

Country Report

Ukraine

Challenges in Attracting the Private Sector to Infrastructure Recovery in Ukraine

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I. Introduction

Prior to the full-scale war, which began on 24 February 2022, Ukraine had done almost all the preparatory work to actively attract private business in the modernisation of infrastructure. Serious efforts have been made to bring PPP legislation in line with world best practices. A new law on concession has been approved, the law on public-private partnership has been significantly updated, and a number of important amendments have been made to other acts of legislation¹. All this has made the PPP mechanism attractive to private business.

The most problematic issue was the possibility of giving government support for PPP implementation in the forms provided for by special legislation. This required amendments to the Budget Code of Ukraine in terms of introducing long-term commitments for PPP projects. It was also expedient to resolve several other issues, in particular:

- to introduce a procedure for private partners to file appeals in the process of initiating and launching PPPs;
- to improve the selection of advisers and independent experts on PPPs;
- to clarify information disclosure requirements; and
- to increase the responsibility of public authorities for the compliance with the requirements of the legislation in the process of initiating and launching PPP projects.

The main problem was almost solved. Five days before the war, the Parliament approved amendments to the Budget Code to introduce long-term commitments in the framework of PPP, and today the relevant law is awaiting the signature of the President of Ukraine². Unfortunately, the voted law failed to un-

block the provision of government support in all forms envisaged by the PPP and concession laws. At the same time, if the law enters into force, it will be possible to provide for the availability payment for road construction projects at the expense of the state road fund, as well as to provide a certain amount of government support at the expense of local budgets.

In 2021, in the framework of a World Bank project a detailed PPP Manual prepared. It explains step by step how to prepare PPP projects, select the most effective private partners for their implementation, as well as how the public partner should organise the control and monitoring of PPP contracts³. The Manual was supposed to facilitate the application of the PPP mechanism in Ukraine.

The active application of the PPP mechanism in Ukraine was unfortunately hampered by the low institutional capacity of public authorities in the field of PPPs and the lack of proper control over its compliance with procedures in the relevant legislation. The result of this state of affairs was that in the last five years public authorities have initiated only two concession projects in relation to State-owned assets (Kherson Trade Seaport and Olvia Seaport in Mykolaiv Oblast). These two projects were structured with the active support of the International Finance Cor-

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1 Iryna Zapatrina, 'Ukraine: Public-Private Partnerships: The Homework on Establishing Attractable Legal Environment Is Almost Done, It Is Time for Implementation' (2021) 2 EPPPL 341 – 344.

2 Information as of 31 May 2022.

3 Ministry of Economy of Ukraine, 'PPP Manual' <<https://bit.ly/3oPaP9V>> accessed 30 May 2022.

poration and the European Bank for Reconstruction and Development. In 2020, concession agreements were signed with foreign companies to implement these two projects. It was expected that these projects would be the first successful examples of PPP implementation in Ukraine and would increase the country's attractiveness for private investment.

During the same period (the last five years), five unsolicited proposals (four to the Ministry of Infrastructure and one to the Ministry of Energy) were prepared and submitted by private partners to the relevant public authorities. One of these proposals was rejected after the consideration period was exceeded three times, one competition was held and in August 2019 the winner was determined (the contract has not yet been concluded). Three proposals have been under consideration by the Ministry of Infrastructure for three years now, and there is no information on the reasons for ignoring the legal requirements for their consideration in the public domain.

II. Current Situation in Ukraine

The sudden start of a full-scale war in Ukraine has disrupted all plans for the future, including those in the field of PPP.

Three months after the beginning of the war, almost 20% of Ukraine's territory was occupied by the Russian Federation. Among the occupied regions was Kherson, where one of the above-mentioned concession projects was located. All sea lines in the Sea of Azov and the Black Sea have been blocked/mined. Consequently, the second concession project in the port of Olvia has also been suspended. The preparation of other concession projects in relation to seaports (Chernomorsk, Odesa) is paused.

