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Institutional environment for public-private partnership in Ukraine: Do institutions really matter?¹

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Abstract

Public-private partnerships (PPPs) have become a popular means of implementing public investment projects across the world. Many governments have been using PPPs to implement and realize investment projects concerning highways, power plants, hospitals and other fixed assets. This paper provides a survey of PPPs practices implementation in Ukraine considering PPP as a socio-economic institution.

Introduction

Many international economic studies prove that poor infrastructure impedes the development of the national economy and deteriorates its international competitiveness^{3,4,5}. Infrastructure projects have high public significance and amounts invested annually into infrastructure by the public sector are vastly exceeding investments made by the private sector⁶.

Public-private partnership (PPP) has become a popular instrument of implementing public investment projects across the world. In contrast to a dominant international approach to PPPs definition, we consider PPPs not only as contractual but as institutional relationship between public and private entities aimed at improving infrastructure and public services. Many governments have been using PPPs, on one hand, to implement and realize investment projects concerning highways, railways, airports, power plants, water sewage plants, hospitals, schools, and other fixed assets. Instead of paying for the asset from budgetary funding, governments engage in a contractual arrangement with private firms that will finance the design, construction, operation, and maintenance of the project. In exchange, the government makes a commitment to provide necessary funding to the firms to cover its expected costs not only for the initial design and construction of the asset but also for the subsequent operation and long-term maintenance of the project in addition to an anticipated level of profit.

¹ Research summary on the Project “Public-private partnership as a component of the strategy of state cooperation with international organizations and transnational corporations” (2012-2014). National Academy of Sciences of Ukraine, Institute for Economics and Forecasting.

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³ World Bank Reports, 2005 – 2006.

⁴ Calderón, Servén, 2004.

⁵ Mantega, 2003.

⁶ Delmon, 2011.

PPPs allow governments to leverage private capital, deferring public outlays without deferring the benefits. PPPs have become particularly attractive to governments with annual budget restrictions but which expect less restriction or control on incurring liabilities in the future^{7,8}.

On the other hand, PPP can be considered as a powerful tool of public regulation in context of investment, innovation, fiscal, competitive, social and regulatory policy^{9,10,11,12}.

PPP as a socio-economic institution

We offer a new concept of PPP as a socio-economic institution. The common use of the term "institution" makes it possible to consider PPP as an institution in five aspects: behavioral, cognitive, associative, regulatory and constitutive.

According to the behavioral aspect, at the level of the national economy PPP should be regarded as an institution of strategic interaction between public and private sector to address socially significant competitive challenges for the socio-economic development. At the micro level, such a strategic interaction is manifested in the investment project implementation. In our opinion, the relationship that form the PPP institution can be searched in the framework of rational choice institutionalism based on the game theory as a set of equilibrium repeated outcomes in the standard cooperative game.

According to the cognitive aspect, PPP is directly connected with the institutions of public confidence and social responsibility, which are the integral parts of the social partnership mechanism. The development of the social partnership in Ukraine requires the formation of the partnership ideology, in which the leading role belongs to the state.

In the associative aspect, PPP can be seen as an institution to reconcile private and public interests based on communitarian paradigm and effective mechanisms for the involvement of business elites in the process of providing public goods. At the same time, according to the regulatory aspect, PPP defines the parameters of partnership between the state, businesses and civil society expressed in the objectives, forms and results of their interaction at all levels. Instrumental PPP capabilities are fully revealed during the implementation of the national anti-crisis policy by creating jobs, introducing tax privileges, simplifying business environment for small enterprises, providing financial support for financial institutions and so on.

⁷ Perrot – Chatelus, 2004.

⁸ Hemming, 2006.

⁹ Revilla – Sarkis, 2003.

¹⁰ Blankenburg, 2000.

¹¹ Silva – Rodrigues, 2004.

¹² Sawyer, 2009.

Constitutive nature of PPP is carried out through a system of state guarantees, which serves as a key factor in ensuring fair behavior (the behavior that matches the promises issued¹³) and stable partnerships, secured in the relevant regulations.

