

ATTRACTING THE EUROPEAN INVESTMENTS TO CONCESSION AGREEMENTS IN UKRAINE

Problem statement in general and its relationship with important scientific or practical tasks. In today's world an essential condition for normal functioning of the mixed economy is a constructive collaboration among business and state. The nature of this interaction and specific forms may differ greatly. Meanwhile, the state is never free from its social responsibility functions related to securing national interests and business, in turn, is always the source and the motive force of development and increase of social wealth. The very special kind of business-and-state collaboration, so-called "public private partnership" (PPP), is actively being formed in economies of some developed and developing countries in recent decades.

The importance of PPP and concession agreements, as one of the PPP forms, is widely recognised by many governments as a policy tool which is reflected in their budgetary allocations, legislation and in developing of the appropriate programs. In the crisis situation it is PPP which is able to become a fruitful form of cooperation between the state and business, because stable demand of the state is an essential tool of reducing investment risks and confidence-building of banks.

However, despite the widespread recognition of PPP as an essential tool to improve the national competitiveness, implementation of PPP mechanisms in the Ukrainian practice is extremely slow. An undeveloped regulatory framework at all levels, a number of unresolved methodological issues of transferring to the partnership between the state and business, lack of experience of this partnership and bureaucratic obstacles are hindering the implementation of PPP in Ukraine, which stipulates the topicality of this article.

Analysis of the latest research and publications in which the given problem solution was initiated. Many works are dedicated to understanding the PPP's role in modern economies, among which the following scientists and international institutions as Gaydutskiy A.P. [1], Savankova N.Ye. [2-3], V.G. Varnavskiy [4], Makhlyn M. [5], Katasonov V. Yu. [6], Neil K. Patterson [7], OECD [8], IMF [9], European Commission [10], and others [11; 12], should be marked out. The works of these scientists have uncovered the latest trends and phenomena of the state restructuring in different countries, as well as the cooperation between business and state. But the specificities of Ukraine willing to attract investments from the EU countries in the sphere of

concession agreements and the ways to improve cooperation between Ukraine and the European investors in PPP were not addressed.

Highlighting unsolved parts of the general problem which this article was devoted to. That's why the separate task arises to develop recommendations for Ukraine's businesses', European investors' and Ukraine state organs' fruitful PPP cooperation as for concession agreements, especially in the frameworks of preparations for the UEFA EURO 2012.

Article purposes formulation (task formulation). The purpose of this article is to demonstrate the role of concession agreements in attracting investments from the European countries and to recommend the ways of improving the cooperation between Ukraine and the European investors in public-private partnerships.

Summary of research main materials with full substantiation of scientific results obtained. In recent years in many countries dramatic changes have been taking place in areas that are consistently in the state-owned and the government management: electricity, roads, railways, utilities, trunk pipelines, harbours, airports. Government transfers the right of user in the gas and energy sector, water supply and sanitation, transport and communication systems to private business for temporary or long- and medium-term ownership, keeping its right to regulate and control business activities.

On the one hand, enterprises in these sectors, primarily network, monopoly segments, cannot be privatised because of their strategic, social and socio-political significance. But on the other hand, there are no sufficient resources in the state budget to ensure their simple, all the more expanded reproduction. To resolve this contradiction, in business practises abroad the concept of PPP is applied, which is a vital alternative to privatisation of public property of strategic importance.

In the modern sense PPP is an institutional and organisational alliance between government and business, which aim is to implement national and international, and local scale, but always socially significant projects in a wide range of areas: from the development of strategically important industries and R&D to providing public services. Each alliance is temporary, as created usually for a specified period to implement a certain project and stops to exist after its implementation [4].

Standard & Poor's define PPP as follows: "Public-private partnership is a medium or long-term cooperation

between the public and the private sector, within which social problems are solving through a combination of experience and knowledge of the affairs of several sectors and allocation of financial risks and benefit". In addition, the European Bank for Reconstruction and Development (EBRD) specifies PPP as "a long-term contract with the private sector to provide services to the state, for the state or on behalf of the state". Further, the EBRD states that "payments under the PPP can be made between the concessionaire and the state in both directions" [2, 35].

