ФІНАНСИ. БАНКІВСЬКА СПРАВА

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FINANCIAL INSTRUMENTS OF PUBLIC AND PRIVATE PARTNERSHIP DEVELOPMENT

Abstract. *The nature, purpose and main types of financial instruments of development of partnership relations between the government and business is explained. World practice of using financial instruments in public and private partnership is investigated. The current state and problems of implementation of above mentioned instruments in Ukraine are analyzed. The need for government financial support for implementation of infrastructure projects is emphasized. It will help to ensure economic growth, welfare of population and achievement of other strategic targets of development of the country.*

Keywords: *financial instruments; public and private partnership; infrastructure projects; government financial support.*

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ФІНАНСОВИЙ ІНСТРУМЕНТАРІЙ РОЗВИТКУ ДЕРЖАВНО-ПРИВАТНОГО ПАРТНЕРСТВА

Анотація. *Висвітлено сутність, призначення та основні види фінансового інструментарію розвитку партнерських відносин держави і бізнесу. Досліджено світову практику використання фінансового інструментарію в діяльності державно-приватного партнерства. Проаналізовано сучасний стан та проблеми реалізації згаданих інструментів в Україні. Акцентовано увагу на необхідності державної фінансової підтримки впровадження інфраструктурних проектів, що дасть змогу забезпечити економічне зростання, добробут населення та досягнення інших стратегічних цілей розвитку країни.*

Ключові слова: *фінансовий інструментарій; державно-приватне партнерство; інфраструктурні проекти; державна фінансова підтримка.*

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ФИНАНСОВЫЙ ИНСТРУМЕНТАРИЙ РАЗВИТИЯ ГОСУДАРСТВЕННО-ЧАСТНОГО ПАРТНЕРСТВА

Аннотация. *Освещено сущность, назначение и основные виды финансового инструментария развития партнерских отношений государства и бизнеса. Исследовано мировую практику использования финансового инструментария в деятельности государственно-частного партнерства. Проанализировано современное состояние и проблемы реализации упомянутых инструментов в Украине. Акцентировано внимание на необходимости государственной финансовой поддержки внедрения инфраструктурных проектов, что позволит обеспечить экономический рост, благосостояние населения и достижения других стратегических целей развития страны.*

Ключевые слова: *финансовый инструментарий; государственно-частное партнерство; инфраструктурные проекты; государственная финансовая поддержка.*

Urgency of the research. Effective implementation of long-term social and economic problems of the government dictates the need for the involvement of private business. The development of partnership relations between the government and business will help to finance innovative-investment and infrastructure programs. Successful implementation of these programs depends on the use of certain financial instruments, in particular, the one used in developed countries. The world practice shows that national policy targets are achieved efficiently, effectively and with minimal costs in case of using innovative financial instruments.

Target setting. In Ukraine, the absence of a favorable legal environment and lack of development of public and private partnership instruments leads to financial unattractiveness of projects for private investors, limited profitability and high risks in the financial market. Therefore it is necessary to develop innovative financial instruments in the process of interaction between the government and business based on legal safety of contract terms of partners, budget support and international cooperation.

Analysis of recent researches and publications. In economic literature following domestic and foreign scientists made the significant contribution to the scientific justification on expediency of development of partnership relations between the government and business : M. Vysnievskyi [1], I. Zapatrina [2], T. Maiorova [3], K. Marchevka-Bartkoviak [1], O. Pyltiai [4-5], B. Puszer [6], S. Skuza [7], F. Uzunov [8] and others.

Emphasizing unresearched aspects of the problem. Measures, presented by authors, aimed at improving the interaction between government and private finance in case of financing of infrastructure projects, are of a general nature. At the same time, comprehensive researches on the implementation of innovative financial instruments in the area of public and private partnership and mechanisms of their implementation are absent.

The research objective. The research aims to reveal the features of usage of financial instruments of public and private partnership in the global and domestic practice in order to improve the effectiveness of realization of infrastructure projects in Ukraine.

The statement of basic material. With the deepening of economic and social problems in the community government financial policy got important task – creation of such model of public and private partnership that would ensure the efficient financing of social development. In fact, an important aspect of cooperation between the public and private sector is the possibility to diversify the cost into strategically important infrastructure projects. The financial participation of the government or local self-governing authorities in public and private partnership projects is realized my means of appropriate instruments, which create incentives to attract the private sector for implementation of socially important infrastructure projects.