Entire cities, such as Mariupol, Kharkiv, Izyum, Irpin, Bucha, Borodyanka, Gostomel and many others, have been almost completely destroyed. Throughout Ukraine, residential buildings, roads, bridges, energy and water infrastructure, hospitals, schools, kindergartens, railways, airports, and cultural heritage sites have been demolished. The destruction of the country continues.

Almost half of all businesses in Ukraine have stopped operating; many companies have slowed down their work or are relocating to the relatively safer western regions of Ukraine. The number of

people forced to leave their homes exceeds 12 million.

Although it is not yet known when this war may end, the government and local authorities are already considering how and on what basis to rebuild the country, including determining whether it will be possible to use the PPP mechanism.

III. Rethinking the Country

Given the current situation and the scale of the destruction after the war, Ukraine has faced the task of not just rebuilding the destroyed infrastructure but rethinking the entire country. It will be necessary to look anew at its spatial development, priorities of organisation of economic activity (production of goods and provision of services), logistics, use of human capital, etc.

It is likely that political and security risks will not lose their relevance for the eastern and southern regions of Ukraine for a long time. Thus, it will be expedient to transfer a significant part of the country's strategic businesses to the safer western regions where a large number of migrants are already concentrated. Most of them have lost their homes and are unlikely to return to their cities. Therefore, they must be provided with jobs. To make that possible, new enterprises have to be created and supplied with energy, water, raw materials, get connected to logistics chains. At the same time, housing and social infrastructure should be built - kindergartens, schools, hospitals.

As most local airports and roads have been destroyed and some sections of the railway have been damaged, it makes sense to take a different approach to the organisation of transport in the country, perhaps focusing more on the development of high-speed railways.

The same applies to life support infrastructure. Most of the infrastructure assets, such as electricity, gas, heat, water supply, were built in Soviet times, so it does not make sense to rebuild them as they were. Firstly, their capacities must be correlated with the existing needs for such infrastructure that will be formed in the country after the end of the war. Secondly, when rehabilitating such assets, it is important to diversify the resources they use (coal, gas, bio-fuels, renewable energy sources, etc). Thirdly, Ukraine needs to rebuild better, which requires the

creation of ‘new-generation’ assets that use modern, innovative, environmentally friendly technologies.

IV. Programmatic Approach

It is only possible to implement the complex, large-scale projects that will ensure the reconstruction of the country, using a programmatic approach. The aim is, on the one hand, to fully meet the infrastructure needs of business and the general population, while on the other hand, also take into account the available resources and the spatial location of residential and industrial premises. This applies to all projects aimed at infrastructure rehabilitation, regardless of what mechanisms are proposed for their implementation.

Given the scale of the devastation, the need to restore normal living conditions and doing business as soon as possible, and the limited resources that can be used to rebuild infrastructure, it is also important to prioritise the existing projects. The prioritisation should be based on the urgency of the infrastructure needs and take into account the current constraints on funding and human resources.

A key element in the application of the programmatic approach is the definition of acceptable mechanisms for the implementation of projects included in the country’s (or a city’s) recovery programme, and the assessment of opportunities to find sources of funding inherent in these mechanisms.

For simpler projects that involve the restoration or new construction of assets, for which the experience exists in Ukraine, it is advisable to use the mechanism of public procurement. This can provide the population with vital services quite quickly. For the implementation of more complex projects, it is advisable to invite private business. This could be the way to creating a new generation of infrastructure, resistant to climate change and other emergencies caused by human behaviour, environmentally friendly and resource-efficient, especially where it involves non-renewables. Cooperating with the private sector will introduce innovative technologies and organisational mechanisms to the country, as well as provide training for experienced local professionals who will then be able to apply the new approaches to economic development in the future.

The main source of infrastructure investment will most likely be donor funds for the reconstruction of

Ukraine, which are already starting to form. Other sources of funds might be reparations from the aggressor country, loans and private business investments. The use of donor funds will require the application of clear and transparent management mechanisms, as well as robust monitoring and control, following the best practices of international financial institutions and donor countries.

V. What Infrastructure Does Ukraine Need?

As it was noted above, the country needs to build a new generation of infrastructure where possible and necessary.

