partnership can be realised through an array of models and in this paper priority is given to the DBFO (design-build-finance-operate) model, due to its importance in implementation. The DBFO model is considered to be a synonym for the public/private partnership, as it is the most suitable for complex projects and gains the most benefits.

Key words: Public private partnership, Public procurement, New public management, DBFO model (design-build-finance-operate).

JEL: R42, H57, L33, P35

1. Introduction

Societies and economies are changing and there is a need to bring together the best elements and best practices of that change. While the assumption that the public sector is responsible for the delivery of basic services remains deeply rooted in minds of many policy makers, the methods by which these services are created, procured and delivered are changing. This is reflected in the desire to engage the private sector to work in complex and demanding projects in the public interest.

Governments worldwide have gained an experience with the increased involvement of the private sector in the delivery of public services. These initiatives have taken many forms, such as the outright privatization of previously

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state-owned industries, contracting-out of services, or the use of private finance in the provision of social infrastructure. An innovative approach in the project realisation was recognised as the partnership relation between two sectors. It is generally recognised that public/private partnerships offer a long-term, sustainable approach making better use of taxpayers' money.

The underlying logic for the establishment of a partnership is that both sectors have specific positively correlated characteristics jointly enabling a more effective provisioning of public services. The most successful partnership agreements draw upon the strengths of *both* public and private sectors to establish complementary relations. Rather than considering this kind of partnership as a model, it should instead be thought of as a process.

2. Drivers of change in the public sector

Dissatisfaction with huge and ineffective Government led to an inclination toward private sector inclusion. As early as the 1980s a new way of thinking called "*New Public Management*" was identified as an alternative. According to Hood [12] the concept of new public management (NPM) could be associated with approximately seven dimensions of change, relating to the issue of how far the public sector should be distinct from private in its organization and methods of accountability and how far managerial and professional discretion should be fenced in by explicit standards and rules. The seven elements of new public management are¹:

• A shift towards greater *disaggregation* of public organizations into separately managed "corporatized" units for each public sector "product."

• A shift towards greater competition both within public sector organizations and between public sector organizations and the private sector.

• A move towards greater use within the public sector of management practices which are broadly drawn from the private corporate sector.

• A move towards greater stress on discipline and parsimony in resource use by actively searching for better alternatives that create less costly ways to deliver public services.

• A move towards more "hands-on management", i.e. more active control of public organizations by visible top managers wielding discretionary power.

• A move towards more explicit and measurable, or at least checkable, standards of performance for public sector organizations, in terms of range, level and content of services to be provided.

• Attempts to control public organizations in a more "homeostatic" style according to preset output measures.

• Another way of presenting new management is by the concept of Reinventing Government.

¹ According to Hood 1995. pp. 95-98 [12].

According to Kettl² "Government is broken, and it is time to fix it" and by implementing new ideas, savings in the USA were estimated at some 177 billion dollars with realisation at 111 billion USA dollars after two years of practise. Savings were incurred by: downsizing the bureaucracy, procurement reform, savings from information technology, reducing intergovernmental administrative costs and agency-based initiatives. The key strategy was and should be reconnecting the citizen with the Government and making public programs more responsible. Although it sounds logical, it is not that easy to determine who the customer is.

There are at least four different perspectives on the citizen as customer. As *service recipients*, citizens naturally want large (sometimes even unlimited) high-quality services at low (or even no) cost. Citizens, however, often are *partners* in service provisioning as well as being service recipients. More government programs, from welfare reform to filing taxes, require citizens to be active participants in the process. Third, citizens expect clear accountability from the government: if problems emerge, they expect that the problems will be solved. Finally, citizens as *taxpayers* pay the government's bills. While as service recipients they might expect virtually unlimited service, as taxpayers they expect tough management, high efficiency, with minimal waste, fraud, and abuse.