Financial instrument is a tool by which capital is transferred from investors to its end users. According to the EU strategy called Europe 2020, financial instruments of public and private partnership provide the following [9]:

– support for the private sector in order to stimulate economic growth and innovation, job creation;

– promotion of the competitiveness and sustainability of the European Union in the field of transport, energy and the environment by supporting infrastructure facilities;

– participation of private sector in public service provision.

Depending on the participants and the conditions of public and private partnership financing, instruments are divided into debt-based, equity and hybrid (Fig. 1). Detailization of the financial instruments of public and private partnership demonstrates rather broad and varied opportunities for the usage of the potential of both the government and private sector.

In world practice debt-based financial instruments are infrastructure bonds, which are presented in three categories:

a) corporate infrastructure bonds (Kazakhstan, Australia, Russia) – bonds issued by private entities to finance infrastructure projects which require significant investment. They are directed to the construction of roads and railways, reconstruction and construction of water supply systems.

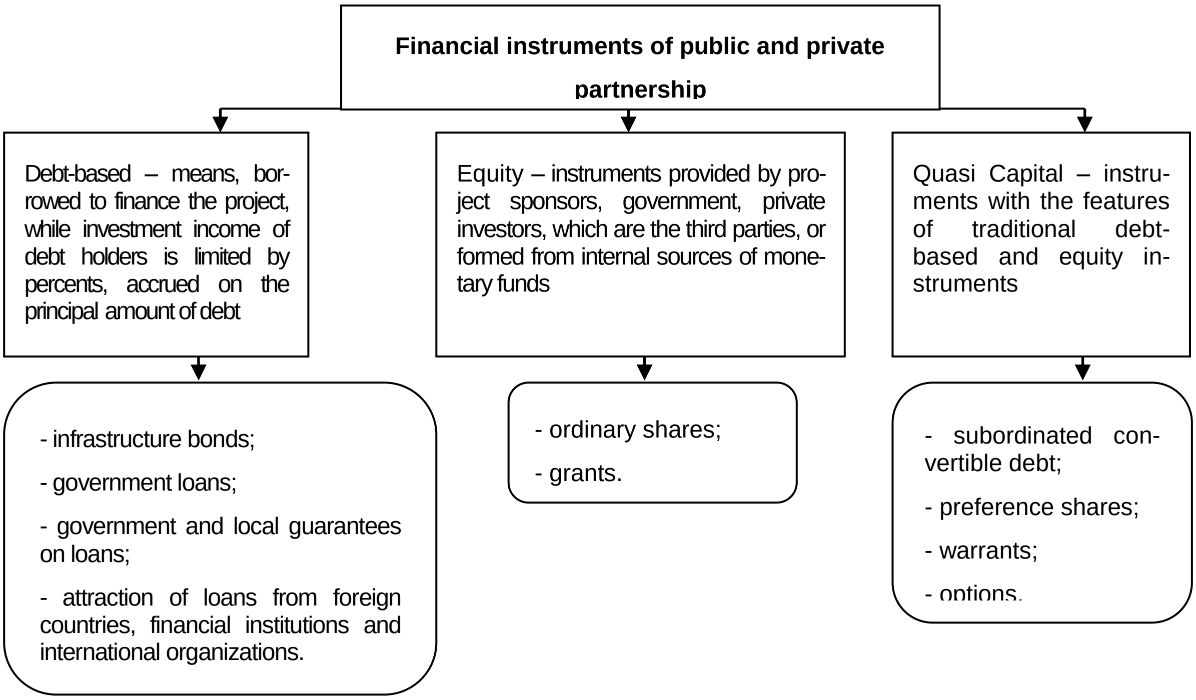

Fig. 1. Types of financial instruments of public and private partnership*
** Prepared by the author*

The above mentioned debt-based instrument is characterized by low profitability and long-term circulation period. Such bonds usually have government guarantees or surety of third parties concerning payments of interest, they are long-term, as calculated for the periods of creation and operation of infrastructure facility;

b) municipal targeted bonds (US, India, Chile) – bonds that are issued by local self-governing authority and have targeted use of resources. In the US municipal obligations are divided into two groups: general obligation bonds and revenue bonds;

c) project bonds are focused on infrastructure projects in the sphere of transport, energy, information and communication technologies (European Union). The European Commission believes the usage of project bonds is the most effective, because their use allows to choose the financial behavior of public and private partnership participants and also to improve financing of infrastructure projects [1, p. 146].

