

# Public–private partnership—Development of long-term relationships in public procurement in Germany

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## Abstract

Hybrid partnerships are well established in the private sector combining market efficiency with the possibility of hierarchical steering mechanisms. By implementing Public–Private Partnerships (PPPs), public authorities seek to benefit from cooperation with specialised suppliers. However, many complex factors, including legal regulations, have to be considered in relation to outsourcing activities in the public sector. The decision on public–private cooperation is not driven only by economic principles. This paper deals with the economic and legal decision process of PPPs. The theoretical and legal framework is then applied and illustrated through a case study of the German Aerospace Center (Deutsches Zentrum für Luft- und Raumfahrt e.V./DLR).

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## 1. Introduction

“New Public Management” (NPM) is the label typically given to the contemporary paradigm shift in public administration applied to a set of reforms over the past 20 years. The perceived lack of effectiveness and efficiency of traditional bureaucracy led to the emergence of alternative management models (Farazmand, 2001; Pollitt, 1993). NPM has its origin in the established business administration concepts of private sector institutions. As a consequence, new concepts designed to overcome the inefficient allocation of resources in public authorities and the production of (public) goods and services (Budaeus, 1998; Loeffler, 2003) have emerged. Many public authorities suffer from financial crisis as a consequence of their functional and structural organisation, and exacerbated by decreasing tax revenues as a result of a falling rate of gross domestic product (Schedler and Proeller, 2003). NPM therefore attempts to enhance the performance of the public sector by adopting management

methods from the private sector. Some key terms are, concentration on core competencies (Pralhad and Hamel, 1990), outsourcing and, more recently, supply chain management as a portfolio of vertical arm’s length and closer relationships between supplier and buyer (Loeffler, 2003). Long-term partnerships with suppliers can build “social capital” (Erridge and Greer, 2002). Social capital, mainly developed by trust and commitment (Morgan and Hunt, 1994), may reduce transaction cost and enhance linkages between public, private and not-for-profit sectors (Erridge and Greer, 2002). Major perspectives of NPM are embedded in the macro- and microeconomic level as shown below (Fig. 1; Hammerschmid, 2001) although they also contain strong ideological overtones (Pollitt, 1993). Macroeconomic considerations result in a basic change in the role of the state, as it is enabled by the public sector. Public sector authorities are expected to concentrate on core competencies in the hope of eliminating non-efficient operations, thus creating a “lean state” (Kyrer, 2001). Further tasks, those outside the core competencies should, ideally, only be vertically integrated if accompanied by economic advantage, a major emphasis being the reduction of transaction costs (Coase, 1937, 1960, 1988).

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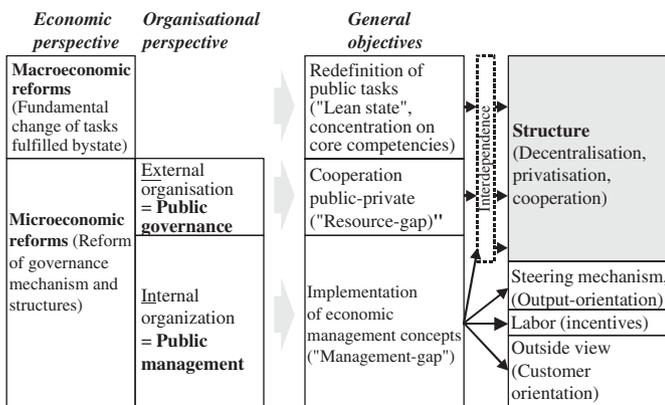


Fig. 1. Framework for new public management (Sources: Adapted from Hammerschmid, 2001; Budaeus, 1994).

First, microeconomic reforms relate to the internal organisation of public authorities, in terms of deficits in bureaucratic governance leading to the implementation of revised management concepts and tools. In Germany, these new paradigms are known as "Neues Steuerungsmodell" and were developed by an association of local authorities named "Kommunale Gemeinschaftsstelle für Verwaltungsvereinfachung" (Local Authorities Association for Simplifying Public Administration; *KGST*). As many activities of "modern government" failed to meet the efficiency goals of NPM, a more fundamental, strategic approach was needed (Savas, 1987). Performance management with a strong focus on outcomes replaced the former input-oriented steering mechanism. Labour and management incentives were seemingly matched to enhanced output quality, and a customer service orientation provided citizens with a more transparent view of public organisations.

Second, the external reform of public organisations intersects with the basic strategies arising from the macroeconomic view. A concentration on core competencies has become associated with decisions about outsourcing former public responsibilities as a consequence of the "lean state". Public managers operating in this environment are simultaneously endeavouring to introduce managed competition and are contracting with the private sector to deliver public goods and services more efficiently and effectively (Savas, 2000; Hammerschmid, 2001) though this is not always achieved (Callender and Johnston, 2001). Contracting is a critical point of a continuum between market and the public sector hierarchy (vertical integration), now often dependent on outsourcing activities and, in specific situations, more innovative forms of public-private cooperation might be needed.

## 2. Theoretical background

### 2.1. A new approach to public authorities' responsibilities

Public Choice, a theory which underlies contemporary macroeconomic and microeconomic external reforms, suggests that politicians and bureaucrats may not act in

the public interest, but with their own self-interest in mind (Budaeus and Gruening, 1997; Loeffler, 2003). This view also suggests the public sector needs to foster more market-driven incentives (competition) and their related microeconomic control mechanisms instead of bureaucratic control (Vogel and Stratmann, 2000; Harms and Reichard, 2003a, b; Bundesministerium für Wirtschaft und Arbeit, 2003). One of the main questions posed by NPM is concerned with optimal "public service market penetration": which tasks have to be fulfilled by the state itself and which tasks should better be co-produced by private companies? That is, what activities might be arranged by the public sector, but produced by private institutions? In the case of outsourcing, the state is responsible for steering goods and services delivery (Gewährleistungsstaat). For example, under the NPM model for energy supply, the state remains responsible, but the institution that "produces" this energy can be in private hands (Budaeus, 2003; Bundesministerium für Wirtschaft und Arbeit, 2003; Callender and Johnston, 2001).

Energy supply is an example of toll goods which are characterised by joint consumption and the feasibility of exclusion. Toll goods (Savas, 1982) and purely individual or private goods, such as a personally owned motor car, are characterised by individual consumption and the feasibility of exclusion of other users can be created and handled in markets which reflect individual demand. But there are also goods and services which are characterised by an absence of such feasibility of exclusion. These are either joint consumption, collective or pure public goods, such as national defence or individual consumption goods such as public transport. Goods such as pure public goods pose a particular problem, as entrepreneurs are unwilling to produce these goods and services unless there is some artificially created method of receiving payment, especially where an individual has an incentive to act as "free rider", using such goods without paying for them.

However, many of the goods and services, especially toll goods, previously provided by public authorities are also well suited to being provided by private partners (Savas, 2000; Borins and Gruening, 1998). Pure public goods lack self-regulating mechanisms, due to their singular characteristics and, in this case, public authorities need to be active in both steering and monitoring the position. In situations where market solutions are not necessarily available, cooperation in Public-Private Partnerships (PPPs) offers a closer relationship between markets and traditional hierarchical governance (Budaeus and Gruening, 1997). The structure of public goods and services stays unaffected by PPPs, as these are mostly exogenously determined by politics and law (Schedler and Proeller, 2003). However, development of PPPs facilitates the movement of the state from the role of direct operator to one of organiser, regulator and controller of the outputs produced by the private partner (Commission of the European Communities, 2004). Categories of responsibility, including public-private co-working, can be divided

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