

## **WHY PUBLIC-PRIVATE PARTNERSHIP DOESN'T WORK IN KYRGYZSTAN?**

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*There is too much talk and not enough action; the law isn't working; there is a lack of projects - this is what many officials and businessmen say when asked about public-private partnership (PPP) in Kyrgyzstan. Why does such opinion arise? Is there a need to change it?*

PPP is a long-term (up to 50 years) arrangement between the public sector (state and municipal authorities and organizations) and the private sector (legal entities and individual entrepreneurs) whereby the private partner undertakes to deliver projects involving the design, construction, reconstruction and/or management of public and municipal facilities (roads, airports, railway stations, hospitals, sports and many other infrastructure facilities).

### **Briefly about PPP in Kyrgyzstan**

*Legislation:* The PPP Act came into force in 2012. Based on lessons learned from the previous PPP Acts, the Government prepared a draft of the new PPP Act significantly simplifying and shortening the PPP project preparation process. In May 2018, the draft passed the first reading in Parliament, its further consideration being scheduled for this autumn.

*Policy:* In 2016, the Government adopted the PPP Development Programme 2016 – 2021. Many national, sectoral, and municipal strategies and programmes mention PPP as a tool for improving the efficiency of public and municipal asset management.

*Institutional framework:* Key PPP units include the Ministry of Economy (a PPP policy unit), the Ministry of Finance (a risk management unit) and the Investment Promotion and Protection Agency (a project implementation unit). Some sector-specific public and municipal authorities have PPP specialists among their staff members.

*Track record:* PPP track record is modest. To date, there are only two PPP projects signed: hemodialysis centers and movie theater reconstruction. A number of projects in the area of public transport, parking lot, kindergarten, customs logistics center, bypass road, computed tomography and other services are at the stage of preparation (feasibility study).

PPP is a tool used by many countries to attract investment into infrastructure and to improve the efficiency of infrastructure facilities management. Kyrgyzstan has undertaken a number of steps to introduce PPP but the launching of PPP projects moves slowly with the public and private sectors having little interest in real projects.

### **Infrastructure problems**

Speaking about infrastructure problems in Kyrgyzstan, we primarily mean roads which are mostly below standard and energy assets whose degraded condition entails great technical and financial losses. Irrigation, plumbing and heating systems are in critical condition. The Government fails to satisfy the growing demand for new schools (many schools have triple shifts) and kindergartens (serving only 25% of preschool children). It is impossible to improve the quality of life of people and economic situation in Kyrgyzstan in general without improving infrastructure. The improved quality of infrastructure makes life and work easier and more comfortable, and makes economic activity more efficient.

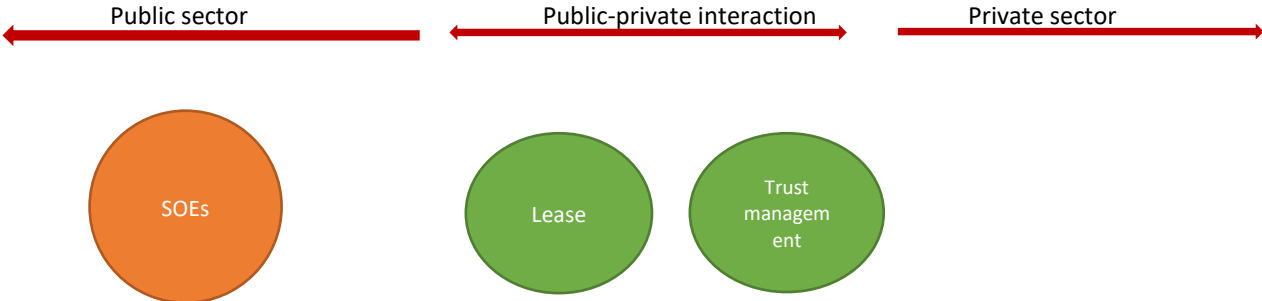
There is a huge list of public infrastructure facilities that require repair, construction and effective management. Most of these facilities are prohibited from being privatized, and the burden of their maintenance and management falls on the Government. State budget is not sufficient to fund infrastructure projects; moreover, the management of state-owned enterprises and joint-stock companies operating infrastructure facilities appears to be less effective. For example, as per end of FY 2017, out of 99 functioning SOEs, 47 were profitable, out of 47 profitable SOEs, 6 SOEs accounted for 87% of the profit. Out of 60 JSCs, 35 were functioning, of them 20 were profitable, out of 20 profitable JSCs, 5 JSCs accounted for 86% of the profit (derived from the public reports of the Government of the KR and decisions of the Parliament of the KR addressing the efficiency of public asset management in the KR).