Definition of Standard & Poor's opens new approaches to PPP: first, defines the terms of this partnership — it is the medium and long-term, and second, provides solving social problems (those social benefits that market cannot tackle) and third, argues that the government and business share the benefits and risks. This definition already contains more factual information, but nonetheless remains unclear what is meant by the term "cooperation" and what "a combination of experience and knowledge of the affairs of several sectors" stands for [2, 36].

The definition of the EBRD has more legal nature; in fact, it is a long-term state contract, and mostly in the form of concession agreements. According to the Law of Ukraine "About PPP" "PPP — is a cooperation between the state of Ukraine, the Autonomous Republic of Crimea, territorial communities in the person of appropriate organs of state authority and organs of local self-government (public partners) and juridical persons, with the exception of state and municipal enterprises, or physical persons-entrepreneurs (private partners), which is realised on a contractual basis..." [13]. One cannot notice here the aim of PPP to solve not only economic, but also social problems as well as the distribution of benefits and risks between the parties.

Three key players are usually involved in PPP: the public sector, private sector and banks. Government agencies, interested in establishing PPP, enter into a contractual relationship (contract of service, contract of joint activity or concession contract, etc.) with the private sector or establish a legal entity with the private sector. Representatives of the private sector or newly created entities through implementation of PPP attract funds by obtaining loans or by selling their corporate rights. The private sector enters into contracts with major project's executors. There can be several such agents. The main performers of the project, in turn, may enter into appropriate agreements with subcontractors as a part of their functions in PPP [11].

Typically, the foreign investors play the role of a private business, primarily because of the desire of the state to ensure the import of capital, including the necessary new equipment, advanced technology and experience from transnational corporations. However, domestic private capital is expected to participate in partnership.

Sources of funding also depend on the PPP participants: state investment fund; venture fund; the budgets of different levels; private investors (institutional investors, private entrepreneurs, international financial organisations) [3].

According to the world experience the following main contractual types of PPP are: "joint business"; "joint venture"; "concession"; "production sharing agreement". The same one can see in Ukraine at the above-mentioned Law "About PPP", clause 5.1: forms of PPP realization are agreements on: "concession; joint venture; production sharing agreement; other agreements" [13].

Let's consider the first one. On the basis of the Law of Ukraine "On Concessions", concession is a provision of the right of establishment (construction) and (or) management (operation) of the object of concession (termed paid ownership), in order to meet public needs by means of appropriate authority or local governments, to legal or natural persons (entrepreneurs) under a fee- and term-based concession agreement, if the business entity (concessionaire) takes responsibility of the creation (construction) and (or) management (operation) of the object of concession, property liability and potential business risk. A concessioner is a body of executive power or the relevant local authority, authorised, respectively, by the Cabinet of Ministers of Ukraine or by local authorities to conclude the concession contract.

Concession is the most advanced and promising form of PPP. First, it is a long-term contract, allowing both parties to make use of strategic planning. Second, in a concession the private sector has more freedom in making managerial decisions, as opposed to joint ventures. Third, under a concession agreement the state has enough leverage to influence concessionaire in case the necessity to protect the public interest because of violations. Fourth, the state assigns only ownership and use of its property to the concessionaire, reserving the right of disposition. Fifth, a concession alleviates public financial burden for the state, because concessionaires assume all responsibility on management and maintenance of facilities given to the concession; in addition, the concessionaire has to pay concession fees to be channelled into the state budget. Finally, the concessionaire is entitled to receive compensation as a result of significant improvements of the property or the creation of property according to concession agreement and the right to repurchase the facility after the expiration of its concession period.

Modern concession practise shows quite often obstacles in the legal regulation of mixed concession agreements that combine both works and rendering services (for example, a combination of highway construction and using rights for a wayside petrol stations, shops, hotels, restaurants). It is determined that when the service is based on the object, which is constructed by concessionaire, concessions are meant to work (for

example, toll road). But, if the agreement contains several separate items, which are regulated by different rules, one should conclude a concession agreement for services (e.g., catering place built near the highway) [10].

