

UDC 330.322:352(497.7)

DISCUSSION ABOUT THE NEEDS TO INTENSIFY THE PPP AT THE LOCAL LEVEL

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Abstract

This paper was prepared in order to provoke debate about the needs in the Republic of Macedonia for capital investments, to illustrate own capacity for capital investments and to promote the needs to intensify the use of Public-Private Partnership-PPP. This discussion paper is neither intended to make an exhaustive and systematic analysis of the transition period economic results in Macedonia, nor to analyse the potential of the Macedonian economy for sustainable development. Therefore, the beginning of the text is an attempt to illustrate the status of Macedonia with its infrastructure and basic resources, i.e. needs for capital investments, and then to provide basic information about the potential for investment. It follows a brief description of competencies which are decentralized, basic cost drivers for the decentralized competencies and finally what are the challenges for the local government in Macedonia. This paper should motivate a request for preparation of an exhaustive study, if the central and local governments are considering effective provision of a package of services on medium and long term, to the general satisfaction of the citizens.

Key words: *Public-Private Partnership-PPP, capital investments, infrastructure, decentralization.*

STATUS WITH THE INFRASTRUCTURE IN MACEDONIA AND THE NEEDS FOR CAPITAL EXPENDITURES: LONG AND INEFFICIENT TRANSITION

Since the independence in 1991 Macedonia has been a subject of monitoring by EBRD on the speed with which it is transiting towards efficient market economy. It is a transition story about lack of recognition of all costs in the calculation of prices for public services as well as a story about giving higher priority to employment (i.e. higher priority for payment of salaries, instead of recognizing the costs of maintenance and depreciation and the long term marginal costs) rather than more efficient maintenance of assets. The problem is that in transiting to efficient market economy the relative prices should've change and the consumers should've pay the full economic cost of production, supply and new investments in public services regardless if the operator is private or public. Calculating the full cost of public services is imminent, in order to ensure that the operator will be able to further cover the needs for additional investments. The choice for appropriate revenues (due to weak purchasing power of Macedonian consumers, the availability and willingness to pay and the free riding) is either to provide subsidies to operators from the government (central or local) or to increase tariffs and/or fees.

Authorities in Macedonia through the transition were sensitive to the need to increase the prices of public services, often tolerating over-employment, political employment and nepotism and unregistered operators, which through unfair competition do not provide equal treatment for all operators. At the same time through a system of quasi-fiscal spending, authorities were further strengthening and fixing their political power at the expense of the value of assets owned by the state (local and central)