In Ukraine, analogue of infrastructure bonds is corporate bonds and local bonds. Key preconditions for effective their implementation are: the existence of perfect legal framework for issue of local bonds and corporate bonds; experience of securitization capital usage (mortgage bonds, mortgage certificates, which are analogous to the infrastructure bonds in case of real estate construction projects); developed financial infrastructure for placement and circulation of corporate bonds and local bonds (pension funds, collective investment institutions, insurance companies).

Corporate bonds have become affordable and effective tool for refinancing of concession projects and municipal bonds in the Ukrainian infrastructure projects are often used in of housing and communal service projects. Thus, the sequence of usage of these financial instruments is shown in Fig. 2.

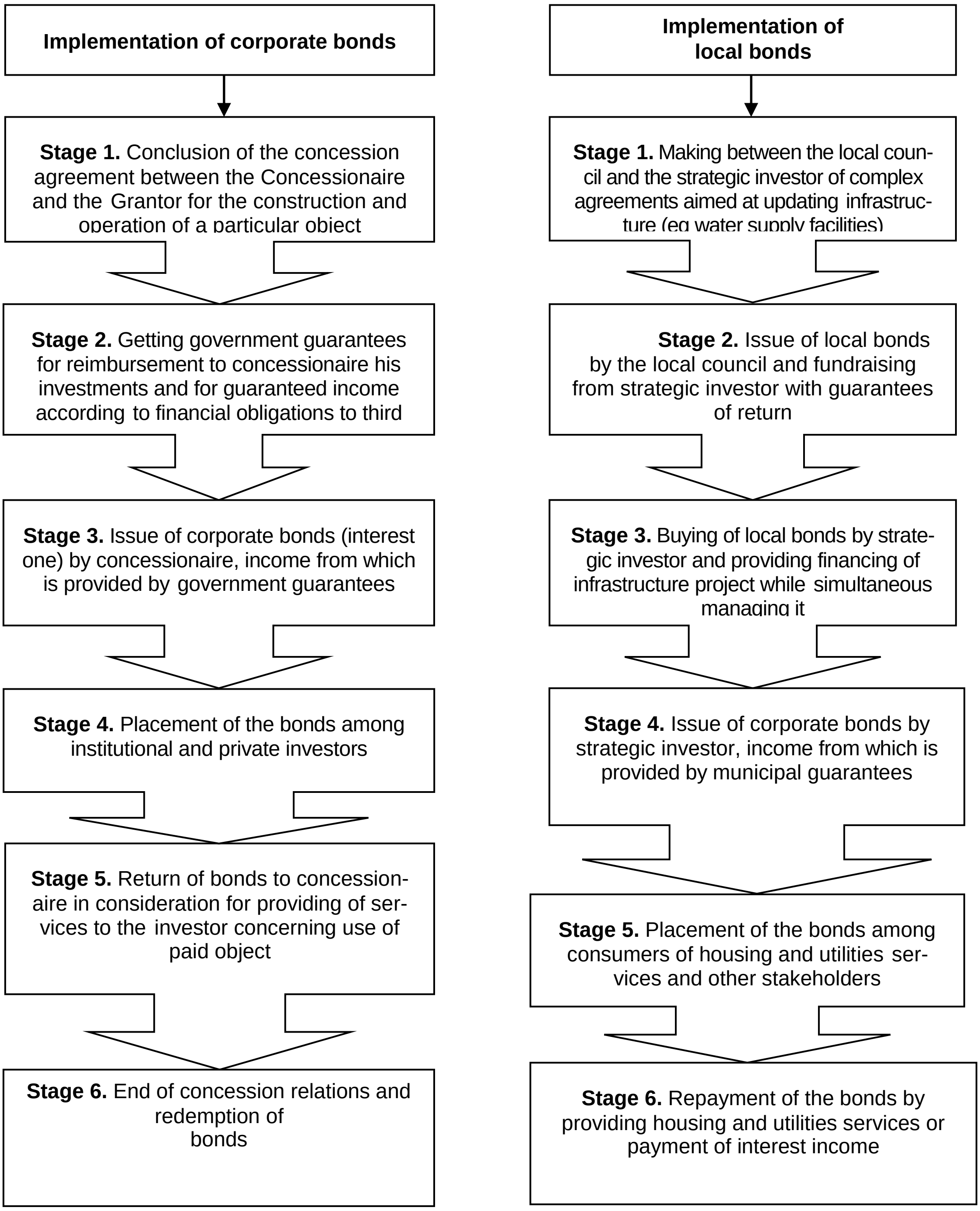

Fig. 2. Algorithum of using corporate bonds and municipal bonds in Ukraine *
** Prepared by the author*

Thus, the main advantages of using infrastructure bonds is in the following: economic viability of instrument is formed by issuer, causing its determination on the optimum level than in case of bank lending; the possibility of rating and quoting of instrument that will let to increase its investment attractiveness; the ability to issue capital derivatives for the supply of infrastructure bonds (for example, options for the supply of bonds).