Concessions in EU as a form of PPP are legally regulated through:

1) framework and special concession national laws (Merloni Law of 1994 in Italy, Sapin Law of 1993 in France);

2) implementation of EU directives (2004/18/ES, 2004/17/ES, 93/36/EES, 93/37/EES, 92/50/EES) in internal concession legislation;

3) the application of tax, investment, administration, banking legislation, laws on environmental protection and special regulations adopted to implement specific concession project.

In accordance with recent changes in the European legislation (2004/18/ES, 2004/17/ES) the term of concession agreement may exceed 30 years, and the compensation of the state may be more than 50% of total spending of the concessionaire's investments. These EU Directives record a special kind of concession agreements, namely the so-called "shadow concession", under which compensation costs, associated with construction and operation of the object, are placed on the state [12, 8]. One obvious example is the roads construction in the UK, where the state provide compensation of investment costs but not drivers, according to special methods of calculation. Thus, the road remains FOC, but in fact the state has to finance the construction. In addition, the EU has the guidelines defining concessions with indefinite duration.

Concession agreements as a form of PPP are characterised by a number of concession schemes: BOT, BOOT, ROT, BTO, BOMT and others (often called "Formula ?zal" because of they were successfully implemented in the early 1980's by the Turgut Özal government (Turkey)). These are [14, 22]:

1) BOT (Build — Operate — Transfer — construction, management, transmission) is a classical concession, when the concessionaire builds and operates (based on ownership) a facility at his/her own expense and at own risk, unless the concession agreement between the state and the concessionaire regulates to share risks and costs of a concession facility. After the expiry of certain period, during which the concessionaire receives income from operation of the facility and compensation for the building, the object of concession is passed to the state. However, the concession agreement can fix concessionaire rights to continue the object management. BOT concessions are typically used for highway construction (Italy, Spain, Malaysia, South Korea), pipelines, power plants (Turkey, India, Thailand), airports (Egypt, Greece, Canada), tunnels (France), stadiums and other infrastructure that require significant investments. A special

form of the BOT is the concession model ROT (Rehabilitate — Own — Transfer), where instead of a new facility a reconstruction of an existing facility is provided.

2) BTO (Build — Transfer — Operate — construction, transmission, management). The peculiarity of BTO is that the concessionaire immediately after completion of the object transfers it to the state, and then performs the operations or management to return all the costs associated with construction and profits under the contract;

3) BOOT (Build — Own — Operate — Transfer) and BOO (Build — Own — Operate) are types of so-called Greenfield projects. The specifics here is that ownership of the facility is remained, or transmitted to the investor after the expiration of a concession agreement. The main BOO feature is that the concession agreement is concluded for an indefinite period. Hence, it is no surprising that BOO are not popular.

4) BOMT (Built — Operate — Maintain — Transfer) involve mostly constructions of gas pipelines.

International banks (the IBRD, the EBRD) are lending concession projects and act as concessioner, exercising control over the proper performance of their financial obligations. Otherwise, they have the right to use "change options", which allow lenders to transfer all rights and obligations to another concessionaire. Moreover, lenders are actively involved in the development of a concession project and monitored the creation of a concessionaire company. In particular, the concession agreement about the construction of the Channel Tunnel contained such conditions [6, 17], being the world's largest transportation infrastructure project, which was implemented by concession scheme (15 billion USD investments) [4].

Currently, the European Commission and the European Parliament coordinate work with an experience exchange among PPP members, which are involved in generalisation the best practices. So-called collections of completed projects of this partnership in various fields of the economy are being created, their common features summarised, differences structured, tips and advices developed [15, 2].

An important role in the implementation of concession projects in the EU plays an organisation coordinating the government authorities and entrepreneurs. Let's examine the UK and Italian experience.