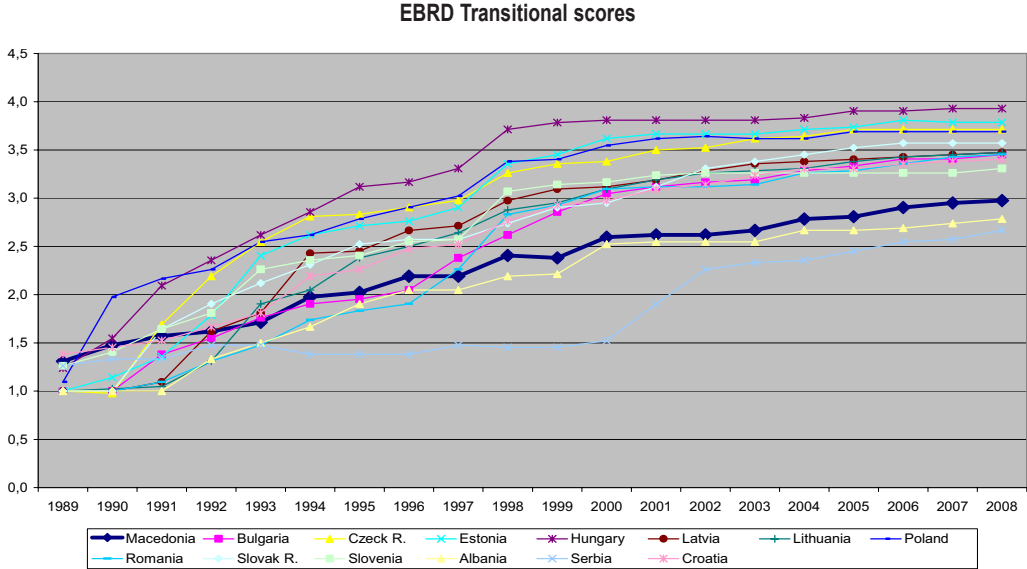
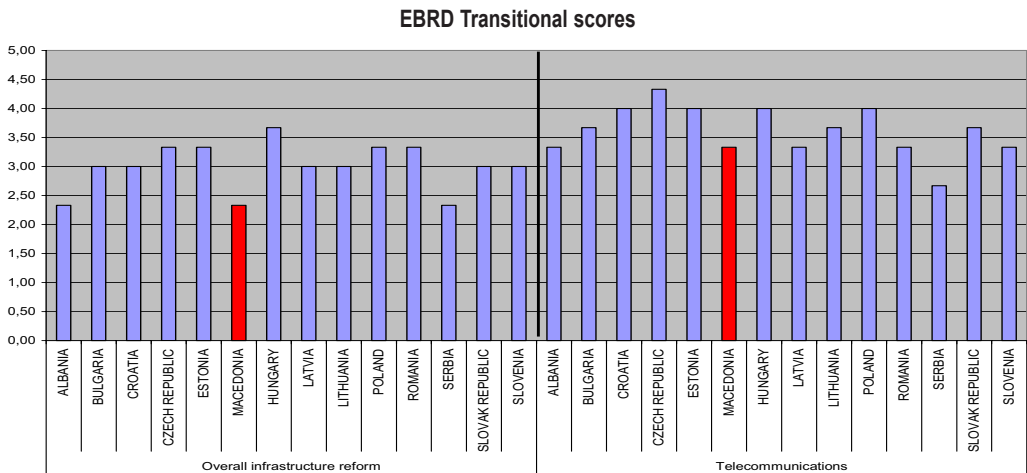


Figure. Macedonia according EBRD's Transitional Indicators¹

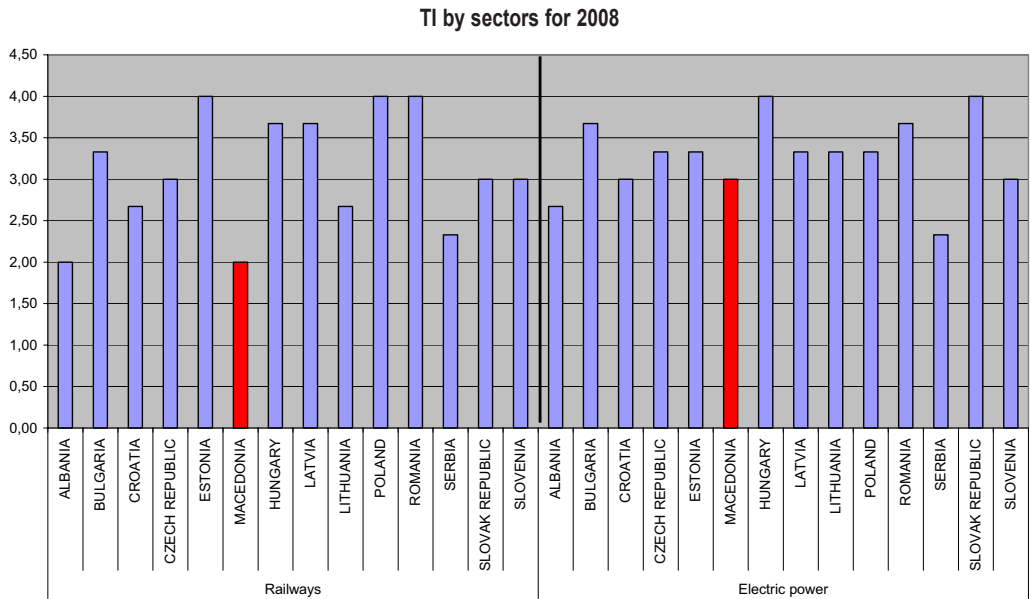
From the figure above we can see how Macedonia in these two decades slowly falls behind the other transition economies.