Concepts of PPP in Ukraine

In Ukrainian scientific literature public-private partnership is frequently translated as *state-private partnership* (SPP) but the term “public-private partnerships” more precisely reflects the whole range of relations within this phenomenon based on the participation of both local governments and the public institutions.

Public-private partnership can ensure additional advantages in reducing prime costs of projects, efficiently distributing risks, improving management, assuring better quality of services, and raising the profitability of projects.

The potential of using PPPs in Ukraine is high due to the high share of public sector in the national economy (37.0%)¹⁴. Considerable part of transport, housing and communal, energy and social infrastructure belongs to the public property. At the same time, the state of motorways, railways, sea ports and airports is unsatisfactory as for a European country. The depreciation rate of the capital assets of heat and water supply and sanitation exceeds 60.0%, of urban electricity transport – up to 90.0%. Neither state nor local budgets have necessary financial resources for the modernization of the infrastructure and they will unlikely appear in the nearest future. In this situation it is naturally that the state is oriented at the development of PPPs.

In Ukraine, the PPP investment potential is underestimated, as evidenced by the figures on implementation of infrastructure projects with the private participation (see Table 1). According to World Bank database, in 1990-2011 private investments in infrastructure projects implemented on the principles of PPPs in the developing countries totaled US \$ 588.5 billion. At the same time, all the investments in infrastructure projects with the private participation in Ukraine from 1990 to 2011 amounted to US \$12.1 billion, of which the telecommunications sector accounted approximately 90 percent. Furthermore, among 39 projects listed above only 18 can be seen as “quasi PPPs”¹⁵ and were implemented as “Greenfield” concession, management and lease projects.

¹³ Brennan – Buchanan, 1985.

¹⁴ Zapatrina, 2011.

¹⁵ “Quasi PPPs” are public investment projects with the private participation which were not classified and adopted as PPPs in accordance with the Ukrainian PPP legislation (Law of Ukraine “On State-Private Partnership”, the Decrees of Cabinet of Ministers of Ukraine # 81, 232, 279, 384). There are no fully fledged PPPs in Ukraine yet.

Table 1

Investment infrastructure projects with the private participation in Ukraine, 1992-2011

Year of onset of project implementation and financing	Sector of PPPs implementation							
	Power		Telecommunications		Water supply and water sewage		Total	
	Number of projects	Investments US \$ mln	Number of projects	Investments US \$ mln	Number of projects	Investments US \$ mln	Number of projects	Investments US \$ mln
1992	-	-	1	11	-	-	1	11
1993	-	-	1	72	-	-	1	72
1994	-	-	-	10	-	-	-	10
1995	-	-	-	18	-	-	-	18
1996	-	-	3	317	-	-	3	317
1997	-	-	2	187	-	-	2	187
1998	6	-	1	331	-	-	7	331
1999	-	-	-	242	-	-	-	242
2000	-	-	1	206	-	-	1	206
2001	6	160	3	255	-	-	9	415
2002	1	-	-	186	-	-	1	186
2003	-	-	-	370	1	-	1	370
2004	-	-	-	738	-	-	-	738
2005	-	-	-	1407	-	100	-	1507
2006	1	24	1	865	-	-	2	889
2007	1	83	-	1346	-	-	1	1429
2008	1	100	-	1364	1	102	2	1566
2009	-	121	-	934	-	-	-	1055
2010	4	89	-	413	-	-	4	501
2011	3	343	1	1607	-	-	4	1950
In all	23	920	14	10878	2	202	39	12001

Source: Ukraine: Private Participation in Infrastructure Database (*without the transport sector*). http://ppi.worldbank.org/explore/ppi_exploreCountry.aspx?countryID=97

Such a trend of attracting private business in the implementation of publicly important infrastructure projects does not correspond to the priority areas of the development of investment in Ukraine's economy. As defined by President Victor Yanukovich in the Program of Economic Reform for 2010-2014 «Prosperous Society, Competitive Economy, Efficient State», these areas are the following: power, new quality of life, infrastructure, design of the Olympic Hope-2022¹⁶.