The Italian experience of successful concession activities in PPP may be extremely useful for Ukrainian concession projects because Italy ranks first among the European countries on the construction and operation of highways under concession. Thus, Autostrade is a famous Italy concession company, which manages about 50% of the Italian highway network. Due to the activity of Autostrade the system of toll highways was created, and

this greatly improved the service level and profitability, as well as provided funds for the redistribution of financial support for other road network, quality, timely and unimpeded access for repair [14, 22]. Autostrade Company has entered into a concession agreement with the state company Azienda Nazionale Autonoma delle Strade Statali — Anas (authorised state body, which represents the state in concession relations about the construction and operation of highways through concessions). Autostrade serves as the main contractor and gives the right to do specialised work and building design or construction to other firms. In addition, the company reserves the right of planning road network, customer functions in the construction of new roads and in their reconstruction, controls the activities of builders-contractors, charges fees for transportation, provides safety and road network maintenance, including repairs, and scientific research work, aimed at finding new technologies of construction and operation of roads for improving service levels and safety of highways. In turn, Anas Company, through its technical staff monitors the implementation of all road works and their compliance with the standards of the approved projects. The specialists of Anas control the transmission of highway in operation. In addition to Autostrade there are another 22 companies in Italy engaged in the concession activities of operating and constructing highways. Moreover, under PPP in Italy the following projects had been successfully implemented: Highway Salerno-Reggio Calabria, Pedemontana-Veneta, Brescia-Milano, and the Stretto di Messina (bridge connecting the island Sicily with Italy) and other objects of manufacturing and industrial infrastructure [14, 23].

The first PPP mechanism in Britain was used during 1970-1980s. The application of PPP mechanisms gave positive results and enabled to solve problems the public sector was being facing with. The experience of PPP in the UK contributed to its spread in other countries: USA, Canada, countries of the European Union, Australia, India and others. Thus, in the UK in the last decade through a special program Private Finance Initiative (PFI), PPP programs worth over 40 billion GBP, was implemented [15, 7]. As a part of the PFI in the UK, contracts are concluded with private consortiums, which develop, construct, maintain and sometimes manage such assets as hospitals, schools, prisons, roads and railways, in the period up to 30 years. The government pays rents to private business, which is enough to recover capital and operating costs and revenue, as well as penalises violations of contractual obligations by companies.

In Britain, virtually the entire infrastructure, which for a long time suffered from underfunding, is renovated using PPP. Through PPP mechanism, major projects were completed such as construction of the Channel Tunnel,

national airport in Hamburg, some branches of the London subway [15, 9].

PPP in the European sense is an alternative form of the added value creation and economic efficiency increase. The share of private investments in EU varies in a wide range, usually from 10 to 60%. The European Investment Bank (EIB) often performs as a credit institution in the financing of railway transport projects on the PPP basis. The following PPP projects were undertaken in the railway transport with the EIB support: Line Oresund (Denmark, Sweden), high-speed line HSL Zuid (Netherlands), and the Tunnel Rail Link (England). Major private investment banks are also participating in PPP projects of railway construction: HSBC, Deutsche Bank, Bank of America [16, 5]. “Siemens AG” (Germany) can be the demonstrative example of manufacturing companies-private investors. “Siemens AG” carried out the unique design of the high-speed line HSL Zuid in the Netherlands. The entire volume of 1.2 billion EUR investments on this PPP project was made by private investors, of which 90% were financed by private banks and 10% by industrial investors, including Siemens [16, 6].

Analysis of randomly selected 915 overseas concession projects in different countries showed that such partnerships are successfully used in transport (roads, railways, airports, ports, pipelines) and social infrastructure (health, education, entertainment, tourism), utilities (water, electricity, water, gas, etc.), in other areas (prisons, defence, military facilities). Transport infrastructure is a leading one, followed by social infrastructure (Fig. 1) [17].

But while analysing the use of PPP projects in Europe, one can see a different picture (Fig. 2). By comparing Fig. 1 and 2, it becomes obvious that transport infrastructure projects in the EU countries are not on the 1st place compared with the whole world. EU has health (536 of 170 projects) on the 1st place, education (137 projects) on the 2nd place, highways (50 projects) on the 3rd place (Table 1) [17]. A similar distribution of industries is not surprising, taking into account the particular socio-economic development of this group.