In addition, given the high risk of resumption of military actions after the war, it is important to ensure the reliability, security and resilience of the new infrastructure to both climate change and the threat of war destruction. This will definitely increase the infrastructure costs, complicate the process of preparing PPP projects and elevate the risks for private partners in the implementation. But it is worth it.

In this context, it is also necessary to provide for the possibility of replacing one type of infrastructure with another in case of danger. This requires planning for alternative transport routes for people and goods, as well as creating reserve sources of heat and electricity, water and other resources.

Particular attention should be paid to the recycling of waste from destroyed infrastructure assets, as well as weapons and military equipment that will remain in Ukraine after the war. Such waste should be recycled mainly in the places of their creation in the optimal way and with minimal impact on the environment. This will also require the creation of appropriate infrastructure.

VI. Attracting Private Companies to Implement PPP Projects in Ukraine

Attracting private business to rebuild infrastructure in Ukraine is important both for our country and for donors who are willing to help in this task.

Apart from helping to accelerate the renovation process by attracting more resources to Ukraine’s economy, it will also raise the country to a new technological level through the transfer of modern tech-

nologies and competencies by private companies. This in turn can help improve living standards and create conditions for the development of high-tech business.

Donors will also be interested in using part of the funds they mobilise for rebuilding Ukraine to provide government support for PPPs in conditions of declining effective demands in post-war Ukraine. They will also seek to cover risks for private partners under PPP contracts, in case of destruction/damage of the assets built by them as a result of military actions. Firstly, this way they will be able to support the socially responsible business of their countries, which will show a desire to help Ukraine in its difficult times, without exposing themselves to too high risks. Secondly, this will ensure effective control over the use of donor funds - all payments on PPP projects must be made in accordance with the private partner's performance indicators. The PPP contracts should clearly state these indicators. And, thirdly, this will establish a partnership between business from economically developed countries and Ukraine, not only in the field of technology and knowledge transfer, but also in the implementation of sustainable business behaviour and corporate culture. This, among other things, can help accelerate the process of Ukraine's accession to the European Union.

The process of initiating and launching PPP projects, in a law-compliant manner, is quite long. At the same time, the need to rebuild the infrastructure in Ukraine is urgent. The country cannot gradually replace obsolete and inefficient assets. It is critical to build new assets quickly to replace the infrastructure destroyed by the war, realising that during their construction and commissioning, the population living in a certain area will be totally deprived of certain services (for example, district heating, water supply, proper medical care, the ability to move around the city or country). However, accelerating the building process by using outdated technology is not always a good alternative. Where possible, a choice should be made in favour of next-generation infrastructure, which in many cases will require the involvement of private business.

In order to increase business participation in PPP projects that will be included in the infrastructure re-

covery programme, the Government of Ukraine is already actively working to speed up and simplify the procedure for initiating and launching PPPs for such projects. Unfortunately, it is not enough for private business to be interested in investing in Ukraine.

In the current circumstances, it is much more important to ensure the possibility of providing government support for PPP implementation for infrastructure rebuilding projects, as well as to provide for the distribution of political and military risks on PPP projects to the public partner or international structures.

Most likely, PPP projects will be implemented in non-concessional form according to the model of 'the government pays'. Non-concession PPPs are regulated in the Law of Ukraine 'On Public-Private Partnership' but this model has never been used in the implementation of PPP projects in relation to State-owned assets. There are also no successful examples of its application to municipal assets. Ukraine has no experience in structuring, procuring and implementing such projects, or in providing government support for non-concession PPPs. This circumstance and the low level of institutional capacity of public authorities in the field of PPP can be a serious obstacle to attracting private business to infrastructure projects in the short or medium term.

VII. Government Support for PPP Implementation

An important issue that needs to be addressed in order to encourage private business to participate in PPP infrastructure rebuilding projects is to ensure government support for the project implementation.

Article 18 of the Law of Ukraine 'On Public-Private Partnership'⁴ provides for a number of forms of government support.

1. Providing State Guarantees and Local Guarantees

There are no mechanisms for implementing this form of government support in Ukraine. As result of the devastating impact of the war on State budget revenues and the country's debt obligations, the introduction of such a mechanism is unlikely to be of interest to private business. Currently, businesses

4 The Law of Ukraine 'On Public -Private Partnership' <<https://zakon.rada.gov.ua/laws/show/2404-17#Text>> accessed 30 May 2022.

will feel safe only if they receives guarantees from international institutions or foreign countries that are able to cover the relevant risks.

2. Funding from State or Local Budgets and Other Sources in Accordance with National and Local Programmes

There is no mechanism for using this form of government support as well. Focusing on this issue is not urgent though, as State and local budgets will not be able to find the financial means for such funding for a long time.

3. Payments to the Private Partner Provided for by the Contract Concluded under PPP, in Particular Availability Payments

The public authorities of Ukraine expect that this form of government support will be used for PPP projects to rebuild infrastructure. The possibility to take long-term commitments on such payments is provided for by the amendments to the Budget Code approved by the Parliament, which are pending the signature of the President of Ukraine. According to this draft law, such payments can be made only from the special fund of the State budget. This will be possible only at the expense of the State road fund. Also, according to the Budget Code, the fund can be support only the creation/reconstruction of roads of national and local importance, which significantly limits the possibilities of using this form of government support. In addition, as a result of the war, the amount of the State road fund is decreasing due to declining revenues from excise tax on fuel and vehicles produced in Ukraine (almost all enterprises producing fuel and vehicles are destroyed). In the present conditions, it is unrealistic to count on the introduction of toll road fees – another typical income stream for this fund.

4. Purchase by Public Partner of Goods/Works/Services Provided by Private Partner in PPPs

This form of government support is similar to the availability payment. In both cases, the public part-

ner guarantees payment for the services provided under the PPP to a private partner (in whole or in part).

Availability payment may include full or partial payment for services provided under a PPP contract.

The purchase of good (works, services) involves their full payment in accordance with the cost stipulated in the PPP contract. The public partner may buy not all goods produced/performed/provided under the PPP agreement, but only a part of them. For some projects this can be useful.

In order to apply this form of government support, it is necessary to amend the Law of Ukraine 'On Public Procurement'. The update should introduce the possibility for public authorities to purchase goods (works, services) without applying the procedures provided for by this Law for the cases when such procurement is carried out in accordance with the PPP contract.

5. Supply to a Private Partner Of Goods (Works, Services) Necessary for the PPP Implementation

This form of government support has never been used in Ukraine, although there are no restrictions on its application in non-financial form.

For example, such support may include an obligation of a public partner to supply (transport) all municipal waste to the waste recycling facility established under a PPP contract. It will also be important for projects to build facilities for recycling waste generated during the war (destroyed buildings, roads, bridges, broken military equipment, etc). In this case, the public partner will not have any additional obligations of a financial nature, except for contingent liabilities related to non-compliance with the terms of the contract.

6. (Re)Construction of State-Owned Infrastructure Assets Necessary for the PPP Implementation

This form of government support can also be used now and is crucial for certain projects. For example, in the case of hospital construction, it may be necessary to build a road to it, or to provide it with energy or water supply.

Funds for government support in this form can be raised from recovery funds established by donors or with donor involvement. The introduction of a programmatic approach to rebuilding Ukraine's infrastructure is critical for providing this form of government support.

VIII. Sources of Funding for Government Support of PPP Implementation

As we found out earlier, government support in one form or another should be provided for most PPP projects that will be included in Ukraine's infrastructure recovery program, and perhaps for all. It is necessary to ensure the return on investment of private partners in the face of declining effective demand of the population and business for life support services. For PPP projects, such reimbursement should normally be made from the commissioning of the PPP asset until the end of the PPP contract (at least 10-15 years).

Such use of target funds for the rebuilding of the country is effective, as investments begin to be reimbursed only after the population / business start to receive services from a PPP asset, and such reimbursement is carried out gradually over time. The difficulty of this funds use is that it requires long-term commitments from public partners, careful budget planning and monitoring of the fiscal risks of PPP projects.

