

RISKS GENERATED BY THE PARTICIPATION OF PUBLIC ENTITIES IN INTERNATIONAL TRANSACTIONS IN THE CASE OF PUBLIC - PRIVATE PARTNERSHIPS

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Abstract

The factual records and the contributions from the specialized literature highlight the role of the public-private partnership as a viable alternative intended to replace the lack of financial resources of the government, the gaps in the management of the administration of large infrastructure projects, bringing at the same time an important contribution to the technological dissemination. Most of the time, the implementation of large financing projects cannot be conceived without the participation of foreign capital. However, there are numerous cases when such partnerships are not completed successfully, given some aspects such as the ineffective allocation of risks between partners, a poor management approach, overly optimistic forecasts. Moreover, the unprecedented opening of national economies to international exchanges creates consistent premises for the propagation of shock waves characteristic of recessionary phases at the national level, contributing to the aggravation of existing macroeconomic problems, at least for developing countries. Our study, through an integrative qualitative approach and filling a relative lack in the field of scientific concerns, aims to analyze what are the main risks arising for public entities in the case of public-private partnerships, formulating relevant recommendations to overcome them.

Key words: public-private partnership, risks, public entity, international transactions.

The factual records and the contributions from the specialized literature highlight the role of the public-private partnership (PPP) as a viable alternative aimed at replacing the lack of financial resources of the state, the gaps in the management of the administration of large infrastructure projects, bringing at the same time an important contribution in technological dissemination.

This approach is not new, some authors finding the institutional beginnings even in antiquity (Grimsey D., Lewis M.K., 2004) while others attribute an effective role to them demonstrated in the construction of the London Underground since 1894. (Đorđević A, Rakić B, 2020).

During the historical evolution of the increasing responsibility of states in the field of public infrastructure financing and against the backdrop of budget deficits doubled by economic recession, disturbances in the supply chain of companies at international level, resorting to such partnerships represents an effective solution in principle, which can explain their proliferation. According to the existing data on the E.P.E.C.

portal. within B.E.I., the number of public-private partnerships that had financial closure in 2021 was 1,913, with a value of 403.2 billion euros, mainly targeting fields such as education (461), transport (411), health (397), average (154).

The E.P.E.C. report from B.E.I. relating to the year 2023, which analyzes the partnerships concluded in EU-27 countries, the United Kingdom, Israel, Turkey and countries of the Western Balkans (Albania, Bosnia and Herzegovina, North Macedonia, Kosovo, Montenegro and Serbia), places Germany in first place, both in terms of number of partnerships and value (11 partnerships worth 3.3 billion euros), followed by France (in terms of number of projects - 6 projects), which was overtaken by Israel in terms of the value of partnerships (*figure 1*) (European Investment Bank, 2024).

Regarding their value, Lithuania and Kosovo are in the last places, but in terms of number, seven states have concluded at least two partnerships, and 13 countries have one, in the conditions where, as previously shown, the developed economies hold the weight. In terms of

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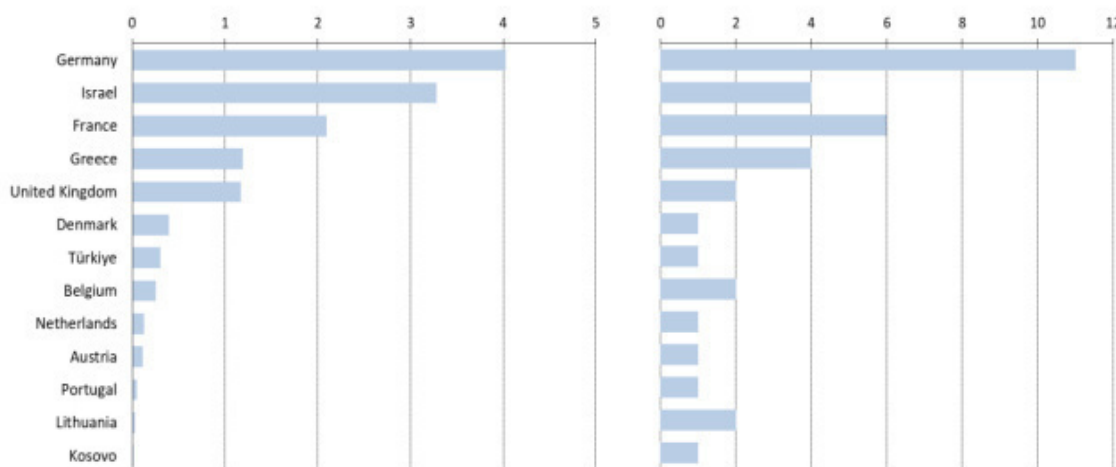


Figure 1 **Country breakdown by value and number of public-private partnership projects 2023**
[European Investment Bank, 2024]

sectoral orientation and value, the same report shows that the first sector targeted was transport, followed by environment, safety and public order. The share of developed states can be explained both by the learning curve and the experience gained over the years, at the same time the partnerships created by them are no longer necessarily aimed at solving some problems at the macroeconomic level, tending towards the meso and microeconomic sphere.