Thus, one can conclude the following: in countries with the market economy, with a high GDP and consumption level per capita, a high level of social protection, a long life expectancy, PPP is often used in health and education spheres, which is dictated by state policy [17].

The Economic Code of Ukraine and Law of Ukraine “About PPP” provide mechanisms of interaction between the state authorities and businesses during the conclusion of a concession. Despite the fact that the definition and general principles of concession were reflected in the Law of Ukraine “On concessions” of July 16, 1999 and “On concessions for construction and operation of highways” of 14

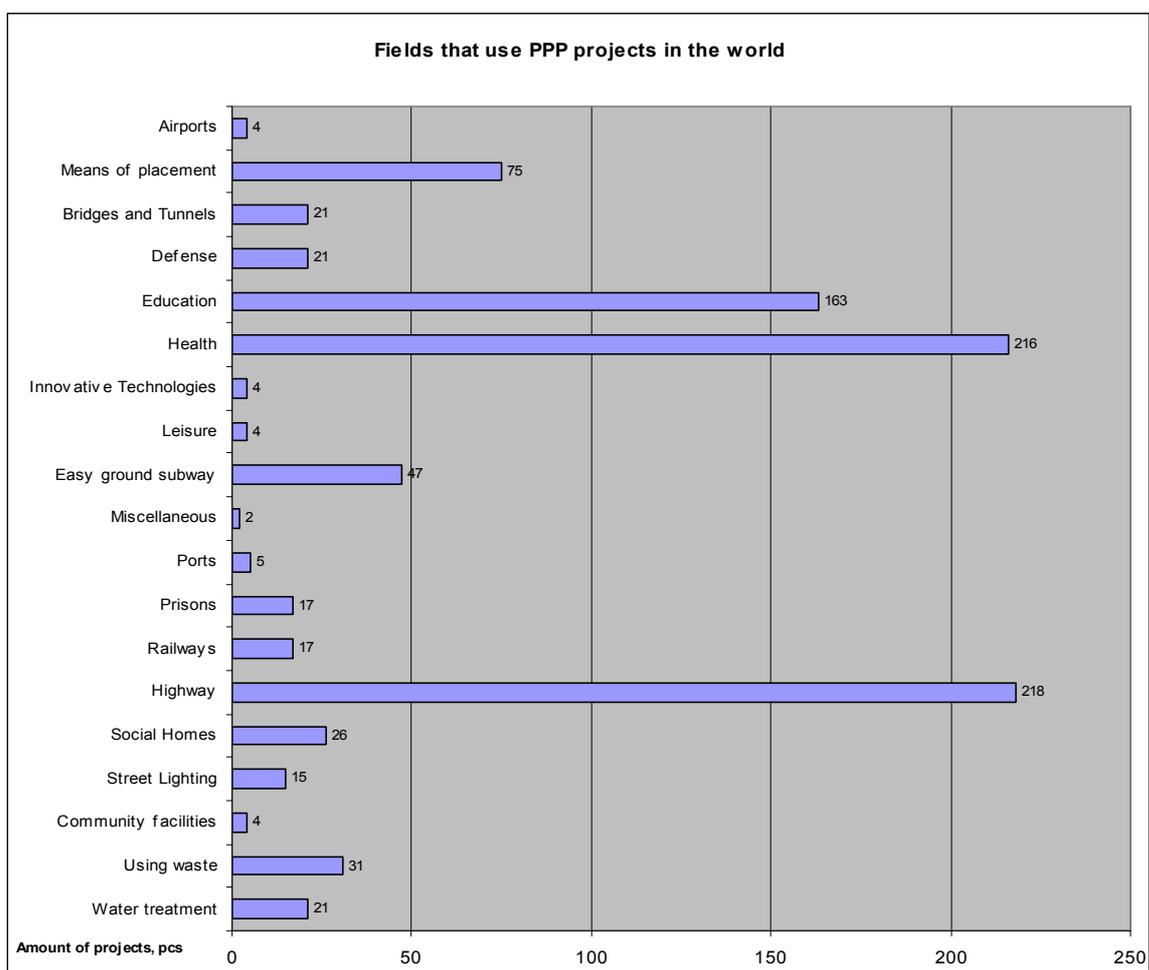


Fig. 1. PPP projects in the world by fields of use

December 1999, concession had not become economically attractive to private investor in Ukraine. From 1999 to 2007, Ukraine signed just four concession contracts: two of them, concerning highways¹ and two — wind power, and it is difficult to judge the success of these projects so far. And the difficulties that arise during the signing of agreements with foreign hydrocarbons companies based on production sharing agreements, speak for themselves [18].

