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## Public Private Partnerships as Common Tool in Globalized Economy

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### Abstract

This paper discusses recent changes evident in improved cooperation between public and private sector in realization of complex projects as the main characteristic of present-day worldwide economies. The creation of new, innovative agreements is driven by a globally identified problem: limitation of public funds and ever-growing demand for increased quality of public services. One of the forms for solving of this problem is the Public Private Partnership (PPP) as a common tool that can find application in all economies, regardless of the level of economic development. Public private partnership was identified as an alternative to the traditional public sector procurement that could be seen as one component of the rearrangement of the public sector, consistent with cost recovery and achievement of value for money.

Governments, globally, have expanded an experience and proficiency in increased involvement of the private sector in the procurement of public services. The fundamental reason for introduction of a partnership is that both sectors have particular positively correlated characteristics that could jointly facilitate more effective provision of public services.

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The most successful partnership agreements portray the strengths of both public and private sector to establish harmonizing relations. Instead of considering a partnership as a model, it should be considered as a process. Commonly accepted partnerships are in the field of infrastructure, although success is granted in technology partnerships, and sometimes in policy partnerships also. Presented as a universal solution, partnerships are being implemented in different political and economical environments with a diverse success rates. Intended for this paper, research has been conducted for two economies of South Balkan (Macedonia and Serbia) with a purpose of identifying current partnership projects and their prospects. As a novice in the implementation of partnership concept, these countries are willing to start with the widely accepted concession agreements in the field of infrastructure development. Proven to be a success story, there is a room form for more kinds of partnerships agreements.

**Keywords:** public private partnerships (PPP); infrastructure partnerships; concession.

## **1. Introduction**

Fast, dynamic and turbulent changes taking place in the global economy, the processes of globalization and internationalization needs a relatively more or less time to be implemented in all economies in the world (from the most developed, to the less developed and developing economies). Nor any national economy is not immune to these processes. It is important for every economy to bring together (with some adjustments to the specific conditions) the elements and practices of that change that shows positive results in economies where they are already implemented. In this paper, we are talking about limitation of public funds and ever-growing demand for increased quality of public services, which was recognized as a significant problem of modern economies. Having in mind that the problem was identified as universal, or globally present, the search for inclusive solution has become preoccupation of contemporary economists, and politicians as well.

The notion that the public sector is responsible for the delivery of basic services still remains, though the method by which these services are created, obtained and delivered is changing. This is reflected in a desire to engage the private sector to work in a complex and demanding projects in a public interest.

The process of involving the private sector in meeting of the public needs beginning to gain intensity starting in the 80's of last century. It is a process which is known as "New Public Management" that brings some new rules and principles of functioning of the public management. The essences of these changes are related to the rationalization of public expenditures, greater transparency and responsibility of the public sector, with a simultaneous better meeting of the common needs of the citizens. From then until today, the public sector at all levels of government worldwide, has already built practices and gained an experience in increased involvement of the private sector in the procurement of public services. It is a practice in which the public and private sectors have common interest and establish positive interaction in a process of meeting the public needs, more effective provision of public services, minimizing costs and achieving profit. "Contract on public private partnership" is a contract of financial interest concluded between a public and a private partner that as its object have projecting (design), financing, construction and maintenance of infrastructure facilities, equipment and/or provision of services by the private partner in order for performing of some specific public service. Contracts for public

private partnership are often realized in the form of a concession contracts.

## **2. Public Private Partnerships as a Common Tool for Developed and Developing Economies**

Public private partnerships were acknowledged as an alternative to traditional public procurement, due to the positive effects arising from this partnership for both parties. The term "public private partnership" (PPP) has been into frequent use not very long time ago, e.g. in UK starting from 1990s. Prior to then, in attempt to improve the quality and the delivery of public services, there has been a great discussion determining the needed degree of involvement of private bodies in delivery of public services, despite the already ongoing process of applying the principles of new public management.