Kettl concludes: "Thus, while it is hard to contest the notion that government should not try to serve the needs of its citizens—and that, in doing so, it has a long way to go—it is by no means clear just what this means. The relationships between citizens and their government in a democratic society are far more intricate and difficult than those between a customer and the private organization seeking the customer's business. Customer service thus is a valuable goal but a weak compass for governance."³

It is critical that reform should succeed in rejuvenating public service provision without detracting from the core needs for which public services provide. The challenge to reform public services is massive and complex, with *increases in expectations* and demand coming hand-in-hand with a *decreasing willingness to pay* through taxation, especially if public services do not improve fast enough. The only way to meet this challenge is through systematic *reform, investment and innovation*. Diversity and contestability will be critical in delivering this.

3. Public/private partnerships as an instrument for transforming public services

Among the solutions for this on-going problem and aforementioned challenge, public private partnerships were identified as an alternative to traditional public procurement. The term "public private partnership" (PPP) has come into fre-

² Kettl (1998), p. 8 [14].

³ Kettl (1998), p. 26 [14].

quent use only recently, e.g. in the UK in the 1990s. Previous to this, in an attempt to improve the delivery of public services, there was a great deal of discussion determining the degree of need for public bodies to involve other organizations in the delivery of public services. In defining the term "partnership" one could say in short that it is a joint venture with shared risks and profits. In this way cooperation, inclusion and association are related to partnership. The concept was encapsulated in the following definition⁴:

"Partnering involves two or more organizations working together to improve performance through mutual objectives, devising a way of resolving disputes and committing to continuous improvement, measuring progress and sharing gains".

Continuing in the same manner the Institute of Public Policy Research (IPPR Report 2001[24]) defined partnerships as:

"A risk sharing relationship based upon a shared aspiration between the public sector and one or more partners from the private and/or voluntary sectors to deliver a publicly agreed outcome and/or public service".

"Public private partnerships are arrangements between government and private sector entities for the purpose of providing public infrastructure, community facilities and related services. Such partnerships are characterised by the sharing of investment, risk, responsibility and reward between the partners" (Municipal Ministry of Municipal Affairs (1999). p.5[25]).

The underlying logic for the establishment of a partnership is that both sectors have unique, advantageous characteristics in specific aspects of public service delivery. The most successful partnership agreements draw on the strengths of *both* the public and private sector to establish complementary relations.

The big advantage of PPP is threefold. Firstly, the partnership allows government to maintain an active role in developing policy initiatives. Secondly, the partnership provides a means for the private sector to complement, rather than replace government. Finally, it encourages a valuable exchange of skills and experience between two sectors.

Public private partnership models

There has been intense political debate about the role of PPP in public service provisioning. This debate has often been confused by an inadequate understanding of the differences between introducing private sector provisioning through partnering or via privatization using private funding exclusively.

Outsourcing is well suited to operational requirements and is usually awarded on a competitive basis and extends for a short time. It allows public agencies to benefit from the particular technical expertise of the private sector, while the overall responsibility remains with public sector. It should not be re-

⁴ Geddes, 2005 p.1 [7]

garded as a partnership, but as a short term cooperation, without the risk and profit sharing. The introduction of private funding could be realised with outsourcing contracts. The simplest models are *service contracts*. Being considered as outsourcing and not partnering, the private party procures, operates and maintains an asset for a short period of time, with the public sector bearing the financial and management risks. These models represent traditional public service procurements.

There is a considerable difference between the whole vs. partial sale of state assets, as specified by the procuring public sector bodies. *Privatization* concentrates all responsibilities on the private sector with no sharing of risk or profit of any kind. Two related processes: Privatization and Liberalization need to be distinguished here. Liberalization is a reduction of government control and refers to the opening of the economy to competitive pressures. On the other hand, Privatization could have liberalizing effects on the economy, but does not have to. Public monopolies can simply turn into private monopolies that oppose liberalization.

