

PROBLEMS OF MANAGEMENT OF PUBLIC-PRIVATE PARTNERSHIPS

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The paper provides the results of an empirical study of evaluation of the efficiency of public and private sectors in provision infrastructure services. The imperative research and comparative analysis methods used, revealed a number of “bottlenecks”, including gaps in the legislation and institutional restrictions, lack of experience in cooperation between state and private enterprises, deficiencies in public procurement procedures and executing PPP contracts. The results allow concluding of the significant potential and viability of PPP model in the conditions of Uzbekistan.

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Introduction

As Fiscal Affairs Department (2004) points out: “Public-private partnerships (PPPs) refer to arrangements where the private sector supplies infrastructure assets and services that traditionally have been provided by the government. PPPs can be attractive to both - the government and the private sector. For the government, private financing can support increased infrastructure investment without immediately adding to government borrowing and debt, and can be a source of government’s revenue. At the same time, better management in the private sector, and its capacity to innovate, can lead to increased efficiency; this in turn should translate into a combination of better quality and lower cost services. For the private sector, PPPs present business opportunities in areas from which it was in many cases previously excluded.”

The study evidences that PPPs are growing especially rapidly at the subnational level and about 30 percent of the services provided by larger EU subnational governments are delivered through PPPs (Pina & Torres, 2001). A weak fiscal position followed by financial downturn and, reflecting a need for infrastructure investment on a large scale, a number of countries in Central and Eastern Europe, including the Czech Republic, Hungary, and Poland, have embarked on PPPs. There are also fledgling PPP programs in UK, Canada and Japan. PPPs in most of these countries are dominated by road projects (Fiscal Affairs Department, 2004).

Economic growth directly depends on infrastructure development, and the study by Fay and Yeppes revealed that developing countries on average spend 3-3.5 % of GDP for infrastructure whereas according to available estimations needs of these countries for such expenses amount about 7 % of GDP (Fay & Yeppes, 2003). The analysis of current state of infrastructure assets (services) in post-soviet states (including Uzbekistan) evidenced the necessity of taking urgent and effective measures - otherwise increasing deficiency of infrastructure becomes a barrier to economic growth, and devalue achievements in economic policy of macroeconomic stability. According to our study, inability of

infrastructure “to keep up” with growing economy and with high-scale social objectives in Uzbekistan is explained by a number of reasons:

- the capacities created 30-40 and more years ago occupy the significant share among production facilities of Uzbekistan’s infrastructure which leads progressing physical and moral wear of equipment and communications,
- provision of various provinces with infrastructure facilities are different, and deficiency of infrastructure is recorded especially sharply in a number of regions of the country,
- economic growth, private sector development and favorable market conditions lead to increase of burden on infrastructure capacities.

Organizational Frameworks

Global financial turmoil and modernization plans of many governments in emerging world increased importance and accelerated tendency of use PPP contracts. PPP assumes participation of business firms in creation and operation of industrial, municipal and social infrastructure facilities, and providing public benefits and services. In PPP, the private sector is involved in providing public benefits and services in infrastructure sector, and the property rights in relation of PPP facilities are not alienated entirely for the benefit of the private investor. In addition to private execution and financing of public investment, PPPs have two other important characteristics (Fiscal Affairs Department, 2004 & de Sa Almeida, 2004):

- there is an emphasis on service provision, as well as investment, by the private sector,
- significant risk is transferred from the government to the private sector.

In addition to mobilization of private investments and increase of infrastructure sector efficiency, PPP possesses a number of other important advantages. The private partner, knowing that he will have to operate the facility being created for a long time, reasoning from own interests provides high quality of design and building works. If an executor of works was responsible only for investment component, it would be much more difficult to formulate the qualitative terms of reference and control their performance, especially in conditions of lack of experience and qualified personnel in the state bodies (UNDP, 2007). Creating and operating infrastructure projects are connected with significant risks. Uncertainty of conditions in project implementation is bound up with fluctuations of macroeconomic conditions, difficulties in forecasting demand, possible changes in legislation, deviations of construction costs and operation from projected values and so forth.

PPP allows distributing risks between the parties based upon the ability of the latter to control uncertainty sources and to be adapted to changing conditions. The private partner should undertake production and building risks, and also respond to demand fluctuations by improving quality of services, more vigorous marketing, and so forth. The government should deal with system and macroeconomic risks, compensating them by due correction of PPP conditions.

PPP contracts are focused on final result and allow distributing risks between the parties based upon from the ability of the latter to control uncertainty sources and to be adapted to changing conditions. PPP represents itself as a filter, which does not allow passing doubtful projects with high probability of big financial losses.