In trying to define the term "partnership", the shortest it can be defined as joint venture where both parties undertake a part of the risk and share the profits. It is a form of cooperation which means undertaking joint activities in the interest of both parties, it means taking advantage of the economy of scale and the economy of scope, and in that way reduce costs, minimizing risks and maximizing profits. The concept was encapsulated in the following definition: "partnering involves two or more organizations working together to improve performance through mutual objectives, devising a way or resolving disputes and committing to continuous improvement, measuring progress and sharing gains" [1].

Public-private partnership on its part must be based on certain principles which will enable rational and efficient use of funds in assigning of public contracts, concessions and PPP contracts. During this partnership, it must respect the rule of equal treatment and non-discrimination of economic operators, transparency and integrity in the assigning of contracts which increases competition and realize the principle of best value for money. The big advantage of public private partnership is threefold. Firstly, the partnership allows government to maintain an active role in developing policy initiatives. Secondly, the partnership provides means for private sector to complement, rather than replace government. Finally, it encourages a valuable exchange of skills and experience between two sectors [2].

There are numerous ways in which the private sector may invest in public infrastructure. Depending on the level of associated risk, the variety of possible contractual arrangements ranges from public procurement, where a contractor does not assume any project risks, to privatization, where public assets or shares are in a publicly owned company and are disposed to the investor, together with all the associated risks.

Arguably, the most interesting and sophisticated arrangements lie in the area somewhere between procurement and privatization. Such options are generally considered to be more effective than those at the extremes of the spectrum focusing a particular category of partnerships - concession type and BOT (build-operate-transfer) and DBFO (design-build-finance-operate) type arrangement. The DBFO (design-build-finance-operate) model is considered to be a synonym for the public private partnership in infrastructure, as it is the most suitable for complex projects and gains the most benefits [2]. The selected category is regarded as the most complex since it involves more sophisticated legal and financial arrangements as well as risk sharing. The legal environment for concessions is vital to the implementation of many types of public private partnerships.

New model of collaboration between the public and the private sector can be realized in an array of different industries and fields. Prevalent are partnerships in demanding and complex infrastructure projects. Moreover, partnerships are suitable for policy making in most developed economies, such as the United States of America, or as a third field - application of technology transfer. All three fields have provided prolific conditions for further development and improvement of the concept. 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 solutions [3]. However, the extent of success was restricted by the advancement of the economies, existing infrastructure and social and political support.

Global problems in a globalized economy impose the need for a global system of thinking to address them. Partnerships on a global scale are predominantly suitable for solving ecological problems, problems regarding medicament or treatment expansion. Most successful are those partnerships in prevention of a number of serious modern diseases, AIDS prevention and vaccine research for Africa, but serving to the rest of the world at the same time. These specific partnerships embrace experts from specific fields from all over the world, regardless of the sector they represent. Usually, the experts come from state institutes, representing public sector, while the funds are primarily from private or mutually private and public sources.

The margins between the public and private sectors are now very indistinct and today's partnerships involve community, educational and health groups, many of whom receive funding from both public and private sources. What is important is to better meet the needs of citizens, and how the public sector will coordinate that with collecting funds from private funds is contractually regulated.

Majority of partnerships are intended for solving smaller scale problems, characteristic for an economy or an industry. Initial projects are always faced towards economic infrastructure renovation, leaving social infrastructure for afterwards phases, when public is familiarized with a concept. Thus, industries having the highest propensity to attract private investment are:

- Transport (roads and motorways, rails, airports, tunnels, bridges).
- Urban development and renovation.
- Social infrastructure.
- Power generation, transmission and distribution.
- Drinking water and waste water treatment.
- Environmental Protection.

Gaining the experience in these preliminary or preparatory projects, economy is enhancing its legal, infrastructural, political and social environment heading to a genuine partnerships where private sector could be awarded even performance of core services, such as: safety, medical treatment, or education. For the time being, this is possible only in most developed economies, such as United Kingdom, United States of America, Australia, some developed European countries etc.