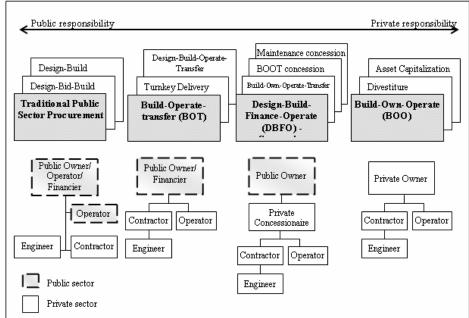


Figure 1. Project Procurement Options

Source: European Commission (2003) [21], p.18.

Privatization should not automatically be equated with increased competition. Unfortunately, different forms of privatization have become synonymous with the debate about public sector reform and the role of the private sector. Although the term PPP has been in general use for some time, no single model of PPP has been identified as the unique and widely accepted one. Public/private partnership approaches are arrayed across a spectrum. At one end, the public sector retains all responsibility for financing, constructing, operating and maintaining assets, together with the responsibility for assuming all associated risks. At the other end, the private sector assumes all of these risks and responsibilities. The vast majority of PPP approaches fall into the middle of the spectrum, between the public sector and its private partners according to their strengths and weaknesses. Figure 1 shows various project procurement options.

Traditional public procurement is covered by Design and Construct (D&C) contracts, while Sale and Leaseback Agreements are often driven by taxation advantages, rather than any partnership motives. Most of the models embrace some form of PPP arrangement with the majority being based upon some form of lease, franchise or fixed-term concession, using different combinations of private sector resources to design, renovate, construct, finance, operate, manage and maintain facilities. Except for BOOT, where ownership is private, at the end of a concession the public body takes over (resumes) responsibility for the ownership, operation and management of the asset.

The relationship between the Government and the market can be viewed as a continuum. As shown in Figure 1, traditional public provisioning is at one pole, and at the opposite end is the purely private activity, with the points in-between representing a slightly different mix between the public and private sectors.

Within PPP the public sector acquires and pays for services from the private sector on behalf of the community and retains ultimate responsibility for the delivery of services, although they are provided by the private sector. Logically, the Government is not indifferent to the quality provided and it would be wrong to argue that engaging the private sector in public service delivery would result in a quality decline, or that there would be an increase in price.

The analysis of a partnership range begins with the simplest of models. Slightly more complex than outsourcing contracts, and closer to a true partnership, is the *Operation and Management Contract* (O&M), where the private sector operates and manages a publicly owned asset. Revenues for the private party are linked to performance targets. The public sector bears financial and investment risks.

Models that concentrate more activities and responsibilities on the private sector are *leasing-type contracts*. These models incorporate BBO (build-buy-operate), LDO (lease-develop-operate) and WAA (wrap-around addition) contracts/models. The private sector buys or leases an existing asset from the public sector, renovates, modernizes, and/or expands it, and then operates the asset, again with no obligation to transfer ownership back to the government.

The model that has been implemented most frequently worldwide is *BOT* (build-operate-transfer). BOT model includes contracts such as: BOOT (build-own-operate-transfer), BROT (build-rent-own-transfer), BLOT (build-

lease-operate-transfer) and BTO (build-transfer-operate). The private sector designs and builds an asset, operates it, and then transfers it to the government when the operating contract ends, or at some pre-specified time. The private partner may subsequently rent or lease the asset from the government. The advantage of the BOT approach is that it combines the responsibilities for what are usually different and separate functions under one single entity. The government awards BOT contracts by competitive biding following a transparent tender process.

The most complex model is *DBFO* (design-build-finance-operate) which embraces models such as: BOO (build-own-operate), BDO (build-developoperate), DCMF (design-construct-manage-finance). With this model the private sector designs, builds, owns, develops, operates and manages an asset with no obligation to transfer ownership to the government. DBFO model is usually realized through concession. Main characteristics of DBFO models are threefold. Firstly, it is a long-term contract (usually 25-30 years). Secondly, it has detailed provisions upon payment, service standards and performance measurements, providing an objective means to vary payment depending upon the performance. Lastly, there may be more than one private party involved, with executive responsibilities generally delivered through various subcontractors to the principal private sector party listed on the DBFO contract. The key driver in the DBFO model is the utilization of private finance, as well as the use of the design and construction, in addition to transfer of operating risk to the private sector party. The core strength follows from those advantages and, above all, the use of private finance. This leads to a more predictable and consistent cost profile, greater incentive for the adoption of whole life costing, lower overall costs and finalization of the project according to the agreed time table.