The main reasons why the dynamics of PPP development in Ukraine does not accord with the requirements of the economy are the following: contradictory and inconsistent legal regulation; insufficient level of political and economic stability; lack of consistent policy and proper management on PPP; no effective PPP public support mechanism; complicated and inconsistent tariff regulation; low institutional capacity of government entities and the private sector in PPP implementation; poor qualification level of officials and low awareness of the private sector as regards PPP specifics and so on.

Most of above mentioned factors, especially legal regulation, political and macroeconomic factors, PPPs management and contracting, institutional capacity of government and private entities for PPPs implementation have an institutional nature and some of them influenced negatively the implementation of most significant “quasi PPP” investment projects (see Table 2¹⁷, the column “Problems”).

PPP legislation and practice in Ukraine

Generally, Ukraine's legal framework governs the economic relations between public and private sectors through a number of laws and regulations, among them the Economic Code of Ukraine, Civil Code of Ukraine, Budget Code of Ukraine, the Law of Ukraine “On Leasing State and Communal Property”, Law of Ukraine “On Concession”, Law of Ukraine “On Concession for the Construction and Operation of Motor Roads”, Law of Ukraine “On the Administration of State and Communal Property”, Law of Ukraine “On Financial Leasing”, Law of Ukraine “On peculiarities of lease or concession facilities of centralized water-supply and sanitation that are municipally owned”, Law of Ukraine “On peculiarities of lease or concession of state-owned fuel and energy complex”, Law of Ukraine “On Local Government” etc.

¹⁶ The President specified the priority investment projects of Ukraine: <http://uaport.net/news/ua/go/UN10082559152>

¹⁷ Prepared by the author.

Table 2

Most significant “quasi PPP” investment projects in Ukraine

Name of Project	Responsible Agency	Type of Project	Location	Year of Inception	Year of Completion	Capital Value of Project	Outcome	Problems
Green Co – Group	Regional Council	Waste recovery	Kyiv	2003	-	-	successfully concluded	-
Lviv-Krakovets	Ministry of Transport, State Road Agency “Ukravtodor”	Highway	Lvivska oblast	1999	2044	UAH 1.6 bln.	aborted after signing of contracts (2010)	Pilot project: lack of funding and experience; political factor
Vanko International	Cabinet of Ministers of Ukraine	Oil and gas production	Black Sea shelf	2005	2013 (tentative term)	USD 15.0 bln. (0.33 bln. – preliminary stage)	aborted after signing of contracts (2008)	Political factor, faults in contracting
Luhanskvoda-Rosvodokanal	Regional Council	Water supply	Luhansk	2007	2031	UAH 0.75 bln.	successfully started	Abuses of public procurement procedures, tariffs were raised by 2.5 times in 2008
Odessvodokanal-Infoxvodokanal	Regional Council	Water supply	Odessa	2004	2052	-	successfully started	Breach of investment plan, tariffs were raised by 2.0 times in 2007
Artemivskteplomerezha	Regional Council	Heating supply	Artemivsk	2007	2046	UAH 90.0 mln.	successfully started	-
“Kirovogradvodokanal”-“Vodne Gospodarstvo”	Regional Council	Water supply	Kirovograd	2006	2054	-	aborted in 2008	Problems with debt and water supply

Among the special legislation regulating the state's interaction with the private sector within the framework of PPP, we should single out the Law of Ukraine "On State-Private Partnership" (PPP Law) that is of a framework nature, and the Concept of the Development of Public-Private Partnerships in the Housing and Municipal Economy (approved by Cabinet of Ministers of Ukraine). The PPP Law specifies the following PPP forms: concession, joint activity and others.

The PPP Law contains many indirect referring regulations. Choosing a particular form for the PPP project implementation, stakeholders should examine numerous pieces of legislation that may not be in sync with each other. Both the large number of laws that regulate the PPPs and contradictions between them make the PPPs implementation in Ukraine rather difficult. In addition, at the level of local government investment projects are regulated by numerous local acts as well, which are also not always consistent with the regulations of the PPP Law.