### **3. Transitional Economies – Getting it Right?**

Public private partnerships are predominantly intended for complex and demanding projects, especially in infrastructure development. Developed economies have significant experience in this area and it was not until recently that Macedonia, Serbia and other transitional economies has made a decision to embark on this adventure also. Resembling most of the transitional countries implementing just one aspect of partnerships in the form of concessions, Serbia is an example that shows firm determination to use reliable and widely accepted solutions. Concessions law plays a vital part in the implementation of many types of PPPs. Under a concession arrangement, a public authority entrusts to a private sector operator total or partial management of services for which that authority would normally be responsible and for which the private sector operator assumes all or part of the risk [4].

Boundaries between countries in terms of information and experience sharing are gradually disappearing. Lagging behind the majority of developed economies considering implementation of new concepts, they nevertheless realize some benefits. To begin with, considerable experience has been gained that could speed up successful project performance in the rest of the world. This is something that transition economies could profit from. The safest implementing partnership project for budget challenged economies is concession agreement. For this reason, most developing countries are opting for this type of leading partnership arrangements.

In the case of a public service concession, a private company enters into agreement with the government to have the exclusive right to operate, maintain and carry out investment in a public utility for a given number of years. This arrangement may involve the transfer to the concessionaire of the right to use some existing infrastructure required to carry out a business. In some cases, such as mining, it may involve merely the transfer of exclusive land use rights. A concession gives a company the right to operate and maintain a public utility, and to invest, leaving public sector with the sole responsibility of taking care of the public interest.

Transitional countries are in a turbulent and highly dynamic process of catching up with developed market economies. Distinguished as planned economies until recently, they are under painstaking process of conversion of law regulations toward western standards. In the analysis, solely Law on Concession has been taken into consideration, as concessions are in focus of the paper. As shown in figure 1 developing economies are on the accurate path. Whether the law is appreciated in practice is another thing. Transition countries that have only ever used traditional public sector procurement processes face a steep and long- term learning curve when they embark upon public-private partnerships (PPPs).

The advantages of PPPs include maximizing value for money, reducing public debt and strengthening infrastructure. The process of developing PPPs as a way of procurement, when starting from a system that has only ever used traditional public sector procurement processes, requires a quantum leap in understanding, procedures, institutional acceptance, market understanding and risk taking. It takes a long time to introduce such a significant change. In the United Kingdom, for instance, the development of the PPP, or Private Finance Initiative (PFI) as it is known, started in the early 1980s and is still being refined [6].

**Table 1:** Quality of concessions laws in transition countries [5] Compliance/conformity with international concessions standards and principles

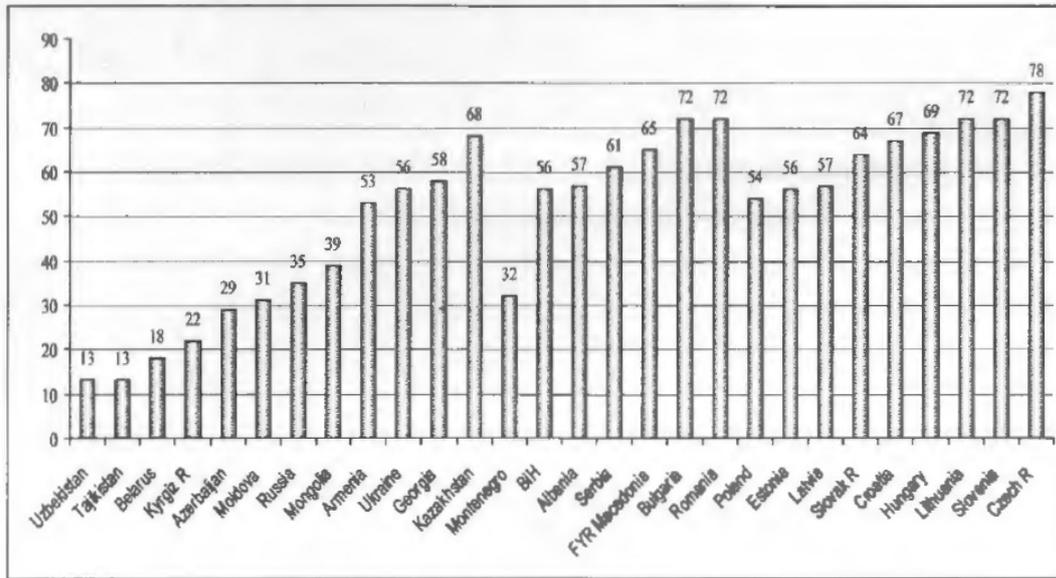
Very high compliance/ Fully conforms	High compliance/ Largely conforms	Medium compliance/ Generally conforms	Low compliance/ Partly conforms	Very low compliance/ Does not conform
Lithuania	Bulgaria Czech Republic Slovenia	Bosnia and Herzegovina FYR Macedonia Moldova Montenegro Romania Russia Serbia Slovak Republic Ukraine Armenia Azerbaijan Estonia Kazakhstan	Albania Croatia Hungary Kyrgyz Republic Latvia Turkmenistan Uzbekistan Poland	Belarus Georgia Tajikistan