Despite its attractiveness, PPP idea is related to serious problems, ignoring which has lead a lot of PPP projects to failure. Such problems can be as weakening control over government expenditures and incomes, as well as quality guarantee problems. Realization of PPP projects can negatively affect

quality of management of the state and aspiration of the private partner in increasing project income can lead to saving capital and operational costs, due to decrease in quality. The problems can be in the forms of miscalculations in estimating project profitability, and risks of contracts revision, political and social risks, and lack of experience and production capacities.

PPP can be realized in diverse forms, among which three basic types of partnership are most widespread – service contracts, build – operate contracts and concessions. Concessions and operating leases, which have also been used to reduce the role of government in the economy, are forms of PPP (Fiscal Affairs Department, 2004).

Hall (2004) writes “The government is in many cases the main purchaser of services provided under a PPP. These services can be purchased either for the government’s own use, as an input to provide another service, or on behalf of final consumers; a school and a free-access road would fall into these respective categories. Private operators also sell services directly to the public, as with a toll road or railway. Such an arrangement is often referred to as a concession, and the private operator of a concession (the concessionaire) pays the government a concession fee and/or a share of profits.”

Fiscal Affairs Department (2004) states: “Where a government has a claim on future project revenue, it can contribute to the financing of a PPP by securitizing that claim. With a typical securitization operation, the government would sell a financial asset - its claim on future project revenue - to an SPV. The SPV would then sell securities backed by this asset to private investors, and use the proceeds to pay the government, which in turn would use them to finance the PPP. Interest and amortization would be paid by the SPV to investors from the government’s share of project revenue. Since investors’ claim is against the SPV, government involvement in the PPP appears limited.”

SPV represents special purpose vehicles - a consortium of banks and other financial institutions, set up to combine and coordinate the use of their capital and expertise (Fiscal Affairs Department, 2004). But organization of such mechanisms is very difficult in countries with undeveloped security markets. Private ownership is to be preferred where competitive market prices can be established which is not relevant to many emerging markets.

Fiscal Affairs Department (2004) states: “Various market failures (natural monopoly, externalities, etc.) can justify government ownership, although government failure can simply substitute for market failure. At a fairly general level, these arguments can be used to motivate PPPs as a means of combining the relative strengths of government and private provision in a way that responds to market failure but minimizes the risk of government failure (Wolfe, 1993).”

The study of de Sa Almeida (2004) revealed “trade-off facing a government seeking to arrange for the provision of a particular service is between quality and efficiency. The government has the capacity to achieve a desired quality standard, but it may have difficulties doing so while also containing costs. The private sector can use its better management skills and capacity for innovation to more actively pursue opportunities to reduce costs, but service quality may be compromised in the process. However, according to Shleifer (1998), even if service quality, or elements of quality, is non-contractible, the normal presumption should probably be that private ownership is to be preferred because of the potential efficiency benefits it offers.”

PPPs involve a range of different risk categories (de Sa Almeida, 2004): *construction risk*, which is related to design problems, building cost overruns, and project delays; *financial risk*, which is related to variability in interest rates, exchange rates, and other factors affecting financing costs; *performance risk*, which is related to the availability of an asset, and the continuity and quality of service provision; *demand risk*, which is related to the ongoing need for services; and *residual value risk*, which is

related to the future market price of an asset. These risks are present in public, private, and PPP projects. PPPs seek to transfer risk from the government to the private sector. While an inflow of private capital and a change in management responsibility alone can be beneficial, significant risk transfer is necessary to derive the full benefit from such changes. The impact of risk transfer on financing costs, and the pricing of risk to ensure efficient risk transfer, then has to be addressed (Kenneth & Lind, 1970; de Sa Almeida, 2004).

Citing Fiscal Affairs Department (2004): “*Transferring project risk from the government to the private sector should not affect the cost of financing a project.* This follows from the Modigliani-Miller theorem, which says that the cost of capital depends only on the risk characteristics of a project, and not on how it is financed. However, the source of financing can influence project risk. With complete markets in risk bearing, project risk is independent of whether it is borne by the government or the private sector. With incomplete markets in risk bearing, project risk depends on how widely that risk is spread. Since the government can spread risk across taxpayers in general, the usual argument is that this gives the government an advantage over the private sector in terms of managing risk (Arrow & Lind, 1970). But the private sector can spread risk across financial markets, which may not put it at a significant disadvantage, and private sector risk managers may be more skilled than those in government. The outcome is likely to be that project risk is lower in the private sector.

The government’s ability to forcibly spread risk across taxpayers, while financial markets have to be provided with an incentive to accept risk, may put the private sector at more of a disadvantage as far as large and very risky projects are concerned. The scope for the private sector to spread risk will also be somewhat limited in countries with less developed financial markets. The private sector may in some cases face lower borrowing costs than the government.