In the European market the financing of public and private partnership projects depends on loans from commercial banks and public financial institutions. However, despite the fact that credit conditions have become more complex, credit resources are actively involved for the implementation of infrastructure projects. In fact, attraction of public finances only is not possible, even in developed countries [6, p. 208].

In Ukraine such financial instruments as government loans can be granted on the following terms: a) interest free or low interest rates in order to reduce the total costs of the project financing; b) provision of subordinated loans by the government; c) accessibility for all project participants or temporary availability for the company that implements the project in case of main project risks.

In the process of granting loan guarantees the government is obliged to repay any lack of funds of the project company related to main payments and interest payments. Government guarantees are provided only on terms of payment, maturity, collateral security and counter guarantees from other economic members (they may be irrevocable and unconditional guarantees of financial institutions or other companies or availability of adequate collateral). However, they are not available if the source of their return is the government budget.

The volume of government guarantees provided to the private partner is determined for the year by the law on the government budget. They are short-term financial instrument, as their scope can not be predicted for the long term. Therefore, the main purpose of local guarantees is to support investment programs, in particular, the one that deals with the development of municipal infrastructure of the region. Terms of local guarantees are similar to government one.

Thus, the main purpose of government and local guarantees is to reduce the risks in the process of borrowing from financial institutions. At the same time in domestic practice above mentioned financial instruments for promotion of public and private partnership development are not common as cause increasing of cost of borrowed credit resources.

Government borrowing from foreign countries, financial institutions and international financial organizations belong to the external debt and are repaid from the government budget. Getting funds in this way for public and private partnership entities is carried out for the management and financing of municipal or state entities, and such property can not be in mortgage.

As for local borrowings from foreign countries and financial institutions, only Verkhovna Rada of the Autonomous Republic of Crimea, Kyiv and Sevastopol city councils and city councils of regional centers have the right to receive them. While all city council can carry out local external borrowings in the way of obtaining credits (loans) from international financial institutions [10].

Considering the above mentioned, it should be noted that in the national practice usage of debt-based instruments is accompanied by problems related to:

– limiting the possibilities of communal enterprises in obtaining loans on a commercial basis;

– absence of guarantees concerning government financial support of municipal infrastructure branches;

– absence of appropriate financial guarantees from the local authority concerning the return of investments to private partner in case of early termination of public and private partnership contract;

– absence of financial guarantees concerning maintenance of loans, assigned to finance public and private partnership projects, by means of local budget;

– unequal opportunities and conditions concerning making of local borrowings for different entities of local government [4, p. 86].

Therefore, considering mentioned problems, debt instruments in the implementation of public and private partnership projects require increased attention from public authorities and determine the need for their revision and clear legal regulation.

In case of equity participation of private capital in financing infrastructure projects, there is high degree of integration of capital within the framework of partnership realization to achieve socially important purposes. Equity financing of investment projects can be carried out in two main forms:

– additional capital stock issues of existing joint-stock company to finance a specific investment project;

– involvement of members who contribute cash or property in the authorized capital of the created company.

Join-stock investment represents investments in shares and receiving of additional investment resources for a specific project. The main advantages of auctioning, as a method of project financing, are the following: payment for the usage of the involved resources is carried out based on financial results; the usage of involved investment resources is unlimited in duration; capital stock issues allow to provide formation of the necessary financial resources at the beginning of the project implementation and to delay the payment of dividends to the period when the project wil start to give income; shareholders can keep control over the targeted use of funds for the project implementation [3, p.153].

However, this method of project financing has some limitations. Thus, the investment resources joint-stock company receives after the placement of shares, and it takes some time, additional costs, evidence of company's financial viability, transparency and others. The procedure of additional capital stock issues relates to the registration, listing and significant transaction costs [3, p. 153]. The joint-stock company, which is going to finance an investment project by means of additional capital stock issues should develop an effective strategy of improvement of liquidity and share value, implies higher degree of financial transparency and information openness of the issuer, expansion and development of activity, capitalization growth, improvement of financial status and image.

In countries with market economy, the second form of financing of public and private partnership projects is common. It is carried out by creation of equity funds of public sector. Funds received through collective investment are used to implement socially important projects.