Note: Countries in green did not have a general law on concessions when the assessment was undertaken in 2005.

For these countries, the assessment rated the level of conformity of other relevant laws – such as contract law or

sector-specific legislation – with internationally accepted principles.

Source: EBRD Assessment of Concessions Law 2005



Notes: Effectiveness is measured on the following scale: very high (90 and above); high (70 to 89); satisfactory (50 to 69); low (30 to 49); very low (less than 30). Data on effectiveness for Turkmenistan were not available. Countries indicated with an asterisk had only implemented one concession project or none at all by July 2006.

Source: EBRD Legal Indicator Survey 2006

**Figure 1:** Effectiveness of concession laws in transition countries [5]

Number of concession agreements in developing countries is encouraging proving determination to be alike in the global village. The industries ascertain to concessions correspond to the experience of advanced economies. Opting securely for infrastructure development or reconstruction, builds up confidence in new methods and makes general public accustomed to innovative solutions in slothful projects.

Thus, in most Central and Eastern Europe's economies first concession agreements are signed for motorway development (Hungary, Czech Republic Poland, Croatia, Serbia and so on). Types of concession agreements were usually DBFO (design-build-finance-operate), leaving private sector with financial risk among all the others.

On a worldwide basis, the breakdown of highway-related infrastructure projects financed through partnership arrangements by contract type is shown in Table 2. Presented data was published in AECOM study for US Government in 2005. The study covered 599 highway-related projects worldwide, representing \$322 billion since 1985.

As concluded, on a worldwide basis, the predominant contracting approaches (shown in bolded text) are: concession and BOT/BTO. These contract approaches place a high degree of responsibility and accountability on the private sector, leaving the public sector serving primarily as a contract administrator. All line functions are included in the contract scope, and maximum flexibility is provided to develop the project in the most cost-effective manner. This is in sharp contrast to the traditional procurement approach, under which the public sector is much more involved in all phases of the project, frequently using prescriptive specifications, and is ultimately responsible for the results of the design process.

**Table 2:** Worldwide road projects by contract type [7]

Contract type	Number	Percent (%)	Billion USD	Percent (%)	B\$/Project
Concession	245	40.90	124	38.52	0.50693878
DBFO	61	10.18	31.5	9.77	0.51639344
DBOM	49	8.18	35.7	11.07	0.72857143
BOT/BTO	183	30.55	84.4	26.18	0.46120219
BOO	8	1.34	1.9	0.59	0.23750000
DB	41	6.84	43.2	13.40	1.05365854
Mgt. countr.	12	2.00	1.5	0.46	0.12500000
<b>TOTAL</b>	<b>599</b>	<b>100.00</b>	<b>322.0</b>	<b>100.00</b>	<b>0.53823038</b>

Source: AECOM Consult, Inc

In a mentioned study conclusion is that among the more frequently used contracting approaches, the largest European and Asian highway projects involve concession and BOT/BTO contracts, as a contrast to Africa & Middle East. Projects in Europe are the most expensive, averaging around \$690 million. Analyzing infrastructure projects in Central and Eastern Europe it could be concluded that they are closely following its Western neighbors in terms of contract type, but also in terms of costs.