Being the most complex, the DBFO model brings the most benefits to the general public service delivery context. This being said, DBFO is usually the model in mind when speaking about public/private partnerships.

Benefits of successful public/private partnerships

Generally, the public/private partnership procurement can provide a wide variety of net benefits for a government. Some of those numerous benefits could be defined as:

• Enhancing the government's capacity to develop *integrated solutions*. In the traditional procurement process complex projects are broken down into separate components due to budgetary limitations. With PPP procurement, the scope is expanded and its focus can be shifted to developing integrated solutions implementing innovative solutions.

• Facilitate *creative and innovative* solutions. Since PPP is more concerned with desired outcomes than on how they are achieved, it is capable of developing a unique and creative approach to the delivery of the required pro-

ject. The defining characteristic of PPP is the integration within a private sector of all the functions of design, building, financing, operating and maintenance of the facility. Bundling is normally argued for on the grounds of enhancing the potential to realize economies of scale and scope along with innovations in design, pricing and risk-sharing. The most important question is what services the private sector should deliver. Core services, in medical, educational or judicial sectors, should be delivered only by the public sector. For other sectors core services could be passed on to the private sector. It is not unusual to find examples of privately managed prisons (e.g. Bridgend and Fazakerley prisons in UK).

 Reduction of costs and time of project implementation. PPP procurement offers the potential benefit of reducing costs and implementation time. Alternatively, it offers higher quality at the same cost. Research has shown that average savings are around 17%⁵. Owing to the integrated approach, planning and design takes less time and overall projects can be finished within the planned time frame

Risk transfer. One of the core objectives of PPP in public procurement is risk transfer. The appropriate risk transfer is essential, i.e. risks are allocated to the party best able to manage them and respond to the incentives they offer. Only by transferring risk can there be certainty that the private sector has the incentives to price and produce efficiently.

PPP attracts *larger*, potentially more *sophisticated bidders* to the project. Biding for Project Tender Procedures offers competition FOR the market, but does not always ensures competition AT the market level. When competing for a project all bidders offer lucrative proposals, but once the contract is awarded the government has to pay close attention to the contract implementation. If government wants to enhance competition AT the market level it can allow the project implementation to be given to more than one private consortium. The sheer size and scope of the projects will attract only "big players" that are capable of conducting complex tasks and roles.

Access skills, experience and technology. Governments can gain new skills, technology and knowledge, as a result of undertaking PPP.

In true PPP, the procuring body remains in control, specifies outcomes and standards, monitors performance, agrees to business plans and controls payments to the supplier. It remains ultimately accountable. This specific characteristic of a partnership distinguishes it from any kind of privatization. With privatization, the government is left with the sole regulatory instrument to improve competition. A successful partnership will exist only if both partners; have shared objectives, have agreed to a realistic set of commercial relationships and contract terms with the final contract and specified outcomes being determined through negotiation, as opposed to imposed solutions⁶.

⁵ Arthur Andersen and Enterprise LSE conducted a research and made quality conclusions about possible success of PPP procurement [20]. ⁶ According to John Tizard in Ghobadian 2004. p139. [8].

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Table 1. Characteristics of successful partnerships			
Purpose and objec- tives	Leadership quality	Partnership values	Management
 Clear objectives Specific added value Long-term commitment 	 Prominent political presence Strong interpersonal skills Consistency 	 Openness and trust Integrity and fairness Mutual support Shared belief in cultural change 	 Through planning Balanced membership Agreed accountability Clear business plans Regular performance reviews Excellent working relations Continuity of resource

Table 1. Characteristics of successful partnerships

Source: Grimsey 2004. pp 160 – 161[9].