EBRD Transitional Indicators-TI for different infrastructure in Macedonia is shown in the following graphs and for comparison, the situation in selected peer economies are also illustrated.

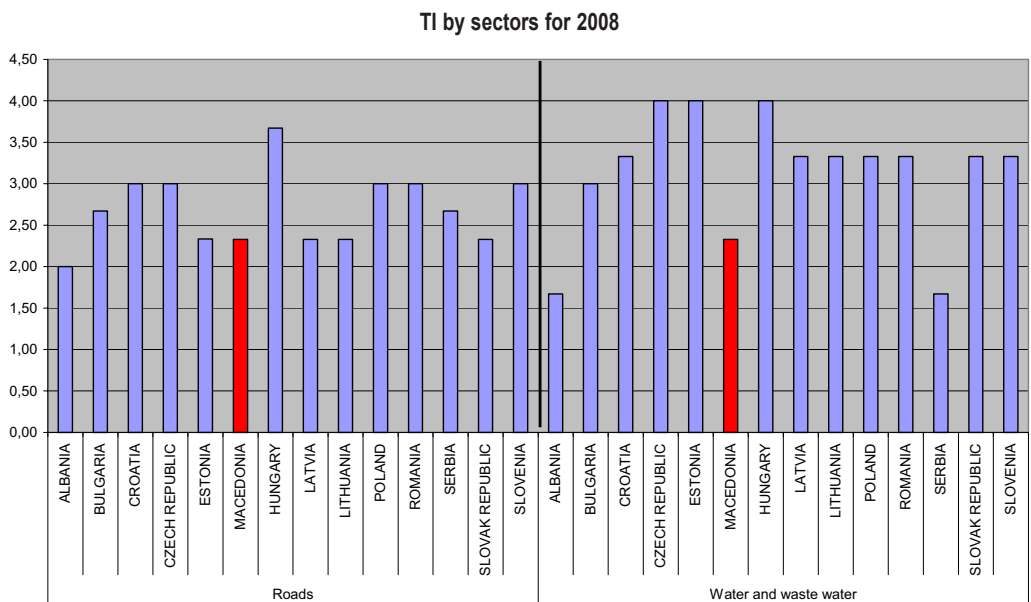


Graph. TI by sectors - Total and Telecommunications

6 1) TI is measured from 1 to 4, where 4 is an efficient market economy.



Graph. TI by sectors - Railways and Electric power



Graph. TI by sectors - Roads and Water and waste water treatment

We can easily see that Macedonia is lagging behind substantially compared with its peer countries in all infrastructure sectors where large financial resources are needed (and where PPPs are welcomed as worldwide experience) to improve situation.

This situation has been confirmed with the World Bank's Public Expenditure Review - PER from 2008 as well. There among others it is stated: "Years of under-spending on road maintenance have left a large maintenance backlog that the authorities will be well advised to tackle within the available budget envelope."

Moreover, new spending may be required to support the country's EU accession process" and more: "Years of under-spending on maintenance in the transport sector has led to a significant deterioration of the quality of public assets". But also, "Looking forward, the Government faces a number of challenges in improving the quality and effectiveness of public spending".

All this led to a situation of depreciated fixed assets in Macedonia, for which less and less money are detached for maintenance, while procurement and construction of new fixed assets are not considered in the past nearly two decades.

Just for illustration, the depreciation in Macedonia as consumption of the fixed capital is around 18% of GDP annually, or one billion euros to be invested annually in order to break even.