**4. Serbian Experience – Modest, but Significant**

The first concession in Serbia, after the Law on Concession has been implemented, was signed on April 2006 for research arid exploitation of ore in Baljevac County (Serbia). This was the silent agreement with little media attention and still no turmoil.

Transport sector is the most prosperous in this part of Europe, because present infrastructure is in its poorest condition. Serbia sits astride the major road, rail and river routes that link South-Central Europe and the Middle East with Western Europe. These routes were temporarily interrupted during the 1990s. Serbia has already received a loan of USD 300 million from the EBRD (European Bank for Reconstruction and Development) and EIB (European Investment Bank) to rehabilitate existing roadways and railways - primarily Corridor 10. The Serbian government is also prioritizing expansion of these routes into motorways to improve regional transport links.

Twenty-five year concession agreement for construction, operation maintenance of the highway route from the Hungarian border to Western Serbia, impatiently anticipated, has finally been signed in March 2007. Estimated contract value has been calculated at rough one billion EUR. This is the biggest partnership project in realization in Serbia.

Most of the remaining works will be on the two southern branches of Corridor 10 in Serbia, from Western Serbia to Macedonian border. The government seems to have the most ambitious plans for these two sections. Envisaged as a true partnership the idea that the construction of this part of Corridor 10 should be financed by Serbia's own funds in part has been revealed by prime minister himself, who asserted it was “the first big strategic investment financed independently after a long period, which is a good indicator that the Serbian economy has recovered”.

Experience of Central and Eastern Europe can also be taken as evidence that concession companies almost always enter into renegotiations, in which they succeeded in gaining additional financial support from the public sector. In an emerging country, which tries to attract foreign investors, the visible bankruptcy of a Concession Company adversely affects the country's reputation, and this is why the public sector is particularly weak in renegotiations.

The European Investment Bank (EIB) approved a USD 100 million loans for the reconstruction of bridges and roads in Serbia. General Electric is interested in investing EUR 120 million in the development of Corridor 10 and the revitalization of the railway network across central Serbia.

The completion of Belgrade's new main train station is the key project for the state railway Company. New loans for infrastructure upgrades worth a total of USD 175 million will be signed with the European Bank for Reconstruction and Development (EBRD) and the European Investment Bank (EIB).

In December 2005, contract for airport restructuring was signed, carrying out a thorough due diligence of the airline and proposing specific measures for the restructuring in order to attract private investments into Serbia's national carrier. The idea is to turn JAT into a sustainable airline and a regional champion.

Besides transportation, water treatment sector is lucrative business. Belgrade solid waste project is a priority project for the Belgrade Municipality and will result in a concession to the private sector to: (i) invest in, expand, upgrade, operate and manage the existing solid waste disposal site; and (ii) maintain and operate separate waste reception and treatment for hazardous medical and industrial waste.

In December 2006, the Government of Serbia adopted the Concession Enactment for the project, approving the concession of Vinca, the municipal landfill of the City of Belgrade. In January, 2007, an invitation for expression of interest for investing and operating the landfill has been posted, and 18 expressions of interest from potential investors were received.

The successful completion of this mandate will help improve the quality of services, rehabilitate the Vinca landfill and bring it to conformity with EU applicable environmental and waste management regulations and

standards. It will furthermore enhance efficiency and lower costs by introducing commercial principles and reduce pollution in the Danube valley, which currently receives totally untreated leachates produced by the landfill.

Two years of experiencing good and not so good effects of partnership projects is not enough for making solid conclusion of successful rates. However it is evident that decision has been made to incorporate new concept of procurement in all possible infrastructure projects.

## **5. The Case of Macedonia**

PPP in Macedonia was introduced by the Law on Concessions and other types of Public - Private Partnership in 2008. The possibility of realizing of PPP in Macedonia was further achieved by adoption of the Law on Concessions and Public - Private Partnership in 2012. This law has undergone several amendments in 2014 and 2015 [8]. The law on Concessions and PPP is set up so that respects the principles of transparency, non-discrimination, proportionality, efficiency, equal treatment and mutual recognition. The mentioned law regulated the manner and types of enforcement procedures for concessions and PPP, preparatory steps of the public sector to make the establishment of such agreements and the commitments that the institutions of the public sector have in the decision-making process for establishing PPP.