In view of the existing contradictions in the legislative and regulatory base and the actual impossibility of fast implementation and harmonization of the Law of Ukraine "On State-Private Partnership" with other special laws, it is necessary to develop PPP on the basis of PPP Law, which should serve as a framework law, which requires:

- improving the PPP Law to ensure a clearer outlining of the competences of the authorities that become involved in PPPs at all stages at both central and local levels; more accurate formulation of PPP characteristics as regards delegating the functions and competences of the government related to infrastructure development and public services to the private sector; improving the list of PPP application areas; introducing the possibility of institutional partnership, including the creation of a 'special purpose company'¹⁸;

- harmonizing regulations of the PPP Law with the special laws that regulate the contractual relationship between the state and the private sector in the field of concession, joint activity, lease and so on;

- introducing tools of methodological support for PPPs by contractual forms;
- legal regulation of issues of assets created under PPPs;
- improving the mechanism of settling disputes arising out of any PPPs agreement with the participation of a non-resident or an enterprise with foreign investments;
- further legislative efforts to introduce stimulating tariff regulation.

Problems of PPPs at local level

The activity of local authorities to involve the private sector in the PPP implementation remains extremely low due to the institutional causes while the main potential of infrastructure

¹⁸ Special Purpose Company is a project company which usually acts as a general contractor in a PPP project.

development and improving the quality of public services is at the local level. In Ukraine weak local PPPs are associated with shortcomings of current legislation, low awareness of local government entities and private business of PPP features, lack of qualified staff in local governments for the PPPs preparation and maintenance. The private sector's willingness to participate in infrastructure projects remains quite low, as evidenced by the results of the survey conducted under the auspices of USAID¹⁹. Only 3.0% of the surveyed businesses have been involved in "quasi PPPs" projects. However, only 39.0% of business respondents are interested in participating in PPPs. At the same time, such a share of local government entities totals 62.0%.

The key task of developing PPPs at the local level is to ensure implementation of pilot projects via a unified algorithm of selection, examination, agreement, and by the involvement of appropriate experts.

PPP projects at the local level should involve financial resources both from oblast and municipal budgets that are responsible for constructing, operating and maintaining local infrastructure projects. The new legislative regulation of the relationship between local government bodies and the PPP unit (Department of Investment and Innovation Policy in the Ministry of Economic Development and Trade of Ukraine) will provide the right of local government bodies to make independent decisions on PPPs expediency and implementation.

Conclusions

In order to improve the PPP management system in Ukraine, the government should establish relations with international institutions and promote more intensively the formation of national institutions whose activities should be oriented to the priorities of innovation-based modernization of the national economy, using the modern risk management approaches. The establishment of institutions should be carried out by observing the financial sustainability, resource diversification, investment risks minimization, administrative pressure and corruption risks elimination requirements.

The role of financial institutions (special banks, state corporations and leasing companies, innovation funds, regional development funds and agencies, etc.) will be providing financial, advisory and information support for PPPs projects. Non-financial institutions (techno parks, industrial parks, business incubators, special economic zones, research centers, centers of technology transfer, and others) will advance the development of business infrastructure within the PPP framework, improvement in the qualifications of state officials and integration of PPP issues

¹⁹ Besedina – Nizalov – Semko, 2012.

into the academic programs for specialists prepared for state authorities and local government bodies. Training sessions, seminars and roundtables on PPP should be organized as well.

The necessity and effectiveness of cooperation between public and private sectors are determined by institutional factors associated with the level of economic freedom. Further PPP development requires an active participation of the community in the PPP projects preparation and implementation, especially at the local level. Moreover, PPP as an institution in Ukraine needs fixing its principles in national and regional strategies for socio-economic development, the creation of institutional environment, improvement of its legal framework, the introduction of public enforcement of contractual obligations by all partners.

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