Specialized literature highlights the permanent recourse to such constructs with the participation of public institutions. It has been estimated that over the past quarter of a century at least 134 countries have had such initiatives, with a larger resurgence after the sub-prime crisis of 2007-2008, accounting for around 20% of infrastructure investment. (Inderst G., Stewart F, 2014). Their conceptualization is heterogeneous, some authors insisting on the fact that they represent a way to cooperate between public and private law partners in order to deliver public services that were mainly the prerogative of the state, against the background of assuming some shared risks, costs and future profits (Klijn E.H., Teisman G.R., 2003). Other authors have pointed out that such institutional structures enable a mobilization of private finance catalyzed by technological progress and the superior managerial expertise of private law entities. (Grimsey D., Lewis, M.K., 2004).

In essence, the intrinsic construction of the PPP involves a series of contractual arrangements (*figure 2*) structured on multiple levels, which is intended to value the idiosyncrasies resulting from the interaction of the managerial/competitive capabilities of private and public law actors.

Thus, at a first level we find the national states, which by virtue of an articulated strategy that transcends from micro to macroeconomic, should identify the main areas of interest and fields to which future projects will be subsumed, as well as the driving effect as a whole, in the scope of ensuring future public goods and services. Not without interest will be the way in which such resulting investments will integrate into the whole of the already existing ones and will remove some regional disparities, ultimately contributing to the increase of the standard of living of the final consumer.

At the same time, it is the prerogative of the state to articulate an adequate legal framework and create a stable climate that attracts foreign direct investments, given that the PPP claims a high financing requirement and the participation of several investors, from bodies with the vocation of international financiers (Bank European Investment Fund, EU) to private investors, other private shareholders, insurance and reinsurance agencies, builders, subcontractors, etc.

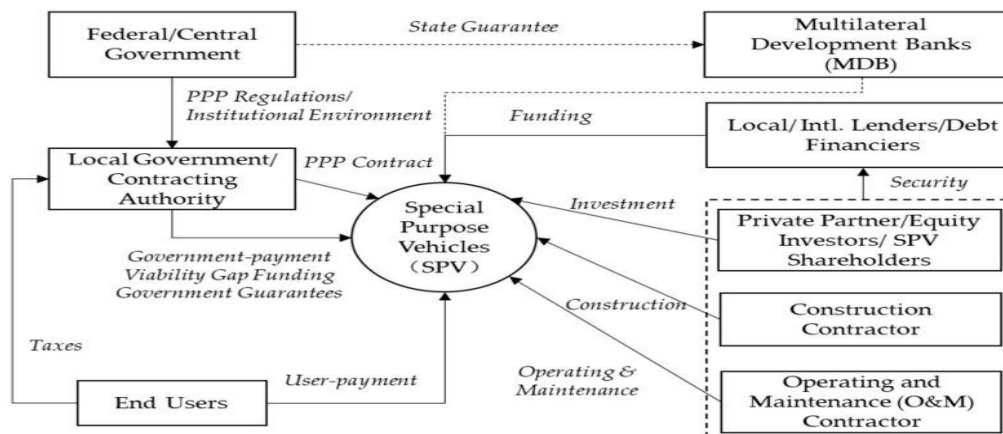


Figure 2 **PPP contractual architecture**

Source: Adapted from (Li Z., Wang H., 2023; Schüle U. *et al*, 2018)

The whole state is subsequently responsible for choosing a project variant from those resulting from the analyzes carried out, as well as for offering guarantees to private partners regarding the possibility of long-term operation of the investments, obtaining profit, avoiding subsequent nationalizations, congruence with the environmental objectives. The involvement of the state can be carried out on various levels, from the central level of the main authorizing officer of credits (ministries), through specialized agencies (secondary/tertiary authorizing officers) or decentralized, at the level of territorial administrative units. The choice of the project variant in the case of decentralized institutions needs to be circumscribed by the national strategy in the field. In this context, the central authorities can refer to international funding bodies regarding the creditworthiness of regional/local public law actors.