This might be the case where there are serious concerns about government liquidity and (or because of political preference), the allocation of risk between the government and the solvency, and is also likely to be the case for foreign partners of many developing country governments.”

Analysis of PPP in Uzbekistan

Statistical data absence and lack of information are the main obstacles to analysis of PPP practice in Uzbekistan. However, the analysis done by UNDP staff in collaboration with Center of Economic Research (Uzbekistan) covers 1992-2006 years. The report indicates existing inefficiencies such as *considerable obsolescence of infrastructure of production facilities, insufficiency of capital investments and use of resources in infrastructure, inability to support infrastructure capacities in capable condition* that leads to their premature wear, often stoppages and breakdowns. According to the report, *budgetary-financial inefficiency of infrastructure* is the source of significant losses. System of tariffs is in many respects obsolete and does not reflect real costs on chargeable infrastructure services since in calculating the tariffs a principle “from what has been achieved” is still being used (UNDP, 2007).

Eight large-scale PPP facilities have been realized in Uzbekistan for the last 15 years, and more than 700 million dollars of private capital has been invested for this purpose (UNDP, 2007). However, the study evidences shortage and losses of water, heat and energy thus depreciate available capacities on distribution and transportation of these resources. “Double deficiency” - expressed first in shortage of resources and, second, in insufficient efficiency of their use lies on the basis of infrastructure problems of Uzbekistan like of many other developing countries. The state cannot cope this deficiency with own resources since it has no necessary resources and comes across with insoluble difficulties in increasing production efficiency in public sector. More active attraction of private sector, both national and

foreign, to overcoming the infrastructure deficiency, could be seen as a way out. Two thirds of investments into national infrastructure in Uzbekistan today is already given by non-state sources (housing and communal services, irrigation, electric power industry, railway, automobile and air transport, education and public health services). It is to be expected that private investments will further grow expanding opportunities of mobilizing resources for infrastructure.

From the beginning 2009 international organizations are actively involved in cooperation to promote PPP projects. IFC is advising the government of Uzbekistan on a public-private partnership to design, build, equip, finance, and operate four Medical Diagnostic Centers in Tashkent City and the regions of Samarkand, Fergana, and Navoi. The centers will offer diagnostic imaging, lab tests, specialist outpatient care, and day surgery to an estimated 300,000 patients, with an emphasis on serving the poor. This is the first public-private partnership in the country and supports the government's health sector reform program. Following the successful completion of the project, a total of \$20 million will have been invested to construct and equip the Medical Diagnostic Centers. Each MDC is expected to treat 80,000 patients annually (IFC, 2009).

Market-economy based solution of infrastructure problems suits both priorities of Uzbekistan's economic strategy which envisages continuation of privatizing the economy, encouragement of private initiative and competition, and prevalent objective realities in national economy, social and budgetary spheres. Obviously the matter does not concern that the state has abandoned infrastructure sector - the question is in what form state should keep its presence in the sector and how the state can divide power, risks, functions and resources with private sector.

Directions	Instruments	Important measures
Legislative base	Law on concessions	<ul style="list-style-type: none"> • Removing limitations for local investors • Indicating the objects of the concessions • Extending the period from 15 to 50 years
	Law on natural monopolies	<ul style="list-style-type: none"> • Putting in place state regulation relationships in the sphere of natural monopolies and adjustments in price formulation
	Pilots	<ul style="list-style-type: none"> • Designing and Implementing 2-3 micro-PPP projects
Institutional adjustments	Reconsider state property management	<ul style="list-style-type: none"> • Adjustments in commitments between state and private sector
Private sector investment	Establishing differentiated requirements to private companies by sector	<ul style="list-style-type: none"> • Ensuring macroeconomic stability • Developing financial markets • Guarantying investment return
Contract implementation	Reconsider regulations and process of private operator selection	<ul style="list-style-type: none"> • Developing typical contracts • Establishing database • Ensuring flexibility of transferring PPP contract to the right candidate, if contract is not satisfactorily implemented
Capacity building	Establishing institutes	<ul style="list-style-type: none"> • Regular trainings • Holding seminars and workshops • Research, raising awareness and PR

Source: Tulyaganov, S. (2007)

Conclusion

The study of problem of PPP in provision of developing countries revealed a number of “bottlenecks”, including gaps in the legislation and institutional restrictions, lack of experience in cooperation between state and private enterprises, deficiencies in public procurement procedures. Considerable obsolescence of infrastructure of production facilities, insufficiency of capital investments, inability to support infrastructure capacities and, budgetary–financial inefficiency of infrastructure is the source of significant losses in Uzbekistan. The results of analysis allow concluding of the significant potential and viability of PPP model in the conditions of Uzbekistan with short-term sectorial priority sectors are: utilities, transport communication, public transport and telecommunication.

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