An EAR project results on strengthening Ministry of environment and physical planning capacity illustrates that some of the other needs at local level for capital investments in Macedonia are estimated around 1 billion euros.

Table. Assessment of the total required investments in million euros/million euros per capita for approximation with EU regulations.

	Macedonia	Romania	Bulgaria
Treatment of urban wastewater, sewage	229/113	1,385/63	2,056/267
Large polluting factories.	274/136	402/18	1,627/211
Solid waste management, landfills	80/40	NA	NA
Management of municipal waste, and other installations.	120/59	NA	NA
IPPC Licenses	381/187	806/36	3,261/424
Total	1,084/537	10,593/475	6,944/902

Source: CEA Publication: *The future of local public finances: Case studies from Macedonia, Romania and Bulgaria 2006*, www.cea.org.mk.

POTENTIAL FOR INVESTMENT IN MACEDONIAN ECONOMY - EXPERIENCE

The following data can illustrate the allocation of capital expenditures in Macedonia but also can indicate what is the vertical equalisation between the central and local government in Macedonia.

The central government for capital expenditure is allocating around 4% of GDP annually which is about 300 million euros and local governments for capital expenditure are allocating around 70 million euros which is around 1% of GDP. The central Government is transferring to local government additional 150 million euros through earmarked and block grants. Local authorities, according to the law, are able to borrow long run in a total volume of around 130 million euros (in amount of the total budgets for 2008). On the other hand, according to the Ministry of Finance, in the period 2003 - 2008 the FDI amounted to an average of 5.3% of GDP per year or nearly 300 million annually.

Now, we have the main elements for an indicative static analysis (dynamic analysis would require data on the demographic development, socio-economic development and planning at least which in Macedonia do not exist). So on one hand we have about 500 million euros capital expenditure from the central and local government, including the potential for borrowing of local government, and if we add those 300 million euros FDI annually again we still cannot reach those required 1 billion euros of annual depreciation.

The conclusion is simple, that Macedonia cannot cover even the depreciation even if FDI is included. Given that, what remains for Macedonia is issuing bonds, borrowing and/or utilizing public-private partnership.

ILLUSTRATION OF THE STATUS WITH THE TRANSFERRED COMPETENCIES AND THE LOCAL GOVERNMENT IN MACEDONIA

In Macedonia there are around 1000 primary schools with around 230 thousand students and around 15 thousand teachers, 100 secondary schools with around 95 thousand students and around 6 thousand teachers. The number of kindergartens is around 50, which serve more than 20 thousand children and the number of employees is approximately 3.5 thousand. These data simply show the main cost drivers and the needs for maintenance at local level for the transferred competencies.

The process of decentralization and the system of financing the local government is reduced to the system of funding of existing facilities instead of funding functions and services. The system at the moment is covering wages with few opportunities and funds for proper maintenance of facilities, much less to build new facilities and none to improve the quality of service or increased coverage of services to more citizens (for example, the total number of children under 5 years of age in Macedonia is about 120 thousand, and the capacity of kindergartens is around 25 thousand children, which is coverage rate of only 21%).

Another calculation from another EAR research on costing of services from 2007 shows that the fiscal gap for the provision of services for the transferred competencies: education, roads, child care, homes of elderly, fire protection and the culture is approximately 25 million euros for the existing coverage of citizens.² This means that transfers from the central government in addition to what local government are earmarking to the competencies each year is less for about 25 millions euros in order to cover the needs of all costs for these competencies with existing quality and existing coverage of citizens.

CHALLENGES FOR THE LOCAL SELF-GOVERNMENT

Overall

From the discussion above we can see that the resources and potentials of Macedonia are limited and needs for capital expenditure is over the capabilities of the budgets of the central and local government in Macedonia, also we are not a particularly attractive destination for FDI. So, what remains as an option is borrowing, issuance of bonds and Public Private Partnership-PPP (less ethically yet known in Macedonia and possible options for local and central government are reducing the quality of services, further decline of the assets, non-payment of obligations). The challenge is how local governments, in real life re-centralization, can increase private and public investment in order to ensure higher quality of public services, while at the same time to strengthen the economic growth of the economy and to preserve macroeconomic stability.