From the point of view of the concrete way of realization, the partnership can be contractual. In this case, the public-private partnership is based on a contract concluded between the public partner, on the one hand, and the private partner, on the other. The contract is to be implemented through a project company that is fully owned by the private partner and the institutional public-private partnership. In this sense, a new company is established, which will act as a project company (Special Purpose Vehicle - S.P.V.), as provided by O.U.G. 31/2018 regarding the public-private partnership in Romania. Establishment of S.P.V. it is carried out after a competitive procedure for awarding the project, in which a number of economic agents participate. The winning offer is the one that optimally meets the criteria established by the contracting authority (*figure 2*).

Shareholders of S.P.V. can be the contracting authority, represented by public entities, the private partner designated as winner,

other private law entities, financiers, investors, builders, etc. In principle, the state, by means of a concession for the provision of public services, understands to give up some of its prerogatives (against a royalty), following that later, after the end of the contract (medium to long time interval), the good will enter the public domain. The adjudicator of the competitive procedure will have the benefit of granting subsidies for the realization of the project, also collecting specific fees from the final users of the investment.

In order to materialize the investment objective, the S.P.V. enters into contractual relations with a series of private entities, those assigned to actually build (with the possibility of having subcontractors), those in charge of managing/operating the works, respectively those that ensure subsequent maintenance.

Eloquent for what was shown previously is the example of PPP aimed at building a highway where we find all the elements described previously. Thus, at the central level, the benefits of its construction for end users are considered (cost-benefit analysis, feasibility study), the way in which the new investment objective will be reintegrated into the already existing network, the designation of a public entity to define the main elements of the future project related to costs, their actual recovery time compared to the expenses incurred by the end users (the purchase of the vignette), the main risks and how they will be allocated between the public and private partners, taking into account the experience of each one.

Partnerships are also an important premise for achieving some of the sustainable development goals adopted in 2015 by the UN member states, by ensuring resilience and long-term socio-economic development, contributing through their deliverables to mitigating disparities regarding access to public utilities, environmental protection, quality education, etc.

Although they reduce the public budget pressure, they do not necessarily lead to the reduction of transaction costs, if we consider the existing risks, the dynamics of the international business environment, some important actors investing in such partnerships such as multinational companies that internalize the world market (Zhao J., 2019).

Transaction costs (generated from the perspective of the emergence of opportunistic behaviors) can be explained by the paradigm of the institutional architecture of such partnerships, which involve participants with different interests, which need to be harmonized. Thus, the central government must ensure that the project is grafted onto its general policy in the field of infrastructure (public utilities – water-sewerage, electricity, heating, roads), considering the costs it incurs, the need to offer guarantees for international financiers and operators, establishing a viable communication with the other state institutions with legal powers in the area targeted by the investment. For private partners, the guarantees given by the government, the macroeconomic climate of a country, the sharing of risks constitute the key trigger of the decision to invest, especially from the point of view of multinational companies. (Nielsen B.B *et al*, 2017). Each of the involved partners seeks to maximize their own benefits, thanks to information asymmetry, and the experience and negotiation ability of each one plays an important role, even if it often comes down to a zero-sum game.

Thus, there are numerous cases when such partnerships are not completed successfully, given some aspects related to the inefficient allocation of risks between partners, a deficient managerial approach, overly optimistic forecasts.

Moreover, the unprecedented opening of national economies to international exchanges creates consistent premises for the propagation of shock waves characteristic of recessionary phases at the national level, contributing to the aggravation of existing macroeconomic problems, at least for developing countries.

MATERIAL AND METHOD

Our study, through an integrative qualitative approach and filling a relative lack in the field of scientific concerns, aims to analyze what are the main risks arising for public entities in the case of public private partnerships, formulating pertinent recommendations to overcome them.

RESULTS AND DISCUSSIONS

At a first level of the analysis of the relationship between the participation of public

entities in international transactions and the generated risks, we find a series of risks of a geopolitical nature that can lead to a contraction of future investment flows. We include here some political tensions between states, wars, events that lead to a geographical reorientation of investments and which multinational companies can hardly overcome.

If the national political risk (expropriation) can be relatively easily overcome by creating a mixed company between the foreign capital and the national company (joint-venture), things are not as easy in the case of the existence of supranational regional tensions, the defusing of which would require a concerted action between several states. (Henisz W.J., Zelner B.A., 2005). For that national economy, the outcome will reflect unavailable foreign capital, or at best foreign capital at a higher cost, imagined to cover the risk. In response to the imminence of such risks, states could opt for some strategic alliances, non-aggression agreements, membership of some supranational military blocs. At the same time, improving the quality of own institutions will create a stable environment, aimed at counterbalancing the amplitude of such tensions, encouraging potential investors by ensuring the predictability of the internal climate. (Bussy A., Zheng H, 2023).