The foregoing indicates that the Law on Concessions and Public - Private Partnership in Macedonia is relatively new, there is no experiential point in its application and it is using and adapting the experiences of countries with a longer tradition of PPP.

PPPs in Macedonia can be established in the form of: (a) public works concession; (b) concession of public service; (c) public procurement contract of work; and (d) public procurement contract of service. Forms under (c) and (d) differ from the classical contracts for public works and services by the Public Procurement Law, because in this case there is established a long-term partnership between the public and private partners with rights and obligations on the both parts.

As PPP/concession projects located in Macedonia in this short period of time can be mentioned: [9]

- Multi –storey parking's in Complex Clinique Mother Tereza (Skopje), Project in tender in the sector of Transport;
- Skopje waste water treatment plant project, Project in planning in the sector of Water & Waste;
- Skopje tram PPP project under DBFOT, Project in tender in the sector of Transport;
- Eastern and western natural gas distribution network PPP project, Project in planning in the sector of Energy;
- Ohrid administrative building PPP project, Project in tender in the sector of Social & Health;
- Bitola street lighting PPP, Project in tender in the sector of Energy;
- Concession for waste disposal at the landfill Drisla-Skopje, Project signed in the sector of Water & Waste.

## **6. Conclusion**

Changing socio-political conditions in the transitional economies forced policy makers to implement new concept of involvement of the private sector in the procurement of public services. Following the footprints of advanced economies, solution for current twofold problem of limited budget and increased demand for higher quality public services was found in innovative concept of private public partnerships.

PPP in countries in which is widely used noted a number of benefits, among which as more significant may be indicated:

- accelerated construction of infrastructure - allowing approach to the construction of infrastructure projects that would otherwise be out of the planned budget funds;
- improving the quality of public services - through transferring a part of the risk to the private partner, a public partner is encouraged to improve the quality of public services;
- faster implementation of the project - given that the design and construction of the project activities is the responsibility of the private partner, i.e. the payment by the public partner is associated with the commencement of the provision of public services, the private partner is motivated to complete the activities as soon as possible;
- improved management - transferring the responsibility for providing services to the private partner, the public partner appears in the role of regulator and focuses on activities related to planning, promotion and control, instead of daily delivery of public services;
- private partner usually has developed a better model for allocating risks;
- increased efficiency - the private partner is interested in cost savings during the entire implementation period of the project, more far-reaching by the public partner.

The experiences of countries with developed application of PPP shows that it is first necessary to establish the legal framework for the implementation of PPPs, so this model will be able to create significant benefits in the public sector activities and better meet the needs of citizens.

The synthesis of PPP projects from around the world demonstrates the wide variety of infrastructure, projects, and contract types using PPP arrangements to finance or deliver critical public-use infrastructure. When some countries and regions of the world began to experiment with different ways to finance and deliver infrastructure and public services through greater involvement by the private sector, in conditions of globalization and internationalization of the economy it is a signal for the development and adaptation of similar models in the rest of the world (developed and developing countries). The only question when that kind of changes will happen and how deep they will be.

Less developed and transitional economies also use some of the PPP models developed in some developed economies in order to take the benefits of such a relationship. There have been some very visible PPP projects undertaken in transition countries, but there are a number of questions still being asked about these projects in terms of their long-term viability and also in terms of how much they truly embrace basic PPP philosophy. The

public sector must be patient and persistent in pursuing and achieving the effects of the PPP projects given that their implementation does not go fast and they are usually a matter of long-term infrastructure projects.

As presented, it is clear that there is huge potential for partnerships in all Central and Eastern Europe economies. What is recognized as a major obstacle is political risk. With more successfully conducted partnerships risk is decreasing, increasing investment inflow. Thus, the existing gap between developed and developing economies is closing.

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