The Ukrainian government has developed an ambitious plan of infrastructure development (resolution № 1295 of 31.10.2007 “On approval of the state program of preparation and holding in Ukraine of the European Championship final 2012”). Investments needed to hold the UEFA EURO 2012 are estimated at 126 billion UAH, whereas local budgets will contribute 1.6%, the state share will amount 17%, and private investors will bear the biggest share of the necessary budget [18]. However, at the moment the state does not cope with the announced

level of funding from foreign sources — none (!) of the objects to the UEFA EURO 2012 is being financed by foreign investors on August 2010 [19].

Conclusions from research and perspectives of further investigations in this field.

1. PPP is of crucial importance to develop national economy competitiveness.

2. Concession agreements, as one of the PPP forms, have been proved their effectiveness both in the world and in European Union but neither foreign nor European investors didn't even dare to take part in financing objects to the UEFA EURO 2012. Consequently, Ukraine has obvious need in concluding concession agreements with the European investors to gain experience and promote real eurointegration.

4. One of the fruitful directions of future research is to substantiate which concession scheme (BOT, BOOT, ROT, BTO, BOMT) is the most appropriate for the concrete infrastructural object in Ukraine.

¹ Implementation of the first Ukrainian concession project concerning construction and operation of the toll road Krakovets-Lviv, with the participation of domestic consortium company “Concession Highways”, failed.