One alternative is a PPP, where private partner for appropriate compensation and opportunity for cooperation and through partnership relations can substitute the local government in providing public services, increasing the quality of the same and/or increase the coverage of citizens. First element of PPP is the volume of capital expenditures for a particular purpose for PPP to be affordable, i.e. on macro level should be fiscally sustainable. Second element is to ensure proper allocation of the risks according to the capabilities of the partners for their effective management. The third element is to have a proper value for money for the public partner. For example, if the municipality decides to go for PPP, it will be obligated to make payments to the private partner annually. These discounted cumulative annual payments to the private partner, for a certain period should be lower than the discounted cumulative costs that the municipality would pay, for the

2) EAR's project for estimation of the costs for the transferred competencies.

same period, if it provides that public service by itself. Only then there will be value for money for the taxpayers and only then will PPP makes sense. Care should be taken that the concept of "value for money" is not replaced for the term "cheapest offer" from the public procurement, because in the PPP, opposed to public procurement, subject to the agreement is the service and its attributes, and not how that service will be provided.

Specifics after the financial crisis

Special types of risks for Macedonian Local Government are the effects from the global crisis. Lower revenues from the planned in the central budget, for the local government will mean lower transfers, poor planning of the central government will be downloaded to the local budgets and can mean possible further increase of contingent liabilities, reducing the credibility of the local government, increased amount of unpaid obligations, termination of contracts and much less likely (due to small size of LSG in Macedonia) but possible, jeopardizing macroeconomic stability.

Is PPP is a solution for local government in Macedonia

According to the World Bank, in the period 1990-2001 year, investors worldwide invested about 754 billion US dollars annually for PPP projects. Studies from IFIs indicate that although the authorities provide various subsidies to the private investors, still investors are reluctant to invest in developing countries, because of commercial, financial and political risks. In such circumstances, central governments are developing special funds in order to reduce transaction costs, increase transparency and consistency in evaluation and allocation of public support. Here should be considered that the PPP as an option for increasing the quality of the services and coverage of people who use these services requires increased awareness for this instrument and strengthening the partnership between central and local governments, and then between the public and private partners in Macedonia.

In Macedonia it is necessarily to strengthen the legislation, not so much for the concessions as for the Private Finance Initiatives-PFI, which are attractive models of PPP for the needs of municipalities in Macedonia, taking into consideration, how Macedonia is organized and what is the legal framework in the area of transferred competencies. Macedonia doesn't have many things that can be praised as competitive advantage, but macroeconomic stability is definitely a public good that can be used as an additional argument for attracting investors and private partners. Financial capabilities of local governments are generally modest, and there must be considered establishing a fund for investments in municipalities (the Centres for Regional Development can be a good instrument if they are really equipped with professional staff) who will not only provide funds but will assist in the preparation of tenders and contracts for PPP.

CONCLUSION

Needs of capital investments, increasing the quality of service, increasing the quantity of services, achieving standards that reflect a country contender for EU membership, increasing the coverage of citizens is anecdotic truth in Macedonia. It is obvious that Macedonia went through ruinous and unsuccessful transition, and couldn't strengthen the capacity for economic sustainability, or even to cover basic fixed costs. This situation leads to the need of funding sources, for which we neither have much choice regarding the terms nor much comfort for negotiation, and therefore we will have to strengthen the knowledge and skills for partnership thinking, but first in our country, then among foreign and domestic private partners. In this constellation, the local government in Macedonia is in extra difficult situation, because is actually brought to the role of payment agency of the central government. In such conditions one way to break a cycle of inefficiency, is to study and use the fundamentals of PPP - partnership between central and local governments and then partnership between local government and private sector.