On the other hand, infrastructure investments demand high expenses from private law actors, projected in a medium to long time horizon. The recovery of these expenses is carried out gradually, even incrementally, and the specificity of the assets removes the possibility of a possible reallocation of resources. As a consequence, some overly optimistic visions of the government regarding the potential end users (for example the number of those who will use a highway paying the vignette) may lead to the need for renegotiations of the initial contractual clauses, respectively of the benefits in the sense of either extending the duration the contract, or the granting of subsidies by the state to cover the gaps created between the financial expectations and the real ones. (Wibowo A., Alfen H.W., 2013).

From the point of view of the involvement of political factors, several adverse effects can be analyzed. The one that seems most important to us is materialized by the possibility of the appearance of eventual white elephants (they represent some investments made in infrastructure, which do not find their usefulness for the final consumer, do not contribute to a driving effect at the level of the national economy and do not fit in a proper articulated strategic perspective - for example a road that connects the center of a territorial

administrative unit to the home of a local elected official.) (Albalade D. *et al*, 2019). The effect can also be manifested when the resources are allocated suboptimally, without taking into account all the options available to satisfy the demand – building a hydropower plant that serves certain consumers whose number will remain relatively constant in the future and abandoning an option that would involve clean energy through photovoltaic systems. Thus, not only will that investment be reflected in high final prices (for energy in order to recover costs) for final consumers, but it will also contribute to the dimming of actions aimed at achieving the SDGs. (Sustainable Development Goals), even emphasizing existing disparities.

Moreover, we can even expect substitution effects in terms of demand; end users can opt out of using the respective road infrastructure (and as such paying the vignette), choosing a longer but free detour. In this sense, the way in which public institutions involved in PPP understand to evaluate some aspects related to a potential future demand, remains decisive for the success of the project. The lack of experience in the preparation of such projects can eventually be repaid by calling on some external specialists (with different professions), especially in the phase of preparing the pre-feasibility studies, which will materialize a better determination and distribution of the incident risks. (Demirel H.C., 2022).

Recent reports, analyzing the performance of some PPPs financed with European funds, draw attention to the fact that although such contractual constructs are used when higher earnings are expected by public authorities compared to traditional procurement procedures, no pertinent analyzes have been carried out regarding the opportunity of such a choice by using an appropriate tool. In this sense, the public sector comparator (P.S.C.) can be used, which provides relevant information on the actual costs of PPPs in relation to classic procurement procedures. The P.S.C. is relevant if we admit that private entities, considering the possibility of long-term operation of the investment, to lower the subsequent maintenance costs, tend to overestimate the expenses related to the actual construction by using much more expensive materials. This leads to the amplification of the total project cost, superior to the variant in which the public contracting authority would have purchased only construction works, without giving the possibility to the private contractor to operate and maintain the investment. (E.C.A., 2018).

At the same time, the respective reports also foresee a series of deficiencies for the member

states in the sense that in some cases the competition was distorted, allowing only contractors with high financial potential to participate, it was opted for the extension of the execution terms and the escalation of the contract price due to insufficient preparations, registering consistent gaps between the forecasted and the actual final demand level.

A peculiarity of partnerships, from a financial and accounting point of view, is the fact that they can be recorded as off-balance sheet elements (public sector expenses), which contributes to the erroneous reflection of the service of the national public debt, an aspect that for the moment beautifies the public debts, but exercises a significant pressure on subsequent budgetary financial years and alters the principle of accrual accounting. (Engel E. *et al*, 2020).

Typical for PPP is the contractual arrangement articulated over a long time horizon, an aspect that can in turn generate pressure on public budgets due to the escalation of the initial price of the contract based on exogenous and endogenous considerations. [Jonathan L. *et al*, 2024]. From an endogenous point of view, the manifestation of the opportunism of private law agents is relevant, which, thanks to the gaps of public management in the administration of the contract, the imperfections of the contractual clauses regarding the execution of obligations, as well as some lax legal frameworks, increases the cost of the initial objective, after the award stage, sometimes with the participation of the public authority (corruption).

Some exogenous variables may have an objective character. In this sense, we mention important fluctuations in terms of the exchange rate (if it is not achieved through the intervention of the state in the sense of encouraging national exporters, intentional devaluation), the compression of demand as a result of the decrease in purchasing power or accentuated unemployment. As a consequence, the thorough preparation of PPP negotiations by public agencies, the estimation of actual demand, potential fluctuations, the provision of a coherent legal framework, the drafting of unambiguous contractual clauses, contribute to reducing the risks associated with changing the contract price.