Explained in some detail several factors must be put in place in order to provide a "proper mechanism" for private sector involvement:

• Government bodies must view the transaction as the purchase of a service and not the acquisition of the underlying asset;

• Both parties must accept that the transaction is not a purchaser-supplier contract but is a partnership in which there is a sharing of risks and responsibilities;

• It is necessary to establish that both sides have the capabilities to fulfil and carry out their side of the bargain;

- Interaction is essential in all parts of the agreement;
- Careful preparation work must be undertaken in respect to:
 - Definition of outputs
 - Consensus among participating bodies
 - A clear approval process
 - Allocation of ownership rights
 - Identification of rights and responsibilities
 - A valid comparator for value for money
 - A clear business model.
- Realistic timelines need to be established;

• The PPP contract should be sufficiently flexible to take into account any

- new targets and future requirements that may develop over time;
 - Risk allocation has to be cost-effective.

In conclusion, a true partnership is present only if:

• it is seen as a medium to long term relationship, and not as a "quick-fix";

it is a relationship based on shared aspirations;

• it involves a sharing of risks, rewards and resources on the part of all the partners;

 its aim is to deliver outcomes and services in the public interest on a continuously improving basis.

Relying on the views presented in Geddes, table 1 sums up all the essential ingredients for a successful partnership.

Obstacles to public private partnerships

Public/private partnership procurement in emerging markets has been applied mainly to the hard infrastructure projects. These projects rely on large-scale foreign currency financing. In these markets the market and political risks are great and it is common practice to implement PPP in industries that can offer predictable revenue streams.

Simply deciding to open up traditional public sectors to private finance is not enough to encourage investments. There are many factors that must be put in place beforehand. PPP is a complex process with all the parties involved and the impact that it has on the public sector must be considered. One of the first questions to be dealt with to enable the possible implementation of PPP is the *legal framework*. In many countries there is no legal framework for PPP. Solutions vary from enacting Laws on PPP to placing amendments to existing commercial laws.

Second possible obstacle is *finance*. High risk is attached to the project and in some economies it is difficult to overcome it. The most common high risks in emerging economies are political and commercial. They could be overcome by international financial institutions and some specific agreements.

Public acceptance may emerge as an obstacle as well. A broad public consensus is needed for the involvement of private finance. At the same time the public administration has to have the capacity and skills to manage and negotiate successful projects.

Though all of these things are required pre-conditions for complex PPP projects, there is also a need to have support from suitable legislation. Establishing a framework for long-term cooperative public/private partnerships relies on political support from the public side as well. A constant dialogue needs to take place between the public and private sectors to create a foundation for true partnering.

4. Conclusion

The boundaries between the public and private sectors are now very blurred and today's partnerships involve community, educational and health groups, many of whom receive funding from both public and private sources. Public services are improving through a variety of means and changing their relationships with their users and the wider economy. The question is whether the change is fast and deep enough. The current answer could be that there are some visible changes, but overall there is still much to be done. The challenge is to ensure the appropriate and adequate pace of change to meet public expectations.

Encapsulating everything that has been said, the public/private partnership can be seen as one component of a rearrangement of the public sector with a management culture that focuses on the centrality of the citizen or customer. This partnership emphasises accountability for the results, investigation of a wide variety of alternative service delivery mechanisms, and competition between public and private bodies for contracts to deliver services, consistent with cost recovery and achievement of value for money.

Partnering represents heritage of "design and build" models, but adds additional layers of complexity. These come from the fact that many of the PPPs are DBFO (design-build-finance-operate) in character, combining ownership with operation and management, and also with design and construction.

Developing this new concept of public/private partnership in the past few years, has demonstrated the immense potential of true partnership in contributing to the drive to improve public services. The public private partnership should not be regarded as representing neither a miracle cure nor a quick fix to infrastructure and service development. The partnership, with all its possible tools, should be regarded as an alternative to traditional public procurement. It is particularly effective in areas of strategic significance, due to the flexibility, sustainability and information sharing inherent in its operation.