In addition, projects can be financed by means of grants, that is irrevocable funding source and is usually provided by organizations interested in implementing the project. Grants can be used to reduce risks and, therefore, to help in attraction of companies to projects with high risks and uncertainty in terms of the cost refund.

Some financial instruments are often called «quasi» or «hybrid» instruments, as they have the characteristics of both debt-based and equity instruments. Quasi-instruments may include subordinated convertible debt, preferred shares with profitability, often warrants or options can be included, providing demand for assets. These instruments are an attractive alternative to traditional equity and debt financing. Firstly, from viewpoint of investor quasi-instruments do not require to give control or voting rights, as it is in the case of ordinary shares issue. Secondly, as a claim on the assets provided by quasi-instruments have a higher priority than stock capital, the quasi debt capital has a lower cost. Thirdly, this type of financing provides greater flexibility because it does not provide such restrictive measures as a traditional debt financing.

Regardless of the use of various types of financial instruments, the authorities should support and stimulate the development of partnership relations between the government and business. Only a few projects of public and private partnership can be profitable in case of absence of any public financial support. At the same time, instruments that are going to be used in any specific case, must be carefully designed in order to provide predictability, required by investors, and flexibility, required by government. In particular, the instruments of state financial support of public and private partnership projects are shown in Fig. 3.

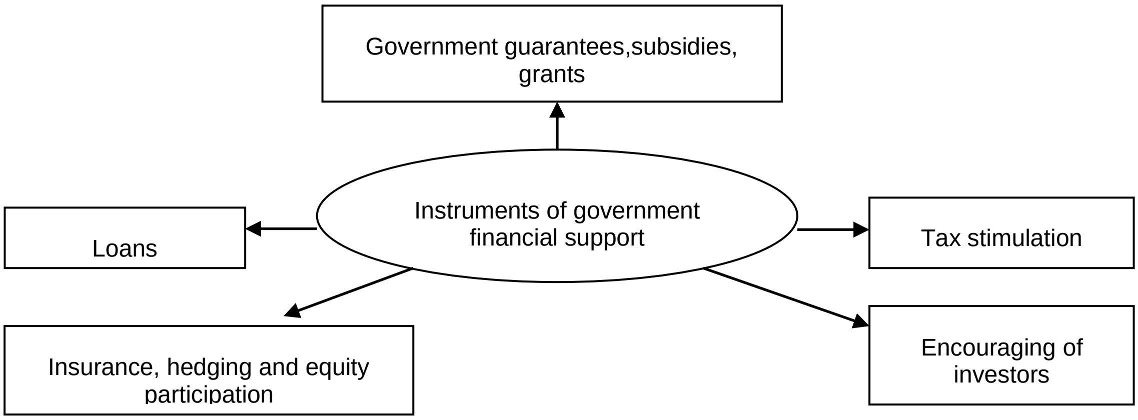

Fig. 3. Instruments of government financial support of public and private partnership projects
** Prepared by the author*

Thus, the government can provide direct financial support through the provision of transfers, subsidies, grants; investment in the authorized capital and crediting; tax and customs allowancei, tax credits, refusal of taxes and so on. These mechanisms are especially important if the project is not financially self-sufficient or is at risks that private investors or creditors can not operate effectively.

The above mentioned instruments of financial support can be used in combination with measures of indirect public support, the purpose of which is to achieve certain result or certain quality of infrastructure services. So the government, instead of direct participation in project financing, assumes indirect financial obligations, such as:

– the use of «shadow» tariffs system – reimbursement of payment for provided services for consumers from the government budget through state subsidies for public utilities;

– guarantees of damage reimbursement, for example, in the case of absence of payments by public authorities, lack of income or excess of expenditure, etc;

– state insurance or hedging of project risks, for example, in case of adverse weather conditions, fluctuations of exchange rate, percentage rate or commodity prices etc.

– contingent loans, such as commitments for future loans etc. [2, p. 14; 5, p. 68–69].

Thus, the effective financing of public and private partnership projects can be carried out thanks to government support, particularly of those projects that are economically attractive, but not profitable. It should be noted that in developing countries, the need for state aid is more important than in developed countries.

Conclusions. The research shows that the financial instruments of public and private partnership are means of realization of social and economic targets of the country. In world practice, they having industrial and sectorial orientation, enhance the competitiveness of countries, provide support of business and good-quality public services. At the same time in Ukraine there is still a need for improvement of existing instruments and development of new one directed at improvement of innovation and investment climate in the region. Herewith, limited financial resources of the government requires intensive public assistance in development of financial instruments of mentioned partnership, which should focus on increasing the capitalization of projects in economic sectors.

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