Translating from formal institutions (law, rule of law) to informal ones (morality, tradition, culture), some authors highlight the risks generated by information asymmetry due to different national perceptions, showing that foreign investments in the formation of public-private partnerships tend to gravitate towards national environments where there are cultural similarities, familiarity and a

congruence of principles. (Chan J.M.L., Zheng H., 2019). As a consequence, the role of the receiving countries would transpose articulated approaches to the creation of a national branding and the intensification of commercial relations with private investors belonging to similar cultures.

The emergence of disputes whose solution remains uncertain represents another important risk deriving from the participation of public entities in PPPs and the interaction with foreign direct investments. Studies carried out in this field emphasize some of the generating causes, among which we note public opposition, delays in decision-making, improper operation of the investment objective, legislative changes, opacity of information (Zheng X. *et al*, 2021).

Possible public opposition can be anticipated by quickly analyzing the implications of the partnership (noise pollution, site-related inconveniences), while promptness in decision-making can be ensured by involving experienced consultants, establishing clear responsibilities for each of the partners. Analyzing the ecological implications related to the operation and maintenance phases by imagining alternatives less likely to create such negative phenomena represents a significant course of action. At the same time, the strengthening of informational symmetry can be created by calling for adequate communication and promoting ubiquitous mutual trust between participants. (Wang D. *et al*, 2019).

CONCLUSIONS

PPP represents a viable alternative intended to replace the lack of financial resources of the state, the gaps in the management of the administration of large infrastructure projects, bringing at the same time an important contribution in technological dissemination. Achieving SDG objectives is a way to cooperate between public and private law partners in order to deliver public services that were mainly the prerogative of the government.

The intrinsic construction of the PPP involves a series of contractual arrangements structured on multiple levels, which is intended to value the idiosyncrasies resulting from the interaction of the managerial/competitive capabilities of private and public law actors. States, through government agencies, are responsible for identifying the areas of interest to which future projects will be subsumed and how such investments will remove some regional disparities, ultimately contributing to increasing the standard of living of the final consumer.

At the same time, it is the prerogative of the state to articulate an adequate legal framework, to create a stable climate that attracts foreign direct investments, as well as to offer guarantees to private partners regarding the possibility of their long-term operation of the investments made, obtaining profit, avoiding further nationalizations. It is necessary to specify that the choice of the project variant in the case of decentralized institutions must be circumscribed by the national strategy in the field.

Although partnerships reduce public budget pressure, they do not necessarily lead to the reduction of transaction costs, generated from the perspective of the emergence of opportunistic behaviors. This is due to the fact that their institutional architecture involves the presence of participants with different interests.

The operation of such partnerships generated by private foreign investments also involves a number of risks. Thus, geopolitical risks can lead to a contraction of future investment flows by making foreign capital unavailable. Strategic alliances, non-aggression agreements, membership of some supranational military blocs and improving the quality of state institutions will create a stable environment, encouraging potential investors by ensuring the predictability of the domestic climate.

On the other hand, infrastructure investments demand high expenses from private law actors, projected in a medium to long time horizon, the recovery of which is achieved gradually. The state's overly optimistic view of potential end users may lead to the need for renegotiations of contractual clauses.

From the point of view of the involvement of political factors, several adverse effects can be analyzed: the appearance of white elephants, the suboptimal allocation of resources without taking into account all the options available to satisfy the demand. At the same time, some substitution effects may occur in terms of demand, and the call to some external specialists can dismantle these risks.

Some partnerships that assumed the contribution of the E.U. were concluded in the absence of relevant analyzes regarding the appropriateness of such a choice, distorting competition, thus necessitating recourse to the specific instruments designated by the PSC.

From a financial and accounting point of view, although these can be recorded as off-balance sheet elements, there is a distortion of the service of the national public debt, which will exert a significant pressure on the subsequent budgetary financial years and alter the principle of accrual-

based accounting, recommending a more great caution about this approach.

The escalation of the initial price of the contract based on exogenous and endogenous considerations is an indisputable aspect, which can be avoided by meticulously preparing the negotiations, estimating the actual demand, its potential fluctuations, ensuring a coherent legal framework and drafting unequivocal contractual clauses.

It cannot be omitted the appearance of disputes brought to the courts, whose resolution methods derive from the participation of public entities in the PPP and the interaction with foreign direct investments, generated by public opposition, delays in decision-making, improper operation of the investment objective, changes legislation, the opacity of information. Rapid analysis of the implications of the partnership, promptness in decision-making by involving experienced consultants, establishing clear responsibilities for each of the partners, adequate communication, represent possible approaches that reduce such risks.

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