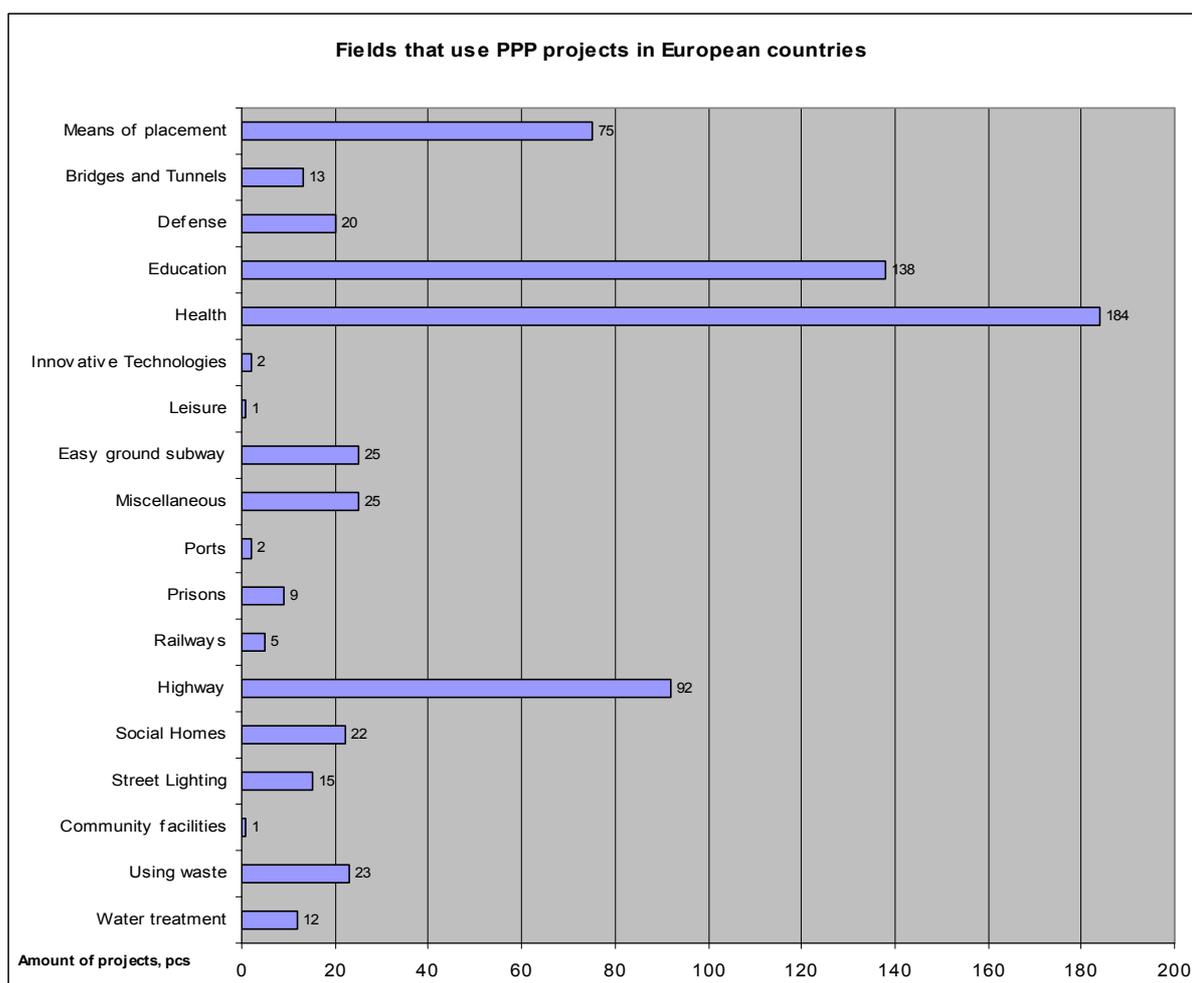


Fig. 2 — PPP projects in the European countries by fields of use

Table 1

Analysis of the use of PPP projects in Europe

Field of project	UK	France	Germany	Italy	Total
Means of placement	18	12	6	4	40
Bridges and tunnels			5	3	8
Defence	18	1		1	20
Education	113	24			137
Health	123	3	32	12	170
Innovative technologies	1	1			2
Easy ground subway	9		12	2	23
Ports			2		2
Prisons	1	3	1	3	8
Railways	2		1	1	4
Highway	12	10	23	5	50
Social homes	22				22
Street lighting	14	1			15
Community facilities		1			1
Using waste	19		4		23
Water treatment			11		11
Total	352	56	97	31	536

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Malyshko A. V. Attracting the European Investments to Concession Agreements in Ukraine

The economic sense of the public-private partnership (PPP) has been considered. The basic types of concession contracts in PPP, world and European examples have been analysed. The current level of concession development in Ukraine under forthcoming UEFA EURO 2012 was examined. European experience in concession agreements was proposed to utilise.

Key words: PPP, concession agreements, infrastructure, UEFA EURO 2012.

Малишко О. В. Залучення європейських інвестицій в концесійні угоди в Україні

У статті розглянуто економічну сутність поняття “державно-приватне партнерство” (ДПП). Проаналізовані основні види концесійних договорів у ДПП, світові та європейські приклади. Досліджено поточний рівень розвитку концесій в Україні у світлі Чемпіонату Європи з футболу-2012, що наближається. Запропоновано використати європейський досвід у сфері концесійних угод.

Ключові слова: ДПП, концесійні угоди, інфраструктура, UEFA EURO 2012.

Мальшко А. В. Привлечение европейских инвестиций в концессионные соглашения в Украине

В статье рассмотрена экономическая сущность понятия “государственно-частное партнерство” (ГЧП). Проанализированы основные виды концессионных договоров в ГЧП, мировые и европейские примеры. Исследован сегодняшний уровень развития концессий в Украине в свете приближающегося Чемпионата Европы по футболу-2012. Предложено использовать европейский опыт в сфере концессионных соглашений.

Ключевые слова: ГЧП, концессионные соглашения, инфраструктура, UEFA EURO 2012.

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