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- Partnerships UK (PUK) being the partnership itself offers useful information concerning PPP. http://www.partnershipsuk.org/

Partnerstvo javnog i privatnog sektora kao poslednje utočište tradicionalnog načina podmirenja javnog interesa

Rezime: Većinu privreda zemalja u tranziciji karakteriše nedostatak kapitala za finansiranje brojnih infrastrukturnih projekata, kao i vrlo izražena potreba za unapređenjem javnih servisa. Upravo takvo stanje privrede najlakše i najbezbolnije se dovodi na nivo željenog primenom koncepta partnerstva.

U radu se analizira prilagođenost partnerstva javnog i privatnog sektora, kao alternativnog modela za zadovoljenje javnog interesa, uslovima savremenih i sofisticiranih zahteva korisnika javnog servisa. Partnerstvo se primenjuje uvek kada je potrebno unaprediti kvalitet i povećati efikasnost javnih servisa, a javni sektor nije u mogućnosti da to samostalno sprovede. Država menja svoju ulogu i prepušta, delimično ili u potpunosti, obavljanje delatnosti od javnog interesa privatnom sektoru, dok se ona posvećuje ulozi menadžera (kontrolora i organizatora). Najpodesnije oblasti za primenu partnerstva su projekti infrastrukture.

Koncept partnerstva obuhvaćen je sa aspekta vlasništva, bliže ga određujući i navodeći moguće koristi od primene. Partnerstvo zahteva dublji oblik saradnje dva sektora uz podelu vlasništva, obaveza i rezultata. Predstavlja ozbiljnu saradnju koja na inovativan način rešava realne probleme. Neke od brojnih koristi primene inovativnog koncepta realizacije projekata od opšteg značaja su: povećana mogućnost razvoja integrisanih rešenja, podsticanje kreativnosti i inovacija, smanjenje troškova i vremena sprovođenja, transfer rizika i pristup veštinama, iskustvu i tehnologiji. Posebna pažnja data je definisanju usluga koje će sprovoditi privatni sektor. Veoma bitan faktor uspeha projekta je pravilno definisan opseg usluga u realizaciji privatnog sektora.

Koncept partnerstva razmatran je kroz oblike moguće saradnje dva sektora. Paleta modela ima raspon od najjednostavnijih i ograničenih ugovora o sprovođenju usluga, do privatizacije kao poslednjeg modela u spektru kojim se prenose sve odgovornosti i nadležnosti na privatni sektor. Najveći značaj pridaje se ugovoru o dizajnu, izgradnji, finansiranju i eksploataciji, poznatijim pod kraćim nazivom *DBFO* ugovor. Koncentracija rizika kod privatnog partnerstva omogućava povećanje efikasnosti i otklanja nepotrebna izdvajanja javnog sektora i pretpostavlja veći stepen angažovanja privatnog sektora. Posmatrajući različite modele partnerstva, mora se imati u vidu činjenica da je ova oblast izuzetno dinamična i da su pojedina rešenja prilagođena specifičnostima konkretnog projekta. Proizilazi da je nemoguće jedan model proglasiti najboljim i univerzalnim, već treba proučiti različita partnerstva i prihvatiti ono što se najbolje može prilagoditi domaćim uslovima i pojedinim projektima.

Partnerstvo javnog i privatnog sektora je koncept koji se još razvija i može se ispoljiti u različitim formama. Uspešnost zavisi od izabranog konkretnog projekta, pravnog, regulativno i kontrolnog okvira, kao i od struktrure aranžmana u kojoj bi svki partner trebalo da prepozna svoju ulogu i svoje interese u potpunoj saglasnosti sa zajedničkim ciljem – zadovoljenjem opšteg interesa.

Ključne reči: Partnerstvo javnog i privatnog sektora, Javne nabavke, Novi javni menadžment, DBFO model (dizajn-izgradnja-finansiranje-eksploatacija).

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