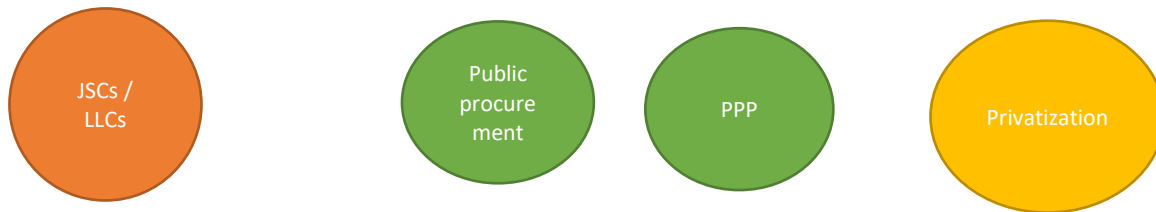
The quality of public infrastructure depends not only on the volume of investment, but also on the efficiency of public asset management.

**How can the Government improve the efficiency of public asset management?**

The first approach (Figure 1, left arrow) suggests mechanisms that can be used by the public sector (state-owned enterprises, joint-stock companies and limited liability companies with state shareholding) without engaging the private sector. For example, the Government can undertake reorganization or restructuring of state-owned enterprises and institutions, set up joint-stock companies, develop requirements for senior management and board of directors, determine reporting requirements and introduce other measures. In 2015, the Government of the KR adopted the Concept of Public Asset Management Reform Policy proposing, among other things, to reform public authorities, to introduce strategic planning, to establish national holding companies and much more. By accomplishing these tasks, the Government can attain the goal of improving the public sector efficiency.

Figure 1





The second approach (Figure 1, right arrow) suggests privatization or alienation of public assets to private owners. Kyrgyzstan has faced several waves of privatization due to various reasons including in connection with transition to free market economy and competition, raising public revenue, reducing public expenditure by getting rid of burdensome public assets, attracting investment in the public sector. At large, mass privatization aimed at transition to market economy has been completed. In the last wave of privatization (2015), the focus shifted to optimizing the structure and improving the performance of public assets.

The third approach (Figure 1, middle arrow) suggests interaction between the Government and private companies in various ways. They include the following:

- *Lease of public immovable and movable assets;*
- *Public procurement of goods/services;*
- *Trust management of state shareholdings and assets of state-owned enterprises;*
- *PPP (engaging the private sector to deliver the design, construction and management of public or municipal assets or to provide public or municipal services).*

These can be briefly described as follows.

*Lease of public immovable and movable assets* represents a widely used mechanism which helps the Government improve the performance of public and municipal immovable and movable assets. In Kyrgyzstan, there are thousands of public asset lease contracts being executed each year, most of which are commercial leases for a period not exceeding one year. Commercial leases for a longer period (up to 10 years) are allowed on condition that reconstruction or major repairs are performed, but there is little demand for such contracts in the market. As for businesses, practically none of them are willing to make capital investments in public assets, since a standard lease contract does not seem to protect investors or their investments.

*Public procurement* is the most widespread and well-regulated form of interaction between the Government and the private sector in Kyrgyzstan. It certainly helps to improve the efficiency of public customers, ensures transparency in the procurement process, and reduces corruption. Public procurement of goods and services is gaining pace with every year totaling to KGS 43.5 billion in 2015. At the same time, public procurement has its limits, as it is only designed for one-time transactions and adjusted to the budgeting period (up to one year or up to three years). In practice, more than 90% of public procurement transactions are executed for a period not exceeding one year and do not require capital investment from suppliers of goods and services. The public procurement system is mainly 'lowest bid' than 'best value' oriented.