In the current situation in Ukraine, it is not possible to count on the fact that government support for PPP implementation can be provided at the expense of the State or local budgets. At present, the source of such support can be donors' funds and funds received as reparations from Russia. Since the process of obtaining reparations is long, donor contributions are presently the only realistic option.

The European Commission has already announced its intention to provide funding for the recovery of Ukraine. Many other potential donor countries have also made such commitments. Discussions are underway on the mechanisms for directing the funds to Ukraine's recovery programme. There are many options but it is not clear yet which one will be selected.

Most of the funds raised by donors will be directed towards urgent infrastructure rebuilding, which will be carried out in the form of public procurement. The preparation and launch of PPP projects will take some time, so funds for government support for such

projects will be provided after at least a few years. Therefore, there is a time to develop mechanisms for providing such support in effective way, including the implementation of monitoring the use of these funds and the fiscal risk management system. Given the complexity of this task, the work should begin now.

The main problem that will need to be addressed in the development of these mechanisms is that government support payments must be made over a long period of time, and they must be in line with the schedule in the long-term PPP contracts. In this context, it will be necessary to find an answer to the question: how can commitments for such payments be guaranteed for 10 to 15 years, given that the horizon for planning the income and expenditure of recovery funds is likely to be measured by approximately five years? To date, the period during which donors will be willing to contribute to recovery funds is unclear. This is a serious problem for the use of international aid funds in the framework of government support for PPP.

Donors could consider making long-term commitments for PPP projects under the Official Development Assistance (ODA) provided for by the Sustainable Development Goal 17 (SDG 17). Such assistance can also be used to provide government support for PPP implementation for projects included in Ukraine's post-war infrastructure rebuilding programme, as they are fully in line with the goal of implementing ODA. It should be noted though that this SDG clearly sets the percentage of ODA/GNI assistance from the developed countries to be annually directed for the implementation of projects that will contribute to the achievement of the SDGs in developing countries.

Box 1. *SDG 17. Strengthen the means of implementation and revitalise the global partnership for sustainable development*

17.2 Developed countries to implement fully their official development assistance commitments, including the commitment by many developed countries to achieve the target of 0.7% of ODA/GNI to developing countries and 0.15 to 0.20% of ODA/GNI to least developed countries ODA providers are encouraged to consider setting a target to provide at least 0.20% of ODA/GNI to least developed countries.

Source: United Nations <<https://sdgs.un.org/goals/goal17>>

Currently, Official Development Assistance can be pooled in special funds or programmes implemented by international institutions, and to directly finance projects to ensure sustainable development by countries with ODA commitments. Part of these funds could be used to restore Ukraine's infrastructure as a source of government support for PPP implementation.

The mechanisms for using these funds may be different, eg special recovery funds, which are currently being formed, with ensuring of their targeted focus on government support for PPP projects. Another mechanism could be for donor countries to support their own businesses, willing to help Ukraine in building a new generation of infrastructure.

Taking into account the goal of implementing Official Development Assistance - to promote the Sustainable Development Goals by helping developing countries and least developed countries, government support for PPPs through this source of funding should be provided only to those projects that will contribute to the achievement of SDGs. To this end, it would be useful to prove in the feasibility study of the relevant projects that they can be classified as People First PPP⁵, using the recently developed by United Nations Economic Commission for Europe (UNECE) the People-first PPP Evaluation Methodology for the SDGs⁶.

IX. Covering Risks of Resumption of Military Actions after the End of the War

Another important prerequisite for involving private business in the rebuilding of Ukraine's infrastructure is the availability of insurance compensation for losses of private partners in PPP projects resulting from damage / destruction of PPP assets as a result of military actions. A private company will only be willing to invest its own or borrowed funds if it is confident that losses will be adequately compensated. It is desirable that such compensation be provided by international institutions or developed countries.

There is no such solution today. In order to create a mechanism for ensuring the risks of private partners with regard to damage to PPP assets or losses on the project resulting from resumed military action, in our opinion, we could focus on the following areas:

- creating a new product of the Multilateral Investment Guarantee Agency (MIGA), a member of the World Bank Group, to provide insurance coverage for the risks of private partners under projects included in the infrastructure recovery programme of Ukraine;
- providing insurance coverage for the consequences of military riots on PPP projects by countries that are willing to assist Ukraine in rebuilding its infrastructure, in favour of private business - residents of the respective countries;
- providing insurance coverage of risks of private partners for projects that are part of the infrastructure recovery program of Ukraine, within the Risk Insurance Fund for PPP projects, which may be created by donors or with their participation.

X. Conclusions

Ukraine suffered devastating consequences from the war started by the Russian Federation: destroyed or significantly damaged life support infrastructure, which made certain parts of the country unfit for human habitation; destroyed residential buildings, energy, heating, water supply and sanitation systems, transport arteries, hospitals, schools, kindergartens. More than 12 million people have been internally displaced. In order for people to be able to return to normal life in their settlements, it is necessary to rebuild the destroyed infrastructure as soon as possible.

Not waiting for the end of the war, Ukraine began the process of rethinking the future of the country. The government faces challenges in developing new approaches for the country's spatial development, defining long-term economic and social priorities, creating logistics networks, using human capital, and so on. It is already agreed that infrastructure rebuilding should be based on the principle of 'building better', to ensure, where possible, the creation of a new

5 Promoting People first Public-Private Partnerships (PPPs) for the UN SDGs - United Nations Economic Commission for Europe (UNECE), July 2016 <https://www.un.org/esa/ffd/wp-content/uploads/2016/01/Promoting-People-first-Public-Private-Partnerships-PPPs-for-the-UN-SDGs_UNECE_IATF-Issue-Brief.pdf> accessed 30 May 2022.

6 People-first Public-Private Partnerships Evaluation Methodology for the Sustainable Development Goals (2021) ECE/CECI/WP/PPP/2021/3 <https://unece.org/sites/default/files/2021-11/ECE_CECI_WP_PPP_2021_03-en.pdf> accessed 30 May 2022.

generation of infrastructure that meets the principles of sustainable development and allows achieving the target indicators of SDGs.

Given the inherent innovation and creativity of the private sector, it will play an important role in creating a new generation infrastructure that will help Ukraine achieve both national and global SDGs in the framework of the recovery programme implementation. In view of this, it is important to establish a PPP Programme for the recovery of the country with the wide application of the People First PPP model developed by the UNECE.

In the conditions that occurred in Ukraine as a result of the war, it should not be expected that attracting private business to rebuild infrastructure can only be achieved by accelerating and simplifying the procedures for initiating and launching PPP projects, although this is also important. What companies need more pressingly are mechanisms for providing government support for PPPs and insurance compensation for losses due to military actions during the implementation of PPP projects.

Providing government support for PPP implementation at the expense of Ukraine's internal resources (State and local budgets) is not realistic in the medium term. This task can be solved only with the assistance of donors, both financial and institutional. That is why, mechanisms that will be used to provide such support should be acceptable to donors in terms of achieving the result - the creation of a sustainable in-

frastructure, efficiency, transparency, zero tolerance for corruption. This requires joint work on these issues by the public authorities of Ukraine and donors.

In this context, the creation of a new institutional mechanism for the use of Official Development Assistance to ensure long-term commitments of public partners in providing government support for PPPs projects included in Ukraine's infrastructure recovery program is promising. The selection and prioritisation of PPP projects to be included in Ukraine's recovery program should be carried out using the criteria used for the People First PPP, which will ensure the country's sustainable development in the long run. Developed by UNECE, the People-first PPP Evaluation Methodology for the SDGs can help solve this problem.

It is equally important to develop a special mechanism(s) to ensure insurance compensation for losses of private partners in case of resumed military actions in Ukraine, to apply it to projects included in the infrastructure recovery programme. To do this, the most appropriate step is to focus on the adaptation of existing political risk insurance products of MIGA, which may be relevant to the Ukrainian recovery of infrastructure projects.

Given the complexity of solving all these problems, we need start working on them now. This will make it possible to attract private business to rebuild Ukraine's infrastructure immediately after the end of the war.