*Trust management of public assets* is used by the State Property Management Fund of the KR to engage private companies to manage state shares or assets of state-owned enterprises for a period of up to five years. The new Public Asset Management Act was enacted in May 2018, but at this point, there are no registered cases of public asset management transactions. At the moment, it is unclear whether any private companies would be ready to provide trust management services, since the regulatory requirements for them are quite high (for example, insurance, bond, collateral, financial standing and much more). Only the practice can make it clear whether the private sector would be interested in such form of interaction with the Government.

*PPP*. Just like in the case of lease, public procurement and trust management, PPP does not suppose the transfer of public assets to the private sector and is based on a contract between the Government and the private sector. But unlike lease, public procurement and trust management, PPP suggests long-term (up to 50 years) relationships with the Government and the possibility of attracting private investment (capital) in the design, construction and management of public/municipal infrastructure facilities. As noted above, PPP has modest track record in Kyrgyzstan so far.

### **How officials treat PPP?**

A majority of officials in Kyrgyzstan treat PPP with caution, discouraged by its complicated and lengthy preparation process. Indeed, PPP project preparation is a quite intricate and time-consuming process. For the sake of clarity, let us illustrate this statement by the following example.

If the Government decides to use the PPP model to procure a bus terminal, it will have to set complex tasks and to find comprehensive solutions. This means addressing the issues of not only reconstruction of buildings and access roads, but also determination of current and future passenger traffic flows, traffic routes, accessibility for general public, fares, new technologies and many other issues. Solutions to these issues can be found only after detailed research (as a rule, a feasibility study or FS). Such research can be made by the public partner itself, but considering the complexity of the issues, it is preferable to engage qualified experts to conduct a FS. Careful research is needed to ensure that in the ultimate perspective the private partner could correctly set tasks to the private partner for the reconstruction and effective management of the bus terminal. The process of conducting research (FS) may take several months. The tender process is no less complicated. It requires the preparation of tender documentation and PPP contract, holding of negotiations with potential private partners, selection of preferred bidders and execution of contract. Thus, the whole preparation process can take at least nine months if not more. The experience of other countries shows that the preparation of an individual PPP project takes a year and a half on the average.

As a result, an overly complex set of tasks and too lengthy process of preparation and holding of tenders make PPP less attractive for officials in Kyrgyzstan. The same is true of SOE executives who are not willing to give up control to the private hands.

### **Are businessmen interested in PPP?**

Yes, businessmen of Kyrgyzstan are interested in PPP, but they don't have much trust in it. Dealing with the Government is too risky. It involves many risks: political (availability or lack of political support for the project), economic (bankability of the project), environmental (extent of environmental exposure), social (community support or opposition) and many others. But today the greatest concern is exposure to political risks. Few expect the Government to protect the private partner's investments, especially in the context of frequent replacement of officials. Furthermore, people are discouraged by the lengthy and multiple approval procedures.

### **So, is there a need for PPP in Kyrgyzstan?**

Despite all doubts and difficulties, public-private partnership is needed in Kyrgyzstan. At the moment, it is the only tool by which the Government can attract long-term private investment in infrastructure. PPP can also help improve the efficiency of infrastructure management by using the experience and knowledge of the private sector.

To date, only 2 PPP project have been signed in Kyrgyzstan, compared to 2,000 PPP projects in Russia and over 800 in Kazakhstan. PPP experience (both positive and negative) has been accumulated in many countries. To ensure the overall development of PPP in Kyrgyzstan, we don't need to reinvent the wheel, we just need to consider the best international practices offering dozens of options that can be used in our country reasonably and with due regard to local conditions. And, certainly, there is need for a simple and clear action plan and decision-making. An overview of the actions needed in Kyrgyzstan will be